Morris County Hospital
A Component Unit of Morris County, Kansas

Independent Auditor's Report and Financial Statements

December 31, 2012 and 2011

BKD LLP
CPAs & Advisors

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

Contents

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CPAs & Advisors

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Independent Auditor's Report

Board of Trustees
Morris County Hospital
Council Grove, Kansas

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

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

Required Supplementary Information

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

BKD, LLP

Wichita, Kansas
May 17, 2013

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

Assets

	2012	2011
Current Assets		
Cash and cash equivalents	$ 1,078,712	$ 1,508,618
Funds held by trustee for debt service	-	3,026
Patient accounts receivable, net	1,943,270	1,663,341
Estimated amounts due from third-party payers	437,160	617,625
Other receivables	179,574	103,113
Supplies	268,650	269,264
Prepaid expenses	156,548	142,584
Guarantee receivable	-	4,314
Total current assets	4,063,914	4,311,885
Noncurrent Cash and Investments		
Board designated for physician recruitment	60,726	60,347
Board designated for capital improvements	2,475,438	1,459,420
Held by trustee for debt service	421	224,931
Held by Morris County Hospital Foundation	488,941	517,968
	3,025,526	2,262,666
Capital Assets, Net	7,464,183	7,872,440
Deferred Financing Costs	57,667	61,811
Total assets	$ 14,611,290	$ 14,508,802

Liabilities and Net Position

	2012	2011
Current Liabilities		
Current maturities of long-term debt	$ 156,299	$ 114,099
Accounts payable	345,452	272,234
Construction payable	-	283,920
Accrued payroll and withholdings	73,409	59,584
Accrued vacation benefits	214,271	195,198
Accrued employee benefits payable	40,249	29,745
Accrued interest payable	17,623	4,539
Total current liabilities	847,303	959,319
Long-term Debt	1,818,957	1,975,685
Total liabilities	2,666,260	2,935,004
Net Position		
Net investment in capital assets	5,488,927	6,006,971
Restricted - expendable for		
Debt service	421	3,642
Capital acquisitions	5,979	18,913
Unrestricted	6,449,703	5,544,272
Total net position	11,945,030	11,573,798
Total liabilities and net position	$ 14,611,290	$ 14,508,802

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

	2012	2011
Operating Revenues		
Net patient service revenue	$ 8,808,843	$ 8,214,676
Electronic health record incentive revenue	-	542,625
Other	97,114	60,613
Total operating revenues	8,905,957	8,817,914
Operating Expenses		
Salaries and wages	3,125,470	3,005,381
Employee benefits	618,561	597,853
Supplies and other	1,467,088	1,498,506
Contracts	2,865,853	2,477,935
Depreciation and amortization	816,269	834,551
Total operating expenses	8,893,241	8,414,226
Operating Income (Loss)	12,716	403,688
Nonoperating Revenues (Expenses)		
Noncapital contributions	13,285	17,161
Property taxes	367,465	366,980
Morris County Hospital Foundation earnings (losses), net of transfers and capital contributions	(1,925)	1,983
Investment income	37,322	29,409
Interest expense	(57,631)	(46,807)
Total nonoperating revenues	358,516	368,726
Increase in Net Position	371,232	772,414
Net Position, Beginning of Year	11,573,798	10,801,384
Net Position, End of Year	$ 11,945,030	$ 11,573,798

