

Phillips County Health Systems
A Component Unit of Phillips County, Kansas

Financial Statements
March 31, 2019 and 2018

Together with Independent Auditor's Report

Phillips County Health Systems

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Independent Auditor's Report

To the Board of Trustees of
Phillips County Health Systems
Phillipsburg, Kansas:

We have audited the accompanying financial statements of Phillips County Health Systems (PCHS), a component unit of Phillips County, Kansas, which comprise the statement of net position as of March 31, 2019, the related statements of revenue, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise PCHS' basic financial statements as listed in the table of contents.

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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the Kansas Municipal Audit and Accounting 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 PCHS as of March 31, 2019 and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Other

The financial statements of PCHS, as of and for the year ended March 31, 2018, were audited by other auditors whose report, dated August 29, 2018, expressed an unmodified opinion on those statements.

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 missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Seim Johnson, LLP

Omaha, Nebraska,
August 26, 2019.

Phillips County Health Systems

Statements of Net Position March 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 763,649	749,420
Receivables -		
Patients, net of allowance for doubtful accounts of \$386,756 in 2019 and \$335,194 in 2018, respectively	1,743,395	1,752,829
Other	46,527	33,536
Inventories	244,821	213,355
Prepaid expenses	94,537	70,151
Total current assets	<u>2,892,929</u>	<u>2,819,291</u>
Noncurrent assets:		
Assets limited as to use, net of current portion	165,806	64,174
Investments	9,500	9,500
Scholarships receivable	70,345	49,465
Capital assets, net	2,207,138	2,055,272
Total noncurrent assets	<u>2,452,789</u>	<u>2,178,411</u>
Total assets	<u>\$ 5,345,718</u>	<u>4,997,702</u>
LIABILITIES		
Current liabilities:		
Line of credit	\$ 300,000	200,000
Current portion of long-term debt	263,841	107,031
Accounts payable	1,320,491	1,271,958
Accrued salaries, vacation, benefits and payroll taxes	1,036,746	974,820
Estimated third-party payor settlements	131,845	115,000
Total current liabilities	3,052,923	2,668,809
Noncurrent liabilities:		
Long-term debt, net of current portion	273,766	539,298
Total liabilities	<u>3,326,689</u>	<u>3,208,107</u>
NET POSITION		
Net investment in capital assets	1,669,531	1,408,943
Restricted for capital acquisitions or operations	165,806	64,174
Unrestricted	183,692	316,478
Total net position	<u>2,019,029</u>	<u>1,789,595</u>
Total liabilities and net position	<u>\$ 5,345,718</u>	<u>4,997,702</u>

See notes to financial statements

Phillips County Health Systems

Statements of Revenue, Expenses and Changes in Net Position For the Years Ended March 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
OPERATING REVENUE:		
Net patient service revenue, net of provision for bad debts of \$246,285 in 2019 and \$157,922 in 2018	\$ 11,569,701	10,389,834
Other operating revenue	<u>1,456,780</u>	<u>1,432,714</u>
Total operating revenue	<u>13,026,481</u>	<u>11,822,548</u>
OPERATING EXPENSES:		
Salaries and wages	5,968,099	5,398,802
Employee benefits	1,402,332	1,407,479
Supplies and other expenses	3,260,164	3,499,036
Professional fees and purchased services	2,670,089	2,262,571
Depreciation and amortization	<u>371,311</u>	<u>296,665</u>
Total operating expenses	<u>13,671,995</u>	<u>12,864,553</u>
OPERATING LOSS	<u>(645,514)</u>	<u>(1,042,005)</u>
NONOPERATING REVENUE (EXPENSE):		
Property taxes	391,635	420,007
Noncapital grants and contributions	534,838	393,740
Investment income	13,587	15,948
Interest expense	<u>(65,112)</u>	<u>(64,151)</u>
Total nonoperating revenue, net	<u>874,948</u>	<u>765,544</u>
INCREASE (DECREASE) IN NET POSITION	229,434	(276,461)
NET POSITION, BEGINNING OF YEAR	<u>1,789,595</u>	<u>2,066,056</u>
NET POSITION, END OF YEAR	<u>\$ 2,019,029</u>	<u>1,789,595</u>

