

FINANCIAL STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
DECEMBER 31, 2012 AND 2011

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the financial performance of Labette County Medical Center d/b/a Labette Health provides a narrative overview of Labette Health's financial activities for the years ended December 31, 2012 and 2011. Please read it in conjunction with the accompanying financial statements.

Financial highlights

Labette Health's net position decreased by \$1,053,942 or 2.9 percent in 2012 and decreased by \$1,527,295 or 4.1 percent in 2011.

Labette Health reported an operating loss of \$62,231 in 2012, an operating loss of \$880,892 in 2011, and an operating loss of \$425,235 in 2010.

Using these financial statements

Labette Health's financial statements consist of three statements - a Statement of Net Position; a Statement of Revenues, Expenses, and Changes in Net Position; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of Labette Health, including resources held by or for the benefit of Labette Health, and resources restricted for specific purposes by contributors, grantors, and indenture agreements.

One of the most important questions asked about Labette Health's finances is, "Is Labette Health as a whole better or worse off as a result of the year's activities?" The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position report information about Labette Health's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. For purposes of these two statements, revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report Labette Health's net position and changes in it. Labette Health's net position - the difference between assets and liabilities - may be thought of as one way to measure its financial health, or financial position. Over time, increases or decreases in Labette Health's net position are one indicator of whether its financial health is improving or deteriorating. Consideration must also be given to other nonfinancial indicators, such as changes in Labette Health's patient base and measures of the quality of service it provides to the community, as well as local economic factors, to assess the overall health of Labette Health.

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?", "What was cash used for?", and "What was the change in cash balance during the reporting period?"

MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Assets, liabilities, and net position

Labette Health's statements of net position as of the end of each of the last three years are summarized as follows:

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|--------------------------|----------------------|----------------------|----------------------|
| Assets | | | |
| Current assets | \$ 19,276,255 | \$ 17,000,510 | \$ 14,871,875 |
| Assets limited as to use | 10,698,342 | 10,634,847 | 10,891,831 |
| Capital assets, net | 39,615,420 | 43,352,688 | 46,704,388 |
| Other assets | <u>1,917,331</u> | <u>2,301,280</u> | <u>2,342,809</u> |
| Total assets | <u>\$ 71,507,348</u> | <u>\$ 73,289,325</u> | <u>\$ 74,810,903</u> |
| Liabilities | | | |
| Current liabilities | \$ 6,532,101 | \$ 6,948,594 | \$ 6,361,206 |
| Long-term liabilities | <u>30,155,617</u> | <u>30,467,159</u> | <u>31,048,830</u> |
| Total liabilities | <u>\$ 36,687,718</u> | <u>\$ 37,415,753</u> | <u>\$ 37,410,036</u> |
| Net position | <u>\$ 34,819,630</u> | <u>\$ 35,873,572</u> | <u>\$ 37,400,867</u> |

Cash and cash equivalents in the current asset category increased by \$868,587 in 2012 and decreased by \$112,917 in 2011. The changes in both years are due to cash flows from operations being more or less than the cash used by capital and related financing activities.

Net patient accounts receivable increased by \$220,701 in 2012 and increased by \$1,795,687 in 2011. The number of days of net revenue represented by net accounts receivable was 70 days, 68 days, and 57 days as of December 31, 2012, 2011, and 2010, respectively. The median value of similar hospitals for this ratio is 48 days.

Net capital assets decreased by \$3,737,268 in 2012 and decreased by \$3,351,700 in 2011. Capital asset acquisitions during 2012 and 2011 were funded from operating cash flow and capital lease obligations. Cash outlays for capital asset acquisitions totaled \$1,344,442 during 2012, of which \$498,329 (37.1 percent) was financed with capital lease obligations and the rest was paid for from operating cash flow. Cash outlays for capital asset acquisitions totaled \$1,478,128 during 2011, of which \$547,000 (37.0 percent) was financed with capital lease obligations and the rest was paid for from operating cash flow.

Labette Health's net position decreased by \$1,053,942 or 2.9 percent in 2012 and decreased by \$1,527,295 or 4.1 percent in 2011. The percentage of total assets financed with net position, or equity, was 48.7 percent, 48.9 percent, and 50.0 percent as of December 31, 2012, 2011, and 2010, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Operating results and changes in net position

Labette Health's operating results and changes in net position for each of the last three years are summarized as follows:

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|----------------------------------|-----------------------|-----------------------|-----------------------|
| Operating revenues | \$ 56,385,395 | \$ 54,120,929 | \$ 53,318,989 |
| Operating expenses | <u>56,447,626</u> | <u>55,001,821</u> | <u>53,744,224</u> |
| Operating loss | (62,231) | (880,892) | (425,235) |
| Ambulance subsidy | 609,497 | 621,345 | 589,341 |
| Interest expense | (1,804,292) | (1,815,519) | (1,661,361) |
| Other nonoperating revenues | 155,738 | 317,996 | 153,574 |
| Capital grants and contributions | <u>47,346</u> | <u>229,775</u> | <u>30,285</u> |
| Change in net position | <u>\$ (1,053,942)</u> | <u>\$ (1,527,295)</u> | <u>\$ (1,313,396)</u> |

The first, and most significant, component of the overall change in Labette Health's net position is its operating income or loss - generally, the difference between net patient service revenue and the expenses incurred to perform those services. Labette Health's operating loss decreased by \$818,661 in 2012 and increased by \$455,657 in 2011.

Gross and net patient service revenue for the past three years are analyzed as follows:

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|-------------------------------|----------------------|----------------------|----------------------|
| Inpatient services | \$ 42,962,690 | \$ 46,482,654 | \$ 41,884,776 |
| Outpatient services | 75,774,173 | 76,116,946 | 67,946,807 |
| Physician services | <u>14,298,675</u> | <u>11,888,527</u> | <u>9,591,243</u> |
| Gross patient service revenue | 133,035,538 | 134,488,127 | 119,422,826 |
| Contractual adjustments | (70,715,653) | (73,222,231) | (59,747,286) |
| Provision for bad debts | (5,914,900) | (6,249,848) | (4,697,687) |
| Charity care | <u>(3,089,055)</u> | <u>(1,996,563)</u> | <u>(2,716,315)</u> |
| Net patient service revenue | <u>\$ 53,315,930</u> | <u>\$ 53,019,485</u> | <u>\$ 52,261,538</u> |

Labette Health did not increase charge rates during 2012 and raised its charge rates by approximately 9.6 percent in 2011. Total inpatient revenues decreased by 7.6 percent during 2012. This decrease was a result of a 13.6 percent decrease in acute and ICU patient days in 2012 and a 7.9 percent decrease in rehabilitation unit patient days in 2012. Total inpatient revenues increased by 11.0 percent during 2011. This increase was a result of the charge rate increases, a 3.8 percent increase in acute and ICU patient days in 2011, and a 65.1 percent increase in rehabilitation unit patient days in 2011. Outpatient revenues decreased by 0.5 percent during 2012. This slight decrease was due to virtually no change in outpatient registrations in 2012 and no increases in charge rates during 2012.

MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Outpatient revenues increased by 12.0 percent during 2011 because of charge rate increases, which were more substantial for emergency and therapy services, and a 0.5 percent decrease in outpatient registrations. The change in physician service revenue is primarily due to changes in the number of physicians working for Labette Health.

Labette Health has agreements with various third-party payors that provide for payments to it at amounts different from its established charge rates. These differences are referred to as contractual adjustments. These adjustments are affected by the mix of revenues as well as by increases in Labette Health's charge rates relative to changes in rates paid by third-party payors.

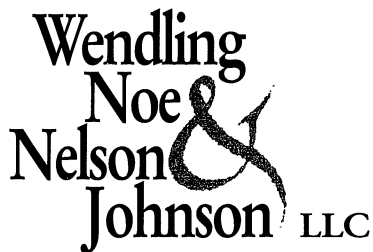
The provision for bad debts and charity care write-offs combined represent 6.8 percent, 6.1 percent, 6.2 percent, and 6.0 percent of gross patient service revenue during 2012, 2011, 2010, and 2009, respectively. This rising trend is reflective of the current health care environment in which an increasing number of patients are uninsured, or insured by plans requiring higher out-of-pocket expense covered by the insured.

Employee salaries and wages increased by \$733,141 or 3.3 percent in 2012 and decreased by \$509,331 or 2.2 percent in 2011. The number of full-time equivalent employees increased by 1.2 (0.3 percent) during 2012 and decreased by 33.4 (7.4 percent) during 2011.

The cost of employee benefits equaled 19.3 percent, 19.3 percent, and 20.0 percent of salaries and wages during 2012, 2011, and 2010, respectively. Variations in employee benefit costs generally correlate with claims experience under Labette Health's self-insured employee health insurance plan.

Supplies and other expenses increased by 3.6 percent in 2012 and increased by 8.5 percent during 2011. These changes are consistent with the patient volume fluctuations experienced by Labette Health combined with the general rate of health care inflation, as well as a shift in 2011 of certain services obtained from contracted individuals rather than employees.

Nonoperating revenues include sales tax revenues received from the County. This subsidy offsets losses incurred by Labette Health in operating the local ambulance service. Labette Health began receiving this subsidy in 2002.



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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Trustees
Labette County Medical Center
d/b/a Labette Health

We have audited the accompanying financial statements of the business-type activity and the discretely presented component units of Labette County Medical Center d/b/a Labette Health as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise Labette Health's 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 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 of 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 previously present fairly, in all material respects, the respective financial position of the business-type activity and the discretely presented component units of Labette County Medical Center d/b/a Labette Health as of December 31, 2012 and 2011, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 1 through 4 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audits of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Wendling, Roe Nelson & Johnson LLC

Topeka, Kansas
May 21, 2013

FINANCIAL STATEMENTS

LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
STATEMENTS OF NET POSITION
December 31,

ASSETS

| | 2012 | | | 2011 | | |
|---|---------------------------|---------------------|-------------------|---------------------------|---------------------|-------------------|
| | <u>Labette Health</u> | <u>Foundation</u> | <u>Clinic</u> | <u>Labette Health</u> | <u>Foundation</u> | <u>Clinic</u> |
| CURRENT ASSETS | | | | | | |
| Cash and cash equivalents | \$ 4,654,288 | \$ 34,448 | \$ 85,265 | \$ 3,785,701 | \$ 256,489 | \$ 96,207 |
| Investments | | 953,985 | | | 810,524 | |
| Assets limited as to use | 1,095,858 | | | 1,122,067 | | |
| Patient accounts receivable, net of allowance for uncollectible accounts of \$2,053,279 in 2012 and \$1,415,087 in 2011 | 10,141,546 | | | 9,920,845 | | |
| Other receivables | 77,050 | 33,095 | | 182,910 | 33,095 | |
| Estimated third-party payor settlements | 1,230,352 | | | 193,247 | | |
| Inventories | 1,280,570 | | | 1,277,304 | | |
| Prepaid expenses | 796,591 | | | 518,436 | | |
| Total current assets | <u>19,276,255</u> | <u>1,021,528</u> | <u>85,265</u> | <u>17,000,510</u> | <u>1,100,108</u> | <u>96,207</u> |
| ASSETS LIMITED AS TO USE | | | | | | |
| Internally designated for capital assets | 8,360,847 | | | 8,327,458 | | |
| Under indenture agreement - held by trustee | 3,433,353 | | | 3,429,456 | | |
| By contributors for employee assistance and capital acquisitions | | 8,089 | | | 8,863 | |
| Principal of permanent endowments | | 58,064 | | | 58,064 | |
| | 11,794,200 | 66,153 | - | 11,756,914 | 66,927 | - |
| Less amounts required to meet current obligations | <u>1,095,858</u> | | | <u>1,122,067</u> | | |
| | <u>10,698,342</u> | <u>66,153</u> | <u>-</u> | <u>10,634,847</u> | <u>66,927</u> | <u>-</u> |
| CAPITAL ASSETS, net | <u>39,615,420</u> | <u>-</u> | <u>145,742</u> | <u>43,352,688</u> | <u>-</u> | <u>161,912</u> |
| OTHER ASSETS | | | | | | |
| Investment in affiliate | 569,661 | | | 619,599 | | |
| Advances receivable | 839,008 | | | 1,139,024 | | |
| Other | 508,662 | 118,513 | | 542,657 | 118,513 | |
| | <u>1,917,331</u> | <u>118,513</u> | <u>-</u> | <u>2,301,280</u> | <u>118,513</u> | <u>-</u> |
| TOTAL ASSETS | <u>\$ 71,507,348</u> | <u>\$ 1,206,194</u> | <u>\$ 231,007</u> | <u>\$ 73,289,325</u> | <u>\$ 1,285,548</u> | <u>\$ 258,119</u> |

The accompanying notes are an integral part of these statements.

LIABILITIES AND NET POSITION

| | 2012 | | | 2011 | | |
|--|---------------------------|-------------------|---------------|---------------------------|-------------------|---------------|
| | <u>Labette Health</u> | <u>Foundation</u> | <u>Clinic</u> | <u>Labette Health</u> | <u>Foundation</u> | <u>Clinic</u> |
| CURRENT LIABILITIES | | | | | | |
| Current maturities of long-term obligations | \$ 820,110 | \$ - | \$ - | \$ 1,036,103 | \$ - | \$ - |
| Accounts payable | 2,114,149 | | | 2,292,770 | | |
| Capital asset acquisitions payable | 217,356 | | | 358,446 | | |
| Accrued salaries, wages, and benefits | 1,176,574 | | 7,951 | 1,005,552 | | 7,184 |
| Accrued compensated absences | 911,335 | | | 929,186 | | |
| Accrued interest payable | 575,858 | | | 587,067 | | |
| Accrued health insurance claims | 241,019 | | | 325,762 | | |
| Estimated third-party payor settlements | 452,851 | | | 397,070 | | |
| Deferred grant revenue | 22,849 | | | 16,638 | | |
| Total current liabilities | 6,532,101 | - | 7,951 | 6,948,594 | - | 7,184 |
| LONG-TERM OBLIGATIONS, less current maturities | 30,151,888 | | | 30,452,575 | | |
| POST-RETIREMENT BENEFITS | 3,729 | | | 14,584 | | |
| Total liabilities | 36,687,718 | - | 7,951 | 37,415,753 | - | 7,184 |
| NET POSITION | | | | | | |
| Net investment in capital assets | 11,716,439 | | 145,742 | 15,033,418 | | 161,912 |
| Restricted | | | | | | |
| For debt service | 1,400,850 | | | 1,315,093 | | |
| Expendable for capital acquisitions | | 34,027 | | 50,000 | 50,456 | |
| Nonexpendable permanent endowments | | 58,064 | | | 58,064 | |
| Unrestricted | 21,702,341 | 1,114,103 | 77,314 | 19,475,061 | 1,177,028 | 89,023 |
| Total net position | 34,819,630 | 1,206,194 | 223,056 | 35,873,572 | 1,285,548 | 250,935 |
| TOTAL LIABILITIES AND NET POSITION | \$ 71,507,348 | \$ 1,206,194 | \$ 231,007 | \$ 73,289,325 | \$ 1,285,548 | \$ 258,119 |

LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
Year ended December 31,

| | 2012 | | | 2011 | | |
|--|---------------------------|---------------------|-------------------|---------------------------|---------------------|-------------------|
| | <u>Labette Health</u> | <u>Foundation</u> | <u>Clinic</u> | <u>Labette Health</u> | <u>Foundation</u> | <u>Clinic</u> |
| Operating revenues | | | | | | |
| Net patient service revenue | \$53,315,930 | \$ - | \$ - | \$ 53,019,485 | \$ - | \$ - |
| Other | <u>3,069,465</u> | <u>98,803</u> | <u>81,122</u> | <u>1,101,444</u> | <u>241,974</u> | <u>81,192</u> |
| Total operating revenues | <u>56,385,395</u> | <u>98,803</u> | <u>81,122</u> | <u>54,120,929</u> | <u>241,974</u> | <u>81,192</u> |
| Operating expenses | | | | | | |
| Salaries and wages | 22,894,153 | | 4,518 | 22,161,012 | | 4,550 |
| Employee benefits | 4,417,697 | | | 4,274,188 | | |
| Supplies and other | 24,292,071 | 281,133 | 88,313 | 23,445,683 | 320,976 | 24,981 |
| Depreciation and amortization | <u>4,843,705</u> | | <u>16,170</u> | <u>5,120,938</u> | | <u>16,170</u> |
| Total operating expenses | <u>56,447,626</u> | <u>281,133</u> | <u>109,001</u> | <u>55,001,821</u> | <u>320,976</u> | <u>45,701</u> |
| Operating income (loss) | <u>(62,231)</u> | <u>(182,330)</u> | <u>(27,879)</u> | <u>(880,892)</u> | <u>(79,002)</u> | <u>35,491</u> |
| Nonoperating revenues (expenses) | | | | | | |
| Ambulance subsidy | 609,497 | | | 621,345 | | |
| Investment income | 50,790 | 102,976 | | 115,646 | 14,751 | |
| Interest expense | (1,804,292) | | | (1,815,519) | | |
| Noncapital grants and contributions | 242,370 | | | 132,842 | | |
| Other | <u>(137,422)</u> | | | <u>69,508</u> | | |
| Total nonoperating revenues (expenses) | <u>(1,039,057)</u> | <u>102,976</u> | <u>-</u> | <u>(876,178)</u> | <u>14,751</u> | <u>-</u> |
| Excess of revenues over (under) expenses before capital grants and contributions | (1,101,288) | (79,354) | (27,879) | (1,757,070) | (64,251) | 35,491 |
| Capital grants and contributions | 47,346 | | | 229,775 | | |
| Distributions to members | | | | | | <u>(54,000)</u> |
| Change in net position | (1,053,942) | (79,354) | (27,879) | (1,527,295) | (64,251) | (18,509) |
| Net position beginning of year | <u>35,873,572</u> | <u>1,285,548</u> | <u>250,935</u> | <u>37,400,867</u> | <u>1,349,799</u> | <u>269,444</u> |
| Net position end of year | <u>\$ 34,819,630</u> | <u>\$ 1,206,194</u> | <u>\$ 223,056</u> | <u>\$ 35,873,572</u> | <u>\$ 1,285,548</u> | <u>\$ 250,935</u> |

The accompanying notes are an integral part of these statements.

LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
STATEMENTS OF CASH FLOWS
Year ended December 31,

| | 2012 | | | 2011 | | |
|---|---------------------------|-------------------|------------------|---------------------------|-------------------|------------------|
| | <u>Labette Health</u> | <u>Foundation</u> | <u>Clinic</u> | <u>Labette Health</u> | <u>Foundation</u> | <u>Clinic</u> |
| Cash flows from operating activities | | | | | | |
| Receipts from and on behalf of patients | \$52,113,905 | \$ - | \$ - | \$51,513,543 | \$ - | \$ - |
| Payments to or on behalf of employees | (27,254,277) | | (3,751) | (26,869,936) | | (3,670) |
| Payments for supplies and services | (24,452,097) | (281,133) | (88,313) | (22,968,587) | (320,976) | (24,981) |
| Other receipts and payments | <u>3,086,728</u> | <u>98,803</u> | <u>81,122</u> | <u>1,073,696</u> | <u>241,974</u> | <u>81,975</u> |
| Net cash provided (used) by operating activities | <u>3,494,259</u> | <u>(182,330)</u> | <u>(10,942)</u> | <u>2,748,716</u> | <u>(79,002)</u> | <u>53,324</u> |
| Cash flows from noncapital financing activities | | | | | | |
| Ambulance subsidy | 620,595 | | | 616,722 | | |
| Noncapital grants and contributions | 283,804 | | | 114,939 | | |
| Distributions to members | | | | | | (54,000) |
| Net cash provided (used) by noncapital financing activities | <u>904,399</u> | <u>-</u> | <u>-</u> | <u>731,661</u> | <u>-</u> | <u>(54,000)</u> |
| Cash flows from capital and related financing activities | | | | | | |
| Acquisition of capital assets | (1,344,442) | | | (1,478,128) | | |
| Capital lease obligations incurred | 498,329 | | | 547,000 | | |
| Repayments of long-term obligations | (986,191) | | | (1,103,704) | | |
| Interest paid | (1,810,324) | | | (1,841,300) | | |
| Capital grants and contributions | 89,622 | | | 187,499 | | |
| Proceeds from sale of capital assets | <u>9,431</u> | | | <u>2,500</u> | | |
| Net cash used by capital and related financing activities | <u>(3,543,575)</u> | <u>-</u> | <u>-</u> | <u>(3,686,133)</u> | <u>-</u> | <u>-</u> |
| Cash flows from investing activities | | | | | | |
| Changes in | | | | | | |
| Assets held by trustee | (116) | | | 2,046 | | |
| Internally designated funds | (36,747) | | | (82,343) | | |
| Assets restricted by contributors | | 774 | | | 210 | |
| Investments | | (65,023) | | | (16,777) | |
| Distribution from affiliate | | | | 41,040 | | |
| Investment income received | <u>50,367</u> | <u>24,538</u> | | <u>132,096</u> | <u>23,330</u> | |
| Net cash provided (used) by investing activities | <u>13,504</u> | <u>(39,711)</u> | <u>-</u> | <u>92,839</u> | <u>6,763</u> | <u>-</u> |
| Net increase (decrease) in cash and cash equivalents | 868,587 | (222,041) | (10,942) | (112,917) | (72,239) | (676) |
| Cash and cash equivalents at beginning of year | <u>3,785,701</u> | <u>256,489</u> | <u>96,207</u> | <u>3,898,618</u> | <u>328,728</u> | <u>96,883</u> |
| Cash and cash equivalents at end of year | <u>\$ 4,654,288</u> | <u>\$ 34,448</u> | <u>\$ 85,265</u> | <u>\$ 3,785,701</u> | <u>\$ 256,489</u> | <u>\$ 96,207</u> |

The accompanying notes are an integral part of these statements.

LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
STATEMENTS OF CASH FLOWS - CONTINUED
Year ended December 31,

| | 2012 | | | 2011 | | |
|---|---------------------------|---------------------|--------------------|---------------------------|--------------------|------------------|
| | <u>Labette Health</u> | <u>Foundation</u> | <u>Clinic</u> | <u>Labette Health</u> | <u>Foundation</u> | <u>Clinic</u> |
| Reconciliation of operating income (loss) to net cash provided (used) by operating activities | | | | | | |
| Operating income (loss) | \$ (62,231) | \$ (182,330) | \$ (27,879) | \$ (880,892) | \$ (79,002) | \$ 35,491 |
| Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities | | | | | | |
| Depreciation and amortization | 4,843,705 | | 16,170 | 5,120,938 | | 16,170 |
| Provision for bad debts | 5,914,900 | | | 6,249,848 | | |
| Changes in | | | | | | |
| Patient accounts receivable | (6,135,601) | | | (8,045,535) | | |
| Other receivables | 17,263 | | | (27,748) | | 783 |
| Advances receivable | 300,016 | | | 50,190 | | |
| Estimated third-party payor settlements | (981,324) | | | 289,745 | | |
| Inventories | (3,266) | | | (47,369) | | |
| Prepaid expenses | (278,155) | | | (36,215) | | |
| Accounts payable and accrued expenses | (121,048) | | 767 | 75,754 | | 880 |
| Net cash provided (used) by operating activities | <u>\$ 3,494,259</u> | <u>\$ (182,330)</u> | <u>\$ (10,942)</u> | <u>\$ 2,748,716</u> | <u>\$ (79,002)</u> | <u>\$ 53,324</u> |

The accompanying notes are an integral part of these statements.

LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
NOTES TO FINANCIAL STATEMENTS
December 31, 2012 and 2011

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES

1. Reporting entity

Labette County Medical Center d/b/a Labette Health is owned by Labette County, Kansas (the County), and governed by a nine-member Board of Trustees appointed by the Board of County Commissioners of the County. Labette Health is a 99-bed, not-for-profit general hospital located in Parsons, Kansas. Labette Health can sue and be sued and can buy, sell, or lease real property. Bond issuances must be approved by the County. Labette Health is a component unit of the County.

The component units discussed in Note A2 are included in Labette Health's reporting entity because of the nature and significance of their relationships with Labette Health.

2. Component units

The financial statements include the financial data of the discretely presented component units described below. The component units are reported separately to emphasize that they are legally separate from Labette Health.

Labette Health Foundation, Inc. (the Foundation), is a not-for-profit corporation formed to receive, invest, and disburse funds received for the benefit, support, and maintenance of Labette Health. The Foundation is administered by a Board of Trustees, of which three members are appointed by Labette Health's Board of Trustees.

Labette County Medical Clinic, LLC (the Clinic), is a Kansas limited liability company that was formed on August 28, 1995, with a duration of 20 years. The Clinic is organized to own, manage, and operate a medical office building and to engage in any other lawful act or activity for which limited liability companies may be formed under the Kansas Limited Liability Company Act.

3. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 these estimates.

4. Basis of accounting

Labette Health uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

5. Cash and cash equivalents

Labette Health considers all cash and invested cash to be cash equivalents, excluding any assets limited as to use and items classified as investments by the Foundation.

6. Allowance for uncollectible accounts

Labette Health provides for accounts receivable that could become uncollectible in the future by establishing an allowance to reduce the carrying value of such receivables to their estimated net realizable value. Labette Health estimates this allowance based on the aging of its accounts receivable and its historical collection experience for each type of payor.

7. Inventories

Inventories are stated at the lower of cost or market with cost determined on the average cost method.

8. Investments and investment income

Investments in debt and equity securities are reported at fair value. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating revenue when earned.

9. Assets limited as to use

Assets limited as to use include assets set aside by the Board of Trustees for replacement of capital assets or for purchase of additional capital assets, over which the Board retains control and may, at its discretion, subsequently use for other purposes; assets held by a trustee under bond indenture agreements; assets restricted by contributors for a particular purpose; and assets required by contributors to be retained in perpetuity. Amounts that are required for obligations classified as current liabilities are reported in current assets.

10. Capital assets

Capital assets (including assets recorded as capital leases) are stated at cost. Depreciation and amortization of capital assets are provided on the straight-line method over the estimated useful lives of the assets which are substantially in conformity with the guidelines established by the American Hospital Association.

The costs of maintenance and repairs are charged to operating expenses as incurred. The costs of significant additions, renewals, and betterments to depreciable properties are capitalized and depreciated over the remaining or extended useful lives of the item or the properties. Gains and losses on disposition of capital assets are included in nonoperating revenues and expenses.

LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

11. Costs of borrowing

Interest costs (including amortization of original issue premiums and discounts, deferred financing costs, and deferred refunding losses) incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Costs incurred in connection with the issuance of long-term debt (including original issue premiums and discounts, and deferred refunding losses) are amortized using the interest method over the term of the related debt.

12. Grants and contributions

From time to time, Labette Health receives grants and contributions from individuals and private organizations. Revenues from grants and contributions, including contributions of capital assets, are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

13. Restricted resources

When Labette Health has both restricted and unrestricted resources available to finance a particular program, its policy is to use restricted resources before unrestricted resources.

14. Accrued health insurance claims

Labette Health is self-insured for health insurance claims of its employees. Management estimates the net liability for reported and unreported claims incurred as of the end of each reporting period. These estimates are based on known claims and historical claims experience.

Management believes that estimates for accrued health insurance claims are reasonable. However, it is possible that actual incurred claims expense may vary significantly from the estimate included in the accompanying financial statements.

15. Net position

Net position of Labette Health is classified in four components. "Net investment in capital assets" consists of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. "Restricted expendable net position" is noncapital net position that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to Labette Health, including amounts deposited with trustees as required by

LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE A - DESCRIPTION OF REPORTING ENTITY AND SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES - Continued

indenture agreements. "Restricted nonexpendable net position" equals the principal portion of permanent endowments. "Unrestricted net position" is remaining net position that does not meet the definitions of the other three components of net position.