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

	2012	2011
Operating Activities		
Receipts from and on behalf of patients	$ 8,709,379	$ 7,714,327
Payments to suppliers and contractors	(4,299,667)	(3,973,957)
Payments to employees	(3,700,629)	(3,577,163)
Other receipts, net	20,653	577,536
Net cash provided by operating activities	729,736	740,743
Noncapital Financing Activities		
Noncapital contributions	13,285	17,161
Transfer from Foundation	27,102	16,476
Property taxes	367,465	366,980
Net cash provided by noncapital financing activities	407,852	400,617
Capital and Related Financing Activities		
Purchases of capital assets	(648,110)	(1,538,024)
Proceeds from issuance of revenue bonds	-	2,000,000
Principal paid on long-term debt	(114,528)	(922,437)
Interest paid on long-term debt	(57,631)	(46,807)
Payment of deferred financing costs	-	(62,156)
Net cash used in capital and related financing activities	(820,269)	(569,424)
Investing Activities		
Change in noncurrent investments	(788,861)	(173,184)
Guarantee payments	4,314	114,045
Investment income	37,322	29,409
Net cash used in investing activities	(747,225)	(29,730)
Increase (Decrease) in Cash and Cash Equivalents	(429,906)	542,206
Cash and Cash Equivalents, Beginning of Year	1,508,618	966,412
Cash and Cash Equivalents, End of Year	$ 1,078,712	$ 1,508,618

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

	2012	2011
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided by Operating Activities		
Operating income (loss)	$ 12,716	$ 403,688
Provision for uncollectible accounts	245,243	620,952
Depreciation and amortization	816,269	834,551
Changes in operating assets and liabilities		
Patient accounts receivable	(525,172)	(793,676)
Estimated amounts due from and to third-party payers	180,465	(327,625)
Other receivables	(76,461)	(25,702)
Supplies	614	(19,559)
Prepaid expenses	(13,964)	(34,693)
Accounts payable	33,540	62,199
Accrued payroll and withholdings	13,825	13,463
Accrued vacation benefits	19,073	5,410
Accrued employee benefits payable	10,504	7,198
Accrued interest payable	13,084	(5,463)
Net cash provided by operating activities	$ 729,736	$ 740,743
Supplemental Cash Flows Information		
Capital assets acquisitions included in accounts payable and construction payable	$ 39,678	$ 283,920

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

Nature of Operations and Reporting Entity

Morris County Hospital (Hospital) is a county-owned, general hospital located in Council Grove, Kansas with a licensed bed capacity of 25 beds. The Hospital is considered a component unit of Morris County, Kansas.

The Hospital maintains an agreement with Morris County, Kansas (County) to operate the County health department. Under the terms of the agreement, the Hospital is responsible for providing overall administration and all related services for the health department. The Hospital is to receive the equivalent of at least a one mill levy from the County and the use of personal property of the health department. The agreement is renewable for successive one-year terms.

Morris County Hospital Foundation (Foundation) is a Kansas not-for-profit corporation exempt from federal income taxation under Internal Revenue Code Section 501(a) as an organization described in Section 501(c)(3). The Foundation was formed July 22, 1986, and is organized and shall be operated exclusively for the benefit of, to perform the functions of, or to do all things that may appear necessary and useful in accomplishing the purposes of the Hospital. The board of the Foundation is self-perpetuating. Although the Hospital does not control the timing or amount of receipts from the Foundation, the majority of the Foundation's resources and related income are restricted by donors for the benefit of the Hospital. Because these restricted 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 included in the financial statements of the Hospital using the blended method. Complete financial statements of the Foundation may be obtained from its administrative offices at the following address:

Morris County Hospital Foundation
600 North Washington, Box 275
Council Grove, Kansas 66846

Basis of Accounting and Presentation

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

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

Use of Estimates

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

Cash Equivalents

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

Property Taxes

The Hospital received approximately 4% in 2012 and 2011 of its financial support from property taxes.

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; medical malpractice; and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than medical malpractice. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Investments and Investment Income

Noncurrent cash and investments include assets held by the Foundation, assets held by trustees, and designated assets set aside by the Board of Trustees for physician recruitment and capital improvements, over which the Board of Trustees retains control and may, at its discretion, subsequently use for other purposes. Assets held by the Foundation primarily consist of cash, certificates of deposit, mutual funds and other investments. All mutual funds are carried at fair value based upon readily determinable market values. The investment portfolio is classified as a trading portfolio. Designated assets set aside by the Board of Trustees consist of certificates of deposit. Assets held by trustee are funds held for debt service that consist of a debt reserve fund and a principal and interest fund.

