WASHINGTON COUNTY HOSPITAL

FINANCIAL STATEMENTS

and

ADDITIONAL INFORMATION

with

INDEPENDENT AUDITOR'S REPORT

YEARS ENDED DECEMBER 31, 2012 AND 2011

George, Bowerman & Noel, P.A.
Certified Public Accountants

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Washington County Hospital
Washington, Kansas

We have audited the financial statements of Washington County Hospital, as listed in the table of contents, at and for the years ended December 31, 2012 and 2011.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the provisions of the Kansas Municipal Audit and Accounting Guide. Those standards require that we plan and perform the audits 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 Washington County Hospital as of December 31, 2012 and 2011, and the changes in financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Additional Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 7 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 basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were made for the purpose of forming opinions on the basic financial statements taken as a whole. The additional information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to the prepare the basic 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 additional information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

George, Bowman & Nael, P.A.

Wichita, Kansas
July 25, 2013

WASHINGTON COUNTY HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of Washington County Hospital's (Hospital's) financial performance provides an overview of the Hospital's financial activities for the fiscal years ended December 31, 2012 and 2011. Please read it in conjunction with the Hospital's financial statements, which begin on page 8.

Financial Highlights

- The Hospital's net position decreased by $46,727 or 2.91 percent in 2012 and decreased by $216,099 or 11.86 percent in 2011.

- Other operating revenue increased in 2012 by $327,235 over the amount for 2011. This was primarily due to the accrual of approximately $324,000 of revenue for the Medicare electronic health record incentive program in 2012 as discussed in Note 2 to the financial statements.

- Contractual allowances and bad debts reduced gross patient service revenue by $1,176,258 or 24.46 percent of gross patient service revenue in 2012 and by $970,873 or 21.67 percent of gross patient service revenue in 2011.

- The Hospital reported operating losses in both 2012 ($298,247) and 2011 ($481,464).

- Net nonoperating revenues and expenses decreased by $7,050 in 2012 and increased by $25,810 in 2011. The net decrease in 2012 was due primarily to a decrease in grants and contributions. The net increase in 2011 was due primarily to an increase of grants and contributions.

Financial Statements

The Hospital's financial statements are prepared using proprietary fund accounting that focuses on the determination of changes in net assets, financial position and cash flows in a manner similar to private-sector businesses. The financial statements are prepared on an accrual basis of accounting which recognizes revenue when earned and expenses when incurred. The basic financial statements include a *balance sheet*, *statement of revenue, expenses and changes in net position*, and *statement of cash flows*, followed by notes to the financial statements and schedules of certain additional information.

The *balance sheet* presents information on the Hospital's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may indicate whether the financial position of the Hospital is improving or deteriorating.

The *statement of revenues, expenses and changes in net position* presents both the operating revenues and expenses and nonoperating revenues and expenses along with other changes in net position for the year. This statement is an indication of the success of the Hospital's operations over the past year.

The *statement of cash flows* presents the change in cash and cash equivalents for the year resulting from operating activities, capital and related financing activities and investing activities. The primary purpose of this statement is to provide information about the Hospital's cash receipts and cash payments during the year.

Financial Position

The Hospital's net position is the difference between its assets, liabilities, and deferred inflows reported in the Balance Sheets on pages 8 and 9. The Hospital's net position decreased in each of the past three years as indicated in the following table.

	December 31,		
	2012	2011	2010
Assets:			
Current assets	$ 1,719,838	$ 1,320,022	$ 1,470,669
Capital assets, net	735,906	766,675	908,156
Other noncurrent assets	351,617	559,963	566,650
Total assets	$ 2,807,361	$ 2,646,660	$ 2,945,475
Liabilities:			
Long-term liabilities	$ 115,946	$ 215,699	$ 318,483
Current liabilities	733,044	473,208	494,789
Total liabilities	$ 848,990	$ 688,907	$ 813,272
Deferred inflows of resources:			
Deferred contributions for building project	$ 399,421	$ 352,076	$ 310,427
Net position:			
Invested in capital assets, net	$ 522,715	$ 356,285	$ 422,348
Unrestricted	1,036,235	1,249,392	1,399,428
Total net position	$ 1,558,950	$ 1,605,677	$ 1,821,776

Overall, total assets increased 6% from 2011 to 2012 and decreased 10% from 2010 to 2011.

- Current assets increased 30% from 2011 to 2012 primarily for amounts due from the Medicare program for cost report settlements and reimbursement under an electronic health records incentive program. Current assets decreased 10% from 2010 to 2011 due to increased collection rates for patient accounts receivable.

- Other noncurrent assets decreased 37% from 2011 to 2012 due to drawdowns of investment funds for use in paying operating expenses and capital asset purchases.

- Liabilities increased 23% from 2011 to 2012 primarily due to increases in accounts payable for operating expenses.

Recent Financial Performance

The schedule below is a summary of the Hospital's revenues, expenses and changes in net position for the past three years.

