

FINANCIAL STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
DECEMBER 31, 2012 AND 2011

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NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
MANAGEMENT'S DISCUSSION AND ANALYSIS
Years ended December 31, 2012 and 2011

Our discussion and analysis of the financial performance of Neosho Memorial Regional Medical Center provides a narrative overview of the Medical Center's financial activities for the years ended December 31, 2012 and 2011. Please read it in conjunction with the accompanying financial statements.

Financial highlights

The Medical Center's net position increased by \$2,463,106 or 9.0 percent in 2012 and increased by \$1,027,707 or 3.9 percent in 2011.

The Medical Center reported operating income of \$3,084,243 in 2012, \$1,765,828 in 2011, and \$1,499,985 in 2010.

Using these financial statements

The Medical Center's financial statements consist of three statements - a Balance Sheet; a Statement of Revenues, Expenses, and Changes in Net Position; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Medical Center, and resources held by or for the benefit of the Medical Center.

One of the most important questions asked about the Medical Center's finances is, "Is the Medical Center 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 Position report information about the Medical Center'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. Revenues and expenses are taken into account regardless of when cash is received or paid.

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

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

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended December 31, 2012 and 2011

Assets, liabilities, and net position

Table 1 below summarizes the Medical Center's assets, liabilities, and net position for the latest three calendar years.

Table 1: Assets, Liabilities, and Net Position

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|-------------------------|----------------------|----------------------|----------------------|
| Assets | | | |
| Current assets | \$ 18,334,849 | \$ 15,110,829 | \$ 13,838,262 |
| Capital assets, net | 27,053,995 | 27,069,690 | 27,875,512 |
| Other noncurrent assets | <u>7,132,926</u> | <u>5,713,400</u> | <u>5,552,264</u> |
| Total assets | <u>52,521,770</u> | <u>47,893,919</u> | <u>47,266,038</u> |
| Current liabilities | 4,569,542 | 3,604,010 | 3,580,410 |
| Long-term liabilities | <u>18,220,213</u> | <u>17,021,000</u> | <u>18,142,326</u> |
| Total liabilities | <u>22,789,755</u> | <u>20,625,010</u> | <u>21,722,736</u> |
| Total net position | <u>\$ 29,732,015</u> | <u>\$ 27,268,909</u> | <u>\$ 25,543,302</u> |

Cash and accounts receivable are the two most significant components of current assets. Cash increased by \$2,235,652 in 2012 after increasing by \$952,672 in 2011 and \$1,781,245 in 2010. The Medical Center continues to generate strong cash flows from operations generating \$6,204,055, \$5,703,198, and \$5,035,253 during 2012, 2011, and 2010. These cash flows are utilized to fund the Medical Center's debt service requirements and capital acquisitions. Cash is also affected by the timing of our collection of accounts receivable and our funding of funded depreciation, or assets limited as to use designated for capital acquisitions. Net accounts receivable at December 31, 2012, 2011, and 2010, were \$5,436,201, \$4,730,660, and \$4,624,548 representing 49, 46, and 49 days of net patient service revenue in net accounts receivable. Assets limited as to use designated for capital acquisitions increased by \$1,440,030 in 2012 as compared with 2011 and by \$1,559,303 in 2011 as compared with 2010. The accompanying cash flow statement provides additional details as to the change in cash balances for 2012 and 2011. This again is a reflection of our strong operating results.

The Medical Center's additions to capital assets were \$3,289,953 in 2012 as compared with \$2,422,888 in 2011 and \$3,227,650 in 2010. Future capital acquisitions are expected to be primarily related to technology enhancements and replacement of equipment.

As noted above, we have added to our assets limited as to use, internally designated for capital acquisitions, each of the last three years. When funds are available, the Medical Center transfers funds to funded depreciation. These funds are then disbursed for the acquisition of capital assets. Funds held by trustees under bond indenture agreements are required to meet the bond reserve and debt service reserve fund requirements for the bonds and to fund hospital renovations. These funds have not significantly changed over the past two years.

Net position or equity, has increased by 16.4 percent from 2010 to 2012. This increase is primarily from the positive operating results which are discussed below in more detail.

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended December 31, 2012 and 2011

Operating results and changes in net position

The Medical Center's net position increased by \$2,463,106 or 9.0 percent in 2012 and \$1,027,707 or 3.9 percent in 2011, as shown in Table 2.

Table 2: Operating Results and Changes in Net Position

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|--|---------------------|-----------------------------|-----------------------------|
| Operating revenues | | | |
| Net patient service revenue | \$ 40,632,364 | \$ 37,768,128 | \$ 34,739,688 |
| Other operating revenue | 893,651 | 784,109 | 605,711 |
| Electronic health record incentive revenue | <u>750,525</u> | <u> </u> | <u> </u> |
| Total operating revenues | <u>42,276,540</u> | <u>38,552,237</u> | <u>35,345,399</u> |
| Operating expenses | | | |
| Salaries and benefits | 21,123,705 | 19,708,431 | 18,228,863 |
| Supplies and other | 14,722,340 | 13,880,294 | 12,674,375 |
| Depreciation and amortization | <u>3,346,252</u> | <u>3,197,684</u> | <u>2,942,176</u> |
| Total operating expenses | <u>39,192,297</u> | <u>36,786,409</u> | <u>33,845,414</u> |
| Operating income | 3,084,243 | 1,765,828 | 1,499,985 |
| Nonoperating revenues (expenses) | (634,848) | (762,551) | (820,370) |
| Capital grants and contributions | <u>13,711</u> | <u>24,430</u> | <u>18,285</u> |
| Increase in net position | <u>\$ 2,463,106</u> | <u>\$ 1,027,707</u> | <u>\$ 697,900</u> |

The first component of the overall change in the Medical Center's net position is its operating income - generally the difference between net patient service revenues and other operating revenues and the expenses incurred to perform those services. The Medical Center's operating margin was 7.3 percent in 2012, increasing slightly from 4.6 percent in 2011.

The change in net patient service revenue is affected by changes in charges to patients, payment rates by third-party payors, patient volumes, the type of services provided, and other special payments. Net patient service revenue is also affected by changes in expenses, as a significant portion of the revenues are associated with services provided to Medicare and Medicaid beneficiaries whose services are reimbursed based on cost reimbursement principles.

The Medical Center's net patient service revenues increased by 7.6 percent in 2012 as compared to 2011 and by 8.7 percent in 2011 as compared to 2010. The increases are due primarily to an increase in outpatient service volumes and revenues. The Medical Center installed an MRI in 2012 which replaced a mobile unit which has resulted in increased volumes. The Medical Center has also expanded its clinic services during the past three years opening the Women's clinic in 2010 and an Orthopedic clinic in 2011. The Medical Center has also leased office space to a physician practice beginning in December 2010. In addition to the direct revenues generated from these clinics, the Medical Center is also experiencing an increase in ancillary services from having these clinics operate on the Medical Center's campus.

