

**Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center**

Independent Accountants' Report and Financial Statements

September 30, 2012 and 2011



Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center
September 30, 2012 and 2011

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Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Directors

Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center
Marion, Kansas

We have audited the accompanying balance sheets of Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center and its discretely presented component unit as of September 30, 2012 and 2011, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center and its discretely presented component unit as of September 30, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis listed in the table of contents be presented to supplement the basic financial statements. Such information, although not 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. 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 basic financial statements and other knowledge we obtained during our audits of the basic 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.

Our audits were performed for the purpose of forming an opinion on the financial statements as a whole. The accompanying supplementary information, including the comparison of revenues and expenses (cash basis) – actual to tax budget required by the Kansas Municipal Audit Guide and schedule of insurance coverage, as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. The schedule of insurance coverage has been subjected to the auditing procedures applied in the audits of the basic 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. The comparison of revenues and expenses (cash basis) – actual to tax budget has not been subjected to auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion or provide any assurance on it.

BKD, LLP

January 29, 2013

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Management's Discussion and Analysis Years Ended September 30, 2012 and 2011

Introduction

This management's discussion and analysis of the financial performance of St. Luke Hospital and Living Center (the Hospital) provides an overview of the Hospital's financial activities for the years ended September 30, 2012 and 2011. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Cash and cash equivalents and short-term certificates of deposit decreased in 2012 by \$387,331 or 14% and increased by \$589,690 or 28% in 2011.
- The Hospital's net assets increased by \$142,401 or 3% and \$513,866 or 12% in 2012 and 2011, respectively.
- The Hospital reported operating losses in both 2012 (\$515,498) and 2011 (\$366,715). The operating loss in 2012 increased by \$148,783 or 41% over the operating loss reported in 2011. The operating loss in 2011 decreased by \$200,952 or 35% from the operating loss reported in 2010.

Using This Annual Report

The Hospital's financial statements consist of three statements – a balance sheet; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

The Balance Sheet and Statement of Revenues, Expenses and Changes in Net Assets

One of the most important questions asked about any Hospital's finances is "Is the Hospital as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement of revenues, expenses and changes in net assets report information about the Hospital'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. Using the accrual basis of accounting means that all of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net assets and changes in them. The Hospital's total net assets – the difference between assets and liabilities – are one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net assets are an indicator of whether its financial health is improving or deteriorating. Other non-financial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

The Statement of Cash Flows

The statement of cash flows reports cash receipts, cash payments and net changes in cash resulting from four defined types of 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 during the reporting period.

The Hospital's Net Assets

The Hospital's net assets are the difference between its assets and liabilities reported in the balance sheet. The Hospital's net assets increased by \$142,401 or 3% in 2012 over 2011, and increased by \$513,866 or 12% in 2011 over 2010, as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets

	2012	2011	2010
Assets			
Cash and short-term certificate of deposits	\$ 2,316,707	\$ 2,704,038	\$ 2,114,348
Restricted cash - held under bond indenture	668,269	978,871	5,838,777
Patient accounts receivable, net	841,477	878,950	947,228
Estimated amounts due from Medicare and Medicaid	290,000	130,000	325,000
Other current assets	254,670	326,357	200,134
Electronic health records incentive receivable	230,000	-	-
Other noncurrent assets	163,261	169,180	177,024
Capital assets, net	7,354,985	7,085,154	1,880,057
Total assets	<u>\$ 12,119,369</u>	<u>\$ 12,272,550</u>	<u>\$ 11,482,568</u>
Liabilities			
Long-term debt, including current portion	\$ 6,097,135	\$ 6,181,278	\$ 6,148,290
Accounts payable and accrued expenses	234,663	524,125	277,455
Accrued interest expense	153,821	154,363	180,090
Accrued wages and benefits	520,799	442,234	420,049
Total liabilities	<u>7,006,418</u>	<u>7,302,000</u>	<u>7,025,884</u>
Net Assets			
Invested in capital assets, net of related debt	1,257,850	1,255,873	1,191,115
Restricted expendable	668,269	626,874	610,747
Unrestricted	3,186,832	3,087,803	2,654,822
Total net assets	<u>5,112,951</u>	<u>4,970,550</u>	<u>4,456,684</u>
Total liabilities and net assets	<u>\$ 12,119,369</u>	<u>\$ 12,272,550</u>	<u>\$ 11,482,568</u>

Significant changes in the Hospital's assets in 2012 and 2011 include a decrease in restricted cash and an increase in capital assets, net. Restricted cash balances declined and capital assets, net increased due to the release of restriction placed on the bond funds which were utilized for construction purchases. The project and bonds will be discussed in greater detail below.