Investment income includes interest income earned on deposits and delinquent patient accounts.

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.

Guarantee Contracts

Guarantee contracts receivable represents the estimated future benefit to be received over the contractual life of the guarantee contract.

Supplies

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

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations are depreciated 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 – 15 years
Buildings	5 – 40 years
Equipment	5 – 20 years

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 or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. 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. Employees with greater than 15 years of service vest in sick leave. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date.

Net Position

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

Net Patient Service Revenue

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

Charity Care

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

Income Taxes

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

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 (CAHs) are eligible to receive incentive payments in the cost reporting period beginning in the federal fiscal year in which meaningful use criteria have been met. The Medicare incentive payment is for qualifying costs of the purchase of certified EHR technology multiplied by the Hospital's Medicare share fraction, which includes a 20% incentive. This payment is an acceleration of amounts that would have been received in future periods based on reimbursable costs incurred, including depreciation. If meaningful use criteria are not met in future periods, the Hospital is subject to penalties that would reduce future payments for services. 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. 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 has recognized the incentive payment revenue received for qualified EHR technology expenditures during 2011, which was the period during which management was reasonably assured meaningful use was achieved and the earnings process was complete. Management believes the incentive payments reflect a change in how "allowable costs" are determined in paying CAHs for providing services to Medicare beneficiaries. The Hospital recorded revenue of $69,554 and $542,625, which is included within operating revenues in the statement of revenues, expenses and changes in net position for the years ended December 31, 2012 and 2011, respectively.

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 licensed as a CAH. Under this reimbursement system, inpatient acute care and swing-bed services rendered to Medicare program beneficiaries are paid under cost reimbursement methodologies. Outpatient services related to Medicare beneficiaries are paid based on a combination of fee schedules and cost reimbursement methodologies. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of an annual cost report by the Hospital and audit thereof by the Medicare administrative contractor.

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

Approximately 58% and 59% of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2012 and 2011, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, 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.

Net patient service revenue consists of the following as of December 31:

	2012	2011
Gross patient service revenue	$ 17,293,084	$ 16,376,764
Less:		
Medicare contractual adjustments	5,023,640	4,529,303
Medicaid contractual adjustment	702,492	710,148
Other adjustments	2,384,584	2,212,321
Charity care	128,282	89,364
Provision for uncollectible accounts	245,243	620,952
	$ 8,808,843	$ 8,214,676

Note 3: Deposits and Investments

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.

The Hospital's bank balances at December 31 were as follows:

	2012	2011
FDIC insured collateral	$ 652,809	$ 698,909
Collateralized by securities held by the pledging financial institution in the Hospital's name	3,281,440	2,739,948
	$ 3,934,249	$ 3,438,857
Carrying value	$ 3,614,776	$ 3,028,285

The carrying amounts of deposits shown above are included in the following balance sheet captions at December 31:

	2012	2011
Cash and cash equivalents	$ 1,078,612	$ 1,508,518
Noncurrent cash and investments	2,536,164	1,519,767
	$ 3,614,776	$ 3,028,285

Investments and Certificates of Deposit

As of December 31, 2012 and 2011, the Hospital has the following investments and certificates of deposit:

	2012		
		Maturities in Years	
Type	Fair Value	Less than 1	1-5
Hospital			
Certificates of deposit	$ 2,536,163	$ 821,426	$ 1,714,737
Foundation			
Certificates of deposit	200,000	200,000	-
Equity securities	203,372	203,372	-
U.S. Treasury securities	12,752	12,752	-
Equity investment	1,847	1,847	-
Total Foundation investments	417,971	417,971	-
	$ 2,954,134	$ 1,239,397	$ 1,714,737