16. Operating revenues and expenses

Labette Health's statement of revenues, expenses, and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, which is Labette Health's principal activity. Nonexchange revenues, including noncapital grants and contributions and the ambulance subsidy, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

17. Net patient service revenue

Net patient service revenue is reported at established charges with deductions for discounts, charity care, contractual adjustments, and provision for bad debts, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

18. Charity care

Labette Health provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because Labette Health does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

19. Income taxes

Labette Health is exempt from federal income taxes pursuant to Sections 115 and 501(a) of the Internal Revenue Code.

The Foundation is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on its related income pursuant to Section 501(a) of the Code.

The Clinic is treated as a partnership for income tax purposes. Each owner not exempt from income taxes is responsible for paying taxes attributable to their share of the Clinic's net earnings.

20. Reclassifications

Certain reclassifications have been made to the 2011 financial statements to conform to the 2012 presentation. These reclassifications did not affect previously reported net position or the change in net position.

LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE B - NET PATIENT SERVICE REVENUE

Labette Health has agreements with third-party payors that provide for payments to it at amounts different from its established charge rates. The amounts reported on the statements of net position as estimated third-party payor settlements consist of the estimated differences between the contractual amounts for providing covered services and the interim payments received for those services. A summary of the payment arrangements with major third-party payors follows:

Medicare - Inpatient acute and rehabilitation care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. Outpatient services are paid at prospectively determined rates per occasion of service. Physician services, other than rural health clinic (RHC) services, rendered to Medicare program beneficiaries are paid based on a prospectively determined fee schedule. The prospectively determined rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. RHC physician services are paid based on cost reimbursement methodologies. Labette Health is paid for cost reimbursable and other items at tentative rates with final settlement determined after submission of annual cost reports by Labette Health and audits or reviews thereof by the Medicare administrative contractor. Labette Health's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. Labette Health's Medicare cost reports have been audited or reviewed by the Medicare administrative contractor through December 31, 2010.

Medicaid - Inpatient acute and rehabilitation care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. RHC physician services are paid based on cost reimbursement methodologies. All other services rendered to Medicaid beneficiaries are paid at prospective rates determined on a fee-for-service basis. Labette Health is paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by Labette Health and reviews thereof by the state Medicaid agency. Labette Health's Medicaid cost reports have been reviewed by the state Medicaid agency through December 31, 2009.

The Kansas Medicaid program provides additional payments to qualifying providers under a reimbursement formula that incorporates uncompensated care costs, Kansas Medicaid utilization, public support of the provider, and other factors. Labette Health qualified for these disproportionate share payments during both 2012 and 2011.

Blue Cross and Blue Shield - All services rendered to patients who are insured by Blue Cross and Blue Shield are paid on the basis of prospectively determined rates per discharge or discounts from established charges.

Labette Health has also entered into payment agreements with certain commercial insurance carriers and preferred provider organizations.

LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE B - NET PATIENT SERVICE REVENUE - Continued

The basis for payment to Labette Health under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

A summary of gross and net patient service revenue follows:

| | <u>2012</u> | <u>2011</u> |
|-------------------------------|----------------------|----------------------|
| Gross patient service revenue | \$ 133,035,538 | \$ 134,488,127 |
| Contractual adjustments | (70,715,653) | (73,222,231) |
| Provision for bad debts | (5,914,900) | (6,249,848) |
| Charity care | <u>(3,089,055)</u> | <u>(1,996,563)</u> |
| Net patient service revenue | <u>\$ 53,315,930</u> | <u>\$ 53,019,485</u> |

Revenue from the Medicare and Medicaid programs accounted for approximately 40 percent and 8 percent, respectively, of Labette Health's net patient service revenue during 2012, and 38 percent and 8 percent, respectively, of Labette Health's net patient service revenue during 2011. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

In 2009, Centers for Medicare & Medicaid Services (CMS) expanded the Recovery Audit Contractor (RAC) program to all 50 states. The RAC program was implemented to detect Medicare overpayments not identified through existing claims review mechanisms and uses private companies paid on a contingency basis to review claims for overpayments. Although Labette Health believes its claims submitted to the Medicare program are accurate, Labette Health has had claims audited and denied by the RAC program. Labette Health is in various stages of appeal levels for these denied claims and intends to vigorously appeal any future claims denied by the RAC program. At December 31, 2012, Labette Health has estimated that approximately \$550,000 in denied claims will be overturned upon appeal. This amount is included in estimated third-party payor settlements in the balance sheets.

During April 2012, CMS entered into a settlement agreement with certain hospitals who claimed that CMS had been improperly calculating Medicare inpatient payments made to the certain hospitals for many years. Labette Health was included in the group of hospitals that entered into the settlement agreement with CMS. The agreement resulted in a payment to Labette Health of approximately \$569,000. This amount is included in net patient service revenue in the statements of revenues, expenses, and changes in net position.

NOTE C - ELECTRONIC HEALTH RECORD INCENTIVE PAYMENTS

The American Recovery and Reinvestment Act of 2009 (ARRA) provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and physician practices that demonstrate meaningful use of certified

LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE C - ELECTRONIC HEALTH RECORD INCENTIVE PAYMENTS - Continued

electronic health record (EHR) technology. These provisions of ARRA are intended to promote the adoption and meaningful use of interoperable health information technology and qualified EHR technology.

Labette Health recognizes revenue for EHR incentive payments when the hospital facility and physician practices have attested that they have demonstrated meaningful use of certified EHR technology for the applicable period and have complied with the reporting conditions to receive the payment. The demonstration of meaningful use is based upon meeting a series of objectives and varies between hospital facilities and physician practices and between the Medicare and Medicaid programs. Additionally, meeting the series of objectives in order to demonstrate meaningful use becomes progressively more stringent as its implementation is phased in through stages as outlined by CMS. During the year ended December 31, 2012, Labette Health recognized approximately \$2,100,000 of revenue for EHR incentive payments. This amount is included in other operating revenues in the statements of revenues, expenses, and changes in net position.

Labette Health incurs both capital expenditures and operating expenses in connection with the implementation of its EHR initiatives. The amounts and timing of these expenditures do not directly correlate with the timing of Labette Health's recognition of EHR incentive payments as revenue.

NOTE D - DEPOSITS WITH FINANCIAL INSTITUTIONS

Kansas statutes authorize Labette Health with certain restrictions, to deposit or invest in open accounts, time deposits, certificates of deposit, repurchase agreements, U.S. Treasury bills and notes, and the State Treasurer's investment pool. Kansas statutes also require that collateral be pledged for bank deposits with a fair value equal to 100 percent of the uninsured amounts and must be assigned for the benefit of Labette Health.

At December 31, 2012, the carrying amount of Labette Health's bank deposits, including certificates of deposit, was \$13,435,656 and the bank balances were \$13,712,465. Of the bank balances, \$1,817,719 was covered by federal depository insurance and \$11,894,746 was covered by collateral held by third-party banks, but not registered in Labette Health's name.