Operating Results and Changes in the Hospital's Net Assets

In 2012, the Hospital's net assets increased by \$142,401 or 3%, as shown in Table 2. This increase is made up of several different components. The Hospital's net assets increased by \$513,866 or 12% in 2011.

Table 2: Operating Results and Changes in Net Assets

	2012	2011	2010
Operating Revenues			
Net patient service revenue	\$ 7,424,760	\$ 7,074,466	\$ 6,649,047
Other operating revenues	340,416	110,403	122,352
Total operating revenues	7,765,176	7,184,869	6,771,399
Operating Expenses			
Salaries and wages and employee benefits	4,101,445	3,804,066	3,685,200
Purchased services and professional fees	1,874,522	1,852,456	1,749,531
Depreciation	641,021	314,929	399,488
Other operating expenses	1,663,686	1,580,133	1,504,847
Total operating expenses	8,280,674	7,551,584	7,339,066
Operating Loss	(515,498)	(366,715)	(567,667)
Nonoperating Revenues (Expenses)			
Property taxes	714,298	696,157	703,061
Investment income	5,261	21,163	24,199
Build America Bonds subsidy	109,072	-	-
Noncapital grants and gifts	226,994	187,151	23,386
Interest expense	(397,726)	(23,890)	(12,188)
Total nonoperating revenues	657,899	880,581	738,458
Increase in Net Assets	<u>\$ 142,401</u>	<u>\$ 513,866</u>	<u>\$ 170,791</u>

Operating Loss

The first component of the overall change in the Hospital's net assets is its operating income or loss – generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In each of the past three years, the Hospital has reported an operating loss. The Hospital levies property taxes to provide sufficient resources to enable the facility to serve lower income and other residents.

The operating loss for 2012 increased by \$148,783 or 41% as compared to 2011. The primary components of the increased operating loss are:

- An increase in net patient service revenue of \$350,294 or 5%.
- An increase in other operating revenues of \$230,013 or 208%. This increase is primarily composed of an Electronic Health Records (EHR) incentive payment. The Hospital has implemented and incurred costs (portions of which have been capitalized) related to the EHR.
- An increase in salaries and wages and employee benefits of \$297,379 or 8%. This increase was supported by an increase in patient volume and corresponding increase in net patient service revenue as noted above.
- An increase in depreciation of \$326,092 or 104%. Fiscal 2012 was the first year that the new assets related to the building project were in service and incurred depreciation.

The operating loss for 2011 decreased by \$200,952 or 35% as compared to 2010. The primary components of the decreased operating loss are:

- An increase in net patient service revenue of \$425,419 or 5%.
- An increase in salaries and wages and employee benefits of \$118,866 or 3%.
- An increase in purchased services and professional fees of \$102,925 or 6%.

Nonoperating Revenues

Nonoperating revenues consist principally of property taxes and noncapital grants and gifts. Property tax revenue remained relatively stable in all three years. The Hospital receives noncapital grants and gifts from various state and federal agencies and individuals. Noncapital grants and gifts received in 2012 totaled \$226,994 as compared to \$187,151 in 2011 and \$23,386 in 2010.

The Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with changes in operating losses and nonoperating revenues, discussed earlier.

Capital Asset and Debt Administration

Capital Assets

At the end of 2012, the Hospital had \$7,354,985 invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. The Hospital purchased new equipment costing \$904,933 and \$5,526,998 in 2012 and 2011, respectively. The majority of the capital purchases made in both 2012 and 2011 were related to the building project that was started in August 2010. The \$6.2 million dollar renovation was completed in December 2011.

Debt

At September 30, 2012, the Hospital had \$6,097,135 in bond and capital lease obligations outstanding, as detailed in *Note 7* to the financial statements. The Hospital issued bonds in May 2010 to fund the building project that was started in August 2010 and completed in December 2011.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Hospital Business Administration by telephoning 620.382.2177.

