

FINANCIAL STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS
MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1
OF DICKINSON COUNTY, KANSAS
D/B/A MEMORIAL HEALTH SYSTEM
DECEMBER 31, 2018 AND 2017

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MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF
DICKINSON COUNTY, KANSAS D/B/A MEMORIAL HEALTH SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended December 31, 2018 and 2017

Our discussion and analysis of the financial performance of Memorial Health System provides a narrative overview of the Health System's financial activities for the years ended December 31, 2018 and 2017. The financial statements include the financial activity of the Memorial Health Foundation which was formed in 2016 under the blending method. These statements do not include the activity of Abilene Housing, Inc. (AHI) which is audited by another accounting firm. Activity of AHI can be located in Note R of the financial statements. Please read this analysis in conjunction with the accompanying basic financial statements.

Financial highlights

The Health System's net position increased by \$786,057 or 16.4% in 2018 and decreased by \$1,963,995 or 29.0% in 2017. For 2017, \$290,590 of the decrease in net position is attributable to bond refinancing costs which in the long term will reduce future debt service for the Memorial Health System by \$1.3 million. Also for 2017, \$306,725 was attributable to a write down of a building asset that was no longer being used by Memorial Health System. These two "one time" events totaled \$597,315. Excluding these two "one time" entries would have changed the decrease in net position to 20.2%.

The Health System's total operating revenue increased in 2018 by \$3,317,131 or 10.7% and decreased by \$126,904 or .4% in 2017.

The increase in total operating revenue in 2018 was primarily the result of adding a physician in December 2017. The decrease in total operating revenue in 2017 was primarily the result of three Family Medicine Physicians discontinuing employment with Memorial Health System. All three resigned effective in the first half of 2017. Memorial Health System is actively recruiting additional physicians.

The Health System experienced a significant turn-around in the change in net position for 2018 when compared to 2017. The improvement amounted to a total of \$2,750,052 which was the result of a decrease in net position in 2017 of \$1,963,995 and an increase in net position in 2018 of \$786,057. There were many things that were the cause of this improvement including an increase of revenue and managing expenses. Management is pleased with this significant improvement in operations.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF
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MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended December 31, 2018 and 2017

Using these financial statements

The Health System's financial statements consist of three statements – (1) Statements of Net Position; (2) Statements of Revenues, Expenses, and Changes in Net Position, and (3) Statements of Cash Flows. These financial statements and related notes provide information about the activities of the Health System, including resources held by or for the benefit of the Health System, and resources restricted for specific purposes by contributors, grantors, and indenture agreements.

One of the most important questions asked about the Health System's finances is, “Is the Health System as a whole better or worse off as a result of the year's activities?” The Statements of Net Position and the Statements of Revenues, Expenses, and Changes in Net Position report information about the Health System'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. For purposes of these two statements, revenues and expenses are taken into account regardless of when cash is received or paid.

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

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

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF
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MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended December 31, 2018 and 2017

Assets, liabilities, and net position

The Health System's statements of net position as of the end of each of the last three years are summarized as follows:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Assets			
Current assets	\$ 7,225,017	\$ 6,272,050	\$ 6,312,665
Assets limited as to use	1,753,632	1,809,124	1,736,933
Capital assets, net	19,855,888	21,175,682	23,935,048
Other assets	22,513	22,184	40,493
Other investments	<u>8,349,234</u>	<u>8,233,563</u>	<u>8,092,014</u>
Total assets	<u>37,206,284</u>	<u>37,512,603</u>	<u>40,117,153</u>
Liabilities			
Long-term obligations	20,088,747	21,094,258	20,080,000
Net pension and OPEB liability	10,200,506	10,629,300	12,088,414
Agency funds	22,513	22,184	40,493
Current liabilities	<u>3,038,764</u>	<u>2,880,150</u>	<u>2,856,997</u>
Total liabilities	<u>33,350,530</u>	<u>34,625,892</u>	<u>35,065,904</u>
Net deferred outflows and inflows of resources			
for pension and OPEB plans	(588,919)	(625,019)	(1,988,284)
Deferred outflow on bond refunding	(1,431,259)	(1,570,240)	
Deferred inflows ad valorem tax revenue	<u>288,000</u>	<u>280,095</u>	<u>273,663</u>
Total net deferred outflows and inflows of resources	<u>(1,732,178)</u>	<u>(1,915,164)</u>	<u>(1,714,621)</u>
Net position	<u>\$ 5,587,932</u>	<u>\$ 4,801,875</u>	<u>\$ 6,765,870</u>

Cash and invested cash in the current asset category increased by \$174,172 during 2018 and increased by \$103,884 in 2017. Although the cash balance is small for an organization with over \$37,000,000 in assets, significant additional cash is available in other investments and is held in money market accounts, certificates of deposit, and marketable securities and is readily available for day-to-day operating cash flow needs.

Assets whose use is limited and other investments increased by \$213,740 in 2017 and increased by \$60,179 in 2018. The change in these balances is from normal funding and reinvestment of earnings.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended December 31, 2018 and 2017

In aggregate, the Health System's unrestricted cash, restricted cash, and investments total \$9,225,616, \$8,935,773, and \$8,690,340 as of December 31, 2018, 2017, and 2016, respectively. This represents 103, 105, and 106 days of average cash expenses on hand, respectively, during each of the years then ended. Increasing these cash and investment balances shows a positive cash flow for 2018 and 2017.

The Health System's net patient accounts receivable were 66.6% of current assets as of December 31, 2018, 64.2% of current assets as of December 31, 2017, and 60.5% of current assets as of December 31, 2016. The average number of days in accounts receivable of net patient revenue was 57 days, 53 days, and 50 days as of December 31, 2018, 2017, and 2016, respectively.

The Health System's investment in capital assets was \$19,855,888, \$21,175,682, and \$23,935,048 at the end of 2018, 2017, and 2016. The decrease each year results primarily from depreciation expense exceeding capital assets acquired each year. The Health System invested approximately \$24,000,000 in the facilities over a three-year period from 2012 through 2014. This significant construction and replacement of key equipment has resulted in lower capital purchases in subsequent years as well as the increase in depreciation taken in subsequent years.

The construction project was the largest capital construction project undertaken by the Health System to date. It is the opinion of management that this addition of facilities, renovation of existing facilities, and replacement of key infrastructure items will have a positive impact on providing health care services in the near and long-term future of the Health System. It is also the opinion of management that accessing capital and using existing cash to accomplish this largest construction project in the history of the Health System, reflects well on the financial health of the organization. The completion of this project has reduced the average age of facilities of the Health System from 13.6 years at December 31, 2012, to 9.7 years at December 31, 2018, and thus reflecting newer facilities.

The Health System adopted Governmental Accounting Standards Board (GASB) Statement No. 75, "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions" in 2018, and adopted GASB Statement No. 68, "Accounting and Financial Reporting for Pensions" in 2015, both standards revised the accounting and reporting standards related to multi-employer pension plans and other employee benefit obligations associated with our participation in the Kansas Public Employers Retirement System. The following chart shows the annual balances since the inception of adopting these two standards to recognize the Health System's proportionate share of these unfunded liabilities.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended December 31, 2018 and 2017

<u>Effects of Adopting GASB 75 and 68</u>		
<u>Year</u>	<u>Reduction in operating expenses</u>	<u>Pension and OPEB liabilities net of deferred inflows and outflows related to these Plans</u>
2016	\$ 93,170	\$ 10,100,130
2017	95,849	10,004,281
2018	392,694	9,611,587

The Health System's net position increased by \$786,057 during 2018 or 16.4% and decreased during 2017 by \$1,963,995 or 29.0%. The percentage of total assets financed with net position, or equity, was 15.0%, 12.8%, and 16.9% as of December 31, 2018, 2017, and 2016, respectively.

Operating results and changes in net position

The Health System's operating results and changes in net position for each of the last three years are summarized as follows:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Operating revenues	\$ 34,230,998	\$ 30,913,867	\$ 31,040,771
Actuarial adjustment to pension expense	(392,694)	(95,849)	(93,170)
Operating expenses (net of actuarial adjustment to pension expense)	<u>33,630,399</u>	<u>32,043,235</u>	<u>31,505,004</u>
Operating income (loss)	993,293	(1,033,519)	(371,063)
Interest expense	(820,530)	(1,183,633)	(914,835)
Nonoperating revenues	555,027	549,745	651,231
Provision for impairment of capital assets		(306,726)	
Capital grants and contributions	<u>58,267</u>	<u>10,138</u>	<u> </u>
Change in net position	<u>\$ 786,057</u>	<u>\$ (1,963,995)</u>	<u>\$ (634,667)</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF
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MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended December 31, 2018 and 2017

The first, and most significant, component of the overall change in the Health System's net position is its operating income (loss) – generally, the difference between net patient service revenue and the expenses incurred to perform these services. The Hospital became designated a Critical Access Hospital (CAH) effective December 16, 2005. This classification change increased the total operating revenue due to contractual adjustments being reduced for Medicare related patients. The financial impact of being designated a CAH was a positive annual amount of approximately \$950,000 as calculated by Stroudwater Associates, a consultant hired by the Health System in 2009. Management believes that the impact of being a CAH facility has increased from 2009.