	Year ended December 31,		
	2012	2011	2010
Operating revenue	$ 3,983,390	$ 3,532,178	$ 3,617,062
Operating expenses:			
Salaries	1,827,075	1,736,235	1,699,660
Employee benefits	425,293	417,712	404,981
Supplies and other	1,813,601	1,641,184	1,624,788
Depreciation and amortization	215,668	218,511	219,174
Total operating expenses	4,281,637	4,013,642	3,948,603
Operating loss	(298,247)	(481,464)	(331,541)
Nonoperating revenues (expenses):			
Taxes	210,000	206,906	204,000
Investment income	2,561	4,083	5,597
Interest expense	(11,938)	(19,789)	(14,348)
Grants and contributions	30,340	46,216	18,468
Other, net	10,024	10,621	8,510
Total net nonoperating revenues (expenses)	240,987	248,037	222,227
Capital grants and contributions	10,533	17,328	63,802
Decrease in net position	$ (46,727)	$ (216,099)	$ (45,512)
Net position at end of year	$ 1,558,950	$ 1,605,677	$ 1,821,776

Overall, operating revenues increased 13% from 2011 to 2012 and decreased 2% from 2010 to 2011.

- Net patient service revenue increased 3.5% from 2011 to 2012 due to increases in service volumes to outpatients. The deductions from gross patient service revenue increased from 22% to 24%.

- Other operating revenues increased significantly from 2011 to 2012 due to the electronic health record incentive program mentioned above.

Overall, operating expenses increased 7% from 2011 to 2012 and 2% from 2010 to 2011.

- Salaries, wages, and employee benefits increased 5% from 2011 to 2012 and 2% from 2010 to 2011 due to employee merit increases.

- Purchased services expense increased 6% from 2011 to 2012 primarily due to increases in physical therapy, laboratory, CRNA services, and emergency room physician coverage costs.

- Maintenance expense increased 42% from 2011 to 2012 primarily due to increases in computer system support costs as a result of the implementation of the computerized electronic health record system.

Overall, the Hospital's operating loss decreased 38% from 2011 to 2012 due in large part to the accrual of other operating revenue for the implementation of the computerized electronic health record system mentioned above. It is important to note that the calculation of the operating loss is a result of the application of accounting principles generally accepted in the United States of America ("GAAP"). The Hospital receives a portion of County tax revenues in part to subsidize the cost of services provided to uninsured patients. Although the expenses incurred to provide these services are recognized as operating expenses, GAAP reporting rules require that the tax revenues be reported as nonoperating revenues.

Nonoperating revenues/expenses consist primarily of property taxes levied by the County, investment earnings, interest expense, and grants and contributions.

Patient Volumes

Patient day volume statistics are summarized in the following table:

	2012	2011	2010
Inpatient acute days	334	380	334
Observation bed days	151	129	74
	485	509	408
Percent change	(4.72)%	24.75%	(12.82)%
Skilled swing bed days	150	250	342
Percent change	(40.00)%	(26.90)%	21.71%
Intermediate swing bed days	1,567	1,704	1,642
Percent change	(8.04)%	3.78%	(0.24)%

Capital Assets

At the end of 2012, the Hospital had $735,906 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. The Hospital placed in service additional capital assets costing approximately $227,284 in 2012 and $433,472 in 2011.

A substantial portion of the additions to capital assets over the last three years are for computer hardware and software needed to implement an electronic health record system to comply with regulatory changes initiated under national healthcare reform programs.

Debt

As discussed in Note 6 to the financial statements, the Hospital has acquired equipment under capital lease agreements, including a new lease agreement of $94,433 in 2011.

Other Economic Factors

Management expects the current economic conditions to continue over the next year.

Issues Facing the Hospital

There are issues facing the Hospital that could result in material changes in its financial position in the long term. Among these issues are:

- Building project. As discussed in Note 11 to the financial statements, the Hospital has ongoing process for the possible construction of a new hospital facility or improving the existing facility.

- Risks related to Medicare and Medicaid reimbursement. A significant portion of the Hospital's revenues are derived from the Medicare program, which provides certain healthcare benefits to beneficiaries who are over 65 years of age or disabled, and the Medicaid program, funded jointly by the federal government and the states, which provides medical assistance to certain needy individuals and families. The funding of these programs by the federal and state governments face increasing pressure due to the significant increases in the costs of providing healthcare services in recent years.

- Employment and labor issues. The Hospital is a major employer within the community, employing a complex mix of professional, technical, clerical, maintenance, dietary, and other workers. Risks include personal tort actions, work-related injuries and exposure to hazardous materials. A relative shortage of nursing and other medical professional/technical employees, is an issue that is causing salary and benefits costs to increase at significant rates.

- Technology and services. Scientific and technological advances, new procedures, drugs and appliances, preventive medicine, and outpatient healthcare delivery may reduce utilization and revenues for the Hospital in the future. Technological advances continue to accelerate the need to acquire sophisticated and expensive equipment and services for diagnosis and treatment of illnesses and diseases.

  As part of the new legislation passed in 2009 and 2010, the federal government is providing financial incentives to healthcare providers to join in implementing a national electronic health record (EHR) system. Accordingly, the Hospital has incurred significant expenditures for hardware and software to meet the requirements for the program. As discussed in Note 2 to the financial statements, the Hospital's initial EHR system implementation was approved by the Medicare fiscal intermediaries in 2012.

- Increasing numbers of uninsured and underinsured patients. Due to the significant increases and high cost of healthcare insurance premiums in recent years, increasing numbers of patients of the Hospital are finding it more and more difficult to obtain or maintain adequate health insurance coverage. This trend could increase the levels of uncompensated care provided by the Hospital.

