

Kiowa Hospital District

Independent Auditor's Report and Financial Statements

December 31, 2012 and 2011



Kiowa Hospital District

December 31, 2012 and 2011

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Independent Auditor's Report on Financial Statements and Supplementary Information

Board of Directors
Kiowa Hospital District
Kiowa, Kansas

We have audited the accompanying basic financial statements of Kiowa Hospital District and its discretely presented component unit, which are comprised of the balance sheets and statements of financial position as of December 31, 2012 and 2011, and the related statements of revenue, expenses and changes in net position, statements of activities and cash flows for the years then ended, and the related notes to the financial statements, as listed in the table of contents.

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 opinions.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Kiowa Hospital District and its discretely presented component unit as of December 31, 2012 and 2011, and the respective changes in financial position and 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 opinions on the financial statements that collectively comprise the District's financial statements. The supplementary schedules as 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
May 16, 2013

Kiowa Hospital District
Balance Sheets
December 31, 2012 and 2011

	2012	2011
Assets		
Current Assets		
Cash and cash equivalents	\$ 37,153	\$ 310,612
Patient accounts receivable, net of allowance; 2012 - \$412,000, 2011 - \$384,000	518,487	493,399
Estimated amounts due from third-party payers	484,000	213,000
Property taxes receivable	876,580	869,522
Supplies	151,414	160,814
Prepaid expenses and other	356,094	93,559
Total current assets	<u>2,423,728</u>	<u>2,140,906</u>
Noncurrent Cash and Investments		
Held under bond indenture for capital acquisitions - held by Public Building Commission	<u>177,105</u>	<u>-</u>
Capital Assets, Net	<u>2,061,363</u>	<u>1,219,482</u>
Other Assets		
Land held for investment	23,867	23,867
Debt issuance costs, net of amortization	<u>1,821</u>	<u>3,642</u>
	<u>25,688</u>	<u>27,509</u>
Total assets	<u><u>\$ 4,687,884</u></u>	<u><u>\$ 3,387,897</u></u>
Liabilities and Net Position		
Current Liabilities		
Current maturities of long-term debt	\$ 89,795	\$ 79,756
Accounts payable	652,268	169,368
Accrued expenses	252,089	243,177
Deferred tax revenue	<u>876,580</u>	<u>869,522</u>
Total current liabilities	1,870,732	1,361,823
Long-term Debt	<u>260,123</u>	<u>149,918</u>
Total liabilities	<u>2,130,855</u>	<u>1,511,741</u>
Net Position		
Net investment in capital assets	1,713,266	993,450
Restricted - expendable for capital acquisitions	177,105	131,400
Unrestricted	<u>666,658</u>	<u>751,306</u>
Total net position	<u>2,557,029</u>	<u>1,876,156</u>
Total liabilities and net position	<u><u>\$ 4,687,884</u></u>	<u><u>\$ 3,387,897</u></u>

Friends of Kiowa Hospital District and Manor Foundation, Inc.
A Discretely Presented Component Unit of Kiowa Hospital District
Statements of Financial Position
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Assets		
Cash	\$ 549,436	\$ 237,706
Total assets	<u>\$ 549,436</u>	<u>\$ 237,706</u>
 Liabilities and Net Assets		
Due to Hospital	\$ -	\$ 25,000
Accounts payable	<u>-</u>	<u>5,858</u>
Total liabilities	-	30,858
 Temporarily Restricted Net Assets	<u>549,436</u>	<u>206,848</u>
Total liabilities and net assets	<u>\$ 549,436</u>	<u>\$ 237,706</u>

