

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
Independent Auditor's Report and Financial Statements  
December 31, 2012 and 2011



**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**December 31, 2012 and 2011**

**Contents**

<b>Independent Auditor's Report on Financial Statements and Supplementary Information .....</b>	<b>1</b>
---	----------

**Financial Statements**

Balance Sheets .....	3
Statements of Revenues, Expenses and Changes in Net Position .....	4
Statements of Cash Flows .....	5
Notes to Financial Statements .....	7

**Supplementary Information**

Balance Sheets of Decatur Health Systems, Inc. ....	22
Statements of Operations of Decatur Health Systems, Inc. ....	23

## **Independent Auditor's Report on Financial Statements and Supplementary Information**

Board of Trustees  
Decatur County Hospital  
Oberlin, Kansas

We have audited the accompanying financial statements of Decatur County Hospital, a component unit of Decatur County, Kansas, which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the provisions of the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Decatur County Hospital as of December 31, 2012 and 2011, and changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

***Required Supplementary Information***

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. Our opinion on the basic financial statements is not affected by this missing information.

***Supplementary Information***

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplementary schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

*BKD, LLP*

Wichita, Kansas  
July 15, 2013

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Balance Sheets**  
**December 31, 2012 and 2011**

**Assets**

	<b>2012</b>	<b>2011</b>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 347,145	\$ 550,518
Short-term certificates of deposit	6,200	6,200
Cash held for debt service	48,359	48,359
Patient accounts receivable, net of allowance; 2012 - \$356,000, 2011 - \$374,000	1,073,583	675,669
Other receivables	13,340	5,760
Estimated amounts due from third-party payers	425,000	393,000
Supplies	89,536	106,005
Prepaid expenses and other	52,814	79,745
	<hr/>	<hr/>
Total current assets	2,055,977	1,865,256
	<hr/>	<hr/>
<b>Noncurrent Assets</b>		
Held by County for debt service	48,786	48,786
	<hr/>	<hr/>
<b>Investments and Long-term Deposit</b>		
Interest in assets of Decatur Health Care Foundation, Inc.	1,045,295	1,783,771
Option deposit	-	250,000
	<hr/>	<hr/>
	1,045,295	2,033,771
	<hr/>	<hr/>
<b>Capital Assets, Net</b>	2,737,707	1,650,961
	<hr/>	<hr/>
<b>Other Assets</b>		
Rural Health Clinic acquisition costs, net of accumulated amortization; 2012 - \$64,167, 2011 - \$27,500	45,833	82,500
Deferred financing costs	6,000	6,375
	<hr/>	<hr/>
	51,833	88,875
	<hr/>	<hr/>
Total assets	\$ 5,939,598	\$ 5,687,649
	<hr/>	<hr/>

## Liabilities and Net Position

	2012	2011
<b>Current Liabilities</b>		
Note payable to bank	\$ 250,000	\$ -
Current maturities of long-term debt	37,414	55,937
Accounts payable	157,262	146,741
Accrued expenses	332,933	426,317
	<hr/>	<hr/>
Total current liabilities	777,609	628,995
<b>Long-term Debt</b>	<hr/>	<hr/>
	533,155	570,569
Total liabilities	<hr/>	<hr/>
	1,310,764	1,199,564
<b>Net Position</b>		
Net investment in capital assets	2,167,138	1,024,455
Restricted - expendable for debt service	97,145	97,145
Unrestricted	2,364,551	3,366,485
	<hr/>	<hr/>
Total net position	4,628,834	4,488,085
Total liabilities and net position	<hr/>	<hr/>
	\$ 5,939,598	\$ 5,687,649