Contacting The Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Hospital Administration Department, at Washington County Hospital, 304 E. Third, Washington, Kansas 66968.

WASHINGTON COUNTY HOSPITAL

BALANCE SHEETS

ASSETS

	December 31,	
	2012	2011
Current assets:		
Cash (Notes 1, 3 and 7)	$ 170,746	$ 200,565
Accounts receivable, net of allowance for doubtful accounts of $320,082 in 2012 and $258,835 in 2011	776,712	741,450
Inventories (Note 1)	223,593	239,112
Estimated third-party payer settlements (Note 2)	499,625	76,304
Other	49,162	62,591
Total current assets	1,719,838	1,320,022
Assets limited as to use (Notes 3 and 7)	351,617	559,963
Property and equipment, at cost (Notes 1 and 5):		
Land and land improvements	131,524	131,524
Building and fixed equipment	1,111,502	1,088,053
Movable equipment	2,691,868	2,511,703
Projects in progress	10,000	52,385
	3,944,894	3,783,665
Less accumulated depreciation	3,208,988	3,016,990
Property and equipment net of accumulated depreciation	735,906	766,675
Total assets	$ 2,807,361	$ 2,646,660

The accompanying notes are an integral
part of the financial statements.

LIABILITIES AND NET POSITION

	December 31,	
	2012	2011
Current liabilities:		
Accounts payable	$ 439,060	$ 127,176
Salaries and wages payable	78,570	71,780
Compensated absences payable (Notes 1 and 6)	88,940	60,726
Payroll taxes payable	23,240	10,003
Interest payable	2,290	6,323
Current portion of capitalized lease obligations (Notes 1 and 6)	100,944	197,200
Total current liabilities	733,044	473,208
Long-term liabilities:		
Capitalized lease obligations (Notes 1 and 6)	112,247	213,191
Compensated absences payable (Notes 1 and 6)	3,699	2,508
Total long-term liabilities	115,946	215,699
Total liabilities	848,990	688,907
Deferred inflows of resources:		
Deferred contributions for building project (Note 11)	399,421	352,076
Net position (Notes 1 and 8):		
Net investment in capital assets	522,715	356,285
Unrestricted	1,036,235	1,249,392
Total net position	1,558,950	1,605,677
Total liabilities, deferred inflows of resources and net position	$ 2,807,361	$ 2,646,660

WASHINGTON COUNTY HOSPITAL

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

	Year ended December 31,	
	2012	2011
Operating revenues:		
Net patient service revenue (Note 1)	$ 3,632,934	$ 3,508,957
Other	350,456	23,221
Total operating revenue	3,983,390	3,532,178
Operating expenses:		
Salaries	1,827,075	1,736,235
Employee benefits	425,293	417,712
Supplies and other	1,813,601	1,641,184
Depreciation (Note 1)	215,668	218,511
Total operating expenses	4,281,637	4,013,642
Operating loss	(298,247)	(481,464)
Nonoperating revenues (expenses):		
Taxes	210,000	206,906
Investment income	2,561	4,083
Interest expense	(11,938)	(19,789)
Noncapital grants and contributions	30,340	46,216
Other	10,024	10,621
Total nonoperating revenues	240,987	248,037
Expenses over revenues before capital grants and contributions	(57,260)	(233,427)
Capital grants and contributions	10,533	17,328
Decrease in net position	(46,727)	(216,099)
Net position at beginning of year	1,605,677	1,821,776
Net position at end of year	$ 1,558,950	$ 1,605,677

The accompanying notes are an integral
part of the financial statements.

WASHINGTON COUNTY HOSPITAL

STATEMENTS OF CASH FLOWS

	Year ended December 31,	
	2012	2011
Cash flows from operating activities:		
Receipts from and on behalf of patients	$ 3,498,095	$ 3,634,081
Payments to suppliers and contractors	(1,467,501)	(1,771,959)
Payments to employees	(1,790,880)	(1,723,015)
Payments for employee benefits	(425,293)	(417,712)
Other receipts and payments, net	26,712	72,614
Net cash flows used by operating activities	(158,867)	(205,991)
Cash flows from noncapital financing activities:		
Property taxes for operations	210,000	206,906
Grants and contributions	10,024	46,216
Other	30,340	10,621
Net cash flows provided by noncapital financing activities	250,364	263,743
Cash flows from capital and related financing activities:		
Purchases of property and equipment	(184,899)	(31,990)
Contributions for capital assets	18,502	56,746
Increase in deferred revenue for building project	47,345	41,649
Increase in building fund	(47,345)	(41,649)
Principal payments on capitalized lease obligations	(197,200)	(169,850)
Interest payments on capitalized lease obligations	(15,971)	(19,005)
Net cash flows used by capital and related financing activities	(379,568)	(164,099)
Cash flows from investing activities:		
Additions to board-designated assets	–	(52,192)
Decreases in board-designated assets	255,691	100,528
Investment income	2,561	4,083
Net cash flows provided by investing activities	258,252	52,419
Net decrease in cash and cash equivalents	(29,819)	(53,928)
Cash and cash equivalents at beginning of year	200,565	254,493
Cash and cash equivalents at end of year	$ 170,746	$ 200,565