Kiowa Hospital District

Statements of Revenues, Expenses and Changes in Net Position

Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating Revenues		
Net patient service revenues, net of provision for uncollectible accounts; 2012 - \$203,786, 2011 - \$114,050	\$ 4,345,073	\$ 4,469,269
Electronic Health Records Incentive revenue	399,050	-
Other	<u>38,979</u>	<u>26,966</u>
Total operating revenues	<u>4,783,102</u>	<u>4,496,235</u>
Operating Expenses		
Salaries and wages	2,928,874	2,875,000
Employee benefits	439,476	409,575
Purchased services and professional fees	584,984	563,981
Supplies and other	695,096	675,227
Drugs	213,105	233,256
Food	94,586	89,401
Insurance	74,668	94,890
Utilities and telephone	115,372	118,927
Repairs and maintenance	79,900	77,336
Depreciation and amortization	<u>345,650</u>	<u>169,265</u>
Total operating expenses	<u>5,571,711</u>	<u>5,306,858</u>
Operating Loss	<u>(788,609)</u>	<u>(810,623)</u>
Nonoperating Revenues (Expenses)		
Property taxes	858,380	886,375
Interest income	20,248	1,518
Interest expense	(13,939)	(12,955)
Noncapital grants and gifts	<u>20,622</u>	<u>15,043</u>
Total nonoperating revenues	<u>885,311</u>	<u>889,981</u>
Excess of Revenues Over Expenses Before Capital Grants and Gifts	96,702	79,358
Transfer from County For Capital Assets	435,126	-
Capital Grants and Gifts	<u>149,045</u>	<u>20,400</u>
Increase in Net Position	680,873	99,758
Net Position, Beginning of Year	<u>1,876,156</u>	<u>1,776,398</u>
Net Position, End of Year	<u><u>\$ 2,557,029</u></u>	<u><u>\$ 1,876,156</u></u>

Friends of Kiowa Hospital District and Manor Foundation, Inc.
A Discretely Presented Component Unit of Kiowa Hospital District
Statements of Activities
Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Revenues, Gains and Other Support		
Donations	\$ 558,643	\$ 226,460
Interest income	<u>99</u>	<u>-</u>
Total revenues, gains and other support	<u>558,742</u>	<u>226,460</u>
Expenses and Losses		
Contributions to Hospital	149,045	-
Fund raising expenses	65,979	18,858
Other expenses	<u>1,130</u>	<u>754</u>
Total expenses	<u>216,154</u>	<u>19,612</u>
Increase in Net Assets	342,588	206,848
Temporarily Restricted Net Assets, Beginning of Year	<u>206,848</u>	<u>-</u>
Temporarily Restricted Net Assets, End of Year	<u><u>\$ 549,436</u></u>	<u><u>\$ 206,848</u></u>

Kiowa Hospital District
Statements of Cash Flows
Years Ended December 31, 2012 and 2011

	2012	2011
Operating Activities		
Receipts from and on behalf of patients	\$ 4,048,985	\$ 4,240,601
Payments to suppliers and contractors	(2,031,159)	(1,781,547)
Payments to employees	(3,355,173)	(3,221,287)
Other receipts, net	438,029	26,966
	<u>(899,318)</u>	<u>(735,267)</u>
Net cash used in operating activities		
Noncapital Financing Activities		
Property taxes supporting operations	858,380	885,375
Noncapital grants and gifts	20,622	15,043
	<u>879,002</u>	<u>900,418</u>
Net cash provided by noncapital financing activities		
Capital and Related Financing Activities		
Principal paid on long-term debt	(79,756)	(115,529)
Interest paid on long-term debt obligations	(18,204)	(12,490)
Capital grants and gifts	149,045	20,400
Purchase of capital assets	(324,476)	(373,308)
	<u>(273,391)</u>	<u>(480,927)</u>
Net cash used in capital and related financing activities		
Investing Activities		
Interest income	20,248	1,518
	<u>20,248</u>	<u>1,518</u>
Net cash provided by investing activities		
Decrease in Cash and Cash Equivalents	(273,459)	(314,258)
Cash and Cash Equivalents, Beginning of Year	<u>310,612</u>	<u>624,870</u>
Cash and Cash Equivalents, End of Year	<u>\$ 37,153</u>	<u>\$ 310,612</u>

Kiowa Hospital District
Statements of Cash Flows (Continued)
Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided by (Used in) Operating Activities		
Operating loss	\$ (788,609)	\$ (810,623)
Depreciation	343,829	167,444
Amortization of debt issue costs	1,821	1,821
Changes in operating assets and liabilities		
Patient accounts receivable, net	(25,088)	(29,668)
Estimated amounts due from and to third-party payers	(271,000)	(199,000)
Supplies and prepaid expenses	(253,135)	14,652
Accounts payable and accrued expenses	92,864	120,107
	<u> </u>	<u> </u>
Net cash used in operating activities	<u><u>\$ (899,318)</u></u>	<u><u>\$ (735,267)</u></u>
 Supplemental Cash Flows Information		
Capital lease incurred for capital assets	<u><u>\$ -</u></u>	<u><u>\$ 110,000</u></u>
Bonds payable obligations incurred for capital assets	<u><u>\$ 200,000</u></u>	<u><u>\$ -</u></u>
Capital assets acquired with Public Building Commission bond funds - transfer from County	\$ 435,126	\$ -
Capital assets acquired with Public Building Commission bond funds - Hospital obligation	<u>22,895</u>	<u>-</u>
Total non-cash construction in progress additions	<u><u>\$ 458,021</u></u>	<u><u>\$ -</u></u>
Capital assets included in accounts payable	<u><u>\$ 403,213</u></u>	<u><u>\$ -</u></u>