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended December 31, 2012 and 2011

The Medical Center experienced a 1.2 percent decrease in inpatient days in 2012 as compared to 2011, and a .4 percent increase in 2011 as compared with 2010. As a critical access hospital, we are limited to having twenty-five inpatients admitted to our Medical Center at any one time. We operate our Medical Center near this limit often and do not anticipate being able to grow our inpatient services in the future. We are focused on growing our outpatient services which is consistent with national trends of having patients treated increasingly in an outpatient setting. We expect that this trend will continue in our service area.

The Medical Center has also consistently met the eligibility requirements for the State of Kansas Medicaid DSH program which awards payments to hospitals based on the level of uncompensated care provided by hospitals to uninsured or Medicaid patients. The payments through Medicaid DSH are disbursed quarterly to the Medical Center. Net patient service revenues recognized from this program were \$1,000,907, \$867,909, and \$735,127 in 2012, 2011, and 2010, respectively. These amounts are expected to be impacted in the future as health care reform regulations are implemented and more patients are provided health coverage through health insurance exchanges or other means.

Other significant items affecting net patient service revenues are the level of charity care and bad debts incurred by the Medical Center. These amounts are deducted from gross revenues along with third-party contractual adjustments to arrive at net patient service revenues. We have been focused on identifying charity care which resulted in a shifting of write-offs to charity care that may have previously been written off as bad debts. For the years ended 2012, 2011, and 2010, the Medical Center's charity care and provision for bad debts were as follows:

| | <u>2012</u> | <u>2011</u> | <u>2010</u> |
|-------------------------|---------------------|---------------------|---------------------|
| Provision for bad debts | \$ 5,016,604 | \$ 3,604,277 | \$ 3,929,053 |
| Charity care | <u>1,058,202</u> | <u>2,276,424</u> | <u>1,785,201</u> |
| | <u>\$ 6,074,806</u> | <u>\$ 5,880,701</u> | <u>\$ 5,714,254</u> |

These amounts represent 6.2 percent, 6.5 percent, and 7.3 percent of gross patient service revenues for the respective years ended 2012, 2011, and 2010. These percentages are affected by the level of uninsured or underinsured patients seeking care in our facility.

In 2012, the Medical Center recognized electronic health record incentive revenues which relate to the Medical Center certifying and meeting the first stage of electronic health record meaningful use. The \$750,525 in revenues recognized were received from both the Medicare and Medicaid program and based on varying formulas. These payments are not expected to continue at the same level in the future.

Employee salaries and wages increased by \$1,007,728 or 6.2 percent in 2012 and increased by \$1,368,130 or 9.3 percent during 2011. The change in salaries is driven by two factors which are the change in full-time equivalent employees (FTEs) and the average increase in employee hourly wages. The Medical Center employed an average of 310 FTEs during 2012, a 6 FTE increase from 2011. FTEs for 2011 increased by 6 from 2010.

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED
Years ended December 31, 2012 and 2011

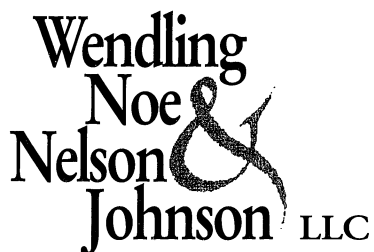
Employee benefit costs as a percentage of salary and wage expense was 23.1 percent, 22.0 percent, and 23.3 percent in 2012, 2011, and 2010, respectively. These costs have remained relatively consistent as a percentage of gross salaries and wages during the past three years. The one component of this expense that has the most variability from year to year is the cost of providing health insurance coverage to our employees. This expense increased by \$331,056 in 2012 after decreasing by \$146,909 in 2011, both as compared to the prior year.

Supplies and other expenses increased by \$842,046 in 2012, increased by \$1,205,919 in 2011, and decreased by \$248,173 in 2010. In 2012, the Medical Center experienced an approximate \$150,000 increase in physical therapy contract service expense, an approximate \$180,000 increase in pharmacy costs, and a continued increase in information systems expenses of approximately \$80,000 due to an increase in system maintenance costs which relate to the continued implementation of the electronic health record system. In 2011, the Medical Center experienced an approximate \$585,000 increase in Medical Supply and Pharmacy expenses, an approximate \$150,000 increase in physical therapy contract service expense, and information systems expenses increased an additional \$192,000 due to an increase in small equipment purchases and system maintenance costs.

Depreciation and interest expenses combined increased by \$137,980 in 2012 as compared to a \$233,607 increase in 2011. We continue to experience higher depreciation costs from the recent capital acquisitions and lower annualized interest expense as the Medical Center pays down outstanding debt.

We are fortunate to be in our current financial position and to attain the operating results that we have produced. We are focused on being the health care provider of choice in Southeast Kansas and will maintain that focus. We continue to monitor the changing health care landscape which includes the implementation of KanCare by the State of Kansas effective January 1, 2013, which is expected to reduce our reimbursement rates. We are also closely monitoring legislation on a national level which is expected to change how health care is delivered and reimbursed by Medicare. We will adapt to these changes when they occur and will remain focused on providing high-quality health care in the community we serve.

This financial report is designed to provide a general overview of the Medical Center's finances and to discuss the significant changes in our financial statements. If you have any questions about the report or need additional financial information, contact the Administration Office at Neosho Memorial Regional Medical Center, 629 S. Plummer, Chanute, Kansas 66720.



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REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Trustees
Neosho Memorial Regional Medical Center

We have audited the accompanying financial statements of the business-type activity of Neosho Memorial Regional Medical Center, a component unit of Neosho County, Kansas, as of and for the years ended December 31, 2012 and 2011, which collectively comprise the Medical Center's financial statements as listed in the table of contents, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of the business-type activity of Neosho Memorial Regional Medical Center as of December 31, 2012 and 2011, and the changes in net position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other-Matters

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 1 through 5 be presented to supplement the basic financial statements. Such 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. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise Neosho Memorial Regional Medical Center's financial statements as a whole. The supplementary information presented on pages 25 through 29 for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects in relations to the financial statements as a whole.

Wendling Noel Nelson & Johnson LLC

Topeka, Kansas
March 22, 2013

FINANCIAL STATEMENTS

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER

BALANCE SHEETS

December 31,

ASSETS

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|----------------------|
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 9,644,435 | \$ 7,408,783 |
| Assets limited as to use | 465,671 | 466,352 |
| Patient accounts receivable, net of estimated uncollectibles of \$2,069,917 in 2012 and \$1,299,768 in 2011 | 5,436,201 | 4,730,660 |
| Inventories | 1,009,602 | 1,024,214 |
| Prepaid expenses | 427,097 | 330,009 |
| Other | 5,155 | 298,569 |
| Estimated third-party payor settlements | <u>1,346,688</u> | <u>852,242</u> |
| Total current assets | <u>18,334,849</u> | <u>15,110,829</u> |
| ASSETS LIMITED AS TO USE | | |
| Internally designated for capital acquisitions | 5,418,939 | 3,978,909 |
| Under bond indenture agreements - held by trustee | <u>1,883,417</u> | <u>1,884,086</u> |
| | 7,302,356 | 5,862,995 |
| Less amount required to meet current obligations | <u>465,671</u> | <u>466,352</u> |
| | <u>6,836,685</u> | <u>5,396,643</u> |
| CAPITAL ASSETS, NET | <u>27,053,995</u> | <u>27,069,690</u> |
| OTHER ASSETS | | |
| Real estate investments, at cost | 58,363 | 58,363 |
| Deferred financing costs, net | <u>237,878</u> | <u>258,394</u> |
| | <u>296,241</u> | <u>316,757</u> |
| Total assets | <u>\$ 52,521,770</u> | <u>\$ 47,893,919</u> |

The accompanying notes are an integral part of these statements.