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Balance Sheets

September 30, 2012 and 2011

Assets

	<u>2012</u>	<u>2011</u>
Current Assets		
Cash and cash equivalents	\$ 2,316,707	\$ 2,245,928
Short-term certificates of deposit	-	458,110
Restricted cash - held under bond indenture	237,340	196,030
Patient accounts receivable, net of allowance; 2012 - \$313,700, 2011 - \$317,300	841,477	878,950
Estimated amounts due from third-party payers	290,000	130,000
Electronic health records incentive receivable	230,000	-
Supplies	132,553	120,715
Prepaid expenses and other	122,117	205,642
	<u>4,170,194</u>	<u>4,235,375</u>
Noncurrent Cash and Investments		
Held under bond indenture for capital acquisitions	-	351,997
Held under bond indenture for debt service	430,929	430,844
	<u>430,929</u>	<u>782,841</u>
Capital Assets, Net	<u>7,354,985</u>	<u>7,085,154</u>
Deferred Bond Costs	<u>163,261</u>	<u>169,180</u>
Total assets	<u><u>\$ 12,119,369</u></u>	<u><u>\$ 12,272,550</u></u>

Liabilities and Net Assets

	2012	2011
Current Liabilities		
Current maturities of long-term debt	\$ 136,955	\$ 84,143
Accounts payable	234,663	524,125
Accrued expenses	674,620	596,597
Total current liabilities	1,046,238	1,204,865
 Long-term Debt	 5,960,180	 6,097,135
Total liabilities	7,006,418	7,302,000
 Net Assets		
Invested in capital assets, net of related debt	1,257,850	1,255,873
Restricted - expendable for debt service	668,269	626,874
Unrestricted	3,186,832	3,087,803
Total net assets	5,112,951	4,970,550
Total liabilities and net assets	\$ 12,119,369	\$ 12,272,550

**Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center**

St. Luke Hospital Foundation

Statements of Financial Position

September 30, 2012 and 2011

	2012	2011
Assets		
Cash	\$ 456,426	\$ 631,876
Short-term certificates of deposit	116,283	56,359
Long-term certificates of deposit	-	59,306
Contributions receivable	<u>174,585</u>	<u>281,074</u>
Total assets	<u>\$ 747,294</u>	<u>\$ 1,028,615</u>
 Unrestricted Net Assets	 <u>\$ 747,294</u>	 <u>\$ 1,028,615</u>

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Statements of Revenues, Expenses and Changes in Net Assets

Years Ended September 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2012 – \$263,000, 2011 – \$278,000	\$ 7,424,760	\$ 7,074,466
Electronic health records incentive	230,000	-
Other	<u>110,416</u>	<u>110,403</u>
Total operating revenues	<u>7,765,176</u>	<u>7,184,869</u>
Operating Expenses		
Salaries and wages	3,437,942	3,170,092
Employee benefits	663,503	633,974
Purchased services and professional fees	1,874,522	1,852,456
Supplies and other	1,663,686	1,580,133
Depreciation and amortization	<u>641,021</u>	<u>314,929</u>
Total operating expenses	<u>8,280,674</u>	<u>7,551,584</u>
Operating Loss	<u>(515,498)</u>	<u>(366,715)</u>
Nonoperating Revenues (Expenses)		
Property taxes	714,298	696,157
Investment income	5,261	21,163
Build America Bonds subsidy	109,072	-
Interest expense	(397,726)	(23,890)
Noncapital grants and gifts	<u>226,994</u>	<u>187,151</u>
Total nonoperating revenues	<u>657,899</u>	<u>880,581</u>
Increase in Net Assets	142,401	513,866
Net Assets, Beginning of Year	<u>4,970,550</u>	<u>4,456,684</u>
Net Assets, End of Year	<u><u>\$ 5,112,951</u></u>	<u><u>\$ 4,970,550</u></u>

**Marion County Hospital District #1 of Marion County, Kansas
d/b/a St. Luke Hospital and Living Center**

St. Luke Hospital Foundation

Statements of Activities

Years Ended September 30, 2012 and 2011

	2012	2011
Unrestricted Revenues, Gains and Other Support		
Contributions	\$ 49,978	\$ 166,953
Interest income	<u>1,881</u>	<u>3,439</u>
Total revenues, gains and other support	<u>51,859</u>	<u>170,392</u>
Unrestricted Expenses		
Support to St. Luke Hospital and Living Center	<u>333,180</u>	<u>114,545</u>
Total expenses	<u>333,180</u>	<u>114,545</u>
Change in Unrestricted Net Assets	(281,321)	55,847
Unrestricted Net Assets, Beginning of Year	<u>1,028,615</u>	<u>972,768</u>
Unrestricted Net Assets, End of Year	<u><u>\$ 747,294</u></u>	<u><u>\$ 1,028,615</u></u>