See notes to financial statements

Phillips County Health Systems

Statements of Cash Flows

For the Years Ended March 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third-party payors	\$ 11,595,980	10,205,630
Cash paid to suppliers and contractors	(5,958,452)	(5,811,726)
Cash paid for employee salaries and benefits	(7,308,505)	(6,821,949)
Other receipts and payments, net	<u>1,443,489</u>	<u>1,446,839</u>
Net cash used in operating activities	<u>(227,488)</u>	<u>(981,206)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Property taxes	391,635	420,007
Noncapital grants and contributions	<u>534,838</u>	<u>393,740</u>
Net cash provided by noncapital financing activities	<u>926,473</u>	<u>813,747</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of capital assets	(398,647)	(289,119)
Proceeds from line of credit	600,000	300,000
Principal paid on line of credit	(500,000)	(100,000)
Proceeds from issuance of long-term debt	--	255,217
Principal paid on long-term debt	(232,952)	(501,191)
Interest paid	<u>(65,112)</u>	<u>(64,151)</u>
Net cash used in capital and related financing activities	<u>(596,711)</u>	<u>(399,244)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Withdrawals from (deposits to) assets limited as to use, net	(101,632)	194,517
Investment income	<u>13,587</u>	<u>15,948</u>
Net cash provided by (used in) investing activities	<u>(88,045)</u>	<u>210,465</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	14,229	(356,238)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>749,420</u>	<u>1,105,658</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 763,649</u>	<u>749,420</u>
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:		
PCHS entered into capital lease obligations for new equipment	<u>\$ 124,230</u>	<u>540,617</u>

See notes to financial statements

Phillips County Health Systems

Statements of Cash Flows (Continued) For the Years Ended March 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating loss	\$ (645,514)	(1,042,005)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	371,311	296,665
Gain on disposal of capital assets	(300)	(4,170)
(Increase) decrease in assets -		
Receivables -		
Patients	9,434	(31,537)
Other	(12,991)	18,295
Inventories	(31,466)	(26,059)
Prepaid expenses	(24,386)	(25,996)
Scholarships	(20,880)	(5,117)
Increase (decrease) in liabilities -		
Accounts payable - trade	48,533	7,053
Accrued salaries, vacation, benefits and payroll taxes	61,926	(15,668)
Estimated third-party payor settlements	16,845	(152,667)
	<u>16,845</u>	<u>(152,667)</u>
Net cash used in operating activities	\$ <u>(227,488)</u>	<u>(981,206)</u>

See notes to financial statements

Phillips County Health Systems

Notes to Financial Statements

March 31, 2019 and 2018

(1) Description of Reporting Entity and Summary of Significant Accounting Policies

A. *Description of Reporting Entity*

Phillips County Hospital d/b/a Phillips County Health Systems (PCHS) provides acute care, swing-bed and clinic services in the Phillipsburg, Kansas area. PCHS is a component unit of Phillips County, Kansas (County) and the Board of County Commissioners appoints members to the Board of Trustees of PCHS.

PCHS' financial statements are an integral part of Phillips County, Kansas. The accompanying financial statements are not intended to present fairly the financial position, changes in financial position, and cash flows of Phillips County, Kansas, in conformity with accounting principles generally accepted in the United States of America.

The Budget Reconciliation Act of 1997 (Act) contained many provisions impacting Medicare reimbursement for PCHS. The Act established the Medicare Rural Hospital Flexibility Program to assist states and rural communities to improve access to essential healthcare services through Critical Access Hospitals (CAH's) and rural health networks. CAH's are acute care facilities that provide emergency, outpatient, and short-term inpatient services. PCHS is a CAH. Medicare reimburses CAHs on a reasonable cost basis.

B. *Basis of Accounting and Presentation*

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

C. *Industry Environment*

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursements for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

Management believes that PCHS is in compliance with applicable government laws and regulations as they apply to the areas of fraud and abuse. While no regulatory inquiries have been made, compliance with laws and regulations is subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

D. *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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Phillips County Health Systems

Notes to Financial Statements March 31, 2019 and 2018

E. Cash and Cash Equivalents

PCHS considers all liquid investments with original maturities of three months or less to be cash equivalents.