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Statements of Revenues, Expenses and Changes in Net Position**  
**Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
<b>Operating Revenues</b>		
Net patient service revenue, net of provision for uncollectible accounts; 2012 - \$111,588, 2011 - \$153,547	\$ 6,209,238	\$ 6,196,505
Other	<u>212,058</u>	<u>162,771</u>
Total operating revenues	<u>6,421,296</u>	<u>6,359,276</u>
<b>Operating Expenses</b>		
Salaries	3,811,013	3,594,470
Employee benefits	1,041,097	889,840
Purchased services	355,771	417,896
Drugs	261,676	299,477
Medical supplies	232,096	204,808
Food	93,911	108,706
Utilities	291,172	284,122
Repairs and maintenance	116,512	65,128
Professional fees	356,899	604,875
Dues	43,199	32,615
Insurance	70,253	61,889
Supplies and other	380,300	371,568
Depreciation and amortization	<u>362,007</u>	<u>254,588</u>
Total operating expenses	<u>7,415,906</u>	<u>7,189,982</u>
<b>Operating Loss</b>	<u>(994,610)</u>	<u>(830,706)</u>
<b>Nonoperating Revenues (Expenses)</b>		
Intergovernmental revenue	203,200	196,399
Net investment income (loss)	119,253	(21,058)
Interest expense	(27,683)	(25,255)
Noncapital gifts and grants	<u>840,589</u>	<u>31,872</u>
Total nonoperating revenues	<u>1,135,359</u>	<u>181,958</u>
<b>Increase (Decrease) in Net Position</b>	140,749	(648,748)
<b>Net Position, Beginning of Year</b>	<u>4,488,085</u>	<u>5,136,833</u>
<b>Net Position, End of Year</b>	<u><u>\$ 4,628,834</u></u>	<u><u>\$ 4,488,085</u></u>

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Statements of Cash Flows**  
**Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
<b>Operating Activities</b>		
Receipts from and on behalf of patients	\$ 5,779,324	\$ 6,117,572
Payments to suppliers and contractors	(2,150,519)	(2,473,017)
Payments to or on behalf of employees	(4,944,430)	(4,545,087)
Other receipts, net	<u>212,058</u>	<u>162,771</u>
Net cash used in operating activities	<u>(1,103,567)</u>	<u>(737,761)</u>
<b>Noncapital Financing Activities</b>		
Intergovernmental revenue	203,200	196,399
Noncapital gifts and grants	305,462	31,872
Proceeds from issuance of short-term debt	<u>250,000</u>	<u>-</u>
Net cash provided by noncapital financing activities	<u>758,662</u>	<u>228,271</u>
<b>Capital and Related Financing Activities</b>		
Cash received in acquisition	60,898	-
Principal paid on long-term debt	(55,937)	(54,461)
Interest paid on note payable to bank	(28,747)	(26,565)
Purchase of capital assets	<u>(692,411)</u>	<u>(164,679)</u>
Net cash used in capital and related financing activities	<u>(716,197)</u>	<u>(245,705)</u>
<b>Investing Activities</b>		
Net investment income	37,756	60,973
Net change in short-term certificates of deposit	-	503,748
Purchase of intangibles associated with RHC acquisition	-	(110,000)
Maturities of investments	840,000	200,000
Purchase of investments	<u>(20,027)</u>	<u>(24,040)</u>
Net cash provided by investing activities	<u>857,729</u>	<u>630,681</u>
<b>Decrease in Cash and Cash Equivalents</b>	<u>(203,373)</u>	<u>(124,514)</u>
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>598,877</u>	<u>723,391</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u><u>\$ 395,504</u></u>	<u><u>\$ 598,877</u></u>

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Statements of Cash Flows (Continued)**  
**Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
<b>Reconciliation of Cash and Cash Equivalents to the Balance Sheets</b>		
Cash and cash equivalents	\$ 347,145	\$ 550,518
Cash held for debt service	<u>48,359</u>	<u>48,359</u>
Total cash	<u><u>\$ 395,504</u></u>	<u><u>\$ 598,877</u></u>
<b>Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided by (Used in) Operating Activities</b>		
Operating loss	\$ (994,610)	\$ (830,706)
Depreciation and amortization	362,007	254,588
Changes in operating assets and liabilities		
Patient accounts receivable, net	(397,914)	592,901
Estimated amounts due from third-party payers	(32,000)	(671,834)
Supplies and prepaid expenses	43,400	(32,814)
Other current and noncurrent assets	(5,585)	29,835
Accounts payable and accrued expenses	<u>(78,865)</u>	<u>(79,731)</u>
Net cash used in operating activities	<u><u>\$ (1,103,567)</u></u>	<u><u>\$ (737,761)</u></u>
<b>Supplemental Cash Flows Information</b>		
Accounts receivable received in acquisition	\$ 1,995	\$ -
Option deposit used in acquisition	\$ 250,000	\$ -
Capital assets received in acquisition	\$ 719,300	\$ -
Prepaid assets received in acquisition	\$ 2,934	\$ -

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 1: Nature of Operations and Summary of Significant Accounting Policies**

***Nature of Operations and Reporting Entity***

Decatur County Hospital (Hospital) is an acute care hospital located in Oberlin, Kansas. The Hospital is a component unit of Decatur County, Kansas (County) and the Board of County Commissioners appoints members to the Board of Trustees of the Hospital. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Decatur county area. It also operates a long-term care facility, outpatient clinic and home health agency in the same geographic area.