Net patient service revenue is analyzed as follows:

	<u>2018</u>	<u>2017</u>	<u>2016</u>
Inpatient services	\$ 18,359,351	\$ 16,143,229	\$ 14,714,257
Outpatient services	<u>36,060,097</u>	<u>33,821,841</u>	<u>33,512,106</u>
Gross patient service revenue	<u>54,419,448</u>	<u>49,965,070</u>	<u>48,226,363</u>
Contractual adjustments	21,442,199	20,552,661	18,783,930
Provision for bad debts	1,577,869	1,258,941	1,301,824
Charity care	<u>463,800</u>	<u>400,805</u>	<u>359,707</u>
Net patient service revenue	<u>\$ 30,935,580</u>	<u>\$ 27,752,663</u>	<u>\$ 27,780,902</u>

Outpatient charges represent 66.3%, 67.7%, and 69.5% of gross patient charges for 2018, 2017, and 2016. The Health System's inpatient services consist of acute care, swing-bed care, inpatient psychiatric services, and nursing facility care services. Beginning with 2008, the Health System has experienced a trend toward more services being performed on an outpatient basis. This is consistent with trends in the health care industry. The purchase of a physicians' clinic effective November 1, 2010, increased the outpatient care percentage as the clinic was operated for the full 2011 year. The purchase of the second physicians' clinic effective January 1, 2012, further increased the outpatient care percentage of total services.

Inpatient gross charges are impacted by utilization and changes in charge rates. The Health System provided 5,376, 4,914, and 4,821 inpatient acute, swing-bed, and behavioral health inpatient days in 2018, 2017, and 2016. Village Manor, which provides nursing facility care services, had 25,913, 24,376, and 23,215 days of care in 2018, 2017, and 2016. The Hospital also increased its most prevalent acute care room rate by 8.0%, 7.8%, and 5.5% effective at the beginning of each calendar year for 2018, 2017, and 2016.

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Years ended December 31, 2018 and 2017

The Health System has agreements with various third-party payors that provide for payments to the Health System at amounts different from its established charge rates. These differences are referred to as contractual adjustments. Contractual adjustments continue to be a significant portion of the reduction in gross patient services revenue and represent 39.4%, 41.1%, and 38.9% of charges for 2018, 2017, and 2016.

The Health System provides care free of charge or at amounts less than its established rates to patients who meet certain criteria under its charity care policy. Charity care write-offs have totaled \$463,800 for 2018, \$400,805 for 2017, and \$359,707 for 2016. There is a growing trend in the health care industry to identify and report the value of charity care provided to patients. Recent enactment of IRS regulation referred to as 501(r) in the past four years has increased the importance of tracking charity care for those patients who are in need of health care services but are unable to pay for those services. The provision for bad debts represented 2.90%, 2.52%, and 2.70% of gross patient service revenue during 2018, 2017, and 2016, respectively. The combined provision for bad debt and charity care write-offs was 3.8%, 3.3%, and 3.4% of gross patient services revenue for 2018, 2017, and 2016, respectively.

Employee salaries and wages decreased by \$5,409 or .04% during 2017 and increased by \$752,387 or 5.35% during 2018. The Health System implemented pay raises commensurate with market conditions for 2017 and 2018 at the beginning of each year.

Employee benefit and supplies and other expenses increased during 2017 by \$639,705 or 4.3% and by \$1,231,331 or 8.0% during 2018.

This financial report is designed to provide a general overview of the Health System's finances and to discuss significant changes in our financial statements. If you have any questions about the report, please contact the Administration Office at the Hospital.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors
Memorial Hospital of Hospital District #1
of Dickinson County, Kansas

We have audited the accompanying financial statements of the business-type activity of Memorial Hospital of Hospital District #1 of Dickinson County, Kansas d/b/a Memorial Health System (the Hospital), as of and for the years ended December 31, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the Hospital's 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to previously present fairly, in all material respects, the financial position of the business-type activity of Memorial Hospital of Hospital District #1 of Dickinson County, Kansas d/b/a Memorial Health System, as of December 31, 2018 and 2017, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A to the financial statement, in 2018, the Hospital adopted Governmental Accounting Standards Board (GASB) Statement No. 75, "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions" (OPEB). Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 1 through 7 be presented to supplement the financial statements. These standards also require that the pension and other postemployment information on pages 43 through 45 be included to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audits of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Wendling Noe Nelson & Johnson LLC

Topeka, Kansas
April 29, 2019

FINANCIAL STATEMENTS

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

STATEMENTS OF NET POSITION

December 31,

ASSETS AND DEFERRED OUTFLOWS OF RESOURCES

	<u>2018</u>	<u>2017</u>
CURRENT ASSETS		
Cash and invested cash	\$ 876,382	\$ 702,210
Assets whose use is limited by indenture agreement - required for current liabilities	223,794	145,356
Patient accounts receivable, net of allowance for doubtful accounts of \$1,959,884 in 2018 and \$1,513,275 in 2017	4,809,053	4,029,509
Accounts receivable - other	313,559	219,072
Interest receivable	18,314	24,988
Estimated third-party payor settlements	11,729	246,051
Inventories	285,106	288,567
Prepaid expenses	399,080	336,202
Ad valorem taxes receivable	<u>288,000</u>	<u>280,095</u>
Total current assets	<u>7,225,017</u>	<u>6,272,050</u>
ASSETS WHOSE USE IS LIMITED		
By indenture agreement	1,977,426	1,954,480
Less amounts required for current liabilities	<u>(223,794)</u>	<u>(145,356)</u>
Noncurrent assets whose use is limited	<u>1,753,632</u>	<u>1,809,124</u>
OTHER INVESTMENTS	<u>8,349,234</u>	<u>8,233,563</u>
CAPITAL ASSETS - NET	<u>19,855,888</u>	<u>21,175,682</u>
OTHER ASSETS	<u>22,513</u>	<u>22,184</u>
Total assets	<u>37,206,284</u>	<u>37,512,603</u>
DEFERRED OUTFLOWS OF RESOURCES		
Pension	1,476,564	1,712,531
Other postemployment benefits	18,949	8,657
Loss on bond refunding	<u>1,431,259</u>	<u>1,570,240</u>
Total deferred outflows of resources	<u>2,926,772</u>	<u>3,291,428</u>
TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	<u>\$ 40,133,056</u>	<u>\$ 40,804,031</u>

The accompanying notes are an integral part of these statements.

LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION

	<u>2018</u>	<u>2017</u>
CURRENT LIABILITIES		
Current maturities of long-term debt	\$ 880,000	\$ 880,000
Accounts payable	1,029,668	925,976
Accrued salaries, wages, and related withholding taxes payable	422,353	377,387
Accrued vacation pay	517,492	485,241
Accrued health insurance claims	65,166	116,784
Accrued interest payable	64,874	42,360
Estimated third-party payor settlements	35,000	23,000
Other current liabilities	<u>24,211</u>	<u>29,402</u>
Total current liabilities	<u>3,038,764</u>	<u>2,880,150</u>
LONG-TERM DEBT, excluding current maturities	20,088,747	21,094,258
AGENCY FUNDS	22,513	22,184
NET PENSION LIABILITY	10,061,366	10,425,476
NET OTHER POSTEMPLOYMENT BENEFITS LIABILITY	<u>139,140</u>	<u>203,824</u>
Total liabilities	<u>33,350,530</u>	<u>34,625,892</u>
DEFERRED INFLOWS OF RESOURCES		
Deferred ad valorem tax revenue	288,000	280,095
Pension	830,997	1,092,729
Other postemployment benefits	<u>75,597</u>	<u>3,440</u>
Total deferred inflows of resources	<u>1,194,594</u>	<u>1,376,264</u>
NET POSITION		
Net investment in capital assets	318,400	771,665
Restricted		
For debt service	1,977,426	1,954,480
Expendable for capital acquisitions	3,728	4,228
For specific operating activities	50,849	75,366
Unrestricted	<u>3,237,529</u>	<u>1,996,136</u>
Total net position	<u>5,587,932</u>	<u>4,801,875</u>
TOTAL LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION	<u>\$ 40,133,056</u>	<u>\$ 40,804,031</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
D/B/A MEMORIAL HEALTH SYSTEM
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
Year ended December 31,

	<u>2018</u>	<u>2017</u>
Operating revenues		
Net patient service revenue	\$ 30,935,580	\$ 27,752,663
Other	<u>3,295,418</u>	<u>3,161,204</u>
Total operating revenues	<u>34,230,998</u>	<u>30,913,867</u>
Operating expenses		
Salaries and wages	14,821,473	14,069,086
Employee benefits	3,425,931	3,095,405
Actuarial adjustments to pension and OPEB expenses	(392,694)	(95,849)
Supplies and other	13,151,707	12,250,902
Depreciation and amortization	<u>2,231,288</u>	<u>2,627,842</u>
Total operating expenses	<u>33,237,705</u>	<u>31,947,386</u>
Operating income (loss)	<u>993,293</u>	<u>(1,033,519)</u>
Nonoperating revenues (expenses)		
Ad valorem taxes	305,527	309,995
Noncapital contributions	140,578	173,015
Investment income	100,830	107,878
Interest expense	(820,530)	(1,183,633)
Provision for impairment of capital assets		(306,726)
Other	<u>8,092</u>	<u>(41,143)</u>
Nonoperating revenues (expenses), net	<u>(265,503)</u>	<u>(940,614)</u>
Excess of revenues over (under) expenses before capital contributions	727,790	(1,974,133)
Capital contributions	<u>58,267</u>	<u>10,138</u>
Change in net position	786,057	(1,963,995)
Net position at beginning of year as previously reported	5,000,482	6,927,166
Prior period adjustment for change in accounting principle	<u>(198,607)</u>	<u>(161,296)</u>
As restated	<u>4,801,875</u>	<u>6,765,870</u>
Net position at end of year	<u>\$ 5,587,932</u>	<u>\$ 4,801,875</u>