LIABILITIES AND NET POSITION

| | <u>2012</u> | <u>2011</u> |
|--|----------------------|----------------------|
| CURRENT LIABILITIES | | |
| Current maturities of long-term debt and capital leases | \$ 739,789 | \$ 570,000 |
| Accounts payable and accrued expenses | 923,502 | 834,976 |
| Construction costs payable | 51,596 | 10,992 |
| Salaries, wages, and payroll taxes payable | 475,481 | 510,238 |
| Accrued vacation pay | 1,410,141 | 1,367,390 |
| Interest payable | 278,833 | 286,303 |
| Estimated third-party payor settlements | <u>690,200</u> | <u>24,111</u> |
| Total current liabilities | 4,569,542 | 3,604,010 |
| LONG-TERM DEBT AND CAPITAL LEASES, net of current maturities | <u>18,220,213</u> | <u>17,021,000</u> |
| Total liabilities | <u>22,789,755</u> | <u>20,625,010</u> |
| NET POSITION | | |
| Invested in capital assets net of related debt | 8,093,993 | 9,478,691 |
| Restricted for debt service | 1,883,417 | 1,884,086 |
| Unrestricted | <u>19,754,605</u> | <u>15,906,132</u> |
| Total net position | <u>29,732,015</u> | <u>27,268,909</u> |
| Total liabilities and net position | <u>\$ 52,521,770</u> | <u>\$ 47,893,919</u> |

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN NET POSITION
Year ended December 31,

| | <u>2012</u> | <u>2011</u> |
|--|----------------------|----------------------|
| Operating revenues | | |
| Net patient service revenue | \$ 40,632,364 | \$ 37,768,128 |
| Other | 893,651 | 784,109 |
| Electronic health records incentive revenue | 750,525 | |
| Total operating revenues | <u>42,276,540</u> | <u>38,552,237</u> |
| Operating expenses | | |
| Salaries and wages | 17,159,760 | 16,152,032 |
| Employee benefits | 3,963,945 | 3,556,399 |
| Supplies and other expenses | 14,722,340 | 13,880,294 |
| Depreciation and amortization | 3,346,252 | 3,197,684 |
| Total operating expenses | <u>39,192,297</u> | <u>36,786,409</u> |
| Operating income | <u>3,084,243</u> | <u>1,765,828</u> |
| Nonoperating revenues (expenses) | | |
| Investment income | 210,452 | 111,794 |
| Interest expense | (886,580) | (897,168) |
| Noncapital grants and contributions | 41,280 | 17,206 |
| Other | | 5,617 |
| Total nonoperating revenues (expenses) | <u>(634,848)</u> | <u>(762,551)</u> |
| Excess of revenues over expenses before capital grants and contributions | 2,449,395 | 1,003,277 |
| Capital grants and contributions | <u>13,711</u> | <u>24,430</u> |
| Increase in net position | 2,463,106 | 1,027,707 |
| Net position beginning of year | <u>27,268,909</u> | <u>26,241,202</u> |
| Net position end of year | <u>\$ 29,732,015</u> | <u>\$ 27,268,909</u> |

The accompanying notes are an integral part of these statements.

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER

STATEMENTS OF CASH FLOWS

Year ended December 31,

| | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| Cash flows from operating activities | | |
| Receipts from and on behalf of patients | \$ 40,098,466 | \$ 38,504,632 |
| Payments to or on behalf of employees | (21,115,711) | (19,489,785) |
| Payments for supplies and services | (14,716,290) | (13,829,296) |
| Other receipts and payments | <u>1,937,590</u> | <u>517,647</u> |
| Net cash provided by operating activities | <u>6,204,055</u> | <u>5,703,198</u> |
| Cash flows from noncapital financing activities | | |
| Noncapital grants and contributions | <u>41,280</u> | <u>17,206</u> |
| Net cash provided by noncapital financing activities | <u>41,280</u> | <u>17,206</u> |
| Cash flows from capital and related financing activities | | |
| Purchase of property and equipment | (3,289,953) | (2,422,888) |
| Proceeds from sale of equipment | | 6,526 |
| Interest paid on capital related debt | (874,413) | (881,351) |
| Capital grants and contributions | 13,711 | 24,430 |
| Capital lease obligation incurred | 2,000,000 | |
| Principal payments on long-term debt obligations | <u>(630,119)</u> | <u>(550,000)</u> |
| Net cash used for capital and related financing activities | <u>(2,780,774)</u> | <u>(3,823,283)</u> |
| Cash flows from investing activities | | |
| Increase in assets limited as to use | (1,439,361) | (1,054,244) |
| Interest received | <u>210,452</u> | <u>109,795</u> |
| Net cash used by investing activities | <u>(1,228,909)</u> | <u>(944,449)</u> |
| Net increase in cash and cash equivalents | 2,235,652 | 952,672 |
| Cash and cash equivalents at beginning of year | <u>7,408,783</u> | <u>6,456,111</u> |
| Cash and cash equivalents at end of year | <u>\$ 9,644,435</u> | <u>\$ 7,408,783</u> |

The accompanying notes are an integral part of these statements.

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER

STATEMENTS OF CASH FLOWS - CONTINUED

Year ended December 31,

| | <u>2012</u> | <u>2011</u> |
|--|---------------------|---------------------|
| Reconciliation of operating income to net cash provided by operating activities | | |
| Operating income | \$ 3,084,243 | \$ 1,765,828 |
| Adjustments to reconcile operating income to net cash provided by operating activities | | |
| Depreciation and amortization | 3,346,252 | 3,197,684 |
| Provision for bad debts | 5,016,604 | 3,604,277 |
| (Increase) decrease in | | |
| Accounts receivable | (5,722,145) | (3,710,389) |
| Estimated third-party payor settlements | 171,643 | 842,616 |
| Inventories | 14,612 | 8,965 |
| Prepaid expenses | (97,088) | (33,447) |
| Other current assets | 293,414 | (266,462) |
| Increase (decrease) in | | |
| Accounts payable and accrued expenses | 88,526 | 75,480 |
| Salaries and payroll taxes payable | (34,757) | 72,692 |
| Accrued vacation | <u>42,751</u> | <u>145,954</u> |
| Net cash provided by operating activities | <u>\$ 6,204,055</u> | <u>\$ 5,703,198</u> |

The accompanying notes are an integral part of these statements.