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Statements of Cash Flows Years Ended September 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating Activities		
Receipts from and on behalf of patients	\$ 7,302,233	\$ 7,337,744
Payments to suppliers and contractors	(3,755,983)	(3,589,736)
Payments to and on behalf of employees	(4,023,422)	(3,807,608)
Other receipts (payments), net	<u>110,416</u>	<u>116,375</u>
Net cash provided by (used in) operating activities	<u>(366,756)</u>	<u>56,775</u>
Noncapital Financing Activities		
Property taxes supporting operations	714,298	696,157
Noncapital grants and gifts	<u>226,994</u>	<u>187,151</u>
Net cash provided by noncapital financing activities	<u>941,292</u>	<u>883,308</u>
Capital and Related Financing Activities		
Principal paid on long-term debt	(84,143)	(161,737)
Payment of bond issuance costs	-	7,844
Build America Bonds subsidy	109,072	-
Interest paid on long-term debt	(397,726)	(23,890)
Purchase of capital assets	(904,933)	(5,054,679)
Proceeds from disposal of capital assets	<u>-</u>	<u>1,000</u>
Net cash used in capital and related financing activities	<u>(1,277,730)</u>	<u>(5,231,462)</u>
Investing Activities		
Investment income	5,261	21,163
Purchase of certificates of deposit	-	(356,488)
Maturities of certificates of deposit	458,110	350,235
Net change in construction escrow and debt-related accounts	<u>310,602</u>	<u>4,859,906</u>
Net cash provided by investing activities	<u>773,973</u>	<u>4,874,816</u>
Increase in Cash and Cash Equivalents	70,779	583,437
Cash and Cash Equivalents, Beginning of Year	<u>2,245,928</u>	<u>1,662,491</u>
Cash and Cash Equivalents, End of Year	<u><u>\$ 2,316,707</u></u>	<u><u>\$ 2,245,928</u></u>

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Statements of Cash Flows (Continued) Years Ended September 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of Net Operating Loss to Cash Provided by (Used in) Operating Activities		
Operating loss	\$ (515,498)	\$ (366,715)
Depreciation and amortization	641,021	314,929
Loss on disposal of capital assets	-	5,972
Changes in operating assets and liabilities		
Patient accounts receivable, net	37,473	68,278
Estimated amounts due from and to third-party payers	(160,000)	195,000
Accounts payable and accrued expenses	(211,439)	(34,466)
Other assets and liabilities	<u>(158,313)</u>	<u>(126,223)</u>
Net cash provided by (used in) operating activities	<u>\$ (366,756)</u>	<u>\$ 56,775</u>
 Supplemental Cash Flows Information		
Capital lease obligation incurred for capital assets	\$ -	\$ 194,725
Capital assets additions included in accounts payable	\$ -	\$ 277,594

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2012 and 2011

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

Nature of Operations and Reporting Entity

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center (Hospital) owns and operates an acute care hospital located in Marion, Kansas. The Hospital is operated by a Board of Directors elected by the qualified voters of the District. The Hospital primarily earns revenues by providing inpatient, outpatient, emergency and residential long-term care services in the Marion County area. It also operates a home health agency in the same geographic area.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place. Operating revenues and expenses include exchange transactions. Property taxes, interest income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989, and do not conflict with or contradict GASB pronouncements.

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 Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At September 30, 2012 and 2011, cash equivalents consisted primarily of certificates of deposit or money market accounts.

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2012 and 2011

Property Taxes

The Hospital received approximately 8% of its financial support from property taxes in 2012 and 9% in 2011. One hundred percent of these funds were used to support operations in both years.

Property taxes are levied in November of one year and are received beginning in January of the following year. Property tax revenue is recognized in full in the year following the year the taxes were levied, which is the year in which use is first permitted.