	Year ended December 31,	
	2012	2011
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (298,247)	$ (481,464)
Adjustments to reconcile operating loss to net cash flows used in operating activities:		
Depreciation and amortization	215,668	218,511
Provision for doubtful accounts	124,054	162,128
Other	–	49,393
Net (increases) decreases in current assets:		
Accounts receivable	(159,316)	(19,225)
Inventories	15,519	(58,055)
Estimated third-party payer settlements	(423,321)	(17,779)
Other	5,460	(9,768)
Net increases (decreases) in current liabilities:		
Accounts payable	311,884	(64,325)
Salaries and wages payable	6,790	13,649
Compensated absences payable	29,405	(429)
Payroll taxes payable	13,237	1,373
Net cash used by operating activities	$ (158,867)	$ (205,991)

The accompanying notes are an integral
part of the financial statements.

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of operations and reporting entity

Washington County Hospital (Hospital) is owned by Washington County, Kansas and provides acute inpatient, outpatient and swing bed care. The Board of County Commissioners appoints the members of the Board of Trustees and provides tax levy support to the Hospital. For these reasons, the Hospital is considered to be a component unit of Washington County, Kansas.

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. Property taxes, investment income, interest on capital asset-related debt are included in nonoperating revenues and expenses.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

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 those estimates.

Operating revenues and expenses

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

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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, payer mix trends, and existing economic conditions. As a service to patients, the Hospital bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are generally due in full when billed. If the patient is unable to pay the full amount at the time the patient is billed, the Hospital negotiates a payment plan whereby monthly payments are made by the patient on the account. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account. If future actual default rates on accounts receivable differ from those currently anticipated, the Hospital may have to adjust its allowance for doubtful accounts, which would affect earnings in the period the adjustments are made.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined by the first-in, first-out method.

Capital assets

The Hospital's capital assets that are $5,000 or greater, are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. All capital assets other than land are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using the following estimated useful lives:

Land improvements	4 years
Buildings	10-40 years
Equipment	5-20 years

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. When depreciable property is retired or otherwise disposed of, the related costs and accumulated depreciation are removed from the accounts and any gain or loss is reflected as non-operating revenue (expense).

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. Payment arrangements include reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors, and a provision for uncollectible accounts. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Grants and contributions

From time to time, the Hospital receives grants and contributions from government agencies, private organizations, and individuals. Revenues from grants and contributions are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenue. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses. When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Net position

Net position of the Hospital is classified into two components. *Net investment in capital assets* consists of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Unrestricted net position* are remaining assets less remaining liabilities and less deferred inflows of resources that do not meet the definition of *net investment in capital assets*.

Compensated absences

Employees of the Hospital are entitled to paid vacation depending on length of service and whether they are full or part time. Upon resignation, termination or retirement from service with the Hospital, employees are entitled to payment for all accrued vacation, up to the allowable maximum. The Hospital accrues vacation benefits as earned.

Cash and cash equivalents

Cash and cash equivalents include cash, certificates of deposit, money market and interest bearing checking accounts with maturities of three months or less, excluding those investments designated by the Board of Trustees for the purchase or replacement of capital assets (Note 7) and cash accounts related to the deferred contributions for the building project (Note 11).

Taxation

The Hospital is a component unit of Washington County, a political subdivision of the State of Kansas and as such, is exempt from Federal income taxes under Section 115 of the Internal Revenue Code.

Risk management

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

The Hospital pays fixed premiums for annual medical malpractice coverage under an occurrence-basis policy. The Hospital accrues the expenses of its share of malpractice claim costs, if any, of reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate cost of any incident. Based on the Hospital's own claims experience, no accrual, for medical malpractice costs has been made in the accompanying financial statements.

Deferred inflows of resources/Deferred outflows of resources

Effective, January 1, 2012, the Hospital implemented the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position* and GASB Statement No. 65, *Items Previously Reported As Assets and Liabilities*. GASB Statement No. 63 provides guidance for reporting deferred inflows and deferred outflows or resources and GASB Statement No. 65 provides additional guidance on reclassifying, as deferred inflows of resources and deferred outflows of resources, certain items that were previously reported as assets and liabilities. Additionally, the term "net assets" was replaced with the term "net position".

A deferred inflow of resources is defined as an acquisition of net position applicable to a future reporting period. A deferred outflow of resources is the consumption of net position that is applicable to a future reporting period. The Hospital identified a certain financial statement item that met the definition of a deferred inflow of resources. This item was reclassified as a deferred inflow of resources. There were no items that met the definition of a deferred outflow of resources.

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Subsequent events

Subsequent events have been evaluated through July 25, 2013, which is the date the financial statements were available to be issued.

Reclassifications

Certain reclassifications have been made to the 2011 financial statements to conform to the 2012 presentation. The reclassifications had no effect on the change in net assets.

2. ESTIMATED THIRD-PARTY PAYER SETTLEMENTS

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** – Inpatient and outpatient services are paid based on cost reimbursement methodologies. The Hospital is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and reviews thereof by the Medicare fiscal intermediary. The Hospital's classification of patients under the Medicare program and appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Hospital. The Hospital's Medicare cost reports have been reviewed by the Medicare fiscal intermediary through December 31, 2010.

