

Allen County Hospital
d/b/a Allen County Regional Hospital
A Component Unit of Allen County, Kansas
Independent Auditor's Report and Financial Statements
December 31, 2017 and 2016



Allen County Hospital
d/b/a Allen County Regional Hospital
A Component Unit of Allen County, Kansas
December 31, 2017 and 2016

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Independent Auditor's Report

Board of Trustees
Allen County Hospital
d/b/a Allen County Regional Hospital
Iola, Kansas

We have audited the accompanying financial statements of Allen County Hospital d/b/a/ Allen County Regional Hospital (Hospital), a component unit of Allen County, Kansas, as of and for the years ended December 31, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the Hospital's 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 audits. We conducted our audits 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 the Hospital as of December 31, 2017 and 2016, 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.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis listed in the table of contents 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.

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 audits 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.

BKD, LLP

Kansas City, Missouri
May 22, 2018

Allen County Hospital
d/b/a Allen County Regional Hospital
A Component Unit of Allen County, Kansas
Management's Discussion and Analysis
Years Ended December 31, 2017 and 2016

Introduction

This management's discussion and analysis of the financial performance of Allen County Hospital d/b/a Allen County Regional Hospital (the "Hospital") provides an overview of the Hospital's financial activities for the years ended December 31, 2017 and 2016. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- The Hospital saw a significant increase in swing bed and outpatient volumes, as well as a modest increase in emergency room volumes from the previous year. Swing bed patient days were up by 10 percent, outpatient registrations were up by 14 percent and emergency room visits were up by 6 percent.
- The Hospital reported operating revenues of \$21,961,811 in 2017, \$20,357,574 in 2016 and \$19,020,086 in 2015.
- The Hospital reported an operating income of \$59,843 in 2017, \$228,999 in 2016 and an operating loss of \$597,645 in 2015.
- The Hospital reported a decrease in net position of \$1,720,181 in 2017, \$852,823 in 2016 and \$1,344,451 in 2015.

Using This Annual Report

The Hospital's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net position; and a statement of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB).

The Balance Sheets and Statements of Revenues, Expenses and Changes in Net Position

One of the most important questions asked about any Hospital's finances is "Is the Hospital as a whole better or worse off as a result of the year's activities?" The Balance Sheets and the Statements of Revenues, Expenses and Changes in Net Position report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. Using the accrual basis of accounting means that all of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net position and changes in it. The Hospital's total net position—the difference between assets and liabilities—is one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net position are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

The Statement of Cash Flows

The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for and what was the change in cash and cash equivalents during the reporting period.

The Hospital's Net Position

The Hospital's net position is the difference between its assets and liabilities reported in the Balance Sheets. The Hospital's net position has shown a decrease in 2017 and 2016, as illustrated in Table 1 below.

Table 1: Assets, Liabilities and Net Position

	2017	2016	2015
Assets			
Patient accounts receivable, net	\$ 2,844,976	\$ 3,078,690	\$ 2,989,780
Other current assets	1,787,384	2,148,574	2,601,496
Capital assets, net	930,727	1,571,020	2,256,274
Other noncurrent assets	8,460	245,539	287,493
Total assets	<u>\$ 5,571,547</u>	<u>\$ 7,043,823</u>	<u>\$ 8,135,043</u>
Liabilities			
Long-term debt	\$ 132,325	\$ 266,127	\$ 411,788
Other current and noncurrent liabilities	3,107,755	2,726,048	2,818,784
Total liabilities	<u>3,240,080</u>	<u>2,992,175</u>	<u>3,230,572</u>
Net Position			
Net investment in capital assets	507,877	723,784	1,272,077
Restricted expendable	8,460	245,539	287,493
Unrestricted	1,815,130	3,082,325	3,344,901
Total net position	<u>2,331,467</u>	<u>4,051,648</u>	<u>4,904,471</u>
Total liabilities and net position	<u>\$ 5,571,547</u>	<u>\$ 7,043,823</u>	<u>\$ 8,135,043</u>

Net patient accounts receivable decreased by \$233,714 or 8 percent at December 31, 2017 compared to December 31, 2016 and increased by \$88,910 or 3 percent at December 31, 2016 compared to December 31, 2015.