The Board of Trustees of Decatur County Hospital (Lessor or DCH) leases the Hospital's operations to Decatur Health Systems, Inc. (Lessee) (DHS) as a Section 501(c)(3) organization. The lease extends through December 31, 2028. Board members of the Lessor act as the Board of Trustees for the Lessee. At the conclusion of the lease, custody of all assets and liabilities reverts to the Lessor. Rent expense under this lease is \$5 per year plus any amounts due on debt incurred by the Lessor on Lessee's behalf for equipment or for operating purposes.

The financial statements include the accounts of the Hospital and DHS as a blended component unit of the Hospital. All significant intercompany accounts and transactions have been eliminated.

***Basis of Accounting and Presentation***

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions. Government-mandated nonexchange transactions that are not program specific such as intergovernmental revenue from property taxes, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net position when an expense or outlay is incurred for purposes for which both restricted and unrestricted net position are available.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB).

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

***Cash Equivalents***

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2012 and 2011, cash equivalents consisted of certificates of deposit with maturities of less than 90 days.

Pursuant to legislation enacted in 2010, the FDIC fully insured all noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012, at all FDIC-insured institutions. This legislation expired on December 31, 2012. Beginning January 1, 2013, noninterest-bearing transaction accounts are subject to the \$250,000 limit on FDIC insurance per covered institution.

***Intergovernmental Revenue***

The Hospital received approximately 3% in both 2012 and 2011 of its financial support from property taxes levied by the County and shared with the Hospital for hospital purposes. One hundred percent of these funds were used to support operations in both years.

Taxes are assessed by the County in November and are received beginning in January of each year. Intergovernmental revenue is recognized in full in the year in which use is first permitted.

***Risk Management***

The Hospital is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than health benefits and workers' compensation. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

A partially self-funded health insurance plan covers medical services up to a certain amount after which point commercial insurance coverage provides the remaining coverage. Management believes adequate reserves are in place to cover claims incurred but not reported at year-end. Workers' compensation coverage is provided through a fund managed by the KHA Workers' Compensation Fund, Inc. The workers' compensation premiums are subject to retrospective adjustment based upon the overall performance of the fund. Management believes adequate reserves are in place to cover claims incurred but not reported for workers' compensation.

The partially self-insured health and dental insurance plan covers medical and dental services up to \$30,000 per individual. Claims in excess of \$30,000 per individual are covered through a reinsurance policy. Management believes adequate accruals are in place to cover claims under \$30,000 which have been incurred but not reported.

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

***Patient Accounts Receivable***

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, the Hospital analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for bad debts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, the Hospital analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payer has not yet paid, or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Hospital records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated or provided by the policy) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

***Supplies***

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

***Capital Assets***

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. The following estimated useful lives are being used by the Hospital:

Land improvements	5 - 20 years
Buildings and building improvements	3 - 21 years
Fixed equipment	8 - 20 years
Major moveable equipment	3 - 15 years

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

***Compensated Absences***

Hospital policies permit most employees to accumulate vacation, holiday, personal and sick leave benefits that may be realized as paid time off or as a cash payment. Expense and the related liability are recognized as benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay rate in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

***Deferred Revenue***

Deferred revenue consists of grant monies received for specific purposes. Revenue is recognized on deferred grant revenue when specific purpose of grant is met.

***Net Position***

Net position of the Hospital are classified in three components. Net investment in capital assets, consist of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net position are noncapital assets that must be used for a particular purpose as specified by creditors, grantors or donors external to the Hospital, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Unrestricted net position are remaining assets less remaining liabilities that do not meet the definition of net investment in capital assets or restricted expendable.

***Net Patient Service Revenue***

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

***Charity Care***

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue.

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

***Income Taxes***

As an essential government function of the County, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. DHS is exempt from income taxes under Section 501 of the Internal Revenue Code and a similar provision of state law. However, DHS is subject to federal income tax on any unrelated business taxable income.

