

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
Independent Auditor's Report and Financial Statements  
December 31, 2012 and 2011



**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**December 31, 2012 and 2011**

**Contents**

**Independent Auditor's Report..... 1**

**Financial Statements**

Balance Sheets..... 3  
Statements of Revenues, Expenses and Changes in Net Position ..... 4  
Statements of Cash Flows ..... 5  
Notes to Financial Statements ..... 7

## Independent Auditor's Report

Board of Trustees  
Fredonia Regional Hospital  
Fredonia, Kansas

We have audited the accompanying financial statements of Fredonia Regional Hospital, a component unit of the City of Fredonia, Kansas, which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and 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 provision of the Kansas Municipal Audit Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

*Opinion*

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

*Required Supplementary Information*

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

*BKD, LLP*

Wichita, Kansas  
May 20, 2013

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Balance Sheets**  
**December 31, 2012 and 2011**

**Assets**

	<u>2012</u>	<u>2011</u>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 3,623,089	\$ 2,969,581
Restricted cash and investments - current	348,599	380,725
Patient accounts receivable, net	1,618,087	1,510,032
Estimated amounts due from third-party payers	734,299	865,000
Supplies	326,048	319,638
Physician receivable	51,925	138,696
Prepaid expenses and other	<u>203,252</u>	<u>217,060</u>
Total current assets	<u>6,905,299</u>	<u>6,400,732</u>
<b>Noncurrent Cash and Investments</b>		
Designated by Board of Trustees	1,714,444	1,806,039
Restricted by donors for capital acquisitions	6,000	-
Held by trustee for debt service	<u>985,040</u>	<u>1,012,169</u>
Total noncurrent cash and investments	<u>2,705,484</u>	<u>2,818,208</u>
<b>Capital Assets, Net</b>	<u>9,850,143</u>	<u>10,706,516</u>
<b>Other Assets</b>		
Deferred financing costs	196,016	208,184
Physician receivable	<u>48,649</u>	<u>100,573</u>
Total other assets	<u>244,665</u>	<u>308,757</u>
Total assets	<u><u>\$ 19,705,591</u></u>	<u><u>\$ 20,234,213</u></u>

## Liabilities and Net Position

	<u>2012</u>	<u>2011</u>
<b>Current Liabilities</b>		
Current maturities of long-term debt	\$ 285,411	\$ 341,733
Accounts payable	388,816	613,429
Accrued salaries and wages	98,615	76,046
Accrued vacation benefits	245,109	262,098
Accrued physician payable	118,075	127,031
Accrued interest payable	233,819	237,713
	<hr/>	<hr/>
Total current liabilities	1,369,845	1,658,050
<b>Long-term Debt</b>	<u>10,213,386</u>	<u>10,515,589</u>
Total liabilities	<u>11,583,231</u>	<u>12,173,639</u>
<b>Net Position</b>		
Net investment in capital assets	(452,638)	57,378
Restricted - expendable for		
Debt service	1,333,639	1,392,894
Capital acquisitions	6,000	-
Unrestricted	7,235,359	6,610,302
	<hr/>	<hr/>
Total net position	8,122,360	8,060,574
Total liabilities and net position	<u>\$ 19,705,591</u>	<u>\$ 20,234,213</u>

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Statements of Revenues, Expenses and Changes in Net Position**  
**Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
<b>Operating Revenues</b>		
Net patient service revenue	\$ 11,854,070	\$ 10,941,187
Other	<u>186,398</u>	<u>251,678</u>
Total operating revenues	<u>12,040,468</u>	<u>11,192,865</u>
<b>Operating Expenses</b>		
Salaries and wages	4,234,871	4,279,271
Employee benefits	968,560	941,393
Supplies and other	5,471,165	5,178,593
Depreciation and amortization	<u>1,348,038</u>	<u>1,364,676</u>
Total operating expenses	<u>12,022,634</u>	<u>11,763,933</u>
<b>Operating Income (Loss)</b>	<u>17,834</u>	<u>(571,068)</u>
<b>Nonoperating Revenues (Expenses)</b>		
Property and sales taxes	518,016	499,599
Investment income (loss)	(1,636)	81,535
Interest expense	(651,545)	(667,911)
Noncapital grants and gifts	<u>435</u>	<u>85,192</u>
Total nonoperating expenses	<u>(134,730)</u>	<u>(1,585)</u>
<b>Deficiency of Revenue Over Expenses Before Capital Grants and Gifts</b>	(116,896)	(572,653)
<b>Capital Grants and Gifts</b>	<u>178,682</u>	<u>-</u>
<b>Increase (Decrease) in Net Position</b>	61,786	(572,653)
<b>Net Position, Beginning of Year</b>	<u>8,060,574</u>	<u>8,633,227</u>
<b>Net Position, End of Year</b>	<u>\$ 8,122,360</u>	<u>\$ 8,060,574</u>