Other current assets decreased by \$361,190 or 17 percent at December 31, 2017 compared to December 31, 2016 and by \$452,922 or 17 percent at December 31, 2016 compared to 2015, due to the decrease in estimated amounts due from third-party payers.

Other noncurrent assets decreased by \$237,079 or 97 percent at December 31, 2017 compared to December 31, 2016 and by \$41,954 or 15 percent at December 31, 2016 compared to 2015.

Long-term debt decreased by \$133,802 or 50 percent at December 31, 2017 compared to December 31, 2016 and by \$145,661 or 35 percent at December 31, 2016 compared to 2015, due to the scheduled debt principal payments.

Operating Results and Changes in the Hospital's Net Position

As shown in Table 2, the Hospital had a decrease in net position for 2017 of \$1,720,181 which is a decline of \$867,358 from 2016. The decrease over prior year's performance is a result of several factors that are discussed below. In 2016, the Hospital had a decrease in net position of \$852,823, which is an improvement of \$491,628 from 2015.

Table 2: Operating Results and Changes in Net Position

	2017	2016	2015
Operating Revenues			
Net patient service revenue	\$ 21,302,528	\$ 19,720,609	\$ 18,749,490
Other operating revenues	659,283	636,965	270,596
Total operating revenues	<u>21,961,811</u>	<u>20,357,574</u>	<u>19,020,086</u>
Operating Expenses			
Salaries and wages and employee benefits	10,077,448	8,768,003	8,478,577
Purchased services and professional fees	3,168,717	2,908,382	2,731,874
Depreciation and amortization	659,594	798,082	917,659
Other operating expenses	7,996,209	7,654,108	7,489,621
Total operating expenses	<u>21,901,968</u>	<u>20,128,575</u>	<u>19,617,731</u>
Operating Income (Loss)	<u>59,843</u>	<u>228,999</u>	<u>(597,645)</u>
Nonoperating Revenues (Expenses)			
Investment income	8,403	8,337	8,898
Interest expense	(5,779)	(9,317)	(13,361)
(Gain) loss on sale of capital assets	(2,469)	2,134	(27,134)
Other	5,000	41,534	-
Contributions to Allen County, Kansas	(1,828,814)	(1,192,375)	(900,667)
Total nonoperating expenses	<u>(1,823,659)</u>	<u>(1,149,687)</u>	<u>(932,264)</u>
Capital Gifts and Grants			
Gifts to purchase capital assets	<u>43,635</u>	<u>67,865</u>	<u>185,458</u>
Decrease in Net Position	<u>\$ (1,720,181)</u>	<u>\$ (852,823)</u>	<u>\$ (1,344,451)</u>

Operating Income (Losses)

The first component of the overall change in the Hospital's net position is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. The operating income for 2017 of \$59,843 was a decrease of \$169,156 from the 2016 operating income of \$228,999. The primary component of the decrease in the operating income is an increase in salaries and wages and employee benefits. The decrease in the operating income was mitigated by an increase in net patient service revenue.

The operating income for 2016 of \$228,999 was an increase of \$826,644 from the 2015 operating loss of \$597,645. The primary component of the decrease in the operating loss is an increase in net patient service revenue.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income, interest expense, gain or loss on sale of capital assets, contributions to Allen County, Kansas and noncapital gifts and grants. The Hospital recognized interest expense of \$5,779, \$9,317, and \$13,361 during 2017, 2016 and 2015, respectively, for the payment of a note payable and capital leases. The Hospital made contributions to Allen County, Kansas of \$1,828,814, \$1,192,375 and \$900,667 during 2017, 2016 and 2015, respectively, for the payment of debt service requirements.

Capital Grants and Gifts

The Hospital received capital grants and gifts of \$43,635, \$67,865 and \$185,458 during 2017, 2016 and 2015, respectively, which primarily related to contributions from local foundations for constructing and equipping the new facility.

The Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with changes in operating losses and nonoperating revenues and expenses discussed earlier.

Capital Asset and Debt Administration

Capital Assets

At the end of 2017, the Hospital had \$930,727 invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2017, the Hospital purchased new equipment and construction services costing \$31,720. Of this amount, \$21,202 was acquired through capital lease obligations and \$0 was included in accounts payable at December 31, 2017.