F. Patients Accounts Receivable

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

G. Inventories

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

H. Assets Limited as to Use

Assets limited as to use include amounts restricted by donors for specific operating activities or by the Board of Trustees. Assets limited as to use consists of money market accounts.

I. Investments

Investments consist of a certificate of deposit carried at amortized cost.

J. Capital Assets, Net

Capital assets are recorded at cost at the date of acquisition, or acquisition 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 amortized over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by PCHS:

Land improvements	15 to 20 years
Buildings	15 to 40 years
Fixed equipment	10 to 20 years
Moveable equipment	3 to 20 years

Gifts of capital assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire capital assets are reported as capital grants and contributions. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the acquired long-lived assets are placed into service.

K. Compensated Absences

PCHS policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off. Expense and the related liability are recognized as vacation benefits are earned. 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. Accrued benefits payable are computed using the regular pay rates in effect at the statement of net position date.

Phillips County Health Systems

Notes to Financial Statements March 31, 2019 and 2018

L. *Net Position*

Net position classifications are defined as follows:

Net investment in capital assets – This component of net position consists of capital assets, including any restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any outstanding borrowings that are attributable to the acquisition, construction, or improvement of those assets.

Restricted – This component of net position consists of constraints placed on net position through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted – This component of net position consists of net position items not meeting the definition of the two preceding categories. This component often has constraints on resources imposed by the Board of Trustees which can be removed or modified.

M. *Net Patient Service Revenue*

PCHS has agreements with third-party payors that provide for payments to PCHS at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered and include estimated retroactive revenue adjustments. 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.

N. *Charity Care*

PCHS provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because PCHS does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges excluded from revenue under PCHS' charity care policy were \$92,142 and \$132,390 in 2019 and 2018, respectively.

O. *Property Taxes*

PCHS received approximately 3% of its financial support from noncapital appropriations from the County property tax levy in 2019 and 2018. These funds were used to support operations.

Property taxes are assessed in November and are received beginning in January of the following year. Noncapital appropriations revenue from property taxes is recognized in full in the year in which use is first permitted.

P. *Risk Management*

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

Phillips County Health Systems

Notes to Financial Statements March 31, 2019 and 2018

Q. *Income Taxes*

As an essential government function of the County, PCHS is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. However, PCHS is subject to federal income tax on any unrelated business taxable income.

R. *Medical Malpractice Insurance*

Medical malpractice insurance is purchased under claims-made policies. Under these policies, only claims made and reported to the insurer are covered during the policy term. PCHS accrues the expense of its share of asserted and unasserted claims occurring during the year by estimating the probable ultimate cost of any such claim. Such estimates are based on PCHS' own claims experience. PCHS' management does not expect any claim to exceed the insurance coverage limits. However, because of the risk involved in providing healthcare services, it is possible an event has occurred that will be the basis of a future material claim.

S. *Subsequent Events*

PCHS considered events occurring through August 26, 2019 for recognition or disclosure in the financial statements as subsequent events. That date is the date the financial statements were available to be issued.

(2) **Net Patient Service Revenue**

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

Medicare - Inpatient acute care services rendered to Medicare program beneficiaries in a critical access hospital are paid based on Medicare defined costs of providing the services. Inpatient nonacute services, certain outpatient services, and rural health clinic services related to Medicare beneficiaries are also paid based on a cost reimbursement methodology. PCHS is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by PCHS and audits thereof by the Medicare Administrative Contractor. PCHS' Medicare cost reports have been audited by the Medicare Administrative Contractor through March 31, 2017.

The "Budget Control Act of 2011" requires, among other things, mandatory across-the-board reductions in Federal spending, also known as sequestration. In general, Medicare claims with dates of service or dates of discharge on or after April 1, 2013, incur a two percent reduction in Medicare payment.

Medicaid - Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed on a prospective payment methodology, which includes a hospital specific add-on percentage based on prior filed cost reports. The add-on percentage may be rebased at some time in the future.