Friends of Kiowa Hospital District and Manor Foundation, Inc.
A Discretely Presented Component Unit of Kiowa Hospital District
Statements of Cash Flows
Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating Activities		
Change in net assets	\$ 342,588	\$ 206,848
Items not requiring (providing) cash		
Due to Hospital	(25,000)	25,000
Accounts payable	<u>(5,858)</u>	<u>5,858</u>
Net cash provided by operating activities	<u>311,730</u>	<u>237,706</u>
Increase in Cash	311,730	237,706
Cash, Beginning of Year	<u>237,706</u>	<u>-</u>
Cash, End of Year	<u><u>\$ 549,436</u></u>	<u><u>\$ 237,706</u></u>

Kiowa Hospital District

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

Kiowa Hospital District (the District) was organized to provide acute health care services for the benefit of the community members, primarily in Barber County, Kansas. The District's facilities are operated by a Board of Directors elected by the qualified voters of the District. The Hospital Division (Hospital) primarily earns revenues by providing inpatient and outpatient services to residents of Barber County, Kansas, and the surrounding communities. In addition, residential long-term care services are provided under a separate license by the Manor Division (Manor) of the District's operations.

Basis of Accounting and Presentation

The financial statements of the District 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 sales taxes), property taxes, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The District 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 District 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.

Cash Equivalents

The District 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 primarily of certificates of deposit with original maturities of 92 days or less.

Kiowa Hospital District

Notes to Financial Statements

December 31, 2012 and 2011

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.

Property Taxes

The District received approximately 14% and 16% of its financial support in 2012 and 2011, respectively, from the proceeds of property taxes. One hundred percent (100%) of these funds were used to support operations in both years.

Property taxes are assessed in November and are received beginning in January of each year. Revenue from property taxes is recognized in the year for which the taxes are levied.

Risk Management

The District 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 workers' compensation. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Workers' compensation coverage is provided through a fund managed by the Kansas Hospital Association. The workers' compensation premiums are subject to retrospective adjustment based on the overall performance of the fund. Management believes adequate reserves are in place within the plan to cover claims incurred but not reported and no additional amounts have been accrued related to claims for this plan.

Patient Accounts Receivable

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

For receivables associated with services provided to patients who have third-party coverage, the District analyzes contractually due amounts and provides an allowance for uncollectible accounts and a provision for uncollectible accounts, 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).

Kiowa Hospital District

Notes to Financial Statements

December 31, 2012 and 2011

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 District records a significant provision for uncollectible accounts 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 policy) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectible accounts.

The District's allowance for uncollectible accounts is based on historical collection rates within individual payer classes, as well as estimated amounts expected to be transferred to patient responsibility. The allowance percentages are re-evaluated each year.

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. Assets under capital lease obligations are depreciated at their respective estimated useful lives. The following estimated useful lives are being used by the District:

Land improvements	5 – 40 years
Buildings	5 – 56 years
Fixed equipment	3 – 43 years
Major moveable equipment	3 – 15 years

The District capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing. Total interest capitalized and incurred was:

	2012	2011
Total interest expense incurred on borrowings for project during construction phase	\$ 3,825	\$ -
Interest income from investment of proceeds of borrowings for project	<u>6</u>	<u>-</u>
Net interest cost capitalized	<u>\$ 3,819</u>	<u>\$ -</u>
Interest capitalized	\$ 3,819	\$ -
Interest charged to expense	<u>13,939</u>	<u>12,955</u>
Total interest incurred	<u><u>\$ 17,758</u></u>	<u><u>\$ 12,955</u></u>

Kiowa Hospital District

Notes to Financial Statements

December 31, 2012 and 2011

Compensated Absences

District policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Sick leave benefits are realized as paid time off and are recognized as expense when the time off occurs and no liability is accrued for such benefits employees have earned but not yet realized. Compensated absence liabilities are computed using the regular pay and termination pay rates 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.