***Subsequent Events***

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the financial statements were available to be issued.

**Note 2: Net Patient Service Revenue**

The Hospital recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the Hospital's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Hospital records a significant provision for bad debts related to uninsured patients in the period the services are provided.

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

*Medicare.* The Hospital is recognized as a Critical Access Hospital (CAH). Under CAH rules, inpatient acute care, skilled swing-bed and outpatient services rendered to Medicare program beneficiaries are paid at one hundred one percent (101%) of allowable cost subject to certain limitations. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare Administrative Contractor.

*Medicaid.* The Medicaid State Plan provides for a cost reimbursement methodology for inpatient and outpatient services rendered to beneficiaries who are not part of a Medicaid managed care network. The Hospital is reimbursed at tentative rates with final settlements determined after submission of annual cost reports and reviews thereof by the Kansas Department of Health and Environment. The Hospital is reimbursed on a prospective payment methodology for inpatient and outpatient services rendered to beneficiaries who are part of a Medicaid managed care network.

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a prospective reimbursement methodology. Medicaid reimbursement for long-term care facility residents is based on a cost-based prospective reimbursement methodology. The Hospital is reimbursed at a prospective rate with annual cost reports submitted to the Medicaid program. Prior to 2011 rates were computed each calendar quarter using an average of the 2005, 2006 and 2007 cost reports and changes in the Medicaid resident case mix index. As part of a provider assessment program approved by the Centers for Medicare and Medicaid Services on February 2, 2011, rates were updated retroactively to July 1, 2010, using 2007, 2008 and 2009 cost report data. Additional net revenues relative to the provider assessment program for the period from July 1, 2010 through June 30, 2011 (the State's fiscal year), were approximately \$100,000 and are included in 2011 net income. Effective July 1, 2011, rates were updated using 2008, 2009 and 2010 cost report data. Rates were not rebased or inflated as of July 1, 2012. The Medicaid cost reports are subject to audit by the State and adjustments to rates can be made retroactively.

Approximately 70% and 68% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2012 and 2011, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Hospital has also entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge and discounts from established charges.

***Patient Protection and Affordable Care Act***

The *Patient Protection and Affordable Care Act* (PPACA) will substantially reform the United States health care system. The legislation impacts multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Starting in 2014, the legislation requires the establishment of health insurance exchanges, which will provide individuals without employer provided health care coverage the opportunity to purchase insurance. It is anticipated that some employers currently offering insurance to employees will opt to have employees seek insurance coverage through the insurance exchanges. It is possible that the reimbursement rates paid by insurers participating in the insurance exchanges may be substantially different than rates paid under current health insurance products. Another significant component of the PPACA is the expansion of the Medicaid program to a wide range of newly eligible individuals. In anticipation of this expansion, payments under certain existing programs, such as Medicare disproportionate share, will be substantially decreased. Each state's participation in an expanded Medicaid program is optional.

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

The state of Kansas has not yet indicated whether or not it will participate in the expansion of the Medicaid program. The legislature has passed HCR 5013 indicating it does not intend to pursue Medicaid expansion, however, that is not yet law as of the date of this report. The impact of that decision on the overall reimbursement to the Hospital cannot be quantified at this point.

The PPACA is extremely complex and may be difficult for the federal government and each state to implement. While the overall impact of the PPACA cannot currently be estimated, it is possible that it will have a negative impact on the Hospital's net patient service revenue. Additionally, it is possible the Hospital will experience payment delays and other operational challenges during PPACA's implementation.

**Note 3: Deposits and Interest Income**

***Deposits***

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Hospital's deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the state of Kansas; bonds of any city, county, school district or special road district of the state of Kansas; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

At December 31, 2012 and 2011, respectively, \$0 and \$218,612 of the Hospital's bank balances of \$337,874 and \$474,885 were exposed to custodial credit risk as follows:

	<u><b>2012</b></u>	<u><b>2011</b></u>
Uninsured and collateral held by pledging financial institution's trust department or agent in other than the Hospital's name	<u>\$ -</u>	<u>\$ 218,612</u>

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

***Summary of Carrying Values***

The carrying values of deposits above are included in the balance sheets as follows:

	<b>2012</b>	<b>2011</b>
Carrying value		
Deposits	\$ 327,380	\$ 474,697
Deposits held by a nongovernmental entity - DHS	74,324	130,380
	<u>\$ 401,704</u>	<u>\$ 605,077</u>
Included in the following balance sheet captions		
Cash and cash equivalents	\$ 347,145	\$ 550,518
Cash held for debt service	48,359	48,359
Short-term certificates of deposit	6,200	6,200
	<u>\$ 401,704</u>	<u>\$ 605,077</u>

Total investment return is comprised of the following:

	<b>2012</b>	<b>2011</b>
Interest and dividend income	\$ 9,911	\$ 57,448
Realized gains	27,845	3,525
Unrealized gain (loss) on investments	81,497	(82,031)
	<u>\$ 119,253</u>	<u>\$ (21,058)</u>

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 4: Patient Accounts Receivable**

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at December 31, 2012 and 2011, consisted of:

	<b>2012</b>	<b>2011</b>
Medicare	\$ 619,103	\$ 342,061
Medicaid	106,052	71,753
Blue Cross	69,140	46,779
Other third-party payers	168,423	125,332
Patients	<u>466,865</u>	<u>463,744</u>
	1,429,583	1,049,669
Less allowance for uncollectible accounts	<u>356,000</u>	<u>374,000</u>
	<u><u>\$ 1,073,583</u></u>	<u><u>\$ 675,669</u></u>

**Note 5: Investments and Long-term Deposit**

***Interest in Assets of Decatur Health Care Foundation, Inc.***

The Hospital has transferred assets (cash) to the Decatur Health Care Foundation, Inc. (Foundation) and retained a beneficial interest in those assets. Earnings on the funds held by the Foundation are to be remitted to the Hospital, and the principal can be invaded in extreme financial circumstances as determined jointly by the boards of both organizations. Currently, the funds held by the Foundation are invested in certificates of deposit and mutual funds.

***Option Deposit***

On February 4, 2004, DHS entered into an agreement with Decatur County Retirement Housing, Inc. (DCRHI) to manage the Wheat Ridge Terrace independent living units. The management agreement calls for DHS to provide meals, maintenance, housekeeping and administrative services for a fee. Actual costs are used to determine the fees charged. As part of the agreement, DHS invested \$250,000 to assist DCRHI in restructuring its debt. In return, DHS has the option of acquiring the assets of DCRHI when all outstanding debt of DCRHI is paid.

On June 20, 2012, the option to acquire the Wheat Ridge property was exercised and assets totaling \$783,915 were recorded on the books of DCH. No liabilities were assumed as part of the transaction. Due to the nature of the acquisition and based on the amount paid to acquire the assets, a contribution was recorded in the amount of \$533,915 and is included in noncapital gifts and grants in the Statements of Revenues, Expenses and Changes in Net Position. Operating revenues and expenses from that date forward have also been recorded on the books of DCH. Management of Wheat Ridge continues to be provided by DHS.

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 6: Capital Assets**

Capital assets activity for the years ended December 31, 2012 and 2011, was:

	<b>2012</b>			
	<b>Beginning Balance</b>	<b>Additions</b>	<b>Disposals</b>	<b>Ending Balance</b>
Land and land improvements	\$ 199,569	\$ 4,900	\$ -	\$ 204,469
Buildings and building improvements	3,719,943	709,400	-	4,429,343
Fixed equipment	715,480	32,269	-	747,749
Major moveable equipment	1,859,060	665,142	(313,952)	2,210,250
	<u>6,494,052</u>	<u>1,411,711</u>	<u>(313,952)</u>	<u>7,591,811</u>
Less accumulated depreciation				
Land improvements	133,515	9,535	-	143,050
Buildings and building improvements	2,928,699	55,483	-	2,984,182
Fixed equipment	229,678	179,707	-	409,385
Major moveable equipment	1,551,199	80,240	(313,952)	1,317,487
	<u>4,843,091</u>	<u>324,965</u>	<u>(313,952)</u>	<u>4,854,104</u>
Capital assets, net	<u>\$ 1,650,961</u>	<u>\$ 1,086,746</u>	<u>\$ -</u>	<u>\$ 2,737,707</u>

  