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER

NOTES TO FINANCIAL STATEMENTS

December 31, 2012 and 2011

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

1. Reporting entity

Neosho Memorial Regional Medical Center is owned by Neosho County, Kansas, and operated by the Board of Trustees of Neosho Memorial Regional Medical Center, a seven-member governing board appointed by the governing body of the County. The Medical Center, which was organized in 1950, is a not-for-profit general hospital located in Chanute, Kansas. The Medical Center can sue and be sued, and can buy, sell, or lease real property. Bond issuances must be approved by the County. The Medical Center is a component unit of the County.

The Medical Center has entered into a management agreement with Quorum Health Resources (QHR) for the operation of the Medical Center. Under the agreement, QHR agrees to manage the daily operations of the Medical Center and to provide the Medical Center with the services of a chief executive officer and a chief financial officer, both of which are employed by QHR. The Medical Center's Board of Trustees retains all authority over the business, policies, operations, and assets of the Medical Center.

2. Use of estimates

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

3. Basis of accounting

The Medical Center uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

4. Cash and cash equivalents

Cash and cash equivalents include all cash and short-term investments, excluding any such amounts included in assets limited as to use.

5. Allowance for doubtful accounts

The Medical Center provides for accounts receivable that could become uncollectible in the future by establishing an allowance to reduce the carrying value of such receivables to their estimated net realizable value. The Medical Center estimates this allowance based on the aging of its accounts receivable and applying specific reserve factors for each type of payor.

6. Inventories

Inventories are stated at the lower of cost or market with cost determined on the first-in, first-out method.

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

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

7. Assets limited as to use

Assets limited as to use include assets set aside by the Board of Trustees for future capital improvements over which the Board retains control and may, at its discretion, subsequently use for other purposes, and assets held by a trustee under a bond indenture agreement.

8. Capital assets

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

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

9. Cost of borrowing

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

10. Investments and investment income

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

11. Accrued vacation pay

The Medical Center employees earn paid time off at varying rates depending on years of service. Paid time off benefits vest to the employee and are paid at the time of termination.

12. Net position

The net position of the Medical Center is classified in three components. "Net position invested in capital assets net of related debt" consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

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

construction of those assets. "Restricted net position" is noncapital related assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center, including amounts deposited with trustees as required by revenue bond indentures. "Unrestricted net position" is the remaining net position that does not meet the definition of "invested in capital assets net of related debt" or "restricted."

13. Operating revenues and expenses

The Medical Center's statement of revenues, expenses, and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, the Medical Center's principal activity. Nonexchange revenues, including grants and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

14. Grants and contributions

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

15. Charity care

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The amount of charity care charges foregone and the estimated cost of providing this care is disclosed in Note C.

16. Income taxes

The Medical Center is exempt from federal income taxes pursuant to Section 115 of the Internal Revenue Code.

17. Reclassifications

Certain reclassifications have been made to the 2011 financial statements to conform with the current year's presentation. These reclassifications did not affect previously reported net position or the increase in net position.

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE B - CAPITAL ASSETS

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

| | Balance December 31, 2011 | Transfers and additions | Retirements | Balance December 31, 2012 |
|--|---------------------------------|-------------------------------|--------------|---------------------------------|
| Land | \$ 286,612 | \$ - | \$ - | \$ 286,612 |
| Land improvements | 1,558,117 | | | 1,558,117 |
| Buildings | 16,744,203 | 845,529 | | 17,589,732 |
| Fixed equipment | 18,148,860 | 66,517 | | 18,215,377 |
| Major movable equipment | 13,758,572 | 3,167,227 | 8,400 | 16,917,399 |
| Totals at historical cost | <u>50,496,364</u> | <u>4,079,273</u> | <u>8,400</u> | <u>54,567,237</u> |
| Less accumulated depreciation and amortization | <u>24,565,963</u> | <u>3,346,252</u> | <u>8,400</u> | <u>27,903,815</u> |
| | 25,930,401 | 733,021 | - | 26,663,422 |
| Projects in progress and minor equipment | <u>1,139,289</u> | <u>(748,716)</u> | | <u>390,573</u> |
| Capital assets, net | <u>\$ 27,069,690</u> | <u>\$ (15,695)</u> | <u>\$ -</u> | <u>\$ 27,053,995</u> |

| | Balance December 31, 2010 | Transfers and additions | Retirements | Balance December 31, 2011 |
|--|---------------------------------|-------------------------------|---------------|---------------------------------|
| Land | \$ 277,954 | \$ 8,658 | \$ - | \$ 286,612 |
| Land improvements | 1,558,117 | | | 1,558,117 |
| Buildings | 14,136,378 | 2,607,825 | | 16,744,203 |
| Fixed equipment | 17,523,294 | 625,566 | | 18,148,860 |
| Major movable equipment | 12,747,257 | 1,027,035 | 15,720 | 13,758,572 |
| Totals at historical cost | <u>46,243,000</u> | <u>4,269,084</u> | <u>15,720</u> | <u>50,496,364</u> |
| Less accumulated depreciation and amortization | <u>21,383,090</u> | <u>3,197,684</u> | <u>14,811</u> | <u>24,565,963</u> |
| | 24,859,910 | 1,071,400 | 909 | 25,930,401 |
| Projects in progress and minor equipment | <u>3,035,251</u> | <u>(1,895,962)</u> | | <u>1,139,289</u> |
| Capital assets, net | <u>\$ 27,895,161</u> | <u>\$ (824,562)</u> | <u>\$ 909</u> | <u>\$ 27,069,690</u> |

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE C - REIMBURSEMENT PROGRAMS

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

Medicare - The Medical Center is a critical access hospital for purposes of the Medicare program and is paid for most services rendered to Medicare beneficiaries under various cost reimbursement methodologies. Ambulance and physician services are prospectively paid based on their respective fee schedules. The Medical Center is paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Medical Center and audits or reviews thereof by the Medicare administrative contractor. The Medical Center's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Medical Center's Medicare cost reports have been audited or reviewed by the Medicare administrative contractor through December 31, 2010.

Medicaid - Acute care services rendered to Medicaid beneficiaries, other than those covered by managed care plans, are paid under provisions applicable to critical access hospitals. Payments to the Medical Center under the critical access hospital provisions are based on cost reimbursement methodologies used by the Medicare program. Final settlement is determined after submission of annual cost reports and reviews thereof by the Kansas Department of Health and Environment.

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

A summary of gross and net patient service revenue is as follows:

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|----------------------|
| Gross patient service revenue | \$100,959,623 | \$ 90,982,833 |
| Deductions from patient service revenue | | |
| Third-party contractual adjustments | (54,819,578) | (47,825,573) |
| Medicaid DSH payments | 1,000,907 | 867,909 |
| Other discounts and allowances | (433,784) | (376,338) |
| Charity care | (1,058,202) | (2,276,424) |
| Provision for bad debts | <u>(5,016,604)</u> | <u>(3,604,277)</u> |
| Net patient service revenue | <u>\$ 40,632,362</u> | <u>\$ 37,768,130</u> |

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE C - REIMBURSEMENT PROGRAMS - Continued

The Medical Center estimates that the cost of providing charity care, based on overall cost to charge ratios obtained from the Hospital's cost reports was \$397,331 and \$899,984 for 2012 and 2011, respectively.