Risk Management

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

Investments and Investment Income

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition and in nonnegotiable certificates of deposit are carried at amortized cost. All other investments are carried at fair value. Fair value is determined using quoted market prices. Investment income includes interest income.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Supplies

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

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2012 and 2011

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 over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

Land improvements	10 years
Buildings	10 – 50 years
Fixed equipment	3 – 20 years
Major moveable equipment	3 – 20 years

The Hospital 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:

	<u>2012</u>	<u>2011</u>
Interest expense incurred on borrowings for project, net of subsidy payments	\$ 77,181	\$ 342,913
Interest income from investment of proceeds of borrowings for project	<u>(21,909)</u>	<u>(7,228)</u>
Net interest cost capitalized	<u>\$ 55,272</u>	<u>\$ 335,685</u>
Interest capitalized	\$ 55,272	\$ 335,685
Interest charged to expense	<u>21,909</u>	<u>7,228</u>
Total interest incurred	<u>\$ 77,181</u>	<u>\$ 342,913</u>

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method.

Compensated Absences

Hospital policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off. 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. Expense and the related liability for sick leave benefits are recognized when earned to the extent the employee is expected to realize the benefit in cash determined using the termination payment method. Sick leave benefits expected to be realized as paid time off 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

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2012 and 2011

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 Assets

Net assets of the Hospital are classified in three components. Net assets invested in capital assets, net of related debt, consist of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital assets that must be used for a particular purpose, as specified by creditors, grantors or donors external to the Hospital. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt.

Net Patient Service Revenue

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

Charity Care

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

Income Taxes

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

Foundation

St. Luke Hospital Foundation (the Foundation) is a legally separate, tax-exempt component unit of the Hospital. The Foundation's primary function is to raise and hold funds to support the Hospital and its programs. The board of the Foundation is self-perpetuating.

Although the Hospital does not control the timing or amount of receipts from the Foundation, the Foundation's by-laws restrict its resources and related income to be used for the benefit of the Hospital. Because these resources held by the Foundation can only be used by, or for the benefit of, the Hospital, the Foundation is considered a component unit of the Hospital and is discretely presented in the Hospital's financial statements.

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2012 and 2011

During the fiscal years ended September 30, 2012 and 2011, the Foundation provided \$333,180 and \$114,545 of support to the Hospital, respectively. Complete financial statements of the Foundation may be obtained from its administrative office at the following address: P.O. Box 12, Marion, Kansas 66861.

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 Hospital'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. 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 Hospital 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.

In 2012, the Hospital completed the first-year requirements under the Medicare program and has recorded revenue of \$230,000, which is included in other revenue within operating revenues in the statement of revenues, expenses and changes in net assets.

Subsequent Events

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

Note 2: Net Patient Service Revenue

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

Medicare. The Hospital is recognized as a Critical Access Hospital (CAH) and is paid at one hundred one percent (101%) of allowable costs for certain inpatient and outpatient services. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2012 and 2011

Medicare Administrative Contractor. Home health services are paid on a per-episode basis using clinical, diagnostic and other factors.

Medicaid. The Hospital is paid for inpatient and outpatient services rendered to Medicaid program beneficiaries who are not part of a Medicaid managed care network on a cost reimbursement methodology. Medicaid managed care patients are reimbursed under a prospective reimbursement methodology. Medicaid rural health clinic services are reimbursed under a cost-based methodology. The Hospital and rural health clinic are reimbursed at tentative rates with final settlements determined after submission of annual cost reports by the Hospital and reviews thereof by the Kansas Department of Health and Environment.

Medicaid reimbursement for long-term care facility residents is based on a cost-based prospective reimbursement methodology. The Hospital is reimbursed at a prospective rate with annual cost reports submitted to the Medicaid program. Rates are computed each calendar quarter using an average of the 2008, 2009 and 2010 cost reports and changes in the Medicaid resident case mix index. The Medicaid cost reports are subject to audit by the State and adjustments to rates can be made retroactively.

Approximately 62% and 59% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended September 30, 2012 and 2011, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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

Note 3: Deposits, Investments and Investment Income

Deposits

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

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

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2012 and 2011

At September 30, 2012 and 2011, respectively, \$1,455,371 and \$2,757,438 of the Hospital's bank balance of \$2,626,708 and \$3,717,326 were exposed to custodial credit risk as follows:

	<u>2012</u>	<u>2011</u>
Uninsured and collateral held by pledging financial institution's trust department or agent in other than the Hospital's name	<u>\$ 1,455,371</u>	<u>\$ 2,757,438</u>

Investments

The Hospital may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities and in bank repurchase agreements. It may also invest to a limited extent in corporate bonds and equity securities.