Net Position

Net position of the District is classified in three components. Net investment in capital assets consists 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 is noncapital assets that must be used for a particular purpose, as specified by donors external to the Hospital. Unrestricted net position is remaining assets less remaining liabilities that do not meet the definition of net investment in capital assets or restricted expendable.

Net Patient Service Revenues

The District has agreements with third-party payers that provide for payments to the District 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 District provides care at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the District does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue.

Income Taxes

As an essential government entity, the District is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law.

Kiowa Hospital District

Notes to Financial Statements

December 31, 2012 and 2011

Foundation

Friends of Kiowa Hospital District and Manor Foundation, Inc. (Foundation) is a legally separate, tax-exempt component unit of the District. The Foundation acts primarily as a fund raising organization to supplement the resources that are available to the District in support of its programs. The five to seven member board of the Foundation is self-perpetuating and consists of area business and community members.

Although the District does not control the timing or amount of receipts from the Foundation, the majority of the Foundation's resources and related income are restricted by donors for the benefits of the District. Because the majority of resources held by the Foundation can only be used by, or for the benefit of, the District and for the benefit of patients served by the District, the Foundation is considered a component unit of the District and is discretely presented in the District's financial statements.

During the years ended December 31, 2012 and 2011, the Foundation distributed \$149,045 and \$0 funds to the District, respectively.

The Foundation is a private nonprofit organization that reports under the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the Foundation's statements in the District's financial reporting entity for these differences.

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). Critical access hospitals are eligible to receive incentive payments for up to four years under the Medicare program for its reasonable costs of the purchase of certified EHR technology multiplied by the District's Medicare utilization plus 20%, limited to 100% of the costs incurred. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services (CMS). Payment under both programs are contingent on the hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year under both programs is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The District recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

Kiowa Hospital District

Notes to Financial Statements

December 31, 2012 and 2011

The District has completed the first-year requirements under the Medicare program and has recorded revenue of \$399,050 and \$0 in the years ended December 31, 2012 and 2011, respectively.

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 Revenues

The District 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 District recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the District's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the District records a significant provision for uncollectible accounts related to uninsured patients in the period the services are provided. This provision for uncollectible accounts is presented as a component of net patient service revenue.

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

Medicare. The District 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 cost subject to certain limitations. The District is reimbursed for most services at tentative rates with final settlement determined after submission of annual cost reports by the District 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. Medicaid Rural Health Clinic services are reimbursed under a cost-based methodology. The District and Rural Health Clinic are reimbursed at tentative rates with final settlements determined after submission of annual cost reports by the District and reviews thereof by the Kansas Department of Health and Environment. The District is reimbursed on a prospective payment methodology for inpatient and outpatient services rendered to beneficiaries who are part of a Medicaid managed care network.

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 District is reimbursed at a prospective rate with annual cost reports submitted to the Medicaid program. Prior to 2011, rates are computed each calendar quarter using an average of the 2005, 2006 and 2007 cost reports and changes in the Medicaid resident case

Kiowa Hospital District

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mix index. As part of a provider assessment program approved by CMS 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 68% and 64% 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 District has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the District under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

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.

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 District 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 District's net patient service revenue. Additionally, it is possible the District will experience payment delays and other operational challenges during PPACA's implementation.

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Notes to Financial Statements

December 31, 2012 and 2011

Note 3: 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 District'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 \$1,708 of the District's bank balances of \$113,315 and \$386,451 were exposed to custodial credit risk as follows:

	2012	2011
	<hr/>	<hr/>
Uninsured and collateral held by pledging financial institution's trust department or agent in other than the District's name	\$ -	\$ 1,708
	<hr/>	<hr/>

Summary of Carrying Values

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

	2012	2011
	<hr/>	<hr/>
Carrying value		
Deposits	\$ 37,153	\$ 310,612
	<hr/>	<hr/>
Included in the following balance sheet captions		
Cash and cash equivalents	\$ 37,153	\$ 310,612
	<hr/>	<hr/>