Revenue from the Medicare and Medicaid programs accounted for approximately 44 percent and 6 percent, respectively, of the Medical Center's net patient service revenue during 2012 and 44 percent and 7 percent, respectively, of the Medical Center's net patient service revenue during 2011. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term.

NOTE D - ASSETS LIMITED AS TO USE

Internally designated

The Medical Center's Board of Trustees has designated certain investments to be used for future capital improvements. These assets may be used for other purposes by action of the Board of Trustees. These assets consist of the following:

| | <u>2012</u> | <u>2011</u> |
|---------------------------|---------------------|---------------------|
| Interest bearing checking | <u>\$ 5,418,939</u> | <u>\$ 3,978,909</u> |

Under bond indenture agreement - held by trustee

Assets limited as to use by a bond indenture agreement are held by a trustee and are invested in cash or money market funds and are stated at fair value. These assets relate to the 2006 revenue bond issues (Note E) and are set aside for the following:

| | <u>2012</u> | <u>2011</u> |
|--------------------------------------|---------------------|---------------------|
| Principal and interest sinking funds | \$ 465,671 | \$ 466,351 |
| Bond reserve account | <u>1,417,746</u> | <u>1,417,735</u> |
| | <u>\$ 1,883,417</u> | <u>\$ 1,884,086</u> |

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE E - LONG-TERM DEBT AND CAPITAL LEASES

Long-term debt and capital lease obligations are summarized as follows:

| | Outstanding balance | |
|---|----------------------|----------------------|
| | <u>2012</u> | <u>2011</u> |
| 5.05% - 5.15% Neosho County, Kansas Hospital Refunding Revenue Bonds, Series 2006 A (Neosho Memorial Regional Medical Center); issued on September 1, 2006, in the original amount of \$10,000,000 term bonds due September 1, 2026 and September 1, 2031, with mandatory annual redemptions beginning September 1, 2023 | \$ 10,000,000 | \$ 10,000,000 |
| 4.10% - 5% Neosho County, Kansas Hospital Revenue Bonds, Series 2006 B (Neosho Memorial Regional Medical Center); issued on September 1, 2006, in the original amount of \$10,000,000 term bonds due serially through September 1, 2018, and term bonds due September 1, 2022, with mandatory annual redemptions beginning September 1, 2019 | 7,010,000 | 7,550,000 |
| Capital lease obligation, interest rate of 2.15%, paid off in 2012 | | 30,000 |
| Capital lease obligation interest rate of 2.50%, due in monthly payments of \$18,855 through August 2022, collater- alized by leased equipment with an amortized cost of \$1,336,330 at December 31, 2012 | <u>1,939,881</u> | |
| | 18,949,881 | 17,580,000 |
| Unamortized bond premium | <u>10,121</u> | <u>11,000</u> |
| | 18,960,002 | 17,591,000 |
| Less current maturities | <u>(739,789)</u> | <u>(570,000)</u> |
| Long-term obligations net of current portion | <u>\$ 18,220,213</u> | <u>\$ 17,021,000</u> |

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE E - LONG-TERM DEBT AND CAPITAL LEASES - Continued

The following is a summary of changes in long-term debt and capital lease obligations:

| | <u>Capital lease obligations</u> | <u>Hospital revenue bonds</u> | <u>Total long-term obligations</u> |
|----------------------------------|--|---------------------------------------|--|
| Outstanding at January 1, 2011 | \$ 60,000 | \$ 18,070,000 | \$ 18,130,000 |
| Principal payments | <u>(30,000)</u> | <u>(520,000)</u> | <u>(550,000)</u> |
| Outstanding at December 31, 2011 | 30,000 | 17,550,000 | 17,580,000 |
| Additions | 2,000,000 | | 2,000,000 |
| Principal payments | <u>(90,119)</u> | <u>(540,000)</u> | <u>(630,119)</u> |
| Outstanding at December 31, 2012 | <u>\$ 1,939,881</u> | <u>\$ 17,010,000</u> | <u>\$ 18,949,881</u> |

On September 1, 2006, the County issued \$20,000,000 in Hospital Revenue Bonds, Series 2006 A and B. The net proceeds of the 2006 Series A bonds, along with other available funds of the Medical Center, were used to refund the \$10,000,000 of Series 2005 Hospital Revenue Bonds issued in December 2005. The net proceeds of the 2006 Series B bonds, along with the net proceeds of the Series 2005 bonds were used to fund the renovation and addition to the current hospital building.

Under the terms of the 2006 bond indenture, the Medical Center is required to maintain certain deposits with a trustee. Such deposits are for the repayment of principal and interest as they come due as well as for the maintenance of required bond reserve accounts. These amounts are included with assets limited as to use in the financial statements. The indenture agreement also includes certain restrictive covenants relating to the acquisition and disposition of property, incurrence of additional indebtedness, and level of fees and rates charged.

Scheduled annual debt service requirements for the Hospital Revenue Bonds are as follows:

| | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|--------------|----------------------|---------------------|----------------------|
| 2013 | \$ 560,000 | \$ 836,500 | \$ 1,396,500 |
| 2014 | 590,000 | 812,980 | 1,402,980 |
| 2015 | 620,000 | 787,905 | 1,407,905 |
| 2016 | 650,000 | 761,245 | 1,411,245 |
| 2017 | 680,000 | 732,970 | 1,412,970 |
| 2018 to 2022 | 3,910,000 | 3,156,700 | 7,066,700 |
| 2023 to 2027 | 5,000,000 | 2,075,750 | 7,075,750 |
| 2028 to 2031 | <u>5,000,000</u> | <u>659,715</u> | <u>5,659,715</u> |
| | <u>\$ 17,010,000</u> | <u>\$ 9,823,765</u> | <u>\$ 26,833,765</u> |

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE E - LONG-TERM DEBT AND CAPITAL LEASES - Continued

The Medical Center has also entered into an agreement to finance the renovation of space and the installation of an MRI in 2012. The transaction is structured as a capital lease and is for a lease term of ten years.

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

| | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|---|---------------------|-------------------|---------------------|
| 2013 | \$ 179,789 | \$ 46,474 | \$ 226,263 |
| 2014 | 184,336 | 41,927 | 226,263 |
| 2015 | 188,997 | 37,265 | 226,262 |
| 2016 | 193,682 | 32,581 | 226,263 |
| 2017 | 198,675 | 27,588 | 226,263 |
| 2018 to 2022 | <u>994,402</u> | <u>60,264</u> | <u>1,054,666</u> |
| Total minimum lease payments | <u>\$ 1,939,881</u> | <u>\$ 246,099</u> | 2,185,980 |
| Less amounts representing interest | | | <u>246,099</u> |
| Present value of net minimum lease payments | | | <u>\$ 1,939,881</u> |

Total interest costs are summarized as follows:

| | <u>2012</u> | <u>2011</u> |
|---|-------------------|-------------------|
| Total interest incurred | \$ 866,943 | \$ 874,244 |
| Amortization of bond premium and deferred financing costs | <u>19,637</u> | <u>22,924</u> |
| | <u>\$ 886,580</u> | <u>\$ 897,168</u> |

Rental expense under operating leases totaled \$433,127 in 2012 and \$460,131 in 2011.