	<b>2011</b>			
	<b>Beginning Balance</b>	<b>Additions</b>	<b>Disposals</b>	<b>Ending Balance</b>
Land improvements	\$ 199,569	\$ -	\$ -	\$ 199,569
Buildings and building improvements	3,700,284	23,629	(3,970)	3,719,943
Fixed equipment	694,484	20,996	-	715,480
Major moveable equipment	2,000,930	120,054	(261,924)	1,859,060
	<u>6,595,267</u>	<u>164,679</u>	<u>(265,894)</u>	<u>6,494,052</u>
Less accumulated depreciation				
Land improvements	123,980	9,535	-	133,515
Buildings and building improvements	2,890,980	41,689	(3,970)	2,928,699
Fixed equipment	141,835	87,843	-	229,678
Major moveable equipment	1,725,477	87,646	(261,924)	1,551,199
	<u>4,882,272</u>	<u>226,713</u>	<u>(265,894)</u>	<u>4,843,091</u>
Capital assets, net	<u>\$ 1,712,995</u>	<u>\$ (62,034)</u>	<u>\$ -</u>	<u>\$ 1,650,961</u>

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 7: Accounts Payable and Accrued Expenses**

Accounts payable and accrued expenses included in current liabilities at December 31, 2012 and 2011, consisted of:

	<u><b>2012</b></u>	<u><b>2011</b></u>
Payable to suppliers and contractors	\$ 157,262	\$ 146,741
Payable to employees (including payroll taxes and benefits)	325,040	419,156
Other	<u>7,893</u>	<u>7,161</u>
	<u><u>\$ 490,195</u></u>	<u><u>\$ 573,058</u></u>

**Note 8: Self-insured Health Insurance**

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance plan. The Hospital was self-insured for health claims of participating employees and dependents up to an annual aggregate amount of \$30,000 per covered employee. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is reasonably possible that the Hospital's estimate will change by a material amount in the near term.

Activity in the Hospital's accrued employee health claims liability during 2012 and 2011 is summarized as follows:

	<u><b>2012</b></u>	<u><b>2011</b></u>
Balance, beginning of year	\$ 30,000	\$ 64,054
Current year claims incurred and changes in estimates for claims incurred in prior years	535,164	467,555
Claims and expenses paid	<u>(535,164)</u>	<u>(501,609)</u>
Balance, end of year	<u><u>\$ 30,000</u></u>	<u><u>\$ 30,000</u></u>

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 9: Medical Malpractice Claims**

The Hospital purchases medical malpractice insurance under a claims-made policy with a fixed premium which provides \$200,000 of coverage for each medical incident and \$600,000 of aggregate coverage for each policy year. The policy only covers claims made and reported to the insurer during the policy term, regardless of when the incident giving rise to the claim occurred. The Kansas Health Care Stabilization Fund provides an additional \$800,000 of coverage for each medical incident and \$2,400,000 of aggregate coverage for each policy year.

Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

**Note 10: Long-term Debt**

The following is a summary of long-term debt transactions for the Hospital for the years ended December 31, 2012 and 2011:

	<b>2012</b>				
	<b>Beginning Balance</b>	<b>Additions</b>	<b>Payments</b>	<b>Ending Balance</b>	<b>Current Portion</b>
Note payable - county - 2002 (A)	\$ 20,000	\$ -	\$ (20,000)	\$ -	\$ -
Note payable - county - 2003 (B)	23,769	-	(11,616)	12,153	12,153
Note payable - county - 2008 (C)	582,737	-	(24,321)	558,416	25,261
Total long-term debt	<u>\$ 626,506</u>	<u>\$ -</u>	<u>\$ (55,937)</u>	<u>\$570,569</u>	<u>\$ 37,414</u>

	<b>2011</b>				
	<b>Beginning Balance</b>	<b>Additions</b>	<b>Payments</b>	<b>Ending Balance</b>	<b>Current Portion</b>
Note payable - county - 2002 (A)	\$ 40,000	\$ -	\$ (20,000)	\$ 20,000	\$ 20,000
Note payable - county - 2003 (B)	34,872	-	(11,103)	23,769	11,616
Note payable - county - 2008 (C)	606,095	-	(23,358)	582,737	24,321
Total long-term debt	<u>\$ 680,967</u>	<u>\$ -</u>	<u>\$ (54,461)</u>	<u>\$626,506</u>	<u>\$ 55,937</u>

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

***Note Payable – County – 2002 (A)***

The note payable – county – 2002 consists of an agreement with the County to repay on its behalf the General Obligation Bonds, Series 2002-A, (Bonds) in the original amount of \$200,000 dated July 2, 2002. These Bonds were purchased in their entirety by Prairie Land Electric Cooperative, Inc. at their par value with no interest due on these Bonds pursuant to a Rural Economic Development Loan and Grant Program. The proceeds from this loan were used to finance equipment purchases. The Bonds were paid in full as of July 2012.