Kiowa Hospital District

Notes to Financial Statements

December 31, 2012 and 2011

Note 4: Patient Accounts Receivable

The District 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:

	2012	2011
Medicare	\$ 226,920	\$ 232,078
Medicaid	28,009	71,476
Blue Cross	104,602	46,949
Other third-party payers	101,325	70,917
Patients	469,631	455,979
	<u>930,487</u>	<u>877,399</u>
Less allowance for uncollectible accounts	<u>412,000</u>	<u>384,000</u>
	<u><u>\$ 518,487</u></u>	<u><u>\$ 493,399</u></u>

Note 5: Capital Assets

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

	2012			
	Beginning Balance	Additions	Disposals	Transfers
Land	\$ 26,668	\$ -	\$ -	\$ -
Land improvements	52,492	-	-	-
Buildings	1,031,113	-	-	-
Fixed equipment	489,377	5,941	-	-
Major moveable equipment	1,908,708	166,833	(100,000)	601,892
Construction in progress	211,347	1,012,936	-	(601,892)
	<u>3,719,705</u>	<u>1,185,710</u>	<u>(100,000)</u>	<u>-</u>
	<u>4,805,415</u>			
Less accumulated depreciation				
Land improvements	46,497	1,004	-	-
Buildings	740,803	24,608	-	-
Fixed equipment	332,348	16,090	-	-
Major moveable equipment	1,380,575	302,127	(100,000)	-
	<u>2,500,223</u>	<u>343,829</u>	<u>(100,000)</u>	<u>-</u>
	<u>2,744,052</u>			
Capital Assets, Net	<u><u>\$1,219,482</u></u>	<u><u>\$ 841,881</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>
	<u><u>\$2,061,363</u></u>			

Kiowa Hospital District
Notes to Financial Statements
December 31, 2012 and 2011

	2011				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	\$ 26,668	\$ -	\$ -	\$ -	\$ 26,668
Land improvements	52,492	-	-	-	52,492
Buildings	1,031,113	-	-	-	1,031,113
Fixed equipment	442,680	46,697	-	-	489,377
Major moveable equipment	1,701,287	207,421	-	-	1,908,708
Construction in progress	-	211,347	-	-	211,347
	<u>3,254,240</u>	<u>465,465</u>	<u>-</u>	<u>-</u>	<u>3,719,705</u>
Less accumulated depreciation					
Land improvements	45,493	1,004	-	-	46,497
Buildings	713,892	26,911	-	-	740,803
Fixed equipment	317,890	14,458	-	-	332,348
Major moveable equipment	1,255,504	125,071	-	-	1,380,575
	<u>2,332,779</u>	<u>167,444</u>	<u>-</u>	<u>-</u>	<u>2,500,223</u>
Capital Assets, Net	<u>\$ 921,461</u>	<u>\$ 298,021</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$1,219,482</u>

Note 6: Medical Malpractice Coverage and Claims

The District 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 District's claims experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

Kiowa Hospital District
Notes to Financial Statements
December 31, 2012 and 2011

Note 7: Long-term Debt

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

2012					
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Certificates of participation	\$ 90,000	\$ -	\$ 45,000	\$ 45,000	\$ 45,000
Public Building Commission bonds payable - 2012	-	200,000	-	200,000	9,250
Capital lease obligations	139,674	-	34,756	104,918	35,545
Total long-term debt	<u>\$ 229,674</u>	<u>\$ 200,000</u>	<u>\$ 79,756</u>	<u>\$ 349,918</u>	<u>\$ 89,795</u>

2011					
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Certificates of participation	\$ 130,000	\$ -	\$ 40,000	\$ 90,000	\$ 45,000
Capital lease obligations	105,203	110,000	75,529	139,674	34,756
Total long-term debt	<u>\$ 235,203</u>	<u>\$ 110,000</u>	<u>\$ 115,529</u>	<u>\$ 229,674</u>	<u>\$ 79,756</u>

Certificates of Participation

In 1998, the District issued Certificates of Participation (COP) to finance the acquisition of the Manor and to provide funds for the improvement of the Manor building. Under the terms of the COP, the District leases the property from Bank of New York, St. Louis, Missouri. The lease agreement between the District and Bank of New York requires the District to make the lease payments to Bank of New York as a trustee who is responsible to maintain specific principal and interest accounts. The actual principal and interest payments are made to the certificate holders by the trustee from the principal and interest accounts. Upon retirement of all the certificates, the District will own the leased property. Accordingly, the leased property and COP indebtedness have been included in the financial statements as assets and liabilities of the District. The COP is secured by substantially all of the Manor's assets. Interest rates vary from 4.90% to 5.15%; principal is due annually in increasing amounts on November 15, with final certificates maturing November 15, 2013.