At the end of 2016, the Hospital had \$1,571,020 invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2016, the Hospital purchased new equipment and construction services costing \$116,426, and \$9,750 was included in accounts payable at December 31, 2016.

At the end of 2015, the Hospital had \$2,256,274 invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2015, the Hospital purchased new equipment and construction services costing \$190,341. Of this amount, \$97,750 was acquired through capital lease obligations.

Debt

At December 31, 2017, the Hospital had \$132,325 in notes payable and capital lease obligations outstanding. During 2017, the Hospital issued a capital lease of \$20,202 for equipment.

At December 31, 2016, the Hospital had \$266,127 in capital lease obligations outstanding.

At December 31, 2015, the Hospital had \$411,788 in capital lease obligations outstanding. During 2015, the Hospital issued a capital lease of \$97,750 for equipment.

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. Questions about this report and requests for additional financial information should be directed to the Hospital Business Administration by telephoning 620.365.1000.

Allen County Hospital
d/b/a Allen County Regional Hospital
A Component Unit of Allen County, Kansas
Balance Sheets
December 31, 2017 and 2016

Assets

	<u>2017</u>	<u>2016</u>
Current Assets		
Cash and cash equivalents	\$ 877,375	\$ 966,046
Patient accounts receivable, net of allowance for doubtful accounts; 2017 - \$2,031,906, 2016 - \$1,751,775	2,844,976	3,078,690
Estimated amounts due from third-party payers	-	458,000
Supplies	465,338	353,214
Prepaid expenses and other	<u>444,671</u>	<u>371,314</u>
Total current assets	<u>4,632,360</u>	<u>5,227,264</u>
Noncurrent Cash and Deposits		
Contributions restricted for capital acquisitions	<u>8,460</u>	<u>245,539</u>
Capital Assets, Net of Accumulated Depreciation	<u>930,727</u>	<u>1,571,020</u>
 Total assets	 <u><u>\$ 5,571,547</u></u>	 <u><u>\$ 7,043,823</u></u>

Liabilities and Net Position

	2017	2016
Current Liabilities		
Current maturities of capital lease and note payable	\$ 124,708	\$ 149,904
Accounts payable	1,190,058	1,076,633
Accrued expenses	860,220	772,203
Estimated amounts due to third-party payers	766,952	305,853
Payable to Allen County, Kansas	290,525	571,359
Total current liabilities	3,232,463	2,875,952
Capital Lease and Note Payable	7,617	116,223
Total liabilities	3,240,080	2,992,175
Net Position		
Net investment in capital assets	507,877	723,784
Restricted - expendable for capital acquisitions	8,460	245,539
Unrestricted	1,815,130	3,082,325
Total net position	2,331,467	4,051,648
Total liabilities and net position	\$ 5,571,547	\$ 7,043,823

Allen County Hospital
d/b/a Allen County Regional Hospital
A Component Unit of Allen County, Kansas
Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2017 and 2016

	2017	2016
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2017 - \$2,632,621, 2016 - \$2,196,212	\$ 21,302,528	\$ 19,720,609
Other	659,283	636,965
Total operating revenues	<u>21,961,811</u>	<u>20,357,574</u>
Operating Expenses		
Salaries and wages	7,533,317	6,977,277
Employee benefits	2,544,131	1,790,726
Supplies	2,529,575	2,164,207
Professional fees	2,234,339	2,108,658
Purchased services and professional fees	934,378	799,724
Contract services	3,748,250	3,818,813
Repairs and maintenance	437,868	454,674
Rents and leases	94,343	97,477
Utilities	347,991	362,955
Other	838,182	755,982
Depreciation and amortization	659,594	798,082
Total operating expenses	<u>21,901,968</u>	<u>20,128,575</u>
Operating Income	<u>59,843</u>	<u>228,999</u>
Nonoperating Revenues (Expenses)		
Investment income	8,403	8,337
Interest expense	(5,779)	(9,317)
Gain (loss) on sale of capital assets	(2,469)	2,134
Other	5,000	41,534
Contributions to Allen County, Kansas	(1,828,814)	(1,192,375)
Total nonoperating expenses	<u>(1,823,659)</u>	<u>(1,149,687)</u>
Deficiency of Revenue Over Expenses Before Capital Gifts and Grants	(1,763,816)	(920,688)
Capital Gifts and Grants	<u>43,635</u>	<u>67,865</u>
Decrease in Net Position	(1,720,181)	(852,823)
Net Position, Beginning of Year	<u>4,051,648</u>	<u>4,904,471</u>
Net Position, End of Year	<u><u>\$ 2,331,467</u></u>	<u><u>\$ 4,051,648</u></u>