***Note Payable – County – 2003 (B)***

The note payable – county – 2003 consists of an agreement with the County to repay on its behalf the General Obligation Bonds, Series 2003, (Bonds) in the original amount of \$100,000 dated March 18, 2003, which bear interest at 4.625%. The proceeds from this loan were used to finance equipment purchases. The Bonds are payable in annual installments through April 1, 2013. The Hospital is required to make annual payments of approximately \$12,716 to the debt service fund held by the trustee. The Bonds are secured by the net revenues and accounts receivable of the Hospital. The debt service requirements as of December 31, 2012, are as follows:

<b>Year Ending December 31,</b>	<b>Total to be Paid</b>	<b>Principal</b>	<b>Interest</b>
2013	<u>\$ 12,714</u>	<u>\$ 12,153</u>	<u>\$ 561</u>

***Note Payable – County – 2008 (C)***

The note payable – county – 2008 consists of an agreement with the County to repay on its behalf the Revenue Bonds, Series 2008, (Bonds) in the original amount of \$650,000 dated February 22, 2008, which bear interest at 4.125%. The proceeds from this loan were used to finance construction of a specialty clinic. The Bonds are payable in annual installments through February 22, 2028. The Hospital is required to make annual payments of approximately \$48,359 to the debt service fund held by the trustee. The Bonds are secured by the net revenues and accounts receivable of the Hospital. The agreement also includes certain financial covenants which, among other things, require monthly deposits of principal and interest payments into a separate Debt Service Account, to the extent necessary to meet on each payment date the payment of all interest and principal.

The bond document requires the Hospital to comply with certain restrictive covenants including maintaining a debt service coverage ratio of 110% on revenue bonds. As of December 31, 2012, the Hospital did not meet the debt service requirement covenant. Pursuant to the bond resolution the Hospital is required to hire a consultant to make recommendations with respect to charges and rates.

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

The debt service requirements as of December 31, 2012, are as follows:

<b>Year Ending December 31,</b>	<b>Total to be Paid</b>	<b>Principal</b>	<b>Interest</b>
2013	\$ 47,254	\$ 25,261	\$ 21,993
2014	47,271	26,366	20,905
2015	47,227	27,454	19,773
2016	43,344	28,586	14,758
2017	52,245	33,601	18,644
2018-2022	242,585	169,031	73,554
2023-2027	237,546	203,530	34,016
2028	48,359	44,587	3,772
	<u>\$ 765,831</u>	<u>\$ 558,416</u>	<u>\$ 207,415</u>

**Note 11: Restricted and Designated Net Position**

At December 31, 2012 and 2011, restricted expendable net position of \$97,145 were available for debt service.

At December 31, 2012 and 2011, respectively, \$58,675 and \$51,897 of unrestricted net position have been designated by the Hospital's Board of Trustees for capital acquisitions. Designated net position remain under the control of the Board of Trustees, which may at its discretion later use these net position for other purposes.

**Note 12: Related Party Transactions**

An officer of a local financial institution is also a member of the Board of Trustees. At December 31, 2012 and 2011, the Hospital had cash balances of approximately \$429,000 and \$548,000, respectively, on deposit with this financial institution.

**Note 13: Pension Plan**

The Hospital contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by the Hospital Board of Trustees. The plan provides retirement benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's governing body. Contribution rates for plan members and the Hospital expressed as a percentage of covered payroll were 3.9% and 2.0% for 2012, 3.9% and 2.1% for

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

2011, and 4.4% and 2.3% for 2010, respectively. Contributions actually made by plan members and the Hospital aggregated \$150,040 and \$74,801 during 2012, \$138,447 and \$76,381 during 2011, and \$156,775 and \$82,161 during 2010, respectively.

**Note 14: Contingencies**

***Litigation***

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

**Note 15: Significant Estimates and Concentrations**

***Current Economic Conditions***

The current protracted economic decline continues to present hospitals with difficult circumstances and challenges, which in some cases have resulted in large and unanticipated declines in assets, large declines in contributions, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the Hospital.