NOTE F - RELATED PARTY TRANSACTIONS

The Medical Center contracts for management services, services of certain management personnel, and other services with QHR. Under the agreement, QHR is responsible for daily management and administration of the Medical Center, with ultimate control over the assets and operations of the Medical Center retained by the Medical Center's board. Amounts paid to QHR during 2012 and 2011, for management services were \$270,394 and \$258,222, respectively. The Medical Center also reimbursed QHR for salaries, employee benefits, and expenses of the chief executive officer and the chief financial officer (Note A1).

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE F - RELATED PARTY TRANSACTIONS - Continued

The Neosho Memorial Regional Medical Center Foundation, Inc., provides support to the Medical Center. During the year ended December 31, 2012 and 2011, the Foundation transferred \$12,299 and \$23,930, respectively, to the Medical Center for the purchase of equipment. Beginning in 2010, the Medical Center has agreed to temporarily fund the costs of a Foundation director.

The Foundation's total assets are approximately \$630,000 as of December 31, 2012. Management considers the Foundation's net position not to be significant in relation to the Medical Center.

The County provides annual support to the Medical Center for the operation of the ambulance department. The County transferred \$81,000 in 2012 and \$66,007 in 2011 to the Medical Center for ambulance operations. The County also occasionally acquires ambulances to replace aging vehicles in the Medical Center's fleet. No ambulances were purchased in 2012 or 2011.

NOTE G - RETIREMENT PLAN

The Medical Center sponsors a defined contribution plan (Plan) as authorized by Kansas statutes. A defined contribution pension plan provides pension benefits in return for services rendered, provides an individual account for each participant, and specifies how contributions to the individual's account are to be determined instead of specifying the amount of benefits the individual is to receive. Under a defined contribution pension plan, the benefits a participant will receive depend solely on the amount contributed to the participant's account, the returns earned on investments of those contributions, and forfeitures of other participants' benefits that may be allocated to such participant's account.

The Plan covers substantially all employees of the Medical Center. Employees are eligible immediately to make contributions to the Plan. To become eligible for contributions made by the Medical Center, the employee must have a year of service, defined as 1,000 hours. Contributions made by the employees vest immediately and contributions made by the Medical Center vest over six years. An employee who leaves the employment of the Medical Center is paid subject to the terms of the individual annuity contract. An employee who retires must begin receiving benefits no later than April 1st of the calendar year following the year in which the participant attains age 70 1/2.

The Medical Center provides for a discretionary match to be determined every year by the Medical Center's Board of Trustees. For the years ended December 31, 2012 and 2011, the Medical Center matched 100 percent of each eligible employee's contribution up to 5 1/2 percent of the participant's compensation. Forfeitures are used to reduce future employer contributions.

The payroll for employees covered by the Plan for the years ended December 31, 2012 and 2011, was \$11,933,496 and \$11,032,486, respectively. The total payroll was \$17,159,760 in 2012 and \$16,152,032 in 2011. Total contributions to the Plan in 2012 were \$1,302,890 which consisted of \$742,885 of employee contributions and \$560,005 of employer matching contributions. Total contributions to the Plan in 2011 were \$1,222,750 which consisted of \$699,543 of employee contributions and \$523,207 of employer matching contributions.

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE G - RETIREMENT PLAN - Continued

No pension provision changes occurred during the year that affected the required contributions to be made by the Medical Center or its employees. The Plan held no securities of the Medical Center or other related parties during the year or as of the close of the year.

Total employer contributions in 2012 and 2011 were 4.7 percent of covered payroll, respectively. Total employee contributions in 2012 were 6.2 percent of covered payroll and in 2011 were 6.3 percent of covered payroll.

NOTE H - DEPOSITS AND INVESTMENTS WITH FINANCIAL INSTITUTIONS

Kansas statutes authorize the Medical Center with certain restrictions, to deposit or invest in open accounts, time deposits, certificates of deposit, repurchase agreements, U.S. Treasury bills and notes, and the State Treasurer's investment pool. Also, statutes require that financial institutions pledge securities with a market value equal to total deposits in excess of F.D.I.C. coverage at any given time and the securities pledged be deposited with a Kansas state or national bank or trust company, the Federal Reserve Bank, or the Federal Home Loan Bank.

The carrying amount of the Medical Center's deposits with financial institutions was \$15,060,130 and the bank balance was \$15,470,257 at December 31, 2012. The bank deposits are categorized as follows at December 31, 2012:

| | |
|--|----------------------|
| Amount insured by the F.D.I.C., or collateralized with securities held by the Medical Center in its name | \$ 1,250,000 |
| Uncollateralized (collateralized with securities held in safekeeping under joint custody receipt by an authorized depository other than the pledging financial institution's trust department, but not in the Medical Center's name) | <u>14,220,257</u> |
| | <u>\$ 15,470,257</u> |

NOTE I - COMMITMENTS AND CONTINGENCIES

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

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2012 and 2011

NOTE J - CONCENTRATION OF CREDIT RISK

The Medical Center is located in Chanute, Kansas. The Medical Center grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors is as follows:

| | <u>2012</u> | <u>2011</u> |
|-----------------------|-------------|-------------|
| Medicare | 35% | 36% |
| Medicaid | 7 | 7 |
| Blue Cross | 16 | 15 |
| Commercial insurance | 22 | 21 |
| Workers' compensation | 2 | 1 |
| Self-pay | <u>18</u> | <u>20</u> |
| | <u>100%</u> | <u>100%</u> |

NOTE K - MEDICAL MALPRACTICE INSURANCE

The Medical Center is insured for professional liability under a comprehensive hospital liability policy provided by an independent insurance carrier with limits of \$200,000 per occurrence up to an annual aggregate of \$600,000 for all claims made during the policy year. The Medical Center is further covered by the Kansas Health Care Stabilization Fund for claims in excess of its comprehensive hospital liability policy up to \$800,000 pursuant to any one judgment or settlement against the Medical Center for any one party, subject to an aggregate limitation for all judgments or settlements arising from all claims made in the policy year in the amount of \$2,400,000. The policy provided by the independent insurance carrier provides for umbrella liability in excess of the underlying limits set forth above in the amount of \$5,000,000 per occurrence with an aggregate amount in any policy year of \$5,000,000. All coverage is on a claims-made basis. The above policies were renewed on January 1, 2013, for the policy period from January 1, 2013 to January 1, 2014. Management believes that any claims asserted for incidents occurring through December 31, 2012, would be settled within the limits of insurance coverage.

NOTE L - SUBSEQUENT EVENTS

Management has evaluated all subsequent events through the date of the independent accountants' report, which is the date the financial statements were available to be issued.