The accompanying notes are an integral part of these statements.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

STATEMENTS OF CASH FLOWS

Year ended December 31,

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities		
Receipts from and on behalf of patients	\$30,402,358	\$27,544,246
Payments to or on behalf of employees	(18,221,805)	(17,140,613)
Payments to suppliers	(13,100,164)	(12,067,457)
Other receipts and payments	<u>3,197,373</u>	<u>3,243,465</u>
Net cash provided by operating activities	<u>2,277,762</u>	<u>1,579,641</u>
Cash flows from noncapital financing activities		
Ad valorem taxes	305,527	309,995
Noncapital contributions	140,578	173,015
Other nonoperating receipts and payments	<u>7,172</u>	<u>9,549</u>
Net cash provided by noncapital financing activities	<u>453,277</u>	<u>492,559</u>
Cash flows from capital and related financing activities		
Purchase of capital assets	(968,762)	(266,641)
Proceeds from sale of assets	49,287	5,103
Contributions for capital assets	58,267	10,138
Repayment of long-term debt	(880,000)	(770,000)
Issuance of long-term debt		18,885,106
Payment of bond issuance costs		(289,962)
Payment to extinguish debt		(18,561,716)
Interest paid	<u>(784,546)</u>	<u>(925,387)</u>
Net cash used by capital and related financing activities	<u>(2,525,754)</u>	<u>(1,913,359)</u>
Cash flows from investing activities		
Change in assets whose use is limited	(22,946)	(14,368)
Increase in investments	(173,261)	(149,509)
Investment income	<u>165,094</u>	<u>108,920</u>
Net cash used by investing activities	<u>(31,113)</u>	<u>(54,957)</u>
Net change in cash and cash equivalents	174,172	103,884
Cash and cash equivalents at beginning of year	<u>702,210</u>	<u>598,326</u>
Cash and cash equivalents at end of year	<u>\$ 876,382</u>	<u>\$ 702,210</u>

The accompanying notes are an integral part of these statements.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

STATEMENTS OF CASH FLOWS - CONTINUED

Year ended December 31,

	<u>2018</u>	<u>2017</u>
Reconciliation of operating income (loss) to net cash provided by operating activities		
Operating income (loss)	\$ 993,293	\$(1,033,519)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities		
Depreciation and amortization	2,231,288	2,627,842
Provision for bad debts	1,577,869	1,258,941
Changes in		
Patient and other accounts receivable	(2,450,267)	(1,397,347)
Estimated third-party payor settlements	246,322	2,184
Inventories and prepaid expenses	(59,417)	96,810
Accounts payable and accrued expenses	131,368	120,579
Net pension liability, deferred inflows, and deferred outflows related to defined benefit pension and OPEB plans	<u>(392,694)</u>	<u>(95,849)</u>
Net cash provided by operating activities	<u>\$ 2,277,762</u>	<u>\$ 1,579,641</u>
Supplemental schedule of noncash investing and financing activities		
Net change in unrealized losses on investments	<u>\$ (57,590)</u>	<u>\$ (7,960)</u>

The accompanying notes are an integral part of these statements.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
D/B/A MEMORIAL HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
December 31, 2018 and 2017

NOTE A - SUMMARY OF ACCOUNTING POLICIES

A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements follows.

1. Financial reporting entity

Memorial Hospital of Hospital District #1 of Dickinson County, Kansas d/b/a Memorial Health System (Hospital), is a municipal corporation operating an acute-care hospital located in Abilene, Kansas, with a licensed bed capacity of 25 acute care beds and 10 psychiatric beds and a long-term care facility with a licensed bed capacity of 74 beds. The Hospital also operates a physician clinic located in Abilene, Kansas. The Hospital is governed by an elected five-member Board of Directors.

2. Component units

The Memorial Health Foundation (Foundation) was formed and organized as a Kansas not-for-profit corporation on August 6, 2013. The Foundation is organized for specific health care purposes and is intended to be an auxiliary association and supporting organization for the financial aid and assistance of the Hospital and all of its component or affiliated organizations and other causes and institutions. The Foundation is organized exclusively for charitable, educational, and scientific purposes, including, but not limited to, the sponsorship of specific projects and programs to improve health care services in the geographic area served by the Hospital.

Since the bylaws of the Foundation provide that the Hospital's board will always make up the majority of the Foundation's board and there exists a financial benefit/burden relationship between the Hospital and the Foundation, the Hospital includes the Foundation as a component unit in the Hospital's financial statements using the blended method. All significant intercompany accounts and transactions have been eliminated in the accompanying financial statements.

Abilene Housing, Inc. (AHI), was formed and organized as a Kansas not-for-profit corporation. AHI provides housing for elderly and handicapped persons in a 60-unit apartment project located in Abilene, Kansas, and provides services specifically designed to meet the physical, social, and psychological needs of those individuals. Membership of AHI's Board consists of three members designated by the Hospital Board, one member is a member of the Board of Directors of the Hospital, the Chief Executive Officer of the Hospital, and either the Chief Financial Officer, Chief Operating Officer, or Chief Nursing Officer of the Hospital.

The Hospital is financially accountable for AHI since the Hospital Board appoints AHI's Board. The Hospital does not have access to AHI's resources and is not legally obligated for AHI's long-term debt. Management has chosen to not blend the financial activity of AHI due to immateriality.

Condensed financial statements of AHI are presented in Note R.

3. Basis of accounting

The accompanying financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Revenues are recognized when earned and expenses and liabilities are recorded when incurred.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

4. Use of estimates

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

5. Cash equivalents

All cash and invested cash include highly liquid investments with an original maturity of three months or less, excluding assets whose use is limited under bond indenture agreements and investments.

6. Patient accounts receivable

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

7. Inventories

Inventories are stated at the lower of cost or net realizable value.

8. Investments in debt and equity securities

Investments in debt and equity securities are carried at fair value. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating investment income.

9. Capital assets

Capital assets are stated at cost. Depreciation and amortization of capital assets is provided on the straight-line method over the estimated useful lives of the assets. The estimated lives used are generally in accordance with the guidelines established by the American Hospital Association.

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

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

10. Costs of borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Costs incurred in connection with the issuance of long-term debt are expensed in the period incurred.

11. Accrued health insurance claims

The Hospital is partially self-insured for health insurance claims of its employees (Note P). Management estimates a liability for reported and unreported claims incurred as of the end of each reporting period. The estimate is based on known claims and historical claims experience.

Although management believes the estimate for accrued health insurance claims is reasonable, it is possible that actual incurred claims expense may vary significantly from the estimate included in the accompanying financial statements.

12. Deferred outflows and inflows of resources

Deferred outflows of resources represent a consumption of net position that applies to a future period and so will not be recognized as an expense or expenditure until then. Deferred inflows of resources represent an acquisition of net position that applies to a future period and so will not be recognized as revenue until then.

13. Pension and Other Postemployment Benefit (OPEB) plans

The Hospital participates in the Kansas Public Employees Retirement System Plan (KPERs), a cost sharing multiple employer defined benefit pension plan. The Hospital also provides long-term disability benefits to its employees through KPERs. The Hospital uses information provided by KPERs to measure the net pension and OPEB liability, deferred outflows of resources, and deferred inflows of resources of the KPERs pension plan.

14. Net position

Net position is classified in three components. "Net investment in capital assets" consists of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. "Restricted net position" is the noncapital net position that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital including amounts deposited with trustees as required by indenture agreements. "Unrestricted net position" is the remaining net position that does not meet the definition of "net investment in capital assets" or "restricted."

15. Net patient service revenue

Net patient service revenue is reported at established charges with deductions for discounts, charity care, the provision for bad debts, and contractual adjustments, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
D/B/A MEMORIAL HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017

NOTE A - SUMMARY OF ACCOUNTING POLICIES - Continued

16. Operating revenues and expenses

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

17. Charity care

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

18. Ad valorem taxes

The Hospital receives financial support from ad valorem taxes. Ad valorem taxes are assessed in November of each year and are available for use by the Hospital in the following year.

19. Income taxes

The Hospital is exempt from federal income taxes pursuant to Sections 115 and 501(a) of the Internal Revenue Code. The Foundation is exempt from federal income taxes pursuant to section 501(c)(3).

20. Subsequent events

The Hospital has evaluated subsequent events through the date of the independent certified public accountants' report, which is the date the financial statements were available to be issued.

21. Adoption of accounting pronouncement

In 2018, the Hospital adopted Governmental Accounting Standards Board (GASB) Statement No. 75, "Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions" which revised accounting and reporting standards related to postemployment benefits for state and local government entities. Comparative financial statements of prior years have been adjusted to apply this standard retrospectively. An adjustment of \$161,296 applicable to 2016 and prior years has been included in the restated 2017 beginning net position balance of the Hospital to recognize the net position of the liability. This restatement decreased the previously reported change in net position of the Hospital by \$37,311 for the year ended December 31, 2017, as a result of this change.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE B - REIMBURSEMENT PROGRAMS

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

Medicare - The Hospital is a critical access hospital for purposes of the Medicare program. Inpatient and outpatient acute care services, swing-bed services, and rural health clinic (RHC) services rendered to Medicare beneficiaries are paid under cost reimbursement methodologies.

Geriatric psychology services and skilled nursing services, provided at the Hospital's long-term care facility, are paid based on prospectively determined per diem rates. Physician services, other than RHC services, rendered to Medicare beneficiaries are paid based on a prospectively determined fee schedule.