At September 30, 2012 and 2011, the Hospital had the following investments and maturities:

		2012			
		Maturities in Years			
Type	Fair Value	Less Than 1	1-5	6-10	More Than 10
Cash and cash equivalents	\$ 237,340	\$ 237,340	\$ -	\$ -	\$ -
State of Kansas municipal obligations	<u>430,929</u>	<u>430,929</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u><u>\$ 668,269</u></u>	<u><u>\$ 668,269</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>

		2011			
		Maturities in Years			
Type	Fair Value	Less Than 1	1-5	6-10	More Than 10
Cash and cash equivalents	\$ 548,027	\$ 548,027	\$ -	\$ -	\$ -
State of Kansas municipal obligations	<u>430,844</u>	<u>430,844</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u><u>\$ 978,871</u></u>	<u><u>\$ 978,871</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements September 30, 2012 and 2011

Summary of Carrying Values

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

	2012	2011
Carrying value		
Deposits	\$ 2,316,407	\$ 2,703,738
Petty cash	300	300
Investments	668,269	978,871
	<u>\$ 2,984,976</u>	<u>\$ 3,682,909</u>

Included in the following balance sheet captions:

	2012	2011
Cash and cash equivalents	\$ 2,316,707	\$ 2,245,928
Short-term certificates of deposit	-	458,110
Restricted cash - held under bond indenture	237,340	196,030
Held under bond indenture for capital acquisitions	-	351,997
Held under bond indenture for debt service	430,929	430,844
	<u>\$ 2,984,976</u>	<u>\$ 3,682,909</u>

Note 4: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at September 30, 2012 and 2011, consisted of:

	2012	2011
Medicare	\$ 208,833	\$ 242,318
Medicaid	7,276	4,539
Blue Cross	103,725	121,406
Other third-party payers	132,738	160,443
Patients	702,584	667,544
	<u>1,155,156</u>	<u>1,196,250</u>
Less allowance for uncollectible accounts	313,679	317,300
	<u>\$ 841,477</u>	<u>\$ 878,950</u>

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements September 30, 2012 and 2011

Note 5: Capital Assets

Capital assets activity for the years ended September 30, 2012 and 2011, was:

	2012				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	\$ 28,253	\$ -	\$ -	\$ -	\$ 28,253
Land improvements	50,908	-	-	-	50,908
Buildings	2,250,221	-	-	6,142,525	8,392,746
Construction in progress	5,702,514	503,628	-	(6,206,142)	-
Fixed equipment	963,139	156,766	(6,996)	-	1,112,909
Major moveable equipment	3,040,873	244,539	(8,403)	63,617	3,340,626
	<u>12,035,908</u>	<u>904,933</u>	<u>(15,399)</u>	<u>-</u>	<u>12,925,442</u>
Less accumulated depreciation					
Land improvements	50,908	-	-	-	50,908
Buildings	1,600,592	345,182	-	-	1,945,774
Fixed equipment	936,338	38,435	(6,996)	-	967,777
Major moveable equipment	2,362,916	251,485	(8,403)	-	2,605,998
	<u>4,950,754</u>	<u>635,102</u>	<u>(15,399)</u>	<u>-</u>	<u>5,570,457</u>
Capital Assets, Net	<u>\$ 7,085,154</u>	<u>\$ 269,831</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,354,985</u>

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2012 and 2011

	2011				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	\$ 28,253	\$ -	\$ -	\$ -	\$ 28,253
Land improvements	50,908	-	-	-	50,908
Buildings	2,250,221	-	-	-	2,250,221
Construction in progress	581,046	5,302,076	-	(180,608)	5,702,514
Fixed equipment	963,139	-	-	-	963,139
Major moveable equipment	2,655,572	224,922	(20,229)	180,608	3,040,873
	<u>6,529,139</u>	<u>5,526,998</u>	<u>(20,229)</u>	<u>-</u>	<u>12,035,908</u>
Less accumulated depreciation					
Land improvements	50,908	-	-	-	50,908
Buildings	1,529,530	71,062	-	-	1,600,592
Fixed equipment	923,747	12,591	-	-	936,338
Major moveable equipment	2,144,897	231,276	(13,257)	-	2,362,916
	<u>4,649,082</u>	<u>314,929</u>	<u>(13,257)</u>	<u>-</u>	<u>4,950,754</u>
Capital Assets, Net	<u>\$ 1,880,057</u>	<u>\$ 5,212,069</u>	<u>\$ (6,972)</u>	<u>\$ -</u>	<u>\$ 7,085,154</u>