	2011		
		Maturities in Years	
Type	Fair Value	Less than 1	1-5
Hospital			
Certificates of deposit	$ 1,519,767	$ 515,428	$ 1,004,339
Federated government obligations	227,957	227,957	-
Total Hospital investments	1,747,724	743,385	1,004,339
Foundation			
Certificates of deposit	200,504	200,504	-
Equity securities	178,762	178,762	-
U.S. Treasury securities	12,161	12,161	-
Equity investments	16,768	16,768	-
Total Foundation investments	408,195	408,195	-
	$ 2,155,919	$ 1,151,580	$ 1,004,339

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	$ 3,614,776	$ 3,028,285
Investments	489,362	745,925
Cash on hand	100	100
	$ 4,104,238	$ 3,774,310
Included in the following balance sheet captions		
Cash and cash equivalents	$ 1,078,712	$ 1,508,618
Funds held by trustee	-	3,026
Board designated for physician recruitment	60,726	60,347
Board designated for capital improvements	2,475,438	1,459,420
Held by trustee	421	224,931
Held by Morris County Hospital Foundation	488,941	517,968
	$ 4,104,238	$ 3,774,310

Note 4: Patient Accounts Receivable

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

	2012	2011
Medicare	$ 1,173,148	$ 1,341,416
Medicaid	189,937	216,000
Blue Cross	374,506	396,131
Commercial	471,540	600,544
Self-pay	1,134,388	740,234
	3,343,519	3,294,325
Less:		
Allowance for uncollectible accounts	415,694	519,530
Allowance for contractual adjustments	984,555	1,111,454
	$ 1,943,270	$ 1,663,341

The mix of receivables from patients and third-party payers at December 31 are as follows:

	2012	2011
Medicare	35%	41%
Medicaid	6%	7%
Blue Cross	11%	12%
Commercial	14%	18%
Self-pay	34%	22%
	100%	100%

Note 5: Guarantee Contracts

The Hospital has entered into guarantee contracts with physicians to relocate to Council Grove, Kansas to establish medical practices. The Hospital, as the guarantor, has agreed to make payments to the physicians, the guaranteed parties, per month if the net income generated by the physicians' new practice during the month does not equal or exceed a specific minimum amount stated in the physicians' contract. The guarantee contracts have guarantee periods of 12 months. The physicians are required, for a minimum of their commitment period, which consists of 24 to 48 months, to diligently and fully devote their efforts and time to the operation of their practice in Council Grove, Kansas. In the event that the physicians fail to perform their obligations under their contract, the physicians are to reimburse the Hospital all sums advanced to them pursuant to the terms of their contract.

Note 6: Capital Assets

Capital assets activity for the years ended December 31 was:

	2012				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 100,644	$ -	$ -	$ -	$ 100,644
Land improvements	227,472	-	-	-	227,472
Building	5,795,097	17,589	-	1,582,433	7,395,119
Fixed equipment	3,843,838	-	-	-	3,843,838
Moveable equipment	4,662,801	289,898	-	-	4,952,699
Construction in progress	1,590,433	96,381	-	(1,582,433)	104,381
	16,220,285	403,868	-	-	16,624,153
Less accumulated depreciation					
Land improvements	(196,910)	(10,858)	-	-	(207,768)
Building	(2,903,284)	(230,914)	-	-	(3,134,198)
Fixed equipment	(1,980,243)	(167,766)	-	-	(2,148,009)
Moveable equipment	(3,267,408)	(402,587)	-	-	(3,669,995)
	(8,347,845)	(812,125)	-	-	(9,159,970)
Capital Assets, Net	$ 7,872,440	$ (408,257)	$ -	$ -	$ 7,464,183