NOTE E - ASSETS LIMITED AS TO USE

The composition of assets limited as to use is as follows:

| | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| Internally designated for capital assets | | |
| Cash | \$ 191,508 | \$ 190,140 |
| Certificates of deposit | 8,164,261 | 8,128,882 |
| Accrued interest receivable | 5,078 | 8,436 |
| | <u>\$ 8,360,847</u> | <u>\$ 8,327,458</u> |

LABETTE COUNTY MEDICAL CENTER
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NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE E - ASSETS LIMITED AS TO USE - Continued

| | <u>2012</u> | <u>2011</u> |
|---|---------------------|---------------------|
| Under indenture agreement - held by trustee | | |
| Cash and money market funds | \$ 3,003,572 | \$ 3,429,456 |
| Certificates of deposit | <u>429,781</u> | <u></u> |
| | <u>\$ 3,433,353</u> | <u>\$ 3,429,456</u> |
| By contributors for employee assis- tance and capital acquisitions | | |
| Cash | <u>\$ 8,089</u> | <u>\$ 8,863</u> |
| Principal of permanent endowments | | |
| Cash | \$ 1,434 | \$ 1,434 |
| Pooled investments (see Note F) | <u>56,630</u> | <u>56,630</u> |
| | <u>\$ 58,064</u> | <u>\$ 58,064</u> |

NOTE F - INVESTMENTS

The Foundation's investments are stated at fair value. The composition of its investments is as follows:

| | <u>2012</u> | <u>2011</u> |
|--|-------------------|-------------------|
| Money market mutual funds | \$ 22,533 | \$ 58,140 |
| Common stock | 123,580 | 53,684 |
| Equity mutual funds | 487,808 | 466,242 |
| Fixed income mutual funds | 376,487 | 288,881 |
| Accrued interest receivable | <u>207</u> | <u>207</u> |
| | 1,010,615 | 867,154 |
| Less principal of permanent endowment | <u>56,630</u> | <u>56,630</u> |
| | <u>\$ 953,985</u> | <u>\$ 810,524</u> |

LABETTE COUNTY MEDICAL CENTER
D/B/A LABETTE HEALTH
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE G - CAPITAL ASSETS

Capital asset additions, retirements, and balances are as follows:

| | 2012 | | | |
|--|-------------------------------------|--|--------------------|-------------------------------------|
| | <u>Beginning balance</u> | <u>Transfers and additions</u> | <u>Retirements</u> | <u>Ending balance</u> |
| Land | \$ 1,007,099 | \$ - | \$ - | \$ 1,007,099 |
| Buildings | 54,404,743 | 160,955 | | 54,565,698 |
| Fixed equipment | 8,674,044 | 59,896 | | 8,733,940 |
| Major movable equipment | <u>19,326,504</u> | <u>905,986</u> | <u>1,359,711</u> | <u>18,872,779</u> |
| Totals at historical cost | <u>83,412,390</u> | <u>1,126,837</u> | <u>1,359,711</u> | <u>83,179,516</u> |
| Less accumulated depreciation and amortization | | | | |
| Buildings | 19,853,413 | 2,944,367 | | 22,797,780 |
| Fixed equipment | 5,643,910 | 529,051 | | 6,172,961 |
| Major movable equipment | <u>14,961,742</u> | <u>1,370,287</u> | <u>1,262,796</u> | <u>15,069,233</u> |
| | <u>40,459,065</u> | <u>4,843,705</u> | <u>1,262,796</u> | <u>44,039,974</u> |
| Construction in progress | <u>42,953,325</u> <u>399,363</u> | <u>(3,716,868)</u> <u>76,515</u> | <u>96,915</u> | <u>39,139,542</u> <u>475,878</u> |
| Capital assets, net | <u>\$ 43,352,688</u> | <u>\$ (3,640,353)</u> | <u>\$ 96,915</u> | <u>\$ 39,615,420</u> |

| | 2011 | | | |
|--|-------------------------------------|--|--------------------|-------------------------------------|
| | <u>Beginning balance</u> | <u>Transfers and additions</u> | <u>Retirements</u> | <u>Ending balance</u> |
| Land | \$ 999,199 | \$ 7,900 | \$ - | \$ 1,007,099 |
| Buildings | 54,240,033 | 534,145 | 369,435 | 54,404,743 |
| Fixed equipment | 8,734,042 | 502,594 | 562,592 | 8,674,044 |
| Major movable equipment | <u>19,042,755</u> | <u>1,207,582</u> | <u>923,833</u> | <u>19,326,504</u> |
| Totals at historical cost | <u>83,016,029</u> | <u>2,252,221</u> | <u>1,855,860</u> | <u>83,412,390</u> |
| Less accumulated depreciation and amortization | | | | |
| Buildings | 17,266,431 | 2,952,833 | 365,851 | 19,853,413 |
| Fixed equipment | 5,238,340 | 539,460 | 133,890 | 5,643,910 |
| Major movable equipment | <u>14,243,548</u> | <u>1,628,645</u> | <u>910,451</u> | <u>14,961,742</u> |
| | <u>36,748,319</u> | <u>5,120,938</u> | <u>1,410,192</u> | <u>40,459,065</u> |
| Construction in progress | <u>46,267,710</u> <u>436,678</u> | <u>(2,868,717)</u> <u>(37,315)</u> | <u>445,668</u> | <u>42,953,325</u> <u>399,363</u> |
| Capital assets, net | <u>\$ 46,704,388</u> | <u>\$ (2,906,032)</u> | <u>\$ 445,668</u> | <u>\$ 43,352,688</u> |

LABETTE COUNTY MEDICAL CENTER
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NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE G - CAPITAL ASSETS - Continued

Construction in progress at December 31, 2012, consists primarily of costs incurred to date for various renovations to Labette Health's facilities.

NOTE H - INVESTMENT IN AFFILIATE

Labette Health's ownership interest in the Clinic was 76 percent at December 31, 2012 and 2011. The other investors in the Clinic are members of Labette Health's medical staff. Labette Health accounts for its investment in the Clinic using the equity method.

NOTE I - ADVANCES RECEIVABLE

Labette Health has determined that recruitment of physicians to serve the residents of Labette County is in the best interests of Labette Health, its patients, and the community, and will enable Labette Health to enhance its ability to meet the health care needs of the community's residents. To accomplish this, Labette Health has entered into agreements with certain physicians to provide them with financial assistance as an inducement for them to establish medical practices in Labette Health's service area. In return, the physicians agree to provide professional services for the residents of Parsons and Labette County over periods varying from three to six years. The financial assistance is rendered in the form of interest-bearing loans from Labette Health to the physicians. Upon establishment of their practices, principal and the accumulated interest on loans are forgiven ratably over the required service periods. If the physicians do not establish a medical practice, or if they leave the community prior to completion of the service obligation, they will be required to repay any unpaid or unforgiven principal and accumulated interest on the loans.

Labette Health's future exposure to credit loss on these agreements is dependent upon the performance of the physicians under these agreements. Outstanding commitments for future advances were approximately \$128,000 at December 31, 2012.