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

Phillips County Health Systems

Notes to Financial Statements March 31, 2019 and 2018

Net patient service revenue consists of the following for the years ending March 31, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Gross patient service revenue:		
Inpatient	\$ 3,406,890	3,362,300
Outpatient	8,520,969	6,858,096
Clinic	<u>1,585,189</u>	<u>1,554,651</u>
Total gross patient services revenue	<u>13,513,048</u>	<u>11,775,047</u>
Deductions from (additions to) gross patient service revenue:		
Medicare	651,188	(43,346)
Medicaid	190,445	320,127
Other payors	763,287	818,120
Charity care	<u>92,142</u>	<u>132,390</u>
Total deductions from gross patient service revenue, net	<u>1,697,062</u>	<u>1,227,291</u>
Provision for uncollectible accounts	<u>11,815,986</u>	<u>10,547,756</u>
	<u>246,285</u>	<u>157,922</u>
Net patient service revenue, net of provision for bad debts	<u>\$ 11,569,701</u>	<u>10,389,834</u>

Approximately 74% and 75% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended March 31, 2019 and 2018, 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.

(3) Cash and Cash Equivalents, Investments, and Assets Limited as to Use

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.

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

At March 31, 2019 and 2018, respectively, \$382,210 and \$336,374 of PCHS' bank balances of \$990,913 and \$834,552 were exposed to custodial credit risk as follows:

	<u>2019</u>	<u>2018</u>
Uninsured and uncollateralized	\$ 13,558	--
Uninsured and collateral held by pledging financial institution	<u>368,652</u>	<u>336,374</u>
	<u>\$ 382,210</u>	<u>336,374</u>

Phillips County Health Systems

Notes to Financial Statements March 31, 2019 and 2018

The following is a summary of cash and cash equivalents, investments, and assets limited as to use as seen on the statements of net position as of March 31, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Included in the following statement of net position captions –		
Cash and cash equivalents	\$ 763,649	749,420
Investments - certificates of deposit	9,500	9,500
Assets limited as to use – cash and cash equivalents	<u>165,806</u>	<u>64,174</u>
	<u>\$ 938,955</u>	<u>823,094</u>

(4) Composition of Patient Receivables

Patient receivable as of March 31, 2019 and 2018 consist of the following:

	<u>2019</u>	<u>2018</u>
Patient accounts receivable	\$ 2,373,406	2,295,969
Less estimated third-party contractual adjustments	(243,252)	(207,946)
Less allowance for doubtful accounts	<u>(386,756)</u>	<u>(335,194)</u>
	<u>\$ 1,743,395</u>	<u>1,752,829</u>

PCHS grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors was as follows:

	<u>2019</u>	<u>2018</u>
Medicare	50%	45%
Medicaid	3	3
Blue Cross	9	9
Other third-party payors	18	18
Self-pay	<u>20</u>	<u>25</u>
	<u>100%</u>	<u>100%</u>

Phillips County Health Systems

Notes to Financial Statements March 31, 2019 and 2018

(5) Capital Assets

Capital assets activity for the years ended March 31, 2019 and 2018 was as follows:

	March 31, 2018	Additions	Transfers or Disposals	March 31, 2019
Capital assets, not being depreciated/amortized:				
Land	\$ 48,100	--	--	48,100
Construction in progress	99,491	--	--	99,491
	<u>147,591</u>	<u>--</u>	<u>--</u>	<u>147,591</u>
Capital assets, being depreciated/amortized:				
Land improvements	107,381	8,160	--	115,541
Buildings	3,957,010	82,998	--	4,040,008
Fixed equipment	2,489,364	164,582	--	2,653,946
Major moveable equipment	2,563,927	267,437	(23,697)	2,807,667
Total capital assets, being depreciated/amortized	<u>9,117,682</u>	<u>523,177</u>	<u>(23,697)</u>	<u>9,617,162</u>
Less accumulated depreciation/amortization:				
Land improvements	(107,144)	(555)	--	(107,699)
Buildings	(3,074,609)	(136,880)	--	(3,211,489)
Fixed equipment	(2,061,766)	(47,418)	--	(2,109,184)
Major moveable equipment	(1,966,482)	(186,458)	23,697	(2,129,243)
Total accumulated depreciation/amortization	<u>(7,210,001)</u>	<u>(371,311)</u>	<u>23,697</u>	<u>(7,557,615)</u>
Total capital assets, being depreciated/amortized, net	<u>1,907,681</u>	<u>151,866</u>	<u>--</u>	<u>2,059,547</u>
Total capital assets, net	<u>\$ 2,055,272</u>	<u>151,866</u>	<u>--</u>	<u>2,207,138</u>
	March 31, 2017	Additions	Transfers or Disposals	March 31, 2018
Capital assets, not being depreciated/amortized:				
Land	\$ 48,100	--	--	48,100
Construction in progress	109,291	--	(9,800)	99,491
	<u>157,391</u>	<u>--</u>	<u>(9,800)</u>	<u>147,591</u>
Capital assets, being depreciated/amortized:				
Land improvements	107,381	--	--	107,381
Buildings	3,690,676	256,534	9,800	3,957,010
Fixed equipment	2,246,661	288,103	(45,400)	2,489,364
Major moveable equipment	2,665,815	298,349	(400,237)	2,563,927
Total capital assets, being depreciated/amortized	<u>8,710,533</u>	<u>842,986</u>	<u>(435,837)</u>	<u>9,117,682</u>
Less accumulated depreciation/amortization:				
Land improvements	(106,738)	(406)	--	(107,144)
Buildings	(2,942,023)	(132,586)	--	(3,074,609)
Fixed equipment	(2,058,847)	(39,239)	36,320	(2,061,766)
Major moveable equipment	(2,242,285)	(124,434)	400,237	(1,966,482)
Total accumulated depreciation/amortization	<u>(7,349,893)</u>	<u>(296,665)</u>	<u>436,557</u>	<u>(7,210,001)</u>
Total capital assets, being depreciated/amortized, net	<u>1,360,640</u>	<u>546,321</u>	<u>720</u>	<u>1,907,681</u>
Total capital assets, net	<u>\$ 1,518,031</u>	<u>546,321</u>	<u>(9,080)</u>	<u>2,055,272</u>

Depreciation and amortization expense of \$371,311 and \$296,665 for fiscal years 2019 and 2018, respectively, is included on the statements of revenue, expenses, and changes in net assets.

Phillips County Health Systems

Notes to Financial Statements March 31, 2019 and 2018

(6) Line of Credit

PCHS has a \$600,000 revolving bank line of credit. The line of credit expires September 26, 2019. The line of credit is for operating purposes with a fixed interest rate of 6.25%, collateralized by primarily all of PCHS' assets. The following is a summary of line of credit transactions for year ended March 31:

	<u>2019</u>	<u>2018</u>
Beginning balance	\$ 200,000	--
Additions	600,000	300,000
Deductions	<u>(500,000)</u>	<u>(100,000)</u>
Ending balance	\$ <u>300,000</u>	<u>200,000</u>

(7) Long-Term Debt

A summary of long-term debt and capital lease activity for the years ending March 31, 2019 and 2018 is as follows:

	<u>March 31, 2018</u>	<u>Borrowings</u>	<u>Payments</u>	<u>March 31, 2019</u>	<u>Due Within One Year</u>
Capital lease obligations (a)	\$ 420,675	124,230	(159,403)	385,502	197,361
Note payable (b)	104,912	--	(11,494)	93,418	7,793
Note payable (c)	<u>120,742</u>	<u>--</u>	<u>(62,055)</u>	<u>58,687</u>	<u>58,687</u>
Total long-term debt	\$ <u>646,329</u>	<u>124,230</u>	<u>(232,952)</u>	<u>537,607</u>	<u>263,841</u>

	<u>March 31, 2017</u>	<u>Borrowings</u>	<u>Payments</u>	<u>March 31, 2018</u>	<u>Due Within One Year</u>
Capital lease obligations (a)	\$ 239,564	540,617	(359,506)	420,675	99,539
Note payable (b)	112,122	--	(7,210)	104,912	7,492
Note payable (c)	<u>--</u>	<u>255,217</u>	<u>(134,475)</u>	<u>120,742</u>	<u>--</u>
Total long-term debt	\$ <u>351,686</u>	<u>795,834</u>	<u>(501,191)</u>	<u>646,329</u>	<u>107,031</u>

- (a) Capital lease obligations for equipment with interest rates ranging from 3.10% to 11.47%, due in monthly installments ranging from \$181 to \$2,467, including interest through January 2024, and an obligation with annual payments of \$69,277 through March 2021. The leases are secured by equipment with an original cost of \$806,493 and a net book value of \$520,618 as of March 31, 2019.
- (b) Note payable to local bank, due in monthly installments of \$958, including interest at 3.94%, through July 2029. The note payable is secured by a mortgage on the purchased property.
- (c) Note payable to local bank, due in annual installments of \$68,033 and \$62,099, including interest at 5.8%, through March 2021. The note payable is secured by accounts receivable.