The Hospital is paid for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits or reviews thereof by the Medicare administrative contractor. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Hospital's Medicare cost reports have been audited or reviewed by the Medicare administrative contractor through December 31, 2016.

Medicaid - Hospital and RHC services rendered to all Medicaid program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors.

Nursing facility services are paid at prospectively determined per diem rates set annually on the basis of cost information from preceding calendar years.

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

The Hospital has also entered into payment agreements with certain commercial insurance carriers 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.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
D/B/A MEMORIAL HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017

NOTE B - REIMBURSEMENT PROGRAMS - Continued

A summary of gross and net patient service revenue follows:

	<u>2018</u>	<u>2017</u>
Gross patient service revenue	\$ 54,419,448	\$ 49,965,070
Adjustments to patient service revenue		
Third-party contractual adjustments, discounts, and allowances	(21,442,199)	(20,552,661)
Provision for bad debts	(1,577,869)	(1,258,941)
Charity care	<u>(463,800)</u>	<u>(400,805)</u>
Net patient service revenue	<u>\$ 30,935,580</u>	<u>\$ 27,752,663</u>

Revenue from the Medicare and Medicaid programs accounted for approximately 55 percent and 14 percent, respectively, of the Hospital's net patient service revenue during 2018, and 57 percent and 13 percent, respectively, of the Hospital's net patient service revenue during 2017. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term.

NOTE C - ELECTRONIC HEALTH RECORD INCENTIVE PAYMENTS

The American Recovery and Reinvestment Act of 2009 (ARRA) provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and physician practices that demonstrate meaningful use of certified electronic health record (EHR) technology. These provisions of ARRA are intended to promote the adoption and meaningful use of interoperable health information technology and qualified EHR technology.

The Hospital recognizes revenue for EHR incentive payments when the hospital facility and physician practices have attested that they have demonstrated meaningful use of certified EHR technology for the applicable period and complied with the reporting conditions to receive the payments. The demonstration of meaningful use is based upon meeting a series of objectives and varies between hospital facilities and physician practices and between the Medicare and Medicaid programs. Additionally, meeting the objectives in order to demonstrate meaningful use becomes progressively more stringent as its implementation is phased in through stages as outlined by Centers for Medicare & Medicaid Services. The Hospital recognized \$70,634 and \$105,951 of revenue for EHR incentive payments during the years ended December 31, 2018 and 2017, respectively. These amounts are included in other operating revenues.

The Hospital incurs both capital expenditures and operating expenses in connection with the implementation of its EHR incentives. The amounts and timing of these expenditures do not directly correlate with the timing of the Hospital's recognition of EHR payments as revenue.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE D - ASSETS WHOSE USE IS LIMITED BY INDENTURE AGREEMENT

Assets whose use is limited by indenture agreement consist of money market mutual funds that are held by a trustee under bond indenture agreements. Amounts that are required for obligations classified as current liabilities are reported in current assets.

NOTE E - INVESTMENTS

Investments are summarized as follows:

	<u>2018</u>	<u>2017</u>
Invested cash consisting of bank certificates of deposit, bank savings accounts, and money market mutual funds	\$6,338,000	\$5,914,897
Common stock at fair value	36,044	34,812
Equity interest in Mobile Clinical Services, Inc.	160,239	169,833
Corporate bonds at fair value	1,804,145	2,104,014
Abilene Community Foundation Endowment fund	<u>10,806</u>	<u>10,007</u>
	<u>\$8,349,234</u>	<u>\$8,233,563</u>

The Hospital received contributions from an outside trust consisting of common stock and corporate bonds. The outside trustee stipulated that the Hospital board administer the resources created by the contributions separate from public monies held by the Hospital and that the assets be invested with the goal of maximizing the benefit to the Hospital by retaining the securities in their existing form through their maturities and placing the assets in similar high-grade securities in the future. Restrictions on the use of the contributions have been met and the investments are now unrestricted as to their use by the Hospital.

The Hospital has a 25-percent ownership interest in Mobile Clinical Services, Inc. (MCSI). The Hospital's equity in undistributed net earnings of MCSI since acquisition is \$160,239. Nuclear medicine and ultrasound services are provided to the Hospital through arrangements with MCSI. Total fees charged to operating expense for these services were approximately \$47,000 in 2018 and \$48,000 in 2017. Amounts payable to MCSI for these services were insignificant at December 31, 2018 and 2017.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE F - CAPITAL ASSETS

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

	2018			
	<u>Beginning balance</u>	<u>Additions/ transfers</u>	<u>Retirements/ impairments</u>	<u>Ending balance</u>
Land	\$ 845,007	\$ -	\$ 50,000	\$ 795,007
Land improvements	1,440,754			1,440,754
Buildings	29,813,571	70,874		29,884,445
Major movable equipment	<u>8,474,521</u>	<u>879,893</u>		<u>9,354,414</u>
Totals at historical cost	<u>40,573,853</u>	<u>950,767</u>	<u>50,000</u>	<u>41,474,620</u>
Less accumulated depreciation				
Land improvements	677,979	77,102		755,081
Buildings	12,040,420	1,601,325		13,641,745
Major movable equipment	<u>6,679,772</u>	<u>552,861</u>		<u>7,232,633</u>
Total accumulated depreciation	<u>19,398,171</u>	<u>2,231,288</u>	<u>-</u>	<u>21,629,459</u>
Construction in process	<u>-</u>	<u>10,727</u>	<u>-</u>	<u>10,727</u>
Capital assets, net	<u>\$21,175,682</u>	<u>\$(1,269,794)</u>	<u>\$ 50,000</u>	<u>\$19,855,888</u>
	2017			
	<u>Beginning balance</u>	<u>Additions/ transfers</u>	<u>Retirements</u>	<u>Ending balance</u>
Land	\$ 875,757	\$ -	\$ 30,750	\$ 845,007
Land improvements	1,440,754			1,440,754
Buildings	30,239,448	8,389	434,266	29,813,571
Major movable equipment	<u>10,077,290</u>	<u>221,170</u>	<u>1,823,939</u>	<u>8,474,521</u>
Totals at historical cost	<u>42,633,249</u>	<u>229,559</u>	<u>2,288,955</u>	<u>40,573,853</u>
Less accumulated depreciation				
Land improvements	600,877	77,102		677,979
Buildings	10,494,546	1,704,164	158,290	12,040,420
Major movable equipment	<u>7,602,778</u>	<u>846,576</u>	<u>1,769,582</u>	<u>6,679,772</u>
Total accumulated depreciation	<u>18,698,201</u>	<u>2,627,842</u>	<u>1,927,872</u>	<u>19,398,171</u>
Capital assets, net	<u>\$23,935,048</u>	<u>\$(2,398,283)</u>	<u>\$ 361,083</u>	<u>\$21,175,682</u>

As of December 31, 2018, the Hospital had outstanding commitments to purchase infusion therapy and medication dispensing equipment totaling approximately \$613,000.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
D/B/A MEMORIAL HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017

NOTE G - DEFERRED AD VALOREM TAX REVENUE

Deferred ad valorem tax revenue is levied in November but not available for expenditure in the current period.

NOTE H - LONG-TERM DEBT

Long-term debt consists of the following:

	<u>2018</u>	<u>2017</u>
2.35% - 4.40% Hospital District No. 1, Dickinson County, Kansas Lease Agreement Certificates of Participation, Series 2011; issued on December 1, 2011, in the original amount of \$6,000,000; due serially through December 1, 2021	\$ 2,190,000	\$ 2,865,000
1.65% - 2.40% Abilene, Kansas Public Building Commission Revenue Bonds, Series 2011; partially defeased in 2017 with remaining amounts due serially through December 1, 2019	115,000	230,000
2.00% - 5.00% Abilene, Kansas Public Building Commission Refunding Revenue Bonds, Series 2017; issued on December 14, 2017, in the original amount of \$17,405,000; due serially through December 1, 2035	<u>17,315,000</u>	<u>17,405,000</u>
	19,620,000	20,500,000
Add net unamortized premium on bonds	<u>1,348,747</u>	<u>1,474,258</u>
Total bonds outstanding	20,968,747	21,974,258
Less current maturities	<u>(880,000)</u>	<u>(880,000)</u>
Long-term debt, excluding current maturities	<u>\$ 20,088,747</u>	<u>\$ 21,094,258</u>

The following is a summary of changes in long-term debt:

Outstanding at January 1, 2017	\$ 20,850,000
Issuance of long-term debt	18,885,106
Principal payments and amortization of premium	(775,848)
Principal defeased through refunding	<u>(16,985,000)</u>
Outstanding at December 31, 2017	21,974,258
Principal payments	(880,000)
Amortization of premium on bonds issued	<u>(125,511)</u>
Outstanding at December 31, 2018	<u>\$ 20,968,747</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE H - LONG-TERM DEBT - Continued

On December 1, 2011, the Abilene, Kansas Public Building Commission issued \$7,760,000 in Revenue Bonds, Series 2011 (the 2011 PBC bonds) and on January 5, 2012, issued \$10,000,000 in Revenue Bonds, Series 2012 (the 2012 PBC bonds), for the benefit of the Hospital pursuant to a Trust Indenture dated December 1, 2011. On December 1, 2011, the Hospital issued its Lease Agreement Certificates of Participation, Series 2011 (the Certificates), pursuant to a Trust Indenture. The Certificates represent proportionate interests of the owners thereof in basic rent payments to be made by the Hospital. The proceeds of the 2011 PBC bonds, the 2012 PBC bonds, and the Certificates (collectively the project debt) were used, together with other available funds of the Hospital, to (1) pay for renovations and additions to the Hospital's facilities, (2) purchase certain medical equipment, (3) fund a debt service reserve fund for the project debt, (4) pay interest costs during the period of construction, and (5) pay for certain costs related to issuance of the project debt.