Kiowa Hospital District
Notes to Financial Statements
December 31, 2012 and 2011

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

Year Ending December 31,	Total to be Paid	Principal	Interest
2013	\$ 47,318	\$ 45,000	\$ 2,318

Public Building Commission Bonds Payable – 2012

The Public Building Commission bonds payable consist of Barber County, Kansas Public Building Commission Revenue Bonds Series 2012 in the original amount of \$4,000,000 dated August 15, 2012, which bear interest at 2.0% to 3.0%. The bonds are payable in annual installments beginning September 1, 2013 through September 1, 2027. Semi-annual interest payments are due beginning March 1, 2013 through September 1, 2027. In connection with the issuance of the bonds, the District has entered into a sublease with the County. Under the sublease, the District is responsible for 5% of the total debt service on the bonds. The bonds are secured by a pledge of the gross revenues of the District and the restricted cash funds set aside under the bond documents.

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

Year Ending December 31,	Total to be Paid	Principal	Interest
2013	\$ 14,711	\$ 9,250	\$ 5,461
2014	15,794	10,750	5,044
2015	16,578	11,750	4,828
2016	16,476	12,000	4,476
2017	16,366	12,250	4,116
2018-2022	82,662	67,750	14,912
2023-2027	82,208	76,250	5,958
	<u>\$ 244,795</u>	<u>\$ 200,000</u>	<u>\$ 44,795</u>

Kiowa Hospital District

Notes to Financial Statements

December 31, 2012 and 2011

Capital Lease Obligations

The District is obligated under a lease for equipment that is accounted for as a capital lease. Assets under capital leases at December 31, 2012 and 2011, totaled \$115,058 and \$143,870, respectively, net of accumulated depreciation of \$60,433 and \$31,621, respectively. The following is a schedule by year of future minimum lease payments under the capital lease including interest at 6.02% with the present value of the future minimum lease payments as of December 31:

<u>Year Ending December 31,</u>	
2013	\$ 36,856
2014	36,851
2015	22,000
2016	<u>11,000</u>
Total minimum lease payments	106,707
Less amount representing interest	<u>1,789</u>
Present value of future minimum lease payments	<u><u>\$ 104,918</u></u>

Note 8: Pension Plan

The District is the trustee of a 457(b) deferred compensation plan covering substantially all employees. Plan contributions are made by participating employees. The plan provides retirement benefits to plan members and their beneficiaries. Benefit provisions and contribution requirements are contained in the plan document and were established and can be amended by action of the District's governing body. Employer contributions to the plan were \$124,715 and \$107,295 for the years ended December 31, 2012 and 2011, respectively. The fair market value of employee investments at December 31, 2012 and 2011, were \$415,565 and \$396,986, respectively. These amounts are not reported as assets or liabilities of the District.

Note 9: Other Information

Compliance with Budgetary Statutes

State law provides that the District must adopt an annual budget and that total actual expenses will not exceed total budgeted expenses. During 2012, the District's total actual expenses exceed approved total budgeted expenses by approximately \$165,000.

Kiowa Hospital District
Notes to Financial Statements
December 31, 2012 and 2011

Note 10: 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 the fair value of investments and other 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 District.

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 District'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 District's ability to maintain sufficient liquidity.

Note 11: Commitments

Hospital Building Project

The Hospital is undertaking a project to build a new hospital at a new site. Total cost of the project is anticipated to be approximately \$8,500,000. The project will be financed primarily with proceeds from the issuance of \$4,000,000 in Barber County, Kansas, Public Building Commission Revenue Bonds Series 2012 (see *Note 7*), \$3,000,000 in United States Department of Agriculture – Rural Development (USDA) funding and contributions from the general public through a local foundation.

On May 21, 2012, the Hospital obtained a loan commitment from USDA for \$3,000,000. Short-term construction funding will be provided through a bank with permanent financing provided by USDA.