Allen County Hospital
d/b/a Allen County Regional Hospital
A Component Unit of Allen County, Kansas
Statements of Cash Flows
Years Ended December 31, 2017 and 2016

	2017	2016
Operating Activities		
Receipts from and on behalf of patients	\$ 22,455,341	\$ 18,813,209
Payments to suppliers and contractors	(11,139,215)	(10,424,238)
Payments to or on behalf of employees	(10,077,448)	(8,767,588)
Other receipts, net	659,283	634,831
	<u>1,897,961</u>	<u>256,214</u>
Net cash provided by operating activities		
Noncapital Financing Activities		
Contributions paid to Allen County, Kansas	(1,828,814)	(1,192,375)
	<u>(1,828,814)</u>	<u>(1,192,375)</u>
Net cash used in noncapital financing activities		
Capital and Related Financing Activities		
Capital grants and gifts	43,635	67,865
Change in payable to Allen County, Kansas	(271,084)	(1,050)
Principal paid on long-term debt	(155,004)	(145,661)
Interest paid on capital debt and leases	(5,779)	(9,317)
Purchase of capital assets	(20,268)	(106,676)
Proceeds from sale of capital assets	200	5,732
	<u>(408,300)</u>	<u>(189,107)</u>
Net cash used in capital and related financing activities		
Investing Activities		
Interest and dividends on investments	8,403	8,337
Insurance proceeds	5,000	41,534
	<u>13,403</u>	<u>49,871</u>
Net cash provided by investing activities		
Decrease in Cash and Cash Equivalents	(325,750)	(1,075,397)
Cash and Cash Equivalents, Beginning of Year	1,211,585	2,286,982
Cash and Cash Equivalents, End of Year	<u>\$ 885,835</u>	<u>\$ 1,211,585</u>
Reconciliation of Cash to the Balance Sheets		
Cash and cash equivalents in current assets	\$ 877,375	\$ 966,046
Cash and cash equivalents in noncurrent cash and deposits	8,460	245,539
	<u>\$ 885,835</u>	<u>\$ 1,211,585</u>
Total cash and cash equivalents		

Allen County Hospital
d/b/a Allen County Regional Hospital
A Component Unit of Allen County, Kansas
Statements of Cash Flows (Continued)
Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Reconciliation of Net Operating Revenues (Expenses) to		
Net Cash Provided by (Used in) Operating Activities		
Operating income	\$ 59,843	\$ 228,999
Depreciation and amortization	659,594	798,082
Provision for uncollectible accounts	2,632,621	2,196,212
Changes in operating assets and liabilities		
Patient accounts receivable	(2,398,907)	(2,285,122)
Accounts payable and accrued expenses	211,192	259,054
Estimated amounts due from (to) third-party payers	919,099	(818,490)
Other assets	<u>(185,481)</u>	<u>(122,521)</u>
Net cash provided by operating activities	<u>\$ 1,897,961</u>	<u>\$ 256,214</u>
Supplemental Cash Flows Information		
Capital lease obligations incurred for capital assets	\$ 21,202	\$ -
Capital assets transferred to Allen County, Kansas	9,750	-
Capital asset acquisitions included in accounts payable	-	9,750

Allen County Hospital
d/b/a Allen County Regional Hospital
A Component Unit of Allen County, Kansas
Notes to Financial Statements
December 31, 2017 and 2016

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

Nature of Operations and Reporting Entity

Allen County Hospital d/b/a Allen County Regional Hospital (the Hospital) is an acute care hospital located in Iola, Kansas. The Hospital is a component unit of Allen County, Kansas (the County), and the Board of County Commissioners appoints members to the Board of Trustees (the Board) of the Hospital. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Allen County area.