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Statements of Cash Flows**  
**Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
<b>Operating Activities</b>		
Receipts from and on behalf of patients	\$ 11,876,716	\$ 10,591,576
Payments to suppliers and contractors	(5,692,274)	(5,031,598)
Payments to employees	(5,197,851)	(5,178,392)
Other receipts	189,622	251,678
	<u>1,176,213</u>	<u>633,264</u>
<b>Noncapital Financing Activities</b>		
Property and sales taxes supporting operations	518,016	499,599
Receipts (payments) under physician guarantee contract	(871)	7,710
Noncapital grants and gifts	435	85,192
	<u>517,580</u>	<u>592,501</u>
<b>Capital and Related Financing Activities</b>		
Capital grants and gifts	178,682	-
Principal paid on long-term debt	(358,525)	(334,701)
Interest paid on long-term debt	(651,545)	(667,911)
Purchases of capital assets	(352,111)	(266,241)
	<u>(1,183,499)</u>	<u>(1,268,853)</u>
<b>Investing Activities</b>		
Investment income	(1,636)	81,535
Purchases of investments	(19,696)	(50,436)
Proceeds from disposition of investments	61,369	-
	<u>40,037</u>	<u>31,099</u>
<b>Increase (Decrease) in Cash and Cash Equivalents</b>	550,331	(11,989)
<b>Cash and Cash Equivalents, Beginning of Year</b>	<u>3,280,411</u>	<u>3,292,400</u>
<b>Cash and Cash Equivalents, End of Year</b>	<u>\$ 3,830,742</u>	<u>\$ 3,280,411</u>



**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Statements of Cash Flows (Continued)**  
**Years Ended December 31, 2012 and 2011**

	<b>2012</b>	<b>2011</b>
<b>Reconciliation of Cash and Cash Equivalents to the Balance Sheets</b>		
Cash and cash equivalents in current assets	\$ 3,623,089	\$ 2,969,581
Restricted cash in current assets	10,252	8,138
Cash in designated by Board of Trustees	191,401	302,692
Cash restricted by donors	6,000	-
	<b>\$ 3,830,742</b>	<b>\$ 3,280,411</b>
<b>Reconciliation of Operating Income (Loss) to Net Cash Provided by Operating Activities</b>		
Operating income (loss)	\$ 17,834	\$ (571,068)
Depreciation and amortization	1,348,038	1,364,676
Provision for uncollectible accounts	755,318	954,840
Loss on disposal of capital assets	3,224	-
Changes in operating assets and liabilities		
Patient accounts receivable	(863,373)	(1,119,451)
Estimated amounts due to and from third-party payers	130,701	(185,000)
Supplies	(6,410)	(8,379)
Prepaid expenses and other	13,808	(37,040)
Accounts payable	(224,613)	196,070
Accrued expenses	1,686	38,616
Net cash provided by operating activities	<b>\$ 1,176,213</b>	<b>\$ 633,264</b>
<b>Supplemental Cash Flows Information</b>		
Capital lease obligations incurred for capital assets	\$ -	\$ 29,611

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

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

***Nature of Operations and Reporting Entity***

Fredonia Regional Hospital (Hospital) is a municipal hospital located in Fredonia, Kansas. The Hospital is a component unit of the City of Fredonia, Kansas (City). The Hospital receives funds from the City's 1% sales tax. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services. It also operates a geriatric psych unit and physician clinics. The Hospital is licensed as a Critical Access Hospital (CAH).