NOTE J - HEALTH INSURANCE CLAIMS

Labette Health sponsors a self-insured employee health insurance plan. Labette Health has reinsured a portion of its risk for health insurance claims of its employees. The reinsurance arrangement generally covers claims totaling over \$60,000 for each covered individual on an annual basis. The reinsurance arrangement also covers aggregate annual claims of the plan in excess of an amount determined in relation to the number of individuals participating in the plan during the year. Covered employees also provide part of the funds to pay claims through monthly contributions at predetermined rates. Labette Health has retained an agent to process and settle claims.

LABETTE COUNTY MEDICAL CENTER
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NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE J - HEALTH INSURANCE CLAIMS - Continued

The following is a summary of the activity under this arrangement:

| | <u>2012</u> | <u>2011</u> |
|--|--------------------|--------------------|
| Estimated net health insurance claims payable at beginning of year | \$ 325,762 | \$ 339,624 |
| Provision for employer's share of incurred claims and related expenses for the year, net of any reinsurance proceeds | 1,904,009 | 1,839,301 |
| Participant contributions | 866,665 | 888,322 |
| Payments made for claims and related expenses | <u>(2,855,417)</u> | <u>(2,741,485)</u> |
| Estimated net health insurance claims payable at end of year | <u>\$ 241,019</u> | <u>\$ 325,762</u> |

NOTE K - LONG-TERM OBLIGATIONS

Long-term obligations are summarized as follows:

| | <u>2012</u> | <u>2011</u> |
|--|---------------|---------------|
| 5.00% - 5.75% Labette County, Kansas Hospital Refunding and Improvement Revenue Bonds, Series A, 2007; issued on July 19, 2007, in the original amount of \$24,765,000; due serially through September 1, 2037, with principal payments beginning on September 1, 2020, including unamortized premium of \$531,853 in 2012 and \$562,389 in 2011 | \$ 25,296,853 | \$ 25,327,389 |
| 7.00% Labette County, Kansas Taxable Hospital Refunding and Improvement Revenue Bonds, Series B, 2007; issued on July 19, 2007, in the original amount of \$6,435,000; due serially through September 1, 2019 | 4,515,000 | 5,000,000 |

LABETTE COUNTY MEDICAL CENTER
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NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE K - LONG-TERM OBLIGATIONS - Continued

| | <u>2012</u> | <u>2011</u> |
|--|-----------------------|-------------------------|
| Capital lease obligations; imputed interest rates from 1.95% to 8.47%; collateralized by leased equipment with an amortized cost of \$1,217,577 at December 31, 2012 | \$ 1,163,674 | \$ 1,166,536 |
| Unamortized deferred refunding loss | 30,975,527 (3,529) | 31,493,925 (5,247) |
| Less current maturities | 30,971,998 820,110 | 31,488,678 1,036,103 |
| Long-term obligations, less current maturities | <u>\$ 30,151,888</u> | <u>\$ 30,452,575</u> |

The following is a summary of changes in long-term obligations:

| | <u>Capital lease obligations</u> | <u>Hospital revenue bonds</u> | <u>Total long-term obligations</u> |
|----------------------------------|--|---------------------------------------|--|
| Outstanding at January 1, 2011 | \$ 1,263,240 | \$ 30,817,926 | \$ 32,081,166 |
| Obligations incurred | 547,000 | | 547,000 |
| Principal payments | (643,704) | (460,000) | (1,103,704) |
| Amortization of bond premium | <u>(30,537)</u> | <u>(30,537)</u> | <u>(30,537)</u> |
| Outstanding at December 31, 2011 | 1,166,536 | 30,327,389 | 31,493,925 |
| Obligations incurred | 498,329 | | 498,329 |
| Principal payments | (501,191) | (485,000) | (986,191) |
| Amortization of bond premium | <u>(30,536)</u> | <u>(30,536)</u> | <u>(30,536)</u> |
| Outstanding at December 31, 2012 | <u>\$ 1,163,674</u> | <u>\$ 29,811,853</u> | <u>\$ 30,975,527</u> |

On July 19, 2007, the County issued \$24,765,000 in Hospital Refunding and Improvement Revenue Bonds, Series A, 2007, and \$6,435,000 in Taxable Hospital Refunding and Improvement Revenue Bonds, Series B, 2007 (the 2007 bonds), for the benefit of Labette Health pursuant to a Bond Trust Indenture dated June 1, 2007. The proceeds of the 2007 bonds were used, together with other available funds of Labette Health, for the purpose of providing funds to (1) pay for renovations and additions to Labette Health's facilities, (2) refund the Hospital Refunding Revenue Bonds, Series A, 1996, and Series A, 2001, previously issued for the benefit of Labette Health, (3) refinance an outstanding bank loan, (4) fund a debt service reserve fund for the 2007 bonds, and (5) pay for certain costs related to issuance of the 2007 bonds.

The indenture agreement for the 2007 bonds requires Labette Health to transfer to a trustee, on a monthly basis, specified amounts which, when combined with interest earned on the respective funds held by the trustee, will provide sufficient funds to pay the bond principal and interest on the appropriate due dates.

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NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE K - LONG-TERM OBLIGATIONS - Continued

Such amounts were maintained and are included with assets limited as to use in the financial statements. The obligations of Labette Health under the indenture agreement are secured by a pledge of its unrestricted revenues, subject to the right of Labette Health to dispose of or encumber property as defined and permitted in the indenture agreement. The indenture agreement also includes certain restrictive covenants relating to the disposition of property, incurrence of additional indebtedness, the level of days cash on hand, and the level of fees and rates charged. The covenant in the indenture agreement regarding the level of days cash on hand requires that those levels equal or exceed 45 days. The covenant in the indenture agreement regarding the level of fees and rates charged requires that fees and rates for services be set at levels sufficient for Labette Health to produce income available for debt service in each fiscal year equal to 125 percent of the debt service requirements during that fiscal year for outstanding debt.

The bond refunding and bank loan refinancing increased total future debt service requirements of Labette Health by \$4,112,932 because the repayment period of the new debt is significantly longer than were the remaining repayment periods for the extinguished debt. This resulted in an economic gain (difference between the present value of the future debt service payments on the old and new debt) of \$36,124. As a result of the bond refunding, a deferred refunding loss of \$5,045 was recognized for the difference between the book value of the refunded debt and the amount required to extinguish that debt.