Basis of Accounting and Presentation

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

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, 2017 and 2016, cash equivalents consisted primarily of deposit and money market accounts.

Allen County Hospital
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A Component Unit of Allen County, Kansas
Notes to Financial Statements
December 31, 2017 and 2016

Risk Management

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

The Hospital is self-insured for a portion of its exposure to risk of loss employee health claims. Annual estimated provisions are accrued for the self-insured portion of medical malpractice and employee health claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

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.

Other Revenue

The Hospital participated in the 340B Drug Pricing Program (the Program), enabling the Hospital to receive discounted prices from drug manufacturers on outpatient pharmaceutical purchases. This program is overseen by the Health Resources and Services Administration (HRSA) Office of Pharmacy Affairs (OPA). The Hospital generated approximately \$382,500 and \$392,000 of gross revenue from the Program in 2017 and 2016, respectively, which is recorded in other operating revenue in the statements of revenues, expenses and changes in net position.

Supplies

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

Allen County Hospital
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Notes to Financial Statements
December 31, 2017 and 2016

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 and leasehold improvements 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 – 25 years
Buildings and leasehold improvement	5 – 40 years
Equipment	3 – 20 years
Computer software	3 – 10 years

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 consists of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net position is made up of 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 the remaining net position that does not meet the definition of net investment in capital assets or restricted net position.

Allen County Hospital
d/b/a Allen County Regional Hospital
A Component Unit of Allen County, Kansas
Notes to Financial Statements
December 31, 2017 and 2016

Net Patient Service Revenue

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

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges excluded from revenue under the Hospital's charity care policy were approximately \$236,100 and \$207,600 in 2017 and 2016, respectively.

Income Taxes

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

Electronic Health Records Incentive Program

The Electronic Health Records (EHR) Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under the Medicare Program to eligible hospitals that demonstrate meaningful use of certified EHR technology. Critical access hospitals (CAHs) are eligible to receive incentive payments in the cost reporting period beginning in the federal fiscal year in which meaningful use criteria have been met. The Medicare incentive payment is for qualifying costs of the purchase of certified EHR technology multiplied by the Hospital's Medicare share fraction, which includes a 20 percent incentive. This payment is an acceleration of amounts that would have been received in future periods based on reimbursable costs incurred, including depreciation. If meaningful use criteria are not met in future periods, the Hospital is subject to penalties that would reduce future payments for services. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services (CMS). The final amount for any payment year under both programs is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

Allen County Hospital
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A Component Unit of Allen County, Kansas
Notes to Financial Statements
December 31, 2017 and 2016

Reclassifications

Certain reclassifications have been made to the 2016 financial statements to conform to the 2017 financial statement presentation. These reclassifications had no effect on the change in net 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. Hospital inpatient acute care and outpatient services rendered to Medicare Program beneficiaries are paid based on a cost reimbursement methodology. Clinic health care services rendered to Medicare Program beneficiaries are paid based on a combination of fee schedules and a cost reimbursement methodology. The Hospital is reimbursed for certain 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. Estimated settlements have been reflected in the accompanying financial statements. Beginning April 1, 2013, a mandatory payment reduction, known as sequestration, of 2 percent went into effect. Under current legislation, sequestration is scheduled to last until 2025.

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.

Approximately 74 percent and 73 percent of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2017 and 2016, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and are 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.

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Note 3: 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:

	2017	2016
Medicare	\$ 1,252,251	\$ 1,113,516
Medicaid	391,887	621,445
Other third-party payers	954,309	1,160,864
Patients	2,278,435	1,934,640
	<u>4,876,882</u>	<u>4,830,465</u>
Less allowance for uncollectible accounts	<u>2,031,906</u>	<u>1,751,775</u>
	<u><u>\$ 2,844,976</u></u>	<u><u>\$ 3,078,690</u></u>

Note 4: Deposits, Investments and Investment Income

Deposits

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

State law requires collateralization of all deposits with federal depository insurance and other acceptable collateral having an aggregate value at least equal to the amount of the deposits.