***Basis of Accounting and Presentation***

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

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

***Use of Estimates***

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

***Cash Equivalents***

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

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

***Property and Sales Taxes***

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

***Risk Management***

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

***Investments and Investment Income***

Investments in U.S. Treasury, agency and instrumentality obligations with a remaining maturity of one year or less at time of acquisition and in nonnegotiable certificates of deposit are carried at amortized cost.

Investment income includes dividend and interest income and realized gains and losses on investments carried at other than fair value.

***Patient Accounts Receivable***

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

***Supplies***

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

***Physician Guarantees***

Physician receivables on the balance sheet include guarantee contracts and represent the estimated future benefit to be received over the contractual life of the guarantee contracts. Physician payable represents the estimated remaining liability to the Hospital over the contractual life of the guarantee contract.

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Capital Assets**

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

Land improvements	10 – 20 years
Buildings and leasehold improvements	10 – 40 years
Fixed equipment	5 – 20 years
Major moveable equipment	3 – 10 years

**Deferred Financing Costs**

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

**Compensated Absences**

Hospital policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Expense and the related liability for sick leave benefits are recognized when earned to the extent the employee is expected to realize the benefit in cash determined using the termination payment method. Sick leave benefits expected to be realized as paid time off are recognized as expense when the time off occurs and no liability is accrued for such benefits employees have earned but not yet realized. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

**Net Position**

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

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

***Net Patient Service Revenue***

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

***Charity Care***

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

***Income Taxes***

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

***Subsequent Events***

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

***Reclassifications***

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

**Note 2: Net Patient Service Revenue**

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

*Medicare.* The Hospital is recognized as a CAH. Under CAH rules, inpatient acute care, skilled swing-bed and outpatient services rendered to Medicare program beneficiaries are paid at one hundred one percent (101%) of cost subject to certain limitations. Inpatient geriatric psych services rendered to Medicare program beneficiaries are paid based on a blend of prospective payment rates and cost subject to certain limitations. The Hospital is reimbursed for most services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare Administrative Contractor.

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

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

Approximately 77% and 79% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2012 and 2011, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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

Net patient service revenue is computed as follows for the years ended December 31:

	<u>2012</u>	<u>2011</u>
Gross patient service revenue	\$ 18,185,277	\$ 16,966,425
Less contractual adjustments		
Medicare	(3,527,158)	(2,966,240)
Medicaid	(996,691)	(685,602)
Other contractals and adjustments	(870,524)	(1,072,998)
Charity care	(32,815)	(174,329)
Administrative discounts	(148,701)	(171,229)
Provision for uncollectible accounts	<u>(755,318)</u>	<u>(954,840)</u>
	<u>\$ 11,854,070</u>	<u>\$ 10,941,187</u>

**Note 3: Deposits and Investments**

***Deposits***

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

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

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

At December 31, 2012 and 2011, respectively, \$4,990,946 and \$4,401,058 of the Hospital's bank balances of \$5,490,946 and \$4,901,058 were exposed to custodial credit risk as follows:

	<b>2012</b>	<b>2011</b>
Uninsured and collateral held by pledging financial institutions	\$ 4,990,946	\$ 4,401,058

**Investments**

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

All of the Hospital's held by trustee for debt service investments were invested in short-term U.S. treasuries at December 31, 2012 and 2011.

**Summary of Carrying Values**

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

	<b>2012</b>	<b>2011</b>
Carrying value		
Deposits	\$ 5,353,785	\$ 4,783,758
Investments	1,323,387	1,384,756
Carrying amount	\$ 6,677,172	\$ 6,168,514

Included in the following balance sheet captions:

	<b>2012</b>	<b>2011</b>
Cash and cash equivalents	\$ 3,623,089	\$ 2,969,581
Restricted cash and investments - current	348,599	380,725
Designated by Board of Trustees	1,714,444	1,806,039
Restricted by donors for capital acquisitions	6,000	-
Held by trustee for debt service	985,040	1,012,169
	\$ 6,677,172	\$ 6,168,514

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 4: Patient Accounts Receivable**