	2011				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 100,644	$ -	$ -	$ -	$ 100,644
Land improvements	221,822	5,650	-	-	227,472
Building	5,795,097	-	-	-	5,795,097
Fixed equipment	3,843,838	-	-	-	3,843,838
Moveable equipment	4,268,984	103,621	-	290,196	4,662,801
Construction in progress	200,687	1,679,942	-	(290,196)	1,590,433
	14,431,072	1,789,213	-	-	16,220,285
Less accumulated depreciation					
Land improvements	(185,131)	(11,779)	-	-	(196,910)
Building	(2,712,922)	(190,362)	-	-	(2,903,284)
Fixed equipment	(1,806,884)	(173,359)	-	-	(1,980,243)
Moveable equipment	(2,808,701)	(458,707)	-	-	(3,267,408)
	(7,513,638)	(834,207)	-	-	(8,347,845)
Capital Assets, Net	$ 6,917,434	$ 955,006	$ -	$ -	$ 7,872,440

Note 7: Medical Malpractice Claims

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

Note 8: Long-term Obligations

The following is a summary of long-term obligation transactions for the Hospital for the years ended December 31:

	2012					
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion	Long-term Portion
Revenue bonds payable						
Series 2011A	$2,000,000	$ -	$ 80,000	$1,920,000	$ 120,000	$ 1,800,000
Capital lease obligations	89,784	-	34,528	55,256	36,299	18,957
	$2,089,784	$ -	$ 114,528	$1,975,256	$ 156,299	$ 1,818,957

	2011					
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion	Long-term Portion
Loan payable	$ 24,568	$ -	$ 24,568	$ -	$ -	$ -
Revenue bonds payable						
Series A 2002	865,000	-	865,000	-	-	-
Revenue bonds payable						
Series 2011A	-	2,000,000	-	2,000,000	80,000	1,920,000
Capital lease obligations	122,653	-	32,869	89,784	34,099	55,685
	$1,012,221	$2,000,000	$ 922,437	$2,089,784	$ 114,099	$ 1,975,685

Loan Payable

The loan payable is a noninterest bearing loan, discounted to reflect 6% interest, payable to Flint Hills Rural Electric Cooperative Association, Inc. The loan payable was due June 25, 2011, with principal payable monthly. The note is secured by a $450,000 irrevocable line of credit at a financial institution. There have been no draws against the line of credit as of December 31, 2011.

Revenue Bonds Payable – Series A 2002

The Series A 2002 Hospital Revenue Bonds (Morris County Hospital Project) payable consist of bonds in the original amount of $1,000,000 dated October 22, 2002, which bear interest at 4.625%. The bonds are payable in annual installments through October 22, 2032. The Hospital is required to make monthly deposits of approximately $5,000 to the debt service fund, of which $535 is deposited in the debt reserve fund. The bonds were purchased by the United States of America Rural Development United States Department of Agriculture. The bonds are secured by the net revenues of the Hospital and the assets held by the County.

Revenue Bonds Payable – Series 2011A

The Series 2011A Revenue Bonds (Morris County Hospital Project) payable consist of bonds in the original amount of $2,000,000 dated December 1, 2011, which bear interest at 1.50% to 3.75%. The bonds are payable in annual installments through September 1, 2026. The Hospital is required to make monthly deposits at a pro-rated amount of the next maturing principal and interest to the debt service fund held by the trustee. The Hospital failed to make the monthly pro-rated amount to the debt service fund during the year, which is a violation of the debt covenants. This violation is not a callable event. All of the bonds still outstanding may be redeemed at the Hospital's option on or after September 1, 2018, at 100%. The bonds are secured by the net revenues of the Hospital. Proceeds from the issuance of these bonds were used to construct an addition to the hospital building and defease the Series A 2002 Hospital Revenue Bonds.

The indenture agreements require that certain funds be established with the trustee. Accordingly, these funds are included as assets held by trustee in the balance sheets. The indenture agreements also require the Hospital to comply with restrictive covenants including maintaining a historical debt-service ratio of at least 1.25.