At December 31, 2017 and 2016, none of the Hospital's bank balances of \$556,429 and \$610,124, respectively, were exposed to custodial credit risk.

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.

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The Hospital categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

The Hospital has the following recurring fair value measurements as of December 31, 2017 and 2016:

- Money market mutual funds of \$646,875 and \$1,000,157, respectively, are valued using quoted market prices (Level 1 inputs).

At December 31, 2017 and 2016, the Hospital had the following investments and maturities:

		December 31, 2017			
		Maturities in Years			
Type	Fair Value	Less Than 1	1-5	6-10	More Than 10
Money market mutual funds	\$ 646,875	\$ 646,875	\$ -	\$ -	\$ -

		December 31, 2016			
		Maturities in Years			
Type	Fair Value	Less Than 1	1-5	6-10	More Than 10
Money market mutual funds	\$ 1,000,157	\$ 1,000,157	\$ -	\$ -	\$ -

Interest Rate Risk - The money market mutual funds are presented as an investment with a maturity of less than one year because they are redeemable in full immediately.

Credit Risk - Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. At December 31, 2017, the Hospital's investments in money market mutual funds were rated AAA by Standard & Poor's and Aaa by Moody's Investors Service.

Custodial Credit Risk - For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. The Hospital's investment policy does not address how securities underlying repurchase agreements are to be held.

Concentration of Credit Risk - The Hospital places no limit on the amount that may be invested in any one issuer. At December 31, 2017, the Hospital's money market mutual fund is invested in the Federated Government Obligation Fund #395.

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Summary of Carrying Values

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

	<u>2017</u>	<u>2016</u>
Carrying value		
Deposits	\$ 238,960	\$ 211,428
Investments	<u>646,875</u>	<u>1,000,157</u>
	<u><u>\$ 885,835</u></u>	<u><u>\$ 1,211,585</u></u>
Included in the following balance sheets captions:		
Cash and cash equivalents	\$ 877,375	\$ 966,046
Noncurrent cash and investments	<u>8,460</u>	<u>245,539</u>
	<u><u>\$ 885,835</u></u>	<u><u>\$ 1,211,585</u></u>

Investment income for the years ended December 31, 2017 and 2016 amounted to \$8,403 and \$8,337, respectively.

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Note 5: Capital Assets

Capital assets activity for the years ended December 31 was:

2017					
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	\$ 303,303	\$ -	\$ -	\$ -	\$ 303,303
Buildings	69,125	-	-	-	69,125
Equipment	3,517,945	31,720	19,600	-	3,530,065
Construction in progress	9,750	-	9,750	-	-
	<u>3,900,123</u>	<u>31,720</u>	<u>29,350</u>	<u>-</u>	<u>3,902,493</u>
Less accumulated depreciation					
Buildings	13,440	3,840	-	-	17,280
Equipment	2,315,663	655,754	16,931	-	2,954,486
	<u>2,329,103</u>	<u>659,594</u>	<u>16,931</u>	<u>-</u>	<u>2,971,766</u>
Capital assets, net	<u>\$ 1,571,020</u>	<u>\$ (627,874)</u>	<u>\$ 12,419</u>	<u>\$ -</u>	<u>\$ 930,727</u>

2016					
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	\$ 303,303	\$ -	\$ -	\$ -	\$ 303,303
Buildings	781,122	-	711,997	-	69,125
Equipment	3,424,060	106,676	12,791	-	3,517,945
Construction in progress	-	9,750	-	-	9,750
	<u>4,508,485</u>	<u>116,426</u>	<u>724,788</u>	<u>-</u>	<u>3,900,123</u>
Less accumulated depreciation					
Buildings	9,600	3,840	-	-	13,440
Equipment	2,242,611	794,242	721,190	-	2,315,663
	<u>2,252,211</u>	<u>798,082</u>	<u>721,190</u>	<u>-</u>	<u>2,329,103</u>
Capital assets, net	<u>\$ 2,256,274</u>	<u>\$ (681,656)</u>	<u>\$ 3,598</u>	<u>\$ -</u>	<u>\$ 1,571,020</u>