SUPPLEMENTARY INFORMATION

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER

ACCOUNTS RECEIVABLE

Year ended December 31,

Aging of accounts receivable, based on date of discharge, is as follows:

| Aging | Amounts | | Percent | |
|--|---------------------|---------------------|---------------|---------------|
| | 2012 | 2011 | 2012 | 2011 |
| Current | \$ 7,773,064 | \$ 6,746,523 | 56.6% | 61.2% |
| 31 to 60 days | 2,341,937 | 2,179,388 | 17.1 | 19.8 |
| 61 to 120 days | 1,999,828 | 1,599,722 | 14.6 | 14.5 |
| Over 120 days | <u>1,608,321</u> | <u>493,748</u> | <u>11.7</u> | <u>4.5</u> |
| | 13,723,150 | 11,019,381 | <u>100.0%</u> | <u>100.0%</u> |
| Less allowance for contractual adjustments | (6,217,032) | (4,988,953) | | |
| Less allowance for uncollectible accounts | <u>(2,069,917)</u> | <u>(1,299,768)</u> | | |
| | <u>\$ 5,436,201</u> | <u>\$ 4,730,660</u> | | |

Changes in the allowance for uncollectible accounts are as follows:

| | 2012 | 2011 |
|--|---------------------|---------------------|
| Balance at beginning of year | \$ 1,299,768 | \$ 1,558,303 |
| Provisions for bad debts | 5,016,604 | 3,604,277 |
| Collections of accounts previously charged off | <u>2,001,695</u> | <u>1,674,728</u> |
| | 8,318,067 | 6,837,308 |
| Accounts charged off | <u>(6,248,150)</u> | <u>(5,537,540)</u> |
| Balance at end of year | <u>\$ 2,069,917</u> | <u>\$ 1,299,768</u> |

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER

PATIENT SERVICE REVENUE

Year ended December 31,

| | 2012 | | 2011 | |
|--|-------------------------------|---|-------------------------------|---|
| | Patient service revenue | % of gross patient service revenue | Patient service revenue | % of gross patient service revenue |
| Inpatient services | | | | |
| Daily patient care | | | | |
| Acute care | \$ 8,583,675 | 8.5 | \$ 7,929,786 | 8.7 |
| Skilled nursing care | 1,212,978 | 1.2 | 1,070,588 | 1.2 |
| Intensive care | 2,131,244 | 2.1 | 1,413,217 | 1.6 |
| Nursery | 710,600 | 0.7 | 615,614 | 0.7 |
| Operating room | 1,498,657 | 1.5 | 1,398,682 | 1.5 |
| Recovery | 249,115 | 0.2 | 240,330 | 0.3 |
| Delivery and labor room | 672,898 | 0.7 | 849,996 | 0.9 |
| Medical and surgical supplies | 1,527,251 | 1.5 | 1,890,153 | 2.1 |
| Emergency | 441,761 | 0.4 | 756,678 | 0.8 |
| Laboratory | 4,485,014 | 4.4 | 4,950,716 | 5.4 |
| Electrocardiology | 120,319 | 0.1 | 125,750 | 0.1 |
| Radiology, nuclear medicine, ultrasound, CT, and MRI | 1,918,762 | 1.9 | 2,068,571 | 2.3 |
| Pharmacy | 3,849,051 | 3.8 | 3,443,910 | 3.8 |
| Anesthesiology | 35,550 | | 37,100 | |
| Respiratory therapy | 2,424,751 | 2.4 | 2,200,330 | 2.4 |
| Physical therapy | 379,436 | 0.4 | 326,693 | 0.4 |
| Electroencephalography | 1,568 | | 713 | |
| Speech therapy | 108,450 | 0.1 | 91,954 | 0.1 |
| Cardiac rehabilitation | 2,244 | | 6,819 | |
| | <u>30,353,324</u> | <u>29.9</u> | <u>29,417,600</u> | <u>32.3</u> |

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER

PATIENT SERVICE REVENUE - CONTINUED

Year ended December 31,

| | 2012 | | 2011 | |
|--|-------------------------------|---|-------------------------------|---|
| | Patient service revenue | % of gross patient service revenue | Patient service revenue | % of gross patient service revenue |
| Outpatient services | | | | |
| Observation and infusion | \$ 4,596,408 | 4.6 | \$ 3,780,595 | 4.3 |
| Operating room | 6,833,071 | 6.8 | 5,407,100 | 5.9 |
| Recovery room | 2,040,788 | 2.0 | 1,766,505 | 1.9 |
| Delivery and labor room | 452,881 | 0.4 | 375,961 | 0.4 |
| Medical and surgical supplies | 3,801,308 | 3.8 | 4,136,959 | 4.5 |
| Emergency | 9,146,926 | 9.2 | 8,700,551 | 9.7 |
| Laboratory | 10,007,641 | 9.9 | 8,531,782 | 9.4 |
| Electrocardiology | 528,155 | 0.5 | 442,240 | 0.5 |
| Radiology, nuclear medicine, ultrasound, CT, and MRI | 17,655,122 | 17.5 | 15,672,600 | 17.2 |
| Pharmacy | 4,313,890 | 4.3 | 3,302,825 | 3.6 |
| Anesthesiology | 123,699 | 0.1 | 101,423 | 0.1 |
| Respiratory therapy | 749,161 | 0.7 | 724,407 | 0.8 |
| Physical therapy | 2,085,447 | 2.1 | 1,858,865 | 2.0 |
| Electroencephalography | 829,909 | 0.8 | 678,809 | 0.7 |
| Speech therapy | 1,296,717 | 1.3 | 1,050,477 | 1.2 |
| Cardiac rehabilitation | 441,788 | 0.4 | 396,293 | 0.4 |
| Home health and hospice | 824,773 | 0.8 | 803,453 | 0.9 |
| Ambulance | 2,101,073 | 2.1 | 1,866,769 | 2.1 |
| Social services | 15,804 | | 11,727 | |
| Womens clinic | 2,117,741 | 2.1 | 1,844,377 | 2.0 |
| Specialty clinic | 69,530 | 0.1 | 11,116 | |
| Orthopedic clinic | 574,467 | 0.6 | 100,399 | 0.1 |
| | <u>70,606,299</u> | <u>70.1</u> | <u>61,565,233</u> | <u>67.7</u> |
| Gross patient service revenue | 100,959,623 | 100.0 | 90,982,833 | 100.0 |
| Deductions from patient service revenue | | | | |
| Contractual adjustments | (54,819,576) | 54.3 | (47,825,575) | 52.6 |
| Medicaid DSH payments | 1,000,907 | (1.0) | 867,909 | (1.0) |
| Charity and other discounts | (1,491,986) | 1.5 | (2,652,762) | 2.9 |
| Provision for bad debts | (5,016,604) | 5.0 | (3,604,277) | 4.0 |
| Net patient service revenue | <u>\$ 40,632,364</u> | <u>40.2</u> | <u>\$ 37,768,128</u> | <u>41.5</u> |