On December 14, 2017, the Abilene, Kansas Public Building Commission issued \$17,405,000, in Refunding Revenue Bonds, Series 2017 (the 2017 PBC bonds), for the benefit of the Hospital pursuant to a Trust Indenture. The proceeds of these bonds were used to (1) pay the costs related to the issuance of the 2017 bonds and (2) advance refund \$6,985,000 of the 2011 PBC bonds and \$10,000,000 of the 2012 PBC bonds by making an irrevocable deposit with a trustee. The trustee used that deposit to purchase direct obligations of the United States of America that will mature and pay interest in amounts and at times that will provide for payment of interest on the refunded (1) 2011 bonds through December 1, 2019, and on that date redeem and pay \$6,985,000 of the refunded debt, (2) 2012 bonds through December 1, 2022, and on that date redeem and pay the \$10,000,000 of refunded debt, at 100 percent on those dates. The refunding transaction decreased the total amount of future debt service requirements by \$1,316,837. This resulted in an economic gain of \$917,298. As a result of this transaction, a deferred refunding loss of \$1,576,716 was recognized for the difference between the book value of the refunded debt and the amount required to extinguish the debt. This deferred loss is reported as a deferred outflow of resources on the statement of net position and is being amortized into expense over the term of the bonds.

The Pledge of Revenues and Intercreditor Agreement between the Hospital and the City of Abilene, Kansas, and Abilene, Kansas Public Building Commission, requires the Hospital to transfer to a trustee, on a monthly basis, specified amounts which, when combined with interest earned on the respective funds held by the trustee, will provide sufficient funds to pay the principal and interest on the appropriate due dates. Such transfers were made and are included in assets whose use is limited. The obligations of the Hospital under the agreement are secured by a pledge of its unrestricted revenues, subject to the right of the Hospital to dispose of or encumber property as defined and permitted in the agreement. The agreement also includes certain restrictive covenants relating to the disposition of property, adequacy of insurance coverage, incurrence of additional indebtedness, the level of days cash on hand, and the level of fees and rates charged. The covenant in the agreement requires that fees and rates for services be set at levels sufficient for the Hospital to produce income available for debt service in each fiscal year equal to 125 percent of the debt service requirements during that fiscal year for outstanding debt.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE H - LONG-TERM DEBT - Continued

Scheduled annual debt service requirements on long-term debt are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 880,000	\$ 778,489	\$ 1,658,489
2020	910,000	747,829	1,657,829
2021	945,000	713,934	1,658,934
2022	980,000	674,944	1,654,944
2023	1,020,000	635,744	1,655,744
2024-2028	5,325,000	2,468,469	7,793,469
2029-2033	6,605,000	1,147,768	7,752,768
2034-2035	<u>4,303,747</u>	<u>139,218</u>	<u>4,442,965</u>
	<u>\$ 20,968,747</u>	<u>\$ 7,306,395</u>	<u>\$ 28,275,142</u>

Total interest costs incurred are as follows:

	<u>2018</u>	<u>2017</u>
Total interest incurred	\$ 807,060	\$ 893,043
Amortization of bond premium	(125,511)	(5,848)
Amortization of deferred outflows on advance refunding	138,981	6,476
Bond issuance costs incurred	<u> </u>	<u>289,962</u>
Interest expense	<u>\$ 820,530</u>	<u>\$ 1,183,633</u>

NOTE I - LEASES

The Hospital leases property and equipment under operating lease arrangements. Total lease expense under all operating leases was approximately \$106,000 for 2018 and \$55,000 for 2017.

NOTE J - RISK MANAGEMENT

The Hospital is insured for professional liability under a comprehensive hospital liability policy provided by an independent insurance carrier with limits of \$200,000 per occurrence up to an annual aggregate of \$600,000 for all claims made during the policy year. The Hospital is further covered by the Kansas Health Care Stabilization Fund for claims in excess of its comprehensive hospital liability policy up to \$300,000 pursuant to any one judgment or settlement against the Hospital for any one party, subject to an aggregate limitation for all judgments or settlements arising from all claims made in the policy year in the amount of \$900,000. All coverage is on a claims-made basis. The above policies have been renewed through January 1, 2019. The Hospital intends to renew this coverage on that date and is aware of no reason why such coverage would be denied at that time.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE J - RISK MANAGEMENT - Continued

The Hospital has entered into a self-insured trust agreement with the Kansas Hospital Association, along with other qualified hospitals in the State of Kansas. The purpose of this trust is to purchase workers' compensation insurance for employees. To the extent the trust would have been unable to meet its claims liabilities, members have, jointly and severally, agreed to pay for all claims. Management has assessed the financial condition of the trust and believes that the trust is sufficiently funded to meet its liabilities as they come due as of December 31, 2018. Management is not aware of any intention by the trust to implement an assessment in the future for past funding shortages.

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

The Hospital is involved in litigation and other disputes arising in the normal course of business. After consultation with legal counsel, management believes that these matters will be resolved without material adverse effect on the Hospital's future financial position or results from operations.

NOTE K - DEPOSITS WITH FINANCIAL INSTITUTIONS

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

The carrying amount of the Hospital's deposits with financial institutions was \$5,798,764 and the bank balances were \$6,018,565 at December 31, 2018. The bank balances are categorized as follows at December 31, 2018:

Amount insured by the F.D.I.C., or collateralized with securities held by the Hospital or by its agent in the Hospital's name	\$ 626,830
Uncollateralized (amount collateralized with securities held in safekeeping by an authorized depository other than the pledging financial institution's trust department, but not in the Hospital's name)	<u>5,391,735</u>
	<u>\$ 6,018,565</u>

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D/B/A MEMORIAL HEALTH SYSTEM
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NOTE L - CONCENTRATION OF CREDIT RISK

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

	<u>2018</u>	<u>2017</u>
Medicare	40%	41%
Medicaid	8	10
Blue Cross	13	11
Other third-party payors	14	11
Patients	<u>25</u>	<u>27</u>
	<u>100%</u>	<u>100%</u>

NOTE M - BUDGETARY COMPARISON

Kansas statutes require that a fixed annual operating budget be legally adopted for the Hospital. All legal annual operating budgets are prepared using the modified accrual basis of accounting, modified further by the encumbrance method of accounting. Revenues are recognized when cash is received. Expenditures include disbursements, accounts payable, and encumbrances. Encumbrances are commitments by the Hospital for future payments and are supported by a document evidencing the commitment, such as a purchase order or contract. All unencumbered appropriations lapse at year-end. Actual expenditures for the year ended December 31, 2018, on the modified accrual basis of accounting and encumbrances were \$34,120,836 as compared to the legally adopted budgeted expenditures of \$38,083,879. Actual expenditures for the year ended December 31, 2017, on the modified accrual basis of accounting and encumbrances were \$31,247,183 as compared to the legally adopted budgeted expenditures of \$36,475,607.

NOTE N - DEFINED BENEFIT PENSION PLAN

Plan description

The Hospital participates in the Kansas Public Employees Retirement System (KPERS), a cost-sharing multiple-employer defined benefit pension plan as provided by K.S.A. 74-4901, et seq. Substantially all employees of the Hospital are eligible to participate in KPERS. KPERS provides retirement benefits, life insurance, disability income benefits, and death benefits. Kansas law establishes and amends benefit provisions. Substantially all public employees in Kansas are covered by KPERS. Participation by local political subdivisions and entities is optional, but irrevocable once elected. KPERS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to KPERS (611 South Kansas Avenue, Suite 100, Topeka, Kansas 66603-3869) or by calling 1-888-275-5737.

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

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NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE N - DEFINED BENEFIT PENSION PLAN - Continued

Benefits

Benefits are established by statute and may only be changed by the Kansas Legislature. Members with ten or more years of credited service, may retire as early as age 55, with an actuarially reduced monthly benefit. Normal retirement is at age 65, age 62 with ten years of credited service, or whenever a member's combined age and years of credited service equal 85 "points."

Monthly retirement benefits are based on a statutory formula that includes final average salary and years of service. When ending employment, members may withdraw their contributions from their individual accounts, including interest. Members who withdraw their accumulated contributions lose all rights and privileges of membership. For all pension coverage groups, the accumulated contributions and interest are deposited into and disbursed from the membership accumulated reserve fund as established by K.S.A. 74-4922.

Members choose one of seven payment options for their monthly retirement benefits. At retirement a member may receive a lump-sum payment of up to 50 percent of the actuarial present value of the member's lifetime benefit. His or her monthly retirement benefit is then permanently reduced based on the amount of the lump sum. Benefit increases, including ad hoc post-retirement benefit increases, must be passed into law by the Kansas Legislature. Benefit increases are under the authority of the Legislature and the Governor of the State of Kansas. For all pension coverage groups, the retirement benefits are disbursed from the retirement benefit payment reserve fund as established by K.S.A. 74-4922.

Contributions

Member contributions are established by state law, and are paid by the employee according to the provisions of Section 414(h) of the Internal Revenue Code. State law provides that the employer contribution rates be determined based on the results of an annual actuarial valuation for each of the three state-wide pension groups. The contributions and assets of all groups are deposited in the Kansas Public Employees Retirement Fund established by K.S.A. 74-4921. All of the retirement systems are funded on an actuarial reserve basis.