- **Medicaid** – The Hospital is reimbursed under a cost reimbursement methodology for inpatient acute and outpatient services. The Hospital is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and reviews thereof by the Medicaid fiscal intermediary through December 31, 2007.

  Inpatient long-term care services for 2012 and 2011 are paid at prospectively determined per diem rates that are based on the patient's acuity.

Approximately 56% and 62% of net patient service revenue is from participation in the Medicare program for the years ended December 31, 2012 and 2011, respectively. Laws and regulations governing the Medicare program 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.

Pursuant to enactment of the *American Recovery and Reinvestment Act of 2009*, the Medicare and Medicaid programs implemented programs to provide for one-time incentive payments for eligible hospitals that demonstrate meaningful use of certified electronic health records systems (EHR).

Under Medicare's incentive program, hospitals are generally eligible to receive these incentive payments for up to four years for reasonable costs incurred for certified EHR systems multiplied by the hospital's Medicare utilization plus 20%, up to 100% of the reasonable costs incurred. Payments under the Medicaid program are generally available for up to four years based upon a formula determined by the state and approved by the Centers for Medicare and Medicaid Services (CMS). Final amounts for any payment year are contingent upon the hospital continuing to meet increasing meaningful use criteria and, accordingly, are subject to review and approval by the Medicare and Medicaid programs fiscal intermediaries. As a result, it is reasonably possible that final determined amounts may differ materially from initial revenues recorded under these programs.

During 2012, the Hospital met the initial requirements to receive EHR incentive payments from the Medicare program and accordingly, $323,744 of other operating revenue has been recorded for the year ended December 31, 2012.

2. ESTIMATED THIRD-PARTY PAYER SETTLEMENTS (continued)

The Hospital has also entered into payment agreements with certain commercial insurance carriers and other third-party payer programs. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and cost reimbursement.

3. CASH AND INVESTED CASH

Cash and invested cash consisted of the following:

	December 31, 2012	December 31, 2011
Cash and cash equivalents:		
Cash on hand	$ 109	$ 100
Interest bearing checking accounts	89,166	140,957
Certificates of deposit	81,471	59,508
	170,746	200,565
Assets whose use is limited (Note 7):		
Checking account (Building Fund)	351,617	304,272
Certificates of deposit	–	255,691
	351,617	559,963
Totals	$ 522,363	$ 760,528

Deposits

The Hospital's policy follows applicable State statutes and requires deposits to be 100% secured by collateral (pledged securities) valued at market, less the amount of the Federal Deposit Insurance Corporation (FDIC) insurance. State statutes define the allowable pledged securities. Custodial credit risk for deposits is the risk that in the event of bank failure, the Hospital's deposits may not be returned to the Hospital or the Hospital will be unable to recover the collateral securities in the possession of an outside party.

At December 31, 2012, the carrying amount of the Hospital's deposits, which approximates fair value, was $522,254 with the bank balances of such accounts being $502,546. Of the bank balances, $331,471 was secured by federal depository insurance and the remaining balance of $171,075 was covered by collateral held by the Hospital's custodial banks in joint custody in the name of the Hospital and its banks. The fair value of those pledged securities held by the Hospital's custodial banks was $499,327 at December 31, 2012.

Investment policies

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The Hospital's investing activities are managed under the custody of the Hospital Chief Executive Officer. Investing is performed in accordance with investment policies adopted by the Board of Trustees and in compliance with State statutes.

3. CASH AND INVESTED CASH (continued)

Applicable state statutes authorize the Hospital to invest in (1) temporary notes or no-fund warrants issued by the Hospital; (2) savings deposits, time deposits, open accounts, certificates of deposit, or time certificates of deposit with maturities of not more than two years, in commercial banks, savings and loan associations, and savings banks; (3) repurchase agreements with commercial banks, savings and loan associations, and savings banks for direct obligations of, or obligations that are insured as to principal and interest by, the United States government or any agency thereof; (4) United States treasury bills or notes with maturities as the governing body shall determine, but not exceeding two years; (5) the municipal investment pool maintained by the State Treasurer's office.

4. CONCENTRATIONS OF CREDIT RISK

The Hospital is a provider of health care services and is located in the City of Washington, Kansas. The Hospital grants credit without collateral to its patients, most of whom are local area residents and some are insured under third-party payor agreements. The mix of receivables from patients and third-party payors is as follows:

	December 31,	
	2012	2011
Medicare	$ 308,703	$ 386,376
Medicaid	27,448	11,162
Commercial	248,739	315,306
Other	511,904	287,441
Gross accounts receivable	1,096,794	1,000,285
Less allowance for doubtful accounts	320,082	258,835
	$ 776,712	$ 741,450

5. CAPITAL ASSETS

Capital asset additions, disposals, and balances for the years ended December 31, 2012 and 2011 were as follows:

	Balance At December 31, 2011	Additions	Disposals	Balance At December 31, 2012
Capital assets not being depreciated:				
Land	$ 85,637	$ –	$ –	$ 85,637
Projects in progress	52,385	–	42,385	10,000
Total capital assets not being depreciated:	138,022	–	42,385	95,637
Capital assets being depreciated:				
Land improvements	45,887	–	–	45,887
Building and fixed equipment	1,088,053	23,449	–	1,111,502
Movable equipment	2,511,703	203,835	23,670	2,691,868
Total capital assets being depreciated	3,645,643	227,284	23,670	3,849,257