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

	<u>2012</u>	<u>2011</u>
Medicare	\$ 1,318,370	\$ 1,164,734
Medicaid	193,600	215,965
Blue Cross	207,135	154,006
Commercial	459,629	376,515
Private pay	341,603	374,815
	<u>2,520,337</u>	<u>2,286,035</u>
Less allowance for contractual adjustments	(721,616)	(605,532)
Less allowance for uncollectible accounts	<u>(180,634)</u>	<u>(170,471)</u>
	<u>\$ 1,618,087</u>	<u>\$ 1,510,032</u>

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

	<u>2012</u>	<u>2011</u>
Medicare	53%	51%
Medicaid	8%	9%
Blue Cross	8%	7%
Commercial	18%	17%
Private pay	<u>13%</u>	<u>16%</u>
	<u>100%</u>	<u>100%</u>



**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 5: Capital Assets**

Capital assets activity for the years ended December 31 was:

	<b>2012</b>			
	<b>Beginning Balance</b>	<b>Additions</b>	<b>Deletions</b>	
Land	\$ 25,474	\$ -	\$ -	\$ 25,474
Land improvements	806,065	7,167	-	813,232
Buildings	11,137,021	24,560	-	11,161,581
Fixed equipment	1,070,758	18,121	-	1,088,879
Moveable equipment	4,089,372	157,136	(31,496)	4,215,012
Construction in process	-	145,127	-	145,127
	<u>17,128,690</u>	<u>352,111</u>	<u>(31,496)</u>	<u>17,449,305</u>
Less accumulated depreciation				
Land improvements	(277,351)	(53,978)	-	(331,329)
Buildings	(2,892,582)	(602,836)	-	(3,495,418)
Fixed equipment	(624,244)	(63,484)	-	(687,728)
Moveable equipment	(2,627,997)	(484,962)	28,272	(3,084,687)
	<u>(6,422,174)</u>	<u>(1,205,260)</u>	<u>28,272</u>	<u>(7,599,162)</u>
Capital assets, net	<u>\$ 10,706,516</u>	<u>\$ (853,149)</u>	<u>\$ (3,224)</u>	<u>\$ 9,850,143</u>

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

	2011			Ending Balance
	Beginning Balance	Additions	Deletions	
Land	\$ 25,474	\$ -	\$ -	\$ 25,474
Land improvements	790,258	15,807	-	806,065
Buildings	11,137,021	-	-	11,137,021
Fixed equipment	1,070,758	-	-	1,070,758
Moveable equipment	3,821,374	280,046	(12,048)	4,089,372
	<u>16,844,885</u>	<u>295,853</u>	<u>(12,048)</u>	<u>17,128,690</u>
Less accumulated depreciation				
Land improvements	(222,909)	(54,442)	-	(277,351)
Buildings	(2,288,132)	(604,450)	-	(2,892,582)
Fixed equipment	(549,117)	(75,127)	-	(624,244)
Moveable equipment	(2,169,531)	(470,514)	12,048	(2,627,997)
	<u>(5,229,689)</u>	<u>(1,204,533)</u>	<u>12,048</u>	<u>(6,422,174)</u>
Capital assets, net	<u>\$ 11,615,196</u>	<u>\$ (908,680)</u>	<u>\$ -</u>	<u>\$10,706,516</u>

**Note 6: Medical Malpractice Claims**

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

**Note 7: Physician Guarantees**

During 2009, the Hospital entered into a contract with a physician to relocate to Fredonia, Kansas to establish a practice. The Hospital has advanced \$92,208 to the physician. The physician is required, for a minimum of five years, to establish and maintain an internal medicine and primary care practice on a full-time basis in Fredonia, Kansas. In the event the physician fails to perform her obligations under the contract, she is to reimburse the Hospital all sums advanced minus any amounts forgiven pursuant to the terms of the contract. This agreement also includes other advances for student loans, sign-on bonuses, relocation expenses and marketing expenses that are

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

included in the physician receivables on the balance sheet. The physician is now in the forgiveness period of the contract. The carrying amount of the liability for the Hospital's obligations under the guarantee contract is \$118,075 and \$127,031 at December 31, 2012 and 2011, respectively.