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Note 6: Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses included in current liabilities at December 31 consisted of:

	<u>2017</u>	<u>2016</u>
Payable to suppliers and vendors for operations	\$ 1,190,058	\$ 1,066,883
Payable to contractors and equipment suppliers	-	9,750
Payable to employees (including payroll taxes and benefits)	683,493	635,904
Other	<u>176,727</u>	<u>136,299</u>
	<u><u>\$ 2,050,278</u></u>	<u><u>\$ 1,848,836</u></u>

Note 7: Medical Malpractice Claims

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

Note 8: Employee Health Claims

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance plan. The Hospital is self-insured for health claims of participating employees and dependents up to specific claim amounts of \$50,000 per individual for both 2017 and 2016, and \$1,000,000 annual aggregate for both 2017 and 2016. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is reasonably possible that the Hospital's estimate will change by a material amount in the near term.

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Activity in the Hospital's accrued employee health claims liability during 2017 and 2016 is summarized as follows:

	2017	2016
Balance, beginning of year	\$ 134,300	\$ 216,500
Current year claims incurred and changes in estimates for claims incurred in prior years	1,586,851	931,928
Claims and expenses paid	<u>(1,547,651)</u>	<u>(1,014,128)</u>
Balance, end of year	<u>\$ 173,500</u>	<u>\$ 134,300</u>

Note 9: Long-term Obligations

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

		2017				
		Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt						
Capital lease obligations		\$ 266,127	\$ 21,202	\$ 155,004	\$ 132,325	\$ 124,708
Total long-term debt		\$ 266,127	\$ 21,202	\$ 155,004	\$ 132,325	\$ 124,708
		2016				
		Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt						
Capital lease obligations		\$ 411,788	\$ -	\$ 145,661	\$ 266,127	\$ 149,904
Total long-term debt		\$ 411,788	\$ -	\$ 145,661	\$ 266,127	\$ 149,904

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Capital Lease Obligations

The Hospital is obligated under financing agreements for equipment that are accounted for as capital leases. Assets under capital leases at December 31, 2017 and 2016 totaled \$720,235 and \$699,035, and net of accumulated depreciation of \$551,138 and \$409,211, respectively. The following is a schedule by year of future minimum lease payments under the capital lease, including interest at rates ranging from 2.35 percent to 7.7 percent together with the present value of the future minimum lease payments as of December 31, 2017:

2018	\$ 126,880
2019	7,741
Total minimum lease payments	<u>134,621</u>
Less amount representing interest	<u>2,296</u>
Present value of future minimum lease payments	<u><u>\$ 132,325</u></u>

Note 10: Allen County Community Foundation

The Allen County Community Foundation (Foundation) is an independent non-profit corporation established in 2012 with the purpose to improve the quality of life in Allen County. In 2010, the Foundation started the Uniting for Excellence Capital Campaign to raise funds for the construction and equipment for the new hospital building and the Uniting for Excellence Endowment Fund to create a permanent endowment for benefit of the Hospital. An advisory committee appointed by the Board of Directors of the Foundation determines the amount, timing and purpose of the distribution of Foundation funds. The Foundation also has funds for the benefit of specific Hospital departments. The Hospital has not recorded an interest in the Foundation due to the lack of control and direction of the funds.

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Note 11: Pledge of Revenue and Operation Agreement

Effective December 1, 2011, the Board of Trustees of Allen County Hospital (the Board) entered into a pledge of revenue and operation agreement with Allen County, Kansas (the County). Under the agreement, the County has delegated management, control and operations of the Hospital to the Board. In exchange, the Board has pledged excess revenues generated from the operations of the Hospital for payment of the debt service on the Series 2011, Series 2012, Series 2013, Series 2017A and Series 2017B Kansas Public Building Commission Revenue Bonds issued by the Allen County, Kansas Public Building Commission (the PBC). Excess revenues are defined by the pledge agreement and are pledged until the bonds have matured. The Series 2011 and 2012 bonds were issued to finance the construction and equipping of the new Hospital building, and the Series 2013 bonds were issued to provide working capital for operations of the Hospital. During 2017, the County refunded the Series 2011, Series 2012 and Series 2013 bonds with the issuance of the Series 2017A and 2017B bonds. During the years ended December 31, 2017 and 2016, the Hospital did not have a transfer of revenues under the pledge agreement to the County.