5. **CAPITAL ASSETS (continued)**

	Balance At December 31, 2011	Additions	Disposals	Balance At December 31, 2012
Less accumulated depreciation for:				
Land improvements	$ 41,994	$ 1,834	$ –	$ 43,828
Buildings and fixed equipment	899,887	17,702	–	917,589
Movable equipment	2,075,109	196,132	23,670	2,247,571
Total accumulated depreciation	3,016,990	215,668	23,670	3,208,988
Total capital assets being depreciated, net	628,653	11,616	–	640,269
Total capital assets, net	$ 766,675	$ 11,616	$ 42,385	$ 735,906

	Balance At December 31, 2010	Additions	Disposals	Balance At December 31, 2011
Capital assets not being depreciated:				
Land	$ 85,637	$ –	$ –	$ 85,637
Projects in progress	408,827	46,903	403,345	52,385
Total capital assets not being depreciated:	494,464	46,903	403,345	138,022
Capital assets being depreciated:				
Land improvements	45,887	–	–	45,887
Building and fixed equipment	934,019	159,385	5,351	1,088,053
Movable equipment	2,262,001	274,087	24,385	2,511,703
Total capital assets being depreciated	3,241,907	433,472	29,736	3,645,643

5. CAPITAL ASSETS (continued)

	Balance At December 31, 2010	Additions	Disposals	Balance At December 31, 2011
Less accumulated depreciation for:				
Land improvements	$ 39,509	$ 2,485	$ –	$ 41,994
Buildings and fixed equipment	888,771	16,467	5,351	899,887
Movable equipment	1,899,935	199,559	24,385	2,075,109
Total accumulated depreciation	2,828,215	218,511	29,736	3,016,990
Total capital assets being depreciated, net	413,692	214,961	–	628,653
Total capital assets, net	$ 908,156	$ 261,864	$ 403,345	$ 766,675

6. LONG-TERM DEBT AND OTHER NONCURRENT LIABILITIES

	Balance At December 31, 2011	Additions	Reductions	Balance At December 31, 2012	Amounts Due Within One Year
Capital lease obligations	$ 410,391	$ –	$ 197,200	$ 213,191	$ 100,944
Compensated absences payable	63,234	84,743	55,338	92,639	88,940
Total long-term liabilities	$ 473,625	$ 84,743	$ 252,538	$ 305,830	$ 189,884

	Balance At December 31, 2010	Additions	Reductions	Balance At December 31, 2011	Amounts Due Within One Year
Capital lease obligations	$ 485,808	$ 94,433	$ 169,850	$ 410,391	$ 197,200
Compensated absences payable	63,663	67,665	68,094	63,234	60,726
Total long-term liabilities	$ 549,471	$ 162,098	$ 237,944	$ 473,625	$ 257,926

The Hospital leases certain equipment under capital lease agreements, including a new lease of $94,433 in 2011. Interest incurred under the leases was $11,938 and $19,789 for the years ended December 31, 2012 and 2011, respectively.

6. LONG-TERM DEBT AND OTHER NONCURRENT LIABILITIES (continued)

These leases qualify as capital leases for accounting purposes and, accordingly, have been recorded at the present value of the minimum lease payments at the date of lease inception. The following is an analysis of the financial presentation of the capital leases:

	December 31,	
	2012	2011
Movable equipment	$ 396,336	$ 652,242
Projects in progress	–	42,385
	396,336	694,627
Accumulated depreciation	114,394	289,428
	$ 281,942	$ 405,199

The following is a schedule by years of future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2012:

Year ending December 31,	
2013	$ 109,450
2014	59,134
2015	59,134
Total minimum lease payments	227,718
Less amount representing interest	14,527
Present value of net minimum lease payments	213,191
Less current portion	100,944
Long-term portion	$ 112,247

7. ASSETS WHOSE USE IS LIMITED

The assets whose use is limited consists of the following:

	December 31,	
	2012	2011
Board Designated	$ –	$ 255,691
Building Project	351,617	304,272
	$ 351,617	$ 559,963

Certain cash and investments have been designated by the Board of Trustees for use in the replacement of capital assets or for the acquisition of additional capital assets. The assets designated by the Board of Trustees can be utilized for other purposes at the discretion of the Board.

The Building Project consists of contributions received for the building project (Note 11) net of related expenses. The Building Fund assets are restricted for the building project.

8. RESTRICTED NET ASSETS

Temporarily restricted net assets are comprised of assets whose use by the Hospital has been limited by donors to specific purposes and is available for the following:

	December 31,	
	2012	2011
Held in cash and assets whose use is limited:		
Building project	$ 399,421	$ 352,076
Less: Amount in deferred revenue (Note 11)	399,421	352,076
	$ –	$ –

Net assets were received and released from donor restrictions by incurring expenditures satisfying the restricted purposes for the following:

	December 31,	
	2012	2011
HIPAA programs	$ 5,311	$ 7,161
SHIP programs	5,000	–
Emergency preparedness	–	8,777
Boiler replacement	4,312	17,328
Equipment purchases	6,221	–
Total	$ 20,844	$ 33,266

9. FAIR VALUE OF FINANCIAL INSTRUMENTS

Generally Accepted Accounting Principles (GAAP) establishes a single authoritative definition of fair value, sets a framework for measuring fair value and requires additional disclosures about fair value measurements. Financial instruments that are measured and reported at fair value are classified and disclosed in one of the following categories based on inputs:

- Level 1 – Quoted market prices are available in active markets for identical instruments as of the reporting date.
- Level 2 – Pricing inputs are observable for the instruments, either directly or indirectly, as of the reporting date, but are other than quoted prices in active markets as in Level 1.
- Level 3 – Pricing inputs are unobservable for the instrument and include situations where there is little, if any, market activity for the instrument.