Phillips County Health Systems

Notes to Financial Statements March 31, 2019 and 2018

Scheduled principal and interest payments on notes payable and capital lease obligations are as follows for the fiscal year ending March 31:

Year Ending	Notes Payable		Capital Leases		Total	
	Principal	Interest	Principal	Interest	Principal	Interest
2020	\$ 66,480	7,114	197,361	16,222	263,841	23,336
2021	8,106	3,388	82,085	8,266	90,191	11,654
2022	8,431	3,063	50,481	4,496	58,912	7,559
2023	8,770	2,724	34,778	2,122	43,548	4,846
2024	9,122	2,372	20,797	857	29,919	3,229
2025-2029	47,396	6,066	--	--	47,396	6,066
2030	3,800	31	--	--	3,800	31
	<u>\$ 152,105</u>	<u>24,758</u>	<u>385,502</u>	<u>31,963</u>	<u>537,607</u>	<u>56,721</u>

(8) Net Position

Of the \$183,692 and \$316,478 of unrestricted net position as of March 31, 2019 and 2018, respectively, \$70,345 and \$49,465 has been designated by PCHS' Board of Trustees for scholarships.

The following is a summary of donor restricted net position purpose as of March 31, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Scholarships	\$ 109,600	37,539
Equipment	24,420	4,973
Provider retention	12,035	--
Clinic electronic medical records	--	7,254
Operations	<u>19,751</u>	<u>14,408</u>
	<u>\$ 165,806</u>	<u>64,174</u>

(9) Medical Malpractice Claims

PCHS carries a professional liability policy (including malpractice) which provides \$1,000,000 of coverage for injuries per occurrence and \$3,000,000 aggregate coverage. These policies provide coverage on a claims-made basis covering only those claims which have occurred and are reported to the insurance company while the coverage is in force. PCHS could have exposure on possible incidents that have occurred for which claims will be made in the future should professional liability insurance not be obtained, should coverage be limited and/or not available.

PCHS is not aware of any known claims or incidents or claims from unknown incidents that may be asserted from services provided to patients. PCHS has also evaluated its paid claims history and has determined that no reserve for losses on both asserted and unasserted claims is needed.

Accounting principles generally accepted in the United States of America require a healthcare provider to recognize the ultimate costs of malpractice claims or similar contingent liabilities, which include costs associated with litigating or settling claims, when the incidents that give rise to the claims occur. PCHS does evaluate all incidents and claims along with prior claim experienced to determine if a liability is to be recognized. For the years ending March 31, 2019 and 2018, management determined no liability should be recognized for asserted or unasserted claims. Management is not aware of any such claim that would have a material adverse impact on the accompanying financial statements.

Phillips County Health Systems

Notes to Financial Statements March 31, 2019 and 2018

(10) Pension Plan

PCHS maintains a contributory pension plan covering substantially all employees. Pension expense is recorded for the amount of PCHS' required contributions, determined in accordance with the terms of the plan. PCHS will contribute 6.2% of eligible employee compensation as well as a matching amount equal to 200% of the employee's deferred amount up to 2%. That maximum employer contribution is 10.2% of eligible employee compensation. Employees are vested 20% in PCHS contribution after one year employment and add 20% after each additional year of service.

The plan provides retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of PCHS' governing body. Contribution rates, expressed as a percentage of covered payroll, were 10% and 11% for plan members and PCHS, respectively, for 2019 and 2018. Contributions by plan members were \$626,198 and \$574,943 for 2019 and 2018, respectively. Contributions by PCHS were \$592,465 and \$536,533 for 2019 and 2018, respectively.