In connection with the pledge of revenues and operation agreement, the Hospital is required, among other things, to maintain certain covenants, including a historical debt service coverage ratio of at least 1.0. At December 31, 2017, the Hospital's historical debt service coverage ratio was less than 1.0 and the Board was required to analyze hospital operations and report findings to the PBC and the County.

The debt service requirements of the County for the Series 2017A and 2017B bonds as of December 31, 2017, are as follows:

Year Ending December 31,	Total to be Paid	Principal	Interest
2018	\$ 1,415,200	\$ 565,000	\$ 850,200
2019	1,414,000	515,000	899,000
2020	1,410,750	525,000	885,750
2021	1,411,550	540,000	871,550
2022	2,221,258	1,365,000	856,258
2023–2027	11,073,058	7,730,000	3,343,058
2028–2032	8,312,787	6,530,000	1,782,787
2033–2037	6,641,400	6,140,000	501,400
	<u>\$ 33,900,003</u>	<u>\$ 23,910,000</u>	<u>\$ 9,990,003</u>

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Payment of debt service requirements are partially funded through sales tax appropriations from the City of Iola, Kansas and Allen County, Kansas, which are set to expire on December 31, 2019 and 2020, respectively. During the years ended December 31, 2017 and 2016, the Hospital contributed \$1,828,814 and \$1,192,375, respectively, to the County to assist with debt service requirements.

Interest payments on the bonds of \$1,185,728 and \$1,178,971 and principal payments of \$1,220,000 and \$790,000 were made from proceeds of sales tax appropriations, excess project funds and contributions from the Hospital during the years ended December 31, 2017 and 2016, respectively.

Note 12: Management Agreement

Effective July 1, 2013, the Hospital entered into a management agreement with HCA. The agreement, which expires on July 1, 2018, provides for certain administrative, management and purchasing services to be provided by HCA to the Hospital. The Hospital has also entered into a data processing and computer services agreement with HCA. The agreement, which expires on December 31, 2019, provides for use of the HCA financial reporting system, network and related support. Payments made to HCA for the years ended December 31, 2017 and 2016 were approximately \$1,348,000 and \$1,650,000, respectively. Included in accounts payable at December 31, 2017 and 2016 are approximately \$93,600 and \$109,000, respectively, in amounts due to HCA for services received.

Note 13: Operating Leases

Noncancellable operating leases for property and equipment expire in various years through 2021 and require the Hospital to pay all executory costs (property taxes, maintenance and insurance).

Future minimum lease payments at December 31, 2017, are:

2018	\$ 57,660
2019	35,599
2020	10,200
2021	<u>10,200</u>
Future minimum lease payments	<u><u>\$ 113,659</u></u>

Rental expense for all operating leases was \$94,343 and \$97,477 in 2017 and 2016, respectively.

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Note 14: Pension Plan

Effective July 1, 2013, the Hospital contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by the Hospital. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's governing body. The pension plan was last amended effective January 1, 2017. Contributions to the plan by plan participants and the Hospital totaled \$430,047 and \$279,850 during 2017, and \$379,381 and \$268,642 during 2016, respectively. Employer contributions to the plan are based on the following contribution types:

Employer Basic Contributions

The Hospital contributes 3 percent of the participant's eligible compensation for all eligible participants earning less than 200 percent of the U.S. poverty guidelines for the plan year.

Employer Matching Contributions

For participants as of December 31, 2016, the Hospital matched 100 percent of the participants' contributions up to the limit specified below based upon years of service worked:

Years of Service	% of Compensation
Less than 5 years	3%
5 but less than 10	4%
10 but less than 15	6%
15 but less than 20	7%
20 but less than 25	8%
25 or more years	9%

For participants on January 1, 2017 and thereafter, the Hospital matches 100 percent of the participants' contributions up to the limit specified below based upon years of service worked:

Years of Service	% of Compensation
Less than 5 years	3%
5 but less than 10	4%
10 but less than 15	5%
15 or more years	6%

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Note 15: Contingencies

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.