During 2007, the Hospital entered into a contract with a physician to relocate to Fredonia, Kansas to establish a practice. The Hospital advanced \$341,336 to the physician. The physician is required, for a minimum of five years, to establish and maintain an internal medicine and primary care practice on a full-time basis in Fredonia, Kansas. In the event this physician fails to perform her obligations under the contract, she is to reimburse the Hospital all sums advanced minus any amounts forgiven pursuant to the terms of the contract. This agreement also includes other advances for student loans, sign-on bonuses and relocation expenses that are included in physician receivables, less amortization, on the balance sheet. The physician is now in the forgiveness period of the contract.

Another physician contract exists in which the Hospital has advanced \$137,479 to the physician. The physician is required to locate his practice in Fredonia, Kansas and provide professional services for residents of the Hospital service area pursuant to and in accordance with the agreement. In the event this physician fails to perform his obligations under the contract, he is to reimburse the Hospital one-half of all sums advanced, plus interest, minus any amounts forgiven pursuant to the terms of the contract. The other half of the sum advanced to the physician is to be repaid to the Hospital beginning August 2007, with a term of 60 months at an interest rate of 7.5%. The physician was given an extension of 12 months in July 2010 for repayment of the note. The Hospital signed a promissory note with the physician pursuant to the agreement. The entire amount advanced to the physician is included in physician receivables on the balance sheet less amortization and payments made by the physician.

**Note 8: Long-term Obligations**

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

	<b>2012</b>					
	<b>Beginning Balance</b>	<b>Additions</b>	<b>Deletions</b>	<b>Ending Balance</b>	<b>Current Portion</b>	<b>Long-term Portion</b>
Series 2010 Hospital Revenue Bonds	\$ 148,787	\$ -	\$ 31,263	\$ 117,524	\$ 16,235	\$ 101,289
Series 2007 Hospital Revenue Bonds	10,270,000	-	160,000	10,110,000	165,000	9,945,000
Capital leases	438,535	-	167,262	271,273	104,176	167,097
	<u>\$10,857,322</u>	<u>\$ -</u>	<u>\$ 358,525</u>	<u>\$10,498,797</u>	<u>\$ 285,411</u>	<u>\$10,213,386</u>

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

	2011					
	Beginning Balance	Additions	Deletions	Ending Balance	Current Portion	Long-term Portion
Series 2010 Hospital Revenue Bonds	\$ 179,000	\$ -	\$ 30,213	\$ 148,787	\$ 15,632	\$ 133,155
Series 2007 Hospital Revenue Bonds	10,420,000	-	150,000	10,270,000	160,000	10,110,000
Capital leases	563,412	29,611	154,488	438,535	166,101	272,434
	<u>\$11,162,412</u>	<u>\$ 29,611</u>	<u>\$ 334,701</u>	<u>\$10,857,322</u>	<u>\$ 341,733</u>	<u>\$10,515,589</u>

**2010 Revenue Bonds Payable**

The 2010 revenue bonds payable, issued by the City, consist of United States Department of Agriculture Revenue Bonds (2010 Bonds) in the original amount of \$179,000 dated October 18, 2010, which bear interest of 3.75%. The 2010 Bonds are payable in annual installments through October 28, 2020. The Hospital is required to make monthly deposits beginning December 1, 2010, of approximately one-twelfth of the next principal and interest payment due to the debt service fund and a monthly deposit of \$150 to the debt service reserve fund both held by a financial institution. Proceeds from the issuance of these 2010 Bonds were used to purchase two ambulances. The owner of the 2010 Bonds may require and compel the Hospital to comply with the above provision of the Bond Resolution. All of the 2010 Bonds still outstanding may be redeemed at the Hospital's option at 100% of the redemption price. The 2010 Bonds are secured by the net revenues of the Hospital.

**2007 Revenue Bonds Payable**

In July 2007, the Series 2007 Hospital Revenue Bonds (2007 Bonds) were issued by the City in the original amount of \$10,745,000 dated August 7, 2007, which bear interest at 6.125%. The Bonds are payable in annual installments through August 15, 2037. The 2007 Bonds are secured by the net revenues of the Hospital. Proceeds from the issuance of these 2007 Bonds were used to fund the construction and equipping of the Hospital's expansion and partial replacement.