KPERS has three benefit structures and funding depending on whether the employee is a Tier 1, Tier 2, or Tier 3 member. Tier 1 members were hired before July 1, 2009, Tier 2 members were first employed on or after July 1, 2009, and Tier 3 members were first employed on or after January 1, 2015. Kansas law establishes the KPERS member-employee contribution rate of 6 percent of covered salary for all members for 2018 and 2017, respectively. The employer rates established by statute at December 31, 2018 and 2017, were 8.39 percent and 8.46 percent, respectively. The Hospital employer contributions to KPERS for the years ended December 31, 2018 and 2017, were \$1,145,275 and \$1,050,727, respectively, equal to the statutory required contributions for each year.

Employer and nonemployer allocations

Although KPERS administers one cost-sharing multiple-employer defined benefit pension plan, separate (sub) actuarial valuations are prepared to determine the actuarial determined contribution rate by group. Following this method,

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NOTE N - DEFINED BENEFIT PENSION PLAN - Continued

the measurement of the collective net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense are determined separately for each of the following groups of the plan:

- State/School
- Local
- Police and Firemen
- Judges

To facilitate the separate (sub) actuarial valuations, the System maintains separate accounts to identify additions, deductions, and fiduciary net position applicable to each group. The Hospital is included in the local group. The allocation percentages presented for each group in the schedule of employer and nonemployer allocations are applied to amounts presented in the schedules of pension amounts by employer and nonemployer. The allocation percentages for the Hospital's share of the collective pension amounts as of December 31, 2018 and 2017, are based on the ratio of each employer's contributions to total employer and nonemployer contributions of the group for the years ended June 30, 2018 and 2017, respectively. The contributions used exclude contributions made for prior service, excess benefits, and irregular payments. As of December 31, 2018, the Hospital's proportion was 0.722 percent which is a increase of .002 percent from its share at December 31, 2017.

Net pension liability

At December 31, 2018 and 2017, the Hospital reported a liability of \$10,061,366 and \$10,425,476, respectively, for its proportionate share of the net pension liability.

Actuarial assumptions

The total pension liability was determined by actuarial valuations as of December 31, 2017 and 2016, which were then rolled forward to June 30, 2018 and 2017, using the following actuarial assumptions:

<u>Actuarial assumptions</u>	<u>2017</u>	<u>2016</u>
Price inflation	2.75%	2.75%
Wage inflation	3.50%	3.50%
Salary increases, including wage increases	3.50% - 12.00%	3.50% - 12.00%
Long-term rate of return, net of investment expense and including price inflation	7.75%	7.75%

Mortality rates were based on the RP-2014 Mortality Tables, with age setbacks and age set forwards as well as other adjustments based on different membership groups. Future mortality improvements are anticipated using Scale MP-2016.

The actuarial assumptions used in the December 31, 2017 and 2016 valuations were based on the results of an actuarial experience study conducted for the period December 31, 2013 through December 31, 2015.

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NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE N - DEFINED BENEFIT PENSION PLAN - Continued

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by weighting the expected future real rates of return by the target asset allocation percentage.

Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocations as of June 30, 2018, are summarized in the following table:

<u>Asset class</u>	<u>Long-term target allocation</u>	<u>Long-term expected real rate of return</u>
Global equity	47.00 %	6.85 %
Fixed income	13.00	1.25
Yield driven	8.00	6.55
Real return	11.00	1.71
Real estate	11.00	5.05
Alternatives	8.00	9.85
Short-term investments	<u>2.00</u>	(0.25)
Total	<u>100.00 %</u>	

Discount rate

The discount rate used to measure the total pension liability for 2017 and 2016 were 7.75 percent. The State, School, and Local employers do not necessarily contribute the full actuarial determined rate. Based on legislation passed in 1993, the employer contribution rates certified by the System's Board of Trustees for these groups may not increase by more than the statutory cap. The statutory cap for the year ended June 30, 2018, was 1.2 percent. The projection of cash flows used to determine the discount rates assumed that contributions from plan members will be made within the same range as have been made during the past few years.

Sensitivity of the net pension liability to changes in the discount rate

The following table presents the net pension liability of the pension plan as of June 30, 2018, calculated using the discount rate of 7.75 percent, as well as what the pension plan's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.75 percent) or 1-percentage-point higher (8.75 percent) than the current rate:

	<u>1% decrease (6.75%)</u>	<u>Current discount rate (7.75%)</u>	<u>1% increase (8.75%)</u>
Hospital's share of net pension liability	\$14,756,461	\$10,061,366	\$ 6,093,587

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NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE N - DEFINED BENEFIT PENSION PLAN - Continued

Pension expense

For the years ended December 31, 2018 and 2017, the Hospital recognized pension expense of \$755,400 and \$917,567, respectively, which includes the changes in the collective net pension liability, projected earnings on pension plan investments, and the amortization of deferred outflows of resources and deferred inflows of resources for the period.

Deferred outflows of resources and deferred inflows of resources

A summary of the collective deferred outflows of resources and deferred inflows of resources related to the defined pension plan at December 31, 2018 and 2017, are included in the tables below. Experience gains/losses and the impact of changes in actuarial assumptions or other inputs, if any, are recognized over the average expected remaining service life of the active and inactive plan members at the beginning of the measurement period. Investment gains and losses are recognized over a fixed five-year period.

	<u>2018</u>	<u>2017</u>
Deferred outflows of resources		
Differences between expected and actual experience	\$ 36,326	\$ 50,424
Changes of assumptions	435,700	561,455
Net difference between projected and actual earnings on pension plan investments	235,366	327,030
Changes in proportion and differences between Hospital contributions and proportionate share of contributions	186,850	253,581
Employer contributions subsequent to the measurement date	<u>582,322</u>	<u>520,041</u>
Total deferred outflows of resources	<u>\$ 1,476,564</u>	<u>\$ 1,712,531</u>
Deferred inflows of resources		
Differences between expected and actual experience	\$ 285,094	\$ 360,491
Changes in assumptions	48,452	76,236
Changes in proportion and differences between Hospital contributions and proportionate share of contributions	<u>497,451</u>	<u>656,002</u>
Total deferred inflows of resources	<u>\$ 830,997</u>	<u>\$ 1,092,729</u>

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NOTE N - DEFINED BENEFIT PENSION PLAN - Continued

The following table provides the deferred outflows of resources and deferred inflows of resources as of December 31, 2018, that will be recognized in pension expense in future years:

Year ended December 31,	Employer contributions subsequent to the measurement date	Recognition of net deferred outflows/(inflows) of resources by year	Total
2019	\$ 582,322	\$ 275,529	\$ 857,851
2020		98,947	98,947
2021		(254,331)	(254,331)
2022		(55,914)	(55,914)
2023		(986)	(986)
	<u>\$ 582,322</u>	<u>\$ 63,245</u>	<u>\$ 645,567</u>

NOTE O - OTHER POSTEMPLOYMENT BENEFIT PLAN

Plan description and benefits provided

The Kansas Public Employees Retirement System (KPERS) sponsors a long-term disability program for participating employers (the Plan). Participating employers pay the cost of the long-term disability and life insurance coverage for their members as provided by K.S.A. 74-04927. The Hospital is considered to be participating in a single employer long-term disability plan. The Plan is administered through a trust held by KPERS that is funded to pay annual benefit payments. However, because the trust's assets are used to pay employee benefits other than postemployment benefits (OPEB), the trust does not meet the criteria in paragraph 4 of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. Accordingly, the Plan is considered to be administered on a pay-as-you-go basis.

Benefits are established by statute and may be amended by the KPERS Board of Trustees. The Plan provides long-term disability benefits equal to 60 percent (prior to January 1, 2006, 66 2/3 percent) of annual compensation, offset by other benefits. Members receiving long-term disability benefits also receive credit towards their KPERS retirement benefits and have their group life insurance coverage continued under the waiver of premium provision.

The monthly long-term disability benefit is 60 percent of the member's monthly compensation, with a minimum of \$100 and a maximum of \$5,000. The monthly benefit is subject to reduction by deductible sources of income, which includes Social Security primary disability or retirement benefits, workers compensation benefits, other disability benefits from other sources by reason of employment, and earnings from any form of employment. If the disability begins before age 60, benefits are payable while the disability continues until the member's 65th birthday or retirement date, whichever occurs first.

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NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017

NOTE O - OTHER POSTEMPLOYMENT BENEFIT PLAN - Continued

If the disability begins after age 60, benefits are payable while the disability continues, for a period of five years or until the member retires, whichever occurs first. Benefit payments for disabilities caused or contributed to by substance abuse or non-biologically based mental illnesses are limited to the shorter of the term of the disability or 24 months per lifetime. There are no automatic cost-of-living increase provisions. KPERS has the authority to implement an ad hoc cost-of-living increase.

The death benefit paid to beneficiaries of disabled members is 150 percent of the greater of 1) the member's annual rate of compensation at the time of disability, or 2) the member's previous 12 months of compensation at the time of the past date on payroll. If the member has been disabled for five or more years, the annual compensation or salary rate at the time of death will be indexed using the consumer price index, less one percentage point, to compute the death benefit. If a member is diagnosed as terminally ill with a life expectancy of 12 months or less, the member may be eligible to receive up to 100 percent of the death benefit rather than having the benefit paid to the beneficiary. If a member retires or disability benefits end, the member may convert the group life insurance coverage to an individual insurance policy.