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
OPERATING EXPENSES BY FUNCTIONAL DIVISION
Year ended December 31,

| | 2012 | | | 2011 | | |
|---|--------------------------------|-----------------------------|-------------------|--------------------------------|-----------------------------|-------------------|
| | Salaries and other wages | Supplies and expenses | Total | Salaries and other wages | Supplies and expenses | Total |
| Routine services | | | | | | |
| Nursing administration | \$ 995,633 | \$ 101,074 | \$ 1,096,707 | \$ 972,872 | \$ 71,507 | \$ 1,044,379 |
| Acute care and nursery | 2,630,018 | 427,277 | 3,057,295 | 2,565,948 | 389,578 | 2,955,526 |
| Intensive care | 691,600 | 78,736 | 770,336 | 689,224 | 63,130 | 752,354 |
| | <u>4,317,251</u> | <u>607,087</u> | <u>4,924,338</u> | <u>4,228,044</u> | <u>524,215</u> | <u>4,752,259</u> |
| Ancillary services | | | | | | |
| Observation | 736,541 | 97,631 | 834,172 | 669,887 | 76,468 | 746,355 |
| Operating and recovery room | 626,272 | 846,850 | 1,473,122 | 579,927 | 874,069 | 1,453,996 |
| Central sterile | 42,352 | 99,553 | 141,905 | 40,892 | 89,122 | 130,014 |
| Delivery and labor | | 3,572 | 3,572 | | 4,015 | 4,015 |
| Medical and surgical supplies | 103,482 | 1,622,758 | 1,726,240 | 104,424 | 1,788,321 | 1,892,745 |
| Emergency | 2,002,078 | 286,999 | 2,289,077 | 1,790,806 | 322,252 | 2,113,058 |
| Laboratory | 749,510 | 886,557 | 1,636,067 | 725,567 | 855,782 | 1,581,349 |
| Electrocardiology | 4,126 | 652 | 4,778 | 6,983 | 929 | 7,912 |
| Radiology, nuclear medicine, ultrasound, CT, and MRI | 1,046,519 | 817,299 | 1,863,818 | 1,001,969 | 848,517 | 1,850,486 |
| Pharmacy | | 1,975,714 | 1,975,714 | | 1,794,670 | 1,794,670 |
| Anesthesiology | | 171,283 | 171,283 | | 138,942 | 138,942 |
| Respiratory therapy | 457,280 | 91,891 | 549,171 | 443,335 | 85,342 | 528,677 |
| Physical therapy | | 1,179,848 | 1,179,848 | | 1,029,508 | 1,029,508 |
| Electroencephalography | 23,202 | 37,789 | 60,991 | 21,496 | 48,386 | 69,882 |
| Speech therapy | 260,164 | 105,817 | 365,981 | 216,841 | 90,847 | 307,688 |
| Cardiac rehabilitation | 54,573 | 10,042 | 64,615 | 37,817 | 8,709 | 46,526 |
| Home health and hospice | 408,913 | 136,917 | 545,830 | 393,986 | 135,334 | 529,320 |
| Lifeline | | 12,303 | 12,303 | | 44,402 | 44,402 |
| Ambulance | 648,876 | 148,286 | 797,162 | 618,283 | 72,541 | 690,824 |
| Social service | | 11,085 | 11,085 | | 6,133 | 6,133 |
| Specialty clinic | 123,121 | 3,323 | 126,444 | 117,607 | 5,215 | 122,822 |
| Womens clinic | 899,369 | 146,733 | 1,046,102 | 888,684 | 163,362 | 1,052,046 |
| Orthopedic clinic | 199,944 | 82,608 | 282,552 | 76,430 | 49,873 | 126,303 |
| | <u>8,386,322</u> | <u>8,775,510</u> | <u>17,161,832</u> | <u>7,734,934</u> | <u>8,532,739</u> | <u>16,267,673</u> |

NEOSHO MEMORIAL REGIONAL MEDICAL CENTER
OPERATING EXPENSES BY FUNCTIONAL DIVISION - CONTINUED
Year ended December 31,

| | 2012 | | | 2011 | | |
|---------------------------------|--------------------------------|-----------------------------|----------------------|--------------------------------|-----------------------------|----------------------|
| | Salaries and other wages | Supplies and expenses | Total | Salaries and other wages | Supplies and expenses | Total |
| General services | | | | | | |
| Administrative and general | | | | | | |
| Administration | \$ 732,971 | \$ 632,462 | \$ 1,365,433 | \$ 756,356 | \$ 624,783 | \$ 1,381,139 |
| Business office | 318,184 | 524,771 | 842,955 | 286,382 | 367,530 | 653,912 |
| Communications | 141,290 | 216,915 | 358,205 | 149,555 | 200,842 | 350,397 |
| Data processing | 340,258 | 771,060 | 1,111,318 | 293,086 | 687,111 | 980,197 |
| Accounting | 192,252 | 104,555 | 296,807 | 230,077 | 107,663 | 337,740 |
| Patient transportation | 67,063 | 16,928 | 83,991 | 64,869 | 17,761 | 82,630 |
| Insurance | | 249,448 | 249,448 | | 223,200 | 223,200 |
| Admissions and switchboard | 359,532 | 47,310 | 406,842 | 359,375 | 49,764 | 409,139 |
| Printing | 27,975 | 13,568 | 41,543 | 27,176 | 15,564 | 42,740 |
| Resident House | | 7,868 | 7,868 | | 8,964 | 8,964 |
| Employee health and welfare | 361,886 | 4,059,489 | 4,421,375 | 346,952 | 3,638,544 | 3,985,496 |
| Dietary | 362,017 | 649,099 | 1,011,116 | 356,913 | 605,397 | 962,310 |
| Plant operation and maintenance | 309,349 | 1,279,969 | 1,589,318 | 285,930 | 1,195,217 | 1,481,147 |
| Rehab and fitness center | | 31,371 | 31,371 | | 29,450 | 29,450 |
| Purchasing | 124,749 | 3,647 | 128,396 | 110,722 | 14,951 | 125,673 |
| Housekeeping | 332,385 | 154,825 | 487,210 | 312,137 | 154,605 | 466,742 |
| Laundry and linen | | 220,905 | 220,905 | | 211,955 | 211,955 |
| Medical records | 447,654 | 256,122 | 703,776 | 401,184 | 183,281 | 584,465 |
| Continuing education | 338,622 | 39,524 | 378,146 | 208,340 | 43,157 | 251,497 |
| Gift shop | | 23,852 | 23,852 | | | |
| | <u>4,456,187</u> | <u>9,303,688</u> | <u>13,759,875</u> | <u>4,189,054</u> | <u>8,379,739</u> | <u>12,568,793</u> |
| Depreciation and amortization | - | 3,346,252 | 3,346,252 | - | 3,197,684 | 3,197,684 |
| | <u>\$ 17,159,760</u> | <u>\$ 22,032,537</u> | <u>\$ 39,192,297</u> | <u>\$ 16,152,032</u> | <u>\$ 20,634,377</u> | <u>\$ 36,786,409</u> |