The indenture agreements require that certain funds be established with the trustee. Accordingly, these funds are included as assets held by trustee for debt service and restricted cash and investments - current in the balance sheets. The indenture agreements also require the Hospital to comply with certain restrictive covenants including maintaining a historical debt-service coverage of at least 1.25. The indenture agreements also require the Hospital to maintain a minimum days' cash on hand of 75 days.

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Capital Lease Obligations**

Equipment cost and accumulated depreciation under the capitalized lease obligations are as follows for the years ended December 31:

	<b>2012</b>	<b>2011</b>
Moveable equipment	\$ 551,492	\$ 594,991
Less accumulated depreciation	(334,513)	(224,516)
	<b>\$ 216,979</b>	<b>\$ 370,475</b>

Scheduled principal and interest payments on long-term debt and capital lease obligations are as follows:

	<b>Long-term Debt</b>		<b>Capital Lease</b>	
	<b>Principal</b>	<b>Interest</b>	<b>Principal</b>	<b>Interest</b>
2013	\$ 181,235	\$ 624,799	\$ 104,176	\$ 12,352
2014	196,843	614,083	73,839	6,467
2015	207,475	602,426	73,359	1,877
2016	218,120	590,134	2,772	1,539
2017	228,810	577,204	2,772	1,539
2018-2022	1,305,089	2,664,398	14,355	2,298
2023-2027	1,710,000	2,219,089	-	-
2028-2032	2,315,000	1,625,882	-	-
2033-2037	3,864,952	825,039	-	-
	<b>\$ 10,227,524</b>	<b>\$ 10,343,054</b>	<b>\$ 271,273</b>	<b>\$ 26,072</b>

**Note 9: Management/Services Agreement**

The Board of Trustees has contracted with Great Plains Health Alliance, Inc. (GPHA) for various services, including management, data processing and accounting services. The terms of the agreements vary from one to seven years and can be canceled with 60 days' notice. The agreements can be renewed after the initial term has expired on a year-to-year basis. Fees incurred for the various services provided by GPHA to the Hospital for the years ended December 31, 2012 and 2011, were \$323,462 and \$258,115, respectively. Amounts included in accounts payable related to these services totaled \$29,367 and \$14,230 at December 31, 2012 and 2011, respectively.

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

**Note 10: Pension Plan**

Fredonia Regional Hospital Employees' Pension Plan (the Plan) is a defined contribution pension plan covering substantially all employees. Eligible employees are those who work 1,000 hours or more each year, have attained the age of 21 and have completed two years of service. The Hospital's share of the contribution is 4% of the covered payroll and the employees' share is 3% of the covered payroll. The employees may contribute any additional amount to the Plan on a voluntary basis. The contributions are invested as each employee directs. Each participant chooses which accounts to use and may change the election once each calendar year. Contributions actually made by plan members and the Hospital aggregated \$148,247 and \$132,399 during 2012 and \$157,624 and \$127,231 during 2011, respectively.

**Note 11: Fredonia Regional Health Care Foundation, Inc.**

The Fredonia Regional Health Care Foundation, Inc. (Foundation) is a nonprofit organized to perpetuate the advancement of health, health care and medical education, research and welfare services for residents of Fredonia, Kansas and its outlying regions. The Foundation is not considered a component unit of the Hospital. The Foundation contributed \$149,510 and \$46,550 to the Hospital in 2012 and 2011, respectively, which is included in capital grants and gifts and noncapital grants and gifts on the statements of revenues, expenses and changes in net position, respectively. In connection with the issuance of the 2007 Bonds, the Foundation has provided a financial guarantee.

**Note 12: Patient Protection and Affordable Care Act**

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

**Fredonia Regional Hospital**  
**A Component Unit of the City of Fredonia, Kansas**  
**Notes to Financial Statements**  
**December 31, 2012 and 2011**

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

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

**Note 13: Risks and Uncertainties**

***Current Economic Conditions***

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

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

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