Scheduled annual debt service requirements on long-term debt are as follows:

| | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|-------------|----------------------|----------------------|----------------------|
| 2013 | \$ 520,000 | \$ 1,727,250 | \$ 2,247,250 |
| 2014 | 560,000 | 1,690,850 | 2,250,850 |
| 2015 | 595,000 | 1,651,650 | 2,246,650 |
| 2016 | 640,000 | 1,610,000 | 2,250,000 |
| 2017 | 685,000 | 1,565,200 | 2,250,200 |
| 2018 - 2022 | 4,135,000 | 7,090,250 | 11,225,250 |
| 2023 - 2027 | 5,440,000 | 5,776,163 | 11,216,163 |
| 2028 - 2032 | 7,195,000 | 4,021,262 | 11,216,262 |
| 2033 - 2037 | <u>9,510,000</u> | <u>1,701,425</u> | <u>11,211,425</u> |
| | <u>\$ 29,280,000</u> | <u>\$ 26,834,050</u> | <u>\$ 56,114,050</u> |

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NOTES TO FINANCIAL STATEMENTS - CONTINUED
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NOTE K - LONG-TERM OBLIGATIONS - Continued

The following is a yearly schedule of future minimum lease payments under capital leases as of December 31, 2012:

| | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|------------------------------|---------------------|-------------------|---------------------|
| 2013 | \$ 300,110 | \$ 48,909 | \$ 349,019 |
| 2014 | 296,204 | 34,672 | 330,876 |
| 2015 | 242,619 | 22,104 | 264,723 |
| 2016 | 245,842 | 10,871 | 256,713 |
| 2017 | <u>78,899</u> | <u>1,453</u> | <u>80,352</u> |
| Total minimum lease payments | <u>\$ 1,163,674</u> | <u>\$ 118,009</u> | <u>\$ 1,281,683</u> |

Total interest costs are summarized as follows:

| | <u>2012</u> | <u>2011</u> |
|---|---------------------|---------------------|
| Total interest incurred | \$ 1,799,115 | \$ 1,811,534 |
| Amortization of bond premium | (30,536) | (30,537) |
| Amortization of deferred financing costs | 33,995 | 34,643 |
| Amortization of deferred loss on bond refunding | <u>1,718</u> | <u>(121)</u> |
| Interest expense | <u>\$ 1,804,292</u> | <u>\$ 1,815,519</u> |

NOTE L - DEFINED CONTRIBUTION PENSION PLANS

Labette Health sponsors a defined contribution pension plan that provides pension benefits for substantially all of its full-time employees. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. The plan is administered by a third-party insurance company and can be amended by the Board of Trustees. The provisions of the plan are as follows.

Employees become eligible for employer contributions after completing one year of service. Labette Health contributes a percentage of gross compensation based on the eligible employee's years of service as follows: 2 percent if more than one year but less than 5 years of service; 4 percent if five or more years of service but less than fifteen; and 6 percent if fifteen or more years of service. Labette Health may also make a discretionary matching contribution of participant contributions to the plan. The contribution cannot exceed a percentage of gross compensation based on the eligible employee's years of service as follows: 1 percent if more than five years of service but less than ten years of service, and 2 percent if more than ten years of service.

The employees are not required to make contributions to the plan but may elect to contribute from 1 percent to 20 percent of the participant's compensation subject to maximum limits as defined by the Internal Revenue Service.

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NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE L - DEFINED CONTRIBUTION PENSION PLANS - Continued

Labette Health's contributions for each employee are fully vested after 10 years of continuous service.

For the years ended December 31, 2012 and 2011, Labette Health and covered employees made contributions to the plan as follows:

| | <u>2012</u> | <u>2011</u> |
|------------------------|-------------------|-------------------|
| Employer contributions | \$ 533,428 | \$ 520,376 |
| Employee contributions | <u>380,608</u> | <u>395,857</u> |
| | <u>\$ 914,036</u> | <u>\$ 916,233</u> |

Labette Health has entered into deferred compensation agreements with certain employees. These agreements are eligible deferred compensation plans under Section 401(a) or 457(b) of the Internal Revenue Code. The plans can be amended by mutual consent of Labette Health and the plans' participants. All assets of the plans are held by a third-party investment company for the sole benefit of the employee and the employee's designated beneficiary. The plans generally provide for employer contributions based on the employees' years of service. The employees are not required to make contributions to the plans but may elect to contribute a percentage of compensation subject to maximum limits as defined by the Internal Revenue Service. Labette Health's contributions become fully vested after periods defined in each plan. For the years ended December 31, 2012 and 2011, Labette Health and covered employees made contributions to these plans as follows:

| | <u>2012</u> | <u>2011</u> |
|------------------------|-------------------|-------------------|
| Employer contributions | \$ 154,791 | \$ 131,232 |
| Employee contributions | <u>66,700</u> | <u>57,340</u> |
| | <u>\$ 221,491</u> | <u>\$ 188,572</u> |

NOTE M - CONCENTRATION OF CREDIT RISK

Labette Health grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of patient accounts receivable from patients and third-party payors at December 31, 2012 and 2011, is as follows:

| | <u>2012</u> | <u>2011</u> |
|----------------|---------------|---------------|
| Medicare | 37.3% | 34.4% |
| Medicaid | 12.2 | 11.5 |
| Blue Cross | 14.7 | 12.0 |
| Other insurers | 17.0 | 20.5 |
| Patients | <u>18.8</u> | <u>21.6</u> |
| | <u>100.0%</u> | <u>100.0%</u> |

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NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE N - RISK MANAGEMENT

For the years ended December 31, 2012 and 2011, Labette Health was insured for hospital professional liability under a comprehensive hospital liability policy provided by an independent insurance carrier with limits of \$200,000 per occurrence up to an annual aggregate of \$600,000 for all claims made during the policy year. Labette Health is further covered by the Kansas Health Care Stabilization Fund for claims in excess of its comprehensive hospital liability policy up to \$300,000 pursuant to any one judgment or settlement against Labette Health for any one party, subject to an aggregate limitation for all judgments or settlements arising from all claims made in the policy year in the amount of \$900,000. The policy provided by the independent insurance carrier provides for umbrella liability in excess of the underlying limits set forth above in the amount of \$1,000,000 per occurrence with an aggregate amount in any policy period of \$3,000,000. All coverage is on a claims-made basis. The above policies were renewed on January 1, 2013, for the policy period from January 1, 2013 to January 1, 2014.

In addition to the risk disclosed elsewhere in these financial statements and notes thereto, Labette Health is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors or omissions; injuries to employees; and natural disasters. Labette Health purchases commercial insurance for these risks. Settled claims have not exceeded this commercial coverage in any of the past three years.

NOTE O - COMMITMENTS AND CONTINGENCIES

Labette Health purchases professional and general liability insurance to cover medical malpractice and other liability claims (see Note N). There are known claims and incidents that have been asserted. These claims have been referred to Labette Health's insurance carriers and are in various stages of processing. No accrual for loss contingencies related to these items has been made in the financial statements as the amount of ultimate settlement, if any, cannot be reasonably estimated.

NOTE P - RELATED PARTY TRANSACTIONS

Labette Health received \$189,483 and \$275,117 of contributions from the Foundation during 2012 and 2011, respectively. Labette Health incurred \$92,612 and \$101,217 in salary expense on behalf of the Foundation during 2012 and 2011, respectively.

Labette Health paid rent to the Clinic totaling \$61,704 during both 2012 and 2011.

Labette Health has a capital lease obligation with a local bank. The outstanding principal balance on this obligation is \$363,324 at December 31, 2012. The President and a member of the board of directors of this bank both serve on Labette Health's Board of Trustees.

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NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE Q - COUNTY TAX PROCEEDS

On June 26, 2001, voters of the County approved a .25 percent health care retailers' sales tax to be used as a source of funding for the provision of emergency medical services. The County has agreed to pay Labette Health an amount equal to the lesser of 100 percent of the sales tax or 95 percent of Labette Health's direct loss attributable to the provision of ambulance services.