The following methods and assumptions were used by the Hospital in estimating the fair value of its financial instruments:

Cash and cash equivalents – The carrying amounts reported in the balance sheet for cash and cash equivalents approximates its fair value.

Accounts receivable – The carrying amounts reported in the balance sheet for accounts receivable approximates fair value because of the short-term nature of those instruments.

Estimated third-party payor settlements – The carrying amounts reported in the balance sheet for estimated third-party payor settlements approximates fair value because of the short-term nature of those instruments.

9. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

Board designated assets and Building Fund – These assets consist of cash and short-term investments and the carrying amounts reported in the balance sheet approximates their fair value.

Accounts and other payables – The carrying amounts reported in the balance sheet for accounts and other payables approximates its fair value.

Long-term debt – These liabilities consist of capitalized lease obligations. The fair value of these liabilities is estimated using discounted cash flow analyses, based on the interest rate implicit in the lease agreements.

The carrying amounts and fair value of the Hospital's financial instruments at December 31, 2012 and 2011 are as follows:

	December 31, 2012		December 31, 2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Primary government:				
Cash and cash equivalents	$ 170,746	$ 170,746	$ 200,565	$ 200,565
Accounts receivable	776,712	776,712	741,450	741,450
Estimated third-party payor settlements	499,625	499,625	76,304	76,304
Building fund	351,617	351,617	304,272	304,272
Board designated assets	–	–	255,691	255,691
Accounts and other payables	1,035,220	1,035,220	630,592	630,592
Capitalized lease obligations	213,191	213,191	410,391	410,391

10. OTHER POST EMPLOYMENT BENEFITS

As provided by K.S.A. 12-5040, the Hospital is required to allow retirees to participate in its group health insurance plan. While each retiree is required to pay the full amount of the applicable premium, conceptually, the Hospital would be subsidizing the retirees because each participant is charged a level premium regardless of age. However, the cost of this subsidy, if any, has not been quantified in these financial statements. The Hospital provides no other post-employment benefits, other than a retirement plan, for former employees.

Under the Consolidated Omnibus Budget Reconciliation Act (COBRA), the Hospital makes health care benefits available to eligible former employees and their eligible dependents. Certain requirements are outlined by the federal government for this coverage.

11. BUILDING PROJECT

Fund-raising

Management of the Hospital has initiated a project to determine the feasibility of raising the necessary funding to remodel the existing facility or construct a new hospital facility. As of December 31, 2012, the Hospital had obtained approximately $1,175,000 of pledges from various individuals and companies for the project. Contributions and pledge amounts received, of which $399,421 has been received to date (Note 8), are recorded as deferred revenue until such time as management decides to commence the construction of a new facility or improvements to the existing facility.

11. BUILDING PROJECT (continued)

Subsequent event

In March 2013, Washington County, Kansas (County) entered into a lease agreement (Base Lease) with the Washington County Public Building Commission (PBC) to lease the existing land and Hospital facility to the PBC in consideration of the PBC issuing $7,000,000 in revenue bonds to finance the acquisition of the Hospital facility and to make improvements thereof. In conjunction with the Base Lease, the PBC and County entered into another lease agreement (Hospital Lease) under which the County will provide rental payments to the PBC sufficient to pay the principal and interest on the revenue bonds.

Pursuant to the lease agreements discussed above, the Hospital Board, the County, and the PBC entered into a pledge of revenues and operating agreement. Under the agreement, the Hospital Board is charged with the management, control, and operation of the Hospital. In addition, the Hospital Board has pledged the Hospital revenues to the County as security for the rental payments to the PBC under the Hospital Lease agreement.

12. RETIREMENT PLAN

The Hospital maintains a defined contribution simple IRA retirement plan. Employees who have received at least $5,000 in compensation during the preceding calendar year are eligible to participate. Participants can contribute up to $11,500 annually. The Hospital matches each employee's contribution up to 3% of an employee's compensation. The total expense under the plan was $35,721 and $33,283 for 2012 and 2011, respectively.