Current economic conditions, including the rising unemployment rate, have made it difficult for certain patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Hospital's future operating results. Further, the effect of economic conditions on the government may have an adverse effect on cash flows related to the Medicare and Medicaid programs.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments in allowances for accounts receivable that could negatively impact the Hospital's ability to maintain sufficient liquidity.

## **Supplementary Information**

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Balance Sheets of Decatur Health Systems, Inc.**  
**December 31, 2012 and 2011**

**Assets**

	<b>2012</b>	<b>2011</b>
<b>Current Assets</b>		
Cash	\$ 74,324	\$ 130,380
Patient accounts receivable, net of allowance; 2012 - \$356,000, 2011 - \$374,000	1,073,583	675,669
Other receivables	9,990	3,010
Estimated amounts due from third-party payers	425,000	393,000
Supplies	89,536	106,005
Prepaid expenses and other	52,814	79,745
	<hr/>	<hr/>
Total current assets	1,725,247	1,387,809
	<hr/>	<hr/>
<b>Option Deposit</b>	-	250,000
	<hr/>	<hr/>
<b>Rural Health Clinic acquisition costs, net of accumulated amortization; 2012 - \$64,167, 2011 - \$27,500</b>	45,833	82,500
	<hr/>	<hr/>
<b>Capital Assets, At Cost</b>		
Property and equipment	1,144,325	1,118,083
Less accumulated depreciation	965,524	903,442
	<hr/>	<hr/>
	178,801	214,641
	<hr/>	<hr/>
Total assets	\$ 1,949,881	\$ 1,934,950
	<hr/> <hr/>	<hr/> <hr/>

## Liabilities and Net Position

	2012	2011
<b>Current Liabilities</b>		
Line of credit	\$ 250,000	\$ -
Accounts payable	148,995	146,741
Accrued payroll and related deductions	158,694	232,968
Accrued vacation pay	113,522	132,300
Accrued expenses	30,000	30,000
Deferred revenue	7,893	7,161
	<hr/>	<hr/>
Total current liabilities	709,104	549,170
<b>Due to Lessor</b>	<hr/>	<hr/>
	1,240,777	1,385,780
	<hr/>	<hr/>
Total liabilities	<hr/>	<hr/>
	1,949,881	1,934,950
	<hr/>	<hr/>
<b>Unrestricted Net Position</b>	<hr/>	<hr/>
	-	-
	<hr/>	<hr/>
Total liabilities and net position	<hr/>	<hr/>
	\$ 1,949,881	\$ 1,934,950

**Decatur County Hospital**  
**A Component Unit of Decatur County, Kansas**  
**Statements of Operations of Decatur Health Systems, Inc.**  
**Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
<b>Revenues, Gains and Other Support</b>		
Net patient service revenue	\$ 6,320,826	\$ 6,350,052
Other revenue	<u>143,638</u>	<u>159,771</u>
	<u>6,464,464</u>	<u>6,509,823</u>
<b>Expenses</b>		
Salaries and wages	3,811,013	3,594,470
Employee benefits	1,041,097	889,840
Purchased services	355,771	417,896
Drugs	261,676	299,477
Medical supplies	232,096	204,808
Food	93,911	108,706
Utilities	278,680	284,122
Repairs and maintenance	85,149	58,032
Professional fees	351,899	604,875
Dues	43,199	32,615
Insurance	64,389	58,261
Other supplies and expenses	285,070	249,672
Interest	3,637	-
Depreciation and amortization	98,749	95,760
Provision for uncollectible accounts	<u>111,588</u>	<u>153,547</u>
	<u>7,117,924</u>	<u>7,052,081</u>
<b>Operating Loss</b>	<u>(653,460)</u>	<u>(542,258)</u>
<b>Other Income</b>		
Interest income	5,807	7,439
Noncapital gifts and grants	<u>828,455</u>	<u>707,588</u>
	<u>834,262</u>	<u>715,027</u>
<b>Increase in Net Position</b>	180,802	172,769
<b>Change in Amount Due to Lessor</b>	<u>(180,802)</u>	<u>(172,769)</u>
<b>Change in Unrestricted Net Position</b>	<u>\$ -</u>	<u>\$ -</u>