Note 6: Medical Malpractice Coverage and Claims

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

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

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements September 30, 2012 and 2011

Note 7: Long-term Debt

The following is a summary of long-term debt transactions for the Hospital for the years ended September 30, 2012 and 2011:

2012					
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
2010 revenue bonds					
Series A	\$ 4,600,000	\$ -	\$ (50,000)	\$4,550,000	\$ 100,000
Series B	1,400,000	-	-	1,400,000	-
Capital lease obligations	181,278	-	(34,143)	147,135	36,955
Total long-term debt	<u>\$ 6,181,278</u>	<u>\$ -</u>	<u>\$ (84,143)</u>	<u>\$6,097,135</u>	<u>\$ 136,955</u>

2011					
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
2010 revenue bonds					
Series A	\$ 4,600,000	\$ -	\$ -	\$4,600,000	\$ 50,000
Series B	1,400,000	-	-	1,400,000	-
Capital lease obligations	148,290	194,725	(161,737)	181,278	34,143
Total long-term debt	<u>\$ 6,148,290</u>	<u>\$ 194,725</u>	<u>\$ (161,737)</u>	<u>\$6,181,278</u>	<u>\$ 84,143</u>

2010 Revenue Bonds

The 2010 bond issue consists of Series A taxable bonds in the original amount of \$4,600,000 and Series B tax-exempt bonds in the original amount of \$1,400,000 dated May 1, 2010, which bear interest at 8.72% and 6.25%, respectively. The Series A bonds were issued as part of the Build America Bonds program and are subject to a 35% rebate of interest paid. The Bonds are payable in annual installments through December 1, 2040. The Hospital is required to make monthly transfers of approximately \$46,000 to the debt service fund. Proceeds from the issuance of these bonds were used for renovation of the Hospital. The Bonds are secured by the net revenues and accounts receivable of the Hospital and the assets restricted under the bond indenture agreement.

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2012 and 2011

The indenture agreements require that certain funds be established. Accordingly, these funds are included as funds held under bond indenture in the balance sheets. The indenture agreements also require the Hospital to comply with certain restrictive covenants including minimum insurance coverage, restrictions on incurrence of additional debt and maintaining a historical debt-service coverage ratio of at least 1.15 during construction and at least 1.40 thereafter. For the year ended September 30, 2012, the Hospital's historical debt-service coverage ratio was 2.10.

The debt service requirements as of September 30, 2012, are as follows:

Year Ending September 30,	Total to be Paid	Principal	Interest
2013	\$ 559,462	\$ 100,000	\$ 459,462
2014	555,088	100,000	455,088
2015	550,087	100,000	450,087
2016	548,989	105,000	443,989
2017	547,988	110,000	437,988
2018-2022	2,670,150	600,000	2,070,150
2023-2027	2,576,044	770,000	1,806,044
2028-2032	2,506,781	995,000	1,511,781
2033-2037	2,430,650	1,340,000	1,090,650
2038-2041	2,097,650	1,730,000	367,650
	<u>\$ 15,042,889</u>	<u>\$ 5,950,000</u>	<u>\$ 9,092,889</u>

Capital Lease Obligations

The Hospital is obligated under leases for equipment that are accounted for as capital leases. Assets under capital leases at September 30, 2012 and 2011, totaled \$139,553 and \$178,529, respectively, net of accumulated depreciation of \$55,172 and \$16,229, respectively. The following is a schedule by year of future minimum lease payments under capital leases including interest at a rate of 7.94% together with the present value of the future minimum lease payments as of September 30, 2012:

Year Ending September 30,	
2013	\$ 47,316
2014	47,316
2015	47,316
2016	27,601
	<u>169,549</u>
Less amount representing interest	<u>22,414</u>
Present value of future minimum lease payments	<u>\$ 147,135</u>

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2012 and 2011

Note 8: Pension Plan

The Hospital contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by the Hospital. The plan provides retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's governing body. Employees may contribute up to 60% of eligible compensation subject to a maximum established by the Internal Revenue Service. Contributions actually made by plan members and the Hospital aggregated \$139,636 and \$27,814, respectively, during 2012, and \$120,345 and \$25,181, respectively, during 2011.

Defined Contribution Plan

The Hospital provides a 457 plan to substantially all employees. The employee's total salary deferral is limited by the Internal Revenue Service annually. The Hospital does not make contributions to the 457 plan.