Kiowa Hospital District

Notes to Financial Statements

December 31, 2012 and 2011

Note 12: Friends of Kiowa Hospital District and Manor Foundation, Inc.

Summary of Significant Accounting Policies

Organization

The Foundation is a not-for-profit organization whose purpose is to raise funds for the support of health and health care programs for the District.

Basis of Accounting

The financial statements have been prepared on the accrual basis of accounting in accordance with generally accepted accounting principles.

Display of Net Assets by Class

Net assets of the two restricted classes are created only by donor-imposed restrictions on their use. All other net assets, including board-designated or appropriated amounts, are legally unrestricted, and are reported as part of the unrestricted class. Temporarily restricted assets received in the current year and whose restrictions are met during the year are shown as unrestricted net assets.

Income Taxes

The Foundation is a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code classified by the Internal Revenue Service as other than a private foundation.

Cash and Cash Equivalents

The Foundation considers all highly liquid investments with a maturity of 90 days or less to be cash equivalents. The Foundation has no cash equivalents.

Functional Allocation of Expenses

The costs of providing the Foundation's programs and administration have been summarized on a functional basis in the Statements of Activities. Accordingly, expenses that benefit both programs and supporting services have been allocated using management's estimates.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Kiowa Hospital District

Notes to Financial Statements

December 31, 2012 and 2011

Donated Staff/Facilities

The District provides the office space and utilities as well as a portion of the salaries. The values of these donations have not been reflected in the financial statements.

Donated Services

The Foundation receives donated services from unpaid volunteers who assist in fund raising and special projects. No amounts have been recognized in the Statements of Activities because the criteria for recognition under accounting principles generally accepted in the United States of America have not been satisfied.

Revenues, Gains and Other Support

Donations are generally available for unrestricted use in the current year unless specifically restricted by the donor. The Foundation is in the process of fund raising for the construction of a replacement hospital for the District. The revenues from these activities are reported separately from their expenses which are recorded in the Statements of Activities as a fund raising activity expense.

Related Entity

The Foundation works closely with the District. Facilities and start-up funds were provided by the Hospital. As discussed above, much of the funds raised by the Foundation are distributed to the District. The entities share one common member of their Boards of Trustees/Directors.

Supplementary Information

Kiowa Hospital District
Net Patient Service Revenues
Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Hospital Revenues		
Inpatient	\$ 765,316	\$ 757,109
Outpatient	1,775,050	1,806,739
Clinic Revenues	642,785	547,349
Long-term Care Facility Revenues	<u>1,316,723</u>	<u>1,403,885</u>
Subtotal	4,499,874	4,515,082
Plus (Less) Contractual Adjustments	48,985	68,237
Plus (Less) Provision for Uncollectible Accounts	<u>(203,786)</u>	<u>(114,050)</u>
Net Patient Service Revenues	<u><u>\$ 4,345,073</u></u>	<u><u>\$ 4,469,269</u></u>

Kiowa Hospital District

Comparison of Revenues and Expenses (Cash Basis) – Actual and Tax Budget Year Ended December 31, 2012

	Actual	Tax Budget	Actual Over (Under) Budget
Net patient service revenues	\$ 4,048,985	\$ 4,272,349	\$ (223,364)
Electronic Health Records Incentive revenue	399,050	-	399,050
Other revenue	<u>38,979</u>	<u>261,387</u>	<u>(222,408)</u>
Total revenues	<u>4,487,014</u>	<u>4,533,736</u>	<u>(46,722)</u>
Operating expenses	5,999,715	5,852,435	147,280
Interest paid	<u>18,204</u>	<u>-</u>	<u>18,204</u>
Operating expenses	<u>6,017,919</u>	<u>5,852,435</u>	<u>165,484</u>
Operating loss	<u>(1,530,905)</u>	<u>(1,318,699)</u>	<u>(212,206)</u>
Property taxes revenue	858,380	869,522	(11,142)
Other nonoperating revenues	<u>40,870</u>	<u>148,772</u>	<u>(107,902)</u>
Total nonoperating revenues	<u>899,250</u>	<u>1,018,294</u>	<u>(119,044)</u>
Decrease of revenues over expenses	<u><u>\$ (631,655)</u></u>	<u><u>\$ (300,405)</u></u>	<u><u>\$ (331,250)</u></u>

Note: The above schedule reflects a comparison of current year operations and the tax budget.