(11) Management/Services Agreement

The Board of Trustees of PCHS contracted with Great Plains Health Alliance (GPHA) for various services, including management and data processing services. During 2019, PCHS terminated the management agreement leaving only the data processing agreement as of March 31, 2019. Fees incurred for the various services provided by GPHA to PCHS totaled \$700,857 and \$810,318 in 2019 and 2018, respectively. Amounts included in accounts payable related to these services totaled \$413,794 and \$579,680 as of March 31, 2019 and 2018, respectively. PCHS has agreed to pay \$10,559 per month through July 2022 to satisfy the payable amount to GPHA.

The Board of Trustees of PCHS has entered into a service agreement with the Cerner RevWorks (Cerner) for billing services. The three year service agreement ends in November 2021 with the option for additional one year extensions. Under the terms of the agreement, Cerner will receive 1.99% of net receipts from patient services. Fees incurred under the service agreement totaled \$78,860 for the year ended March 31, 2019. Amounts included in accounts payable related to these services totaled \$56,598 as of March 31, 2019.

(12) Other Operating Revenue

Other operating revenue for the years ended March 31, 2019 and 2018 consisted of the following:

	<u>2019</u>	<u>2018</u>
340B drug pricing program	\$ 1,143,311	1,115,716
Contract therapy	148,388	138,579
Telemedicine	32,569	36,289
Cafeteria sales	22,291	20,558
Gain on sale of capital assets	300	4,170
Miscellaneous revenue	<u>109,921</u>	<u>117,402</u>
	<u>\$ 1,456,780</u>	<u>1,432,714</u>

Phillips County Health Systems

Notes to Financial Statements March 31, 2019 and 2018

340B Drug Pricing Program

PCHS participates in the 340B Drug Pricing Program (340B Program) enabling PCHS to receive discounted prices from drug manufacturers on outpatient pharmaceutical purchases and enter into certain contracts with unrelated pharmacies who provide certain prescriptive drugs to PCHS patients who receive rural health clinic and outpatient services from PCHC. This program is overseen by the Health Resources and Services Administration (HRSA) Office of Pharmacy Affairs (OPA). HRSA is currently conducting routine audits of these programs at health care organizations and increasing its compliance monitoring processes. Laws and regulations governing the 340B Program are complex and subject to interpretation and change. As a result, it is reasonably possible that material changes to financial statement amounts related to the 340B Program could occur in the near future. During 2019 and 2018, PCHS recognized \$1,143,311 and \$1,115,716, respectively, of other operating revenue related to the 340B Program contracts with unrelated pharmacies.

(13) Great Plains Employee Benefits Trust

In response to amendments to Kansas Insurance Code related to multi-employer welfare arrangements, GPHA restated its existing voluntary employees' beneficiary association (VEBA) trust as described in Section 501(c)(9) of the Internal Revenue Code, which is named the Great Plains Employee Benefits Trust (the Trust). The Trust is governed by its Board of Trustees. One of the purposes of the Trust is to provide the self-funded GPHA Employee Benefits Plan (the Plan) for its member organizations and their participating employees. PCHS is a member organization in the Trust and substantially all of PCHS' employees and their dependents are eligible to participate in the Plan. The Plan provides medical benefits, prescription drug benefits and dental benefits for a benefit period that runs each year from July 1 through June 30. The participant's monthly premiums are determined by the Trust. The Trust may change the premiums from time to time. The Plan agreement specifies that the Trust will be self-sustaining through member premiums and will reinsure through commercial carriers for claims in excess of stop-loss amounts. The Trust accrues a provision for self-insured employee benefit claims including both claims reported and claims incurred but not yet reported. If a net deficit position is anticipated by the Trust after consideration of the accrued provision, the Trust will administer insurance assessments to its member organizations based on a systematic allocation method.

PCHS made employer premium contributions of \$598,370 and \$641,383 during fiscal years 2019 and 2018, respectively. These contributions are included in employee benefit expense in the statements of revenue, expenses and changes in net position. During 2016, PCHS was assessed approximately \$126,400 to cover the Trust shortfalls. No shortfall assessment was requested for 2018 and management does not expect an assessment for 2019.