Note 9: St. Luke Hospital Foundation

Financial Statements

The financial statements of the Foundation are presented in accordance with the provisions of the Financial Accounting Standards Board Accounting Standards Codification (FASB ASC). The FASB ASC requires the Foundation to distinguish between contributions that increase permanently restricted net assets, temporarily restricted net assets and unrestricted net assets. It also requires recognition of contributions, including contributed services meeting certain criteria, at fair values. The FASB ASC establishes standards for external financial statements of not-for-profit organizations and requires a statement of financial position, a statement of activities and a statement of cash flows. As permitted by GASB Statement No. 34, the Hospital has elected not to present a statement of cash flows for the Foundation in the basic financial statements of the Hospital's reporting entity.

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Notes to Financial Statements

September 30, 2012 and 2011

Contributions Receivable

Contributions receivable consisted of the following:

	September 30, 2012			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Due within one year	\$ 92,990	\$ -	\$ -	\$ 92,990
Due in one to five years	86,491	-	-	86,491
	<u>179,481</u>	<u>-</u>	<u>-</u>	<u>179,481</u>
Less				
Allowance for uncollectible contributions	-	-	-	-
Unamortized discount	4,896	-	-	4,896
	<u>\$ 174,585</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 174,585</u>

	September 30, 2011			
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Due within one year	\$ 112,142	\$ -	\$ -	\$ 112,142
Due in one to five years	184,283	-	-	184,283
	<u>296,425</u>	<u>-</u>	<u>-</u>	<u>296,425</u>
Less				
Allowance for uncollectible contributions	-	-	-	-
Unamortized discount	15,351	-	-	15,351
	<u>\$ 281,074</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 281,074</u>

Supplementary Information

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Comparison of Revenues and Expenses (Cash Basis) – Actual and Tax Budget Calendar Year Ended December 31, 2011

	<u>Actual</u>	<u>Tax Budget</u>	<u>Actual Over (Under) Budget</u>
Net patient service revenue	\$ 6,952,729	\$ 7,000,000	\$ (47,271)
Other revenue	<u>106,376</u>	<u>115,000</u>	<u>(8,624)</u>
Total operating revenue	<u>7,059,105</u>	<u>7,115,000</u>	<u>(55,895)</u>
Operating expenses	13,892,767	15,025,548	(1,132,781)
Interest paid	<u>56,157</u>	<u>15,000</u>	<u>41,157</u>
Operating expenses	<u>13,948,924</u>	<u>15,040,548</u>	<u>(1,091,624)</u>
Operating loss	<u>(6,889,819)</u>	<u>(7,925,548)</u>	<u>1,035,729</u>
Property tax revenue	688,761	725,854	(37,093)
Other nonoperating revenues	<u>219,241</u>	<u>40,000</u>	<u>179,241</u>
Total nonoperating revenues	<u>908,002</u>	<u>765,854</u>	<u>142,148</u>
Deficiency of revenue over expenses	<u><u>\$ (5,981,817)</u></u>	<u><u>\$ (7,159,694)</u></u>	<u><u>\$ 1,177,877</u></u>

Marion County Hospital District #1 of Marion County, Kansas d/b/a St. Luke Hospital and Living Center

Insurance Coverage

September 30, 2012

	<u>Coverage Limits</u>	<u>Premiums</u>
CHUBB		
Expiring October 1, 2012:		\$ 20,316
Buildings and contents	\$ 21,596,000	
Electronic data processing equipment	Included in building and contents	
Business income with extra expense	6,000,000	
Flood or Earthquake	10,000,000	
Cincinnati Insurance Company		
Expiring October 1, 2012:		
Directors and officers with employment practices	2,000,000	6,482
Expiring October 1, 2012:		523
Employee theft	525,000	
Forgery and alteration	525,000	
Expiring October 1, 2012:		
Commercial automobile	1,000,000	1,165
KHA Workers' Compensation Fund, Inc.		
Expiring January 1, 2013:		
Workers' compensation:		66,078
Per accident	500,000	
Per employee disease	500,000	
Policy limit	500,000	
Kansas Medical Mutual Insurance Company		
Expiring October 15, 2012:		
Professional liability	200,000/600,000	14,135
Kansas Healthcare Stabilization Fund	800,000/2,400,000	5,654
General liability	1,000,000/3,000,000	2,000
Additional insureds	5,000,000/5,000,000	16,644
Fire legal liability	50,000	
Old Republic Surety Company		
Expiring October 2, 2012:		