Upon issuance and delivery of the bonds, the Hospital defeased its outstanding Series A 2002 Hospital Revenue Bonds. Proceeds from the bonds were used to pay the State of Kansas amount sufficient to pay existing and interest on the defeased bonds. This advance refunding transaction resulted in an extinguishment of debt since the Hospital was legally released from its obligation on the Series A 2002 Hospital Revenue Bonds at the time of defeasance.

Funds relative to the revenue bonds are as follows at December 31, 2012 and 2011:

	2012	2011
Principal and interest fund	$ -	$ 3,026
Cost of issuance fund	421	616
Project fund	-	224,315
	421	227,957
Less current portion	-	3,026
	$ 421	$ 224,931

Scheduled debt service requirements are as follows:

	Long-term Debt		Capital Lease Obligations	
	Principal	Interest	Principal	Interest
Year Ending December 31,				
2013	$ 120,000	$ 52,869	$ 36,299	$ 1,925
2014	120,000	50,469	18,957	255
2015	125,000	48,069	-	-
2016	125,000	45,569	-	-
2017	125,000	43,694	-	-
2018-2022	680,000	175,256	-	-
2023-2026	625,000	58,875	-	-
	$ 1,920,000	$ 474,801	$ 55,256	$ 2,180

The following is an analysis of the financial presentation of capital leases at December 31:

	2012	2011
Equipment	$ 169,657	$ 169,657
Less accumulated depreciation	(82,809)	(58,572)
	$ 86,848	$ 111,085

Note 9: Employee Benefit Plan

Pension Plan

In 1983, the Board of Trustees elected to withdraw from the social security system and approved a defined contribution retirement plan covering substantially all employees. The retirement plan is a part of an overall employee benefit package which also provides for health care, life and disability insurance. The total employee benefit is based on a specified percentage of the employee's wages. The health care costs and other benefits paid for each employee are deducted from this total, arriving at the amount for retirement. However, the retirement benefit may not be less than 7.5% or greater than 25% of the employee's wages, regardless of the amount of health and other insurance benefits paid on the employee's behalf. The Hospital makes contributions to the plan equal to amounts accrued for benefits. Total retirement plan expense was $231,642 and $223,710 for the years ended December 31, 2012 and 2011, respectively.

Profit Sharing Plan

In 1992, the Board of Trustees established a profit sharing plan to provide an additional benefit to its employees. The Hospital provides the profit sharing plan to substantially all employees of the Hospital who have reached the age of 21 and completed one year of service or 800 hours. The Hospital's annual contribution to the trust is equal to the amount the Hospital deems to be advisable from time to time. An employee becomes fully vested in the plan upon completion of six years of service. Total profit sharing expense was $46,664 and $32,640 for the years ended December 31, 2012 and 2011, respectively.

Deferred Compensation Plan

In 2005, the Board of Trustees elected to provide its employees with a deferred compensation plan, also known as a 457(b) plan. The purpose of the plan is to benefit those employees who choose to participate by permitting them to defer a portion of future compensation in order to provide payments at retirement. The Hospital provides the 457(b) plan to substantially all employees of the Hospital. The employees may contribute up to 100% of their salary to the 457(b) plan. The employees' salary deferral is limited by the Internal Revenue Service (IRS) annually. Employees are 100% vested in the contributions they choose to defer. If an employee is 50 years old or older and has met the annual IRS deferral limit, the employee may contribute a catch-up deferral that is also limited by the IRS annually. Contributions from employees to the 457(b) plan were $13,500 and $15,010 for the years ended December 31, 2012 and 2011, respectively. The Hospital does not contribute to the 457(b) plan.

Note 10: Patient Protection and Affordable Care Act

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

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

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

Note 11: Risks and Uncertainties

Current Economic Conditions

The current economic environment presents hospitals with unprecedented circumstances and challenges, which in some cases have resulted in large declines in the fair value of investments and other assets, large declines in contributions, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the Hospital.

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

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

Note 12: Subsequent Events

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