ADDITIONAL INFORMATION

WASHINGTON COUNTY HOSPITAL

SCHEDULE OF PATIENT SERVICE REVENUE

	Year ended December 31,					
	2012			2011		
	Inpatient	Outpatient	Total	Inpatient	Outpatient	Total
Routine service	$ 227,635	$ 151,015	$ 378,650	$ 245,806	$ 156,153	$ 401,959
Swing beds	264,926	–	264,926	295,794	–	295,794
Nursery	13,482	–	13,482	8,074	–	8,074
Operating room	70,173	481,735	551,908	52,893	429,938	482,831
Delivery room	8,127	–	8,127	8,127	–	8,127
Anesthesiology	22,425	96,000	118,425	10,880	80,535	91,415
Radiology	135,779	1,162,985	1,298,764	87,256	935,829	1,023,085
Laboratory	105,715	514,985	620,700	145,191	480,562	625,753
Physical therapy	8,262	526,672	534,934	14,853	471,242	486,095
Occupational therapy	–	1,805	1,805	–	–	–
Speech therapy	378	6,934	7,312	–	–	–
Electrocardiology	3,969	60,071	64,040	8,599	30,055	38,654
Medical supplies	142,207	141,649	283,856	137,432	131,527	268,959
Pharmacy	117,258	347,960	465,218	174,608	375,590	550,198
Cardiac rehabilitation	–	29,475	29,475	–	51,525	51,525
Emergency room	2,353	165,217	167,570	729	146,632	147,361
Gross patient service revenue	$ 1,122,689	$ 3,686,503	4,809,192	1,190,242	$ 3,289,588	4,479,830
Contractual adjustments			(1,052,204)			(808,745)
Bad debts			(124,054)			(162,128)
Net patient service revenue			$ 3,632,934			$ 3,508,957

WASHINGTON COUNTY HOSPITAL

SCHEDULE OF OPERATING EXPENSES BY FUNCTIONAL DIVISION

	Year ended December 31, 2012				
Department	Salaries	Supplies and other	Depreciation	Total	Percent of total operating expenses
Routine service:					
Adult and pediatrics	$ 730,362	$ 23,410	$ 92,692	$ 846,464	19.77 %
Nursery	2,598	422	1,760	4,780	0.11
	732,960	23,832	94,452	851,244	19.88
Ancillary services:					
Operating room	30,914	14,938	15,813	61,665	1.44
Delivery room	1,929	4	813	2,746	0.06
Anesthesiology	–	98,025	–	98,025	2.29
Radiology	126,651	183,877	23,615	334,143	7.80
Laboratory	134,900	133,287	6,208	274,395	6.41
Physical therapy	–	278,434	–	278,434	6.50
Occupational therapy	–	2,933	–	2,933	0.07
Speech therapy	–	5,213	–	5,213	0.12
Electrocardiology	3,882	802	1,078	5,762	0.13
Medical supplies	12,710	135,904	–	148,614	3.47
Pharmacy	5,324	197,484	–	202,808	4.74
Cardiac rehab	18,515	416	–	18,931	0.44
Emergency room	144,872	172,093	1,027	317,992	7.43
	479,697	1,223,410	48,554	1,751,661	40.90
General services:					
Nursing administration	102,210	14,264	–	116,474	2.72
Operation of plant	55,399	160,676	–	216,075	5.05
Laundry	22,488	5,407	679	28,574	0.67
Housekeeping	36,131	949	–	37,080	0.87
Dietary	82,268	66,786	312	149,366	3.49
Medical records	155,989	28,549	4,592	189,130	4.42
Administration and general	159,933	289,381	47,543	496,857	11.60
Employee benefits	–	425,640	–	425,640	9.94
Depreciation - building	–	–	19,536	19,536	0.46
	614,418	991,652	72,662	1,678,732	39.22
	$ 1,827,075	$ 2,238,894	$ 215,668	$ 4,281,637	100.00 %

Department	Salaries	Supplies and other	Depreciation	Total	Percent of total operating expenses
	Year ended December 31, 2011				
Routine service:					
Adult and pediatrics	$ 677,859	$ 11,630	$ 49,237	$ 738,726	18.40 %
Nursery	4,446	262	1,755	6,463	0.16
	682,305	11,892	50,992	745,189	18.56
Ancillary services:					
Operating room	39,758	22,562	13,531	75,851	1.89
Delivery room	4,144	–	761	4,905	0.12
Anesthesiology	–	81,494	–	81,494	2.03
Radiology	120,019	177,443	19,138	316,600	7.89
Laboratory	118,334	110,055	2,812	231,201	5.76
Physical therapy	–	265,321	–	265,321	6.61
Occupational therapy	–	–	–	–	–
Speech therapy	–	–	–	–	–
Electrocardiology	3,766	793	1,307	5,866	0.15
Medical supplies	10,675	74,330	–	85,005	2.12
Pharmacy	19,189	201,069	–	220,258	5.49
Cardiac rehab	18,319	54	–	18,373	0.46
Emergency room	138,302	156,990	1,024	296,316	7.38
	472,506	1,090,111	38,573	1,601,190	39.90
General services:					
Nursing administration	80,217	7,289	–	87,506	2.18
Operation of plant	55,422	171,060	–	226,482	5.64
Laundry	20,223	776	735	21,734	0.54
Housekeeping	42,557	54	–	42,611	1.06
Dietary	75,697	67,942	311	143,950	3.59
Medical records	146,871	28,055	–	174,926	4.36
Administration and general	160,437	264,005	108,947	533,389	13.29
Employee benefits	–	417,712	–	417,712	10.41
Depreciation - building	–	–	18,953	18,953	0.47
	581,424	956,893	128,946	1,667,263	41.54
	$ 1,736,235	$ 2,058,896	$ 218,511	$ 4,013,642	100.00 %