Covered employees

The Hospital has the following employees covered by the Plan as of December 31,

	<u>2017</u>	<u>2016</u>
Inactive employees or beneficiaries		
currently receiving benefit payments	1	2
Active employees	286	286
Total	287	288

Net OPEB liability

At December 31, 2018 and 2017, the Hospital reported a total OPEB liability of \$139,140 and \$203,824, respectively.

Actuarial assumptions

The total OPEB liability was determined by actuarial valuations as of December 31, 2017 and 2016, which were then rolled forward to June 30, 2018 and 2017, using the following actuarial assumptions:

<u>Actuarial assumptions</u>	<u>2017</u>	<u>2016</u>
Price inflation	2.75%	2.75%
Wage inflation	3.00%	3.00%
Salary increases, including wage increases	3.50% - 10.00%	3.50% - 10.00%
Discount rate	3.87%	3.58%

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NOTE O - OTHER POSTEMPLOYMENT BENEFIT PLAN - Continued

In 2017 and 2016, mortality rates used for the death benefits were based on the RP-2014 Mortality Tables. Future mortality improvements were projected using Scales MP-2018 and MP-2017 in 2017 and 2016, respectively. Mortality rates used for disability benefits were included in long-term disability claim termination rates.

The actuarial assumptions used in the December 31, 2017 and 2016 valuations were based on the results of an actuarial experience study conducted for the period December 31, 2013 through December 31, 2015.

Changes in total OPEB liability

	<u>June 30,</u> <u>2018</u>	<u>June 30,</u> <u>2017</u>
Balance at beginning of period	\$ 203,824	\$ 169,953
Changes for the year		
Service cost	45,849	49,024
Interest	8,266	5,996
Changes of economic/demographic gains or losses	(79,785)	
Changes in assumptions or other inputs	(1,117)	(3,836)
Benefit payments	<u>(37,897)</u>	<u>(17,313)</u>
	<u>(64,684)</u>	<u>33,871</u>
Balance at end of period	<u>\$ 139,140</u>	<u>\$ 203,824</u>

Sensitivity of the OPEB liability to changes in the discount rate

The following table presents the total OPEB liability as of June 30, 2018, calculated using the discount rate of 3.87 percent, as well as what the OPEB's liability would be if it were calculated using a discount rate that is 1-percentage-point lower (2.87 percent) or 1-percentage-point higher (4.87 percent) than the current rate:

	<u>1% decrease</u> <u>(2.87%)</u>	<u>Current</u> <u>discount rate</u> <u>(3.87%)</u>	<u>1% increase</u> <u>(4.87%)</u>
Total OPEB liability	\$ 142,613	\$ 139,140	\$ 134,928

OPEB expense

For the years ended December 31, 2018 and 2017, the Hospital recognized OPEB expense of \$45,370 and \$54,624, respectively, which includes the changes in the total OPEB liability and the amortization of deferred outflows of resources and deferred inflows of resources for the period.

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NOTE O - OTHER POSTEMPLOYMENT BENEFIT PLAN - Continued

Deferred outflows of resources and deferred inflows of resources

A summary of the collective deferred outflows of resources and deferred inflows of resources related to the OPEB plan at December 31, 2018 and 2017, are included in the tables below.

	<u>2018</u>	<u>2017</u>
Deferred outflows of resources		
Benefit payments subsequent to the measurement date	\$ 18,949	\$ 8,657
Total deferred outflows of resources	<u>\$ 18,949</u>	<u>\$ 8,657</u>
Deferred inflows of resources		
Differences between expected and actual experience	\$ 71,551	\$ -
Changes of assumptions	<u>4,046</u>	<u>3,440</u>
Total deferred inflows of resources	<u>\$ 75,597</u>	<u>\$ 3,440</u>

The following table provides the deferred outflows of resources and deferred inflows of resources as of December 31, 2018, that will be recognized in OPEB expense in future years:

<u>Year ended December 31,</u>	<u>Benefit payments subsequent to the measurement date</u>	<u>Recognition of net deferred outflows/(inflows) of resources by year</u>	<u>Total</u>
2019	\$ 18,949	\$ (8,745)	\$ 10,204
2020		(8,745)	(8,745)
2021		(8,745)	(8,745)
2022		(8,745)	(8,745)
2023		(8,745)	(8,745)
Thereafter		<u>(31,872)</u>	<u>(31,872)</u>
	<u>\$ 18,949</u>	<u>\$ (75,597)</u>	<u>\$ (56,648)</u>

NOTE P - EMPLOYEE HEALTH INSURANCE CLAIMS

The Hospital is partially self-insured for health insurance claims of its employees. The Hospital has reinsured a portion of its risk for such claims. The reinsurance arrangement covers annual claims in excess of \$65,000 for each covered individual. Covered employees also provide part of the funds to pay claims through monthly contributions at predetermined rates. The Hospital has retained an insurance company as its agent to process and settle claims. The Hospital reimburses the agent twice a month for the amount of claims paid by the agent net of any amounts covered by reinsurance.

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December 31, 2018 and 2017

NOTE P - EMPLOYEE HEALTH INSURANCE CLAIMS - Continued

The following is a summary of the activity under this arrangement:

	<u>2018</u>	<u>2017</u>
Estimated employee health insurance claims payable at beginning of period	\$ 116,784	\$ 161,000
Provision for employer's share of incurred claims expenses for the period	736,132	716,539
Employee contributions	725,163	656,249
Payments made for claims, expenses, and reinsurance	<u>(1,512,913)</u>	<u>(1,417,004)</u>
Estimated employee health insurance claims payable at end of period	<u>\$ 65,166</u>	<u>\$ 116,784</u>

NOTE Q - FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is determined according to a hierarchy that gives highest priority to use of observable inputs and lowest priority to use of unobservable inputs. These inputs are described as follows:

Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Hospital has the ability to access.

Level 2 inputs to the valuation methodology are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 inputs to the valuation methodology are unobservable, supported by little or no market activity, and are significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following is a description of the valuation methodologies used by the Hospital for assets measured at fair value on a recurring basis:

Cash, certificates of deposit, money market funds, and common stocks are valued at unadjusted quoted prices for identical securities in active markets.

Corporate bonds are valued at prices provided by an independent pricing service.

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NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017

NOTE Q - FAIR VALUE MEASUREMENTS - Continued

The following tables set forth, by level, the Hospital's assets measured at fair value on a recurring basis:

	December 31, 2018			Total
	Level 1	Level 2	Level 3	
Cash and certificates of deposit	\$ 5,012,427	\$ -	\$ -	\$ 5,012,427
Money market mutual funds	3,302,999			3,302,999
Common stocks	36,044			36,044
Corporate bonds		1,804,145		1,804,145
	<u>\$ 8,351,470</u>	<u>\$ 1,804,145</u>	<u>\$ -</u>	<u>\$ 10,155,615</u>
	December 31, 2017			Total
	Level 1	Level 2	Level 3	
Cash and certificates of deposit	\$ 4,928,650	\$ -	\$ -	\$ 4,928,650
Money market mutual funds	2,940,727			2,940,727
Common stocks	34,812			34,812
Corporate bonds		2,104,014		2,104,014
	<u>\$ 7,904,189</u>	<u>\$ 2,104,014</u>	<u>\$ -</u>	<u>\$ 10,008,203</u>

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NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017

NOTE R - RELATED PARTIES

As discussed in Note A2, the Hospital is responsible for appointing members of AHI's Board of Directors. The Hospital does not make any appropriations to AHI or receive any distributions. The following is a summary of the assets, liabilities, net position, revenues and expenses, and changes in net position of AHI as of and for the years ended September 30, 2018 and 2017:

	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 409,326	\$ 106,739
Other current assets	<u>33,078</u>	<u>33,055</u>
Total current assets	442,404	139,794
Investments	226,360	198,237
Capital assets - net	1,219,034	972,050
Other assets	<u>22,883</u>	<u>22,822</u>
Total assets	<u>\$ 1,910,681</u>	<u>\$ 1,332,903</u>
Accounts payable	\$ 17,324	\$ 33,574
Current portion of mortgage payable	90,610	103,501
Other current liabilities	<u>2,510</u>	<u>5,174</u>
Total current liabilities	110,444	142,249
Mortgage payable, excluding current portion	854,985	340,728
Other liabilities	<u>22,742</u>	<u>23,319</u>
Total liabilities	988,171	506,296
Net position	<u>922,510</u>	<u>826,607</u>
Total liabilities and net position	<u>\$ 1,910,681</u>	<u>\$ 1,332,903</u>
Revenues	<u>\$ 564,121</u>	<u>\$ 527,175</u>
Management fee paid to Hospital	68,665	64,975
Depreciation and amortization	105,406	100,710
Other expenses	<u>294,147</u>	<u>277,516</u>
Total expenses	<u>468,218</u>	<u>443,201</u>
Increase in net position	<u>\$ 95,903</u>	<u>\$ 83,974</u>

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NOTES TO FINANCIAL STATEMENTS - CONTINUED
December 31, 2018 and 2017

NOTE S - CONDENSED COMBINING INFORMATION

Condensed financial data for the Hospital and its blended component unit as of and for the year ended December 31, 2018, are presented in the following tables:

	Statement of Net Position - 2018			
	<u>Hospital</u>	<u>Foundation</u>	<u>Eliminations</u>	<u>Consolidated</u>
Assets				
Cash and invested cash	\$ 787,551	\$ 88,831	\$ -	\$ 876,382
Other current assets	6,351,232		(2,597)	6,348,635
Capital assets	19,855,888			19,855,888
Other assets	10,125,379			10,125,379
Total assets	<u>37,120,050</u>	<u>88,831</u>	<u>(2,597)</u>	<u>37,206,284</u>
Deferred outflows of resources	2,926,772	-	-	2,926,772
Total assets and deferred outflows of resources	<u>\$40,046,822</u>	<u>\$ 88,831</u>	<u>\$ (2,597)</u>	<u>\$ 40,133,056</u>
Liabilities				
Accounts payable	\$ 1,029,668	\$ 2,597	\$ (2,597)	\$ 1,029,668
Other current liabilities	2,009,096			2,009,096
Noncurrent liabilities	30,311,766			30,311,766
Total liabilities	<u>33,350,530</u>	<u>2,597</u>	<u>(2,597)</u>	<u>33,350,530</u>
Deferred inflows of resources	1,194,594	-	-	1,194,594
Net position				
Net investment in capital assets	318,400			318,400
Restricted				
For debt service	1,977,426			1,977,426
Expendable for capital acquisitions		3,728		3,728
For specific operating activities		50,849		50,849
Unrestricted	3,205,872	31,657		3,237,529
Total net position	<u>5,501,698</u>	<u>86,234</u>	<u>-</u>	<u>5,587,932</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$40,046,822</u>	<u>\$ 88,831</u>	<u>\$ (2,597)</u>	<u>\$ 40,133,056</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE S - CONDENSED COMBINING INFORMATION - Continued

	Statement of Revenues, Expenses, and Changes in Net Position - 2018			
	<u>Hospital</u>	<u>Foundation</u>	<u>Eliminations</u>	<u>Consolidated</u>
Operating revenue				
Net patient service revenue	\$30,935,580	\$ -	\$ -	\$ 30,935,580
Other revenues	<u>3,295,418</u>	<u>-</u>	<u>-</u>	<u>3,295,418</u>
Total operating revenues	<u>34,230,998</u>	<u>-</u>	<u>-</u>	<u>34,230,998</u>
Operating expenses				
Salaries and wages, employee benefits, and actuarial adjustments to pension and OPEB expenses	17,854,710			17,854,710
Supplies and other	13,180,707		(29,000)	13,151,707
Depreciation and amortization	<u>2,231,288</u>	<u>-</u>	<u>-</u>	<u>2,231,288</u>
Total operating expenses	<u>33,266,705</u>	<u>-</u>	<u>(29,000)</u>	<u>33,237,705</u>
Operating income	964,293	-	29,000	993,293
Nonoperating revenues (expenses)	<u>(201,061)</u>	<u>(35,442)</u>	<u>(29,000)</u>	<u>(265,503)</u>
Excess of revenues over (under) expenses before capital contributions	763,232	(35,442)	-	727,790
Capital grants and contributions	<u>58,267</u>	<u>-</u>	<u>-</u>	<u>58,267</u>
Change in net position	<u>821,499</u>	<u>(35,442)</u>	<u>-</u>	<u>786,057</u>
Net position at beginning of year as previously reported	4,878,806	121,676		5,000,482
Prior period adjustment for change in accounting principle	<u>(198,607)</u>	<u>-</u>	<u>-</u>	<u>(198,607)</u>
As restated	<u>4,680,199</u>	<u>121,676</u>	<u>-</u>	<u>4,801,875</u>
Ending net position	<u>\$ 5,501,698</u>	<u>\$ 86,234</u>	<u>\$ -</u>	<u>\$ 5,587,932</u>
	Statement of Cash Flows - 2018			
	<u>Hospital</u>	<u>Foundation</u>	<u>Eliminations</u>	<u>Consolidated</u>
Net cash provided (used) by				
Operating activities	\$ 2,248,762	\$ -	\$ 29,000	\$ 2,277,762
Noncapital financing activities	519,352	(37,075)	(29,000)	453,277
Capital and related financing activities	(2,525,754)			(2,525,754)
Investing activities	<u>(31,113)</u>	<u>-</u>	<u>-</u>	<u>(31,113)</u>
Net change in cash and cash equivalents	211,247	(37,075)		174,172
Cash and cash equivalents at beginning of year	<u>576,304</u>	<u>125,906</u>	<u>-</u>	<u>702,210</u>
Cash and cash equivalents at end of year	<u>\$ 787,551</u>	<u>\$ 88,831</u>	<u>\$ -</u>	<u>\$ 876,382</u>

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE S - CONDENSED COMBINING INFORMATION - Continued

Condensed financial data for the Hospital and its blended component unit as of and for the year ended December 31, 2017, are presented in the following tables:

	Statement of Net Position - 2017			
	<u>Hospital</u>	<u>Foundation</u>	<u>Eliminations</u>	<u>Consolidated</u>
Assets				
Cash and invested cash	\$ 576,304	\$ 125,906	\$ -	\$ 702,210
Other current assets	5,574,070		(4,230)	5,569,840
Capital assets	21,175,682			21,175,682
Other assets	10,064,871			10,064,871
Total assets	37,390,927	125,906	(4,230)	37,512,603
Deferred outflows of resources	3,291,428	-	-	3,291,428
Total assets and deferred outflows of resources	\$40,682,355	\$ 125,906	\$ (4,230)	\$40,804,031
Liabilities				
Accounts payable	\$ 925,976	\$ 4,230	\$ (4,230)	\$ 925,976
Other current liabilities	1,954,174			1,954,174
Noncurrent liabilities	31,745,742			31,745,742
Total liabilities	34,625,892	4,230	(4,230)	34,625,892
Deferred inflows of resources	1,376,264	-	-	1,376,264
Net position				
Net investment in capital assets	771,665			771,665
Restricted				
For debt service	1,954,480			1,954,480
Expendable for capital acquisitions		4,228		4,228
For specific operating activities		75,366		75,366
Unrestricted	1,954,054	42,082		1,996,136
Total net position	4,680,199	121,676	-	4,801,875
Total liabilities, deferred inflows of resources, and net position	\$40,682,355	\$ 125,906	\$ (4,230)	\$40,804,031

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

D/B/A MEMORIAL HEALTH SYSTEM

NOTES TO FINANCIAL STATEMENTS - CONTINUED

December 31, 2018 and 2017

NOTE S - CONDENSED COMBINING INFORMATION - Continued

	Statement of Revenues, Expenses, and Changes in Net Position - 2017			
	<u>Hospital</u>	<u>Foundation</u>	<u>Eliminations</u>	<u>Consolidated</u>
Operating revenue				
Net patient service revenue	\$27,752,663	\$ -	\$ -	\$27,752,663
Other revenues	<u>3,161,204</u>	<u>-</u>	<u>-</u>	<u>3,161,204</u>
Total operating revenues	<u>30,913,867</u>	<u>-</u>	<u>-</u>	<u>30,913,867</u>
Operating expenses				
Salaries and wages, employee benefits, and actuarial adjustments to pension and OPEB expenses	17,068,642			17,068,642
Supplies and other	12,250,902			12,250,902
Depreciation and amortization	<u>2,627,842</u>	<u>-</u>	<u>-</u>	<u>2,627,842</u>
Total operating expenses	<u>31,947,386</u>	<u>-</u>	<u>-</u>	<u>31,947,386</u>
Operating income (loss)	(1,033,519)	-	-	(1,033,519)
Nonoperating revenues (expenses)	<u>(945,914)</u>	<u>5,300</u>	<u>-</u>	<u>(940,614)</u>
Excess of revenues over (under) expenses before capital contributions	(1,979,433)	5,300	-	(1,974,133)
Capital grants and contributions	<u>10,138</u>	<u>-</u>	<u>-</u>	<u>10,138</u>
Change in net position	<u>(1,969,295)</u>	<u>5,300</u>	<u>-</u>	<u>(1,963,995)</u>
Net position at beginning of year as previously reported	6,810,790	116,376		6,927,166
Prior period adjustment for change in accounting principle	<u>(161,296)</u>	<u>-</u>	<u>-</u>	<u>(161,296)</u>
As restated	<u>6,649,494</u>	<u>116,376</u>	<u>-</u>	<u>6,765,870</u>
Ending net position	<u>\$ 4,680,199</u>	<u>\$ 121,676</u>	<u>\$ -</u>	<u>\$ 4,801,875</u>
	Statement of Cash Flows - 2017			
	<u>Hospital</u>	<u>Foundation</u>	<u>Eliminations</u>	<u>Consolidated</u>
Net cash provided (used) by				
Operating activities	\$ 1,579,641	\$ -	\$ -	\$ 1,579,641
Noncapital financing activities	485,821	6,738		492,559
Capital and related financing activities	(1,913,359)			(1,913,359)
Investing activities	<u>(54,957)</u>	<u>-</u>	<u>-</u>	<u>(54,957)</u>
Net change in cash and cash equivalents	97,146	6,738	-	103,884
Cash and cash equivalents at beginning of year	<u>479,158</u>	<u>119,168</u>	<u>-</u>	<u>598,326</u>
Cash and cash equivalents at end of year	<u>\$ 576,304</u>	<u>\$ 125,906</u>	<u>\$ -</u>	<u>\$ 702,210</u>

REQUIRED SUPPLEMENTARY INFORMATION

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
SCHEDULE OF HOSPITAL'S PROPORTIONATE SHARE OF
THE NET DEFINED PENSION PLAN LIABILITY
December 31,

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Hospital's proportion of the net pension liability	0.7219%	0.7198%	0.7710%	0.7508%	0.7610%
Hospital's proportionate share of the net pension liability	\$10,061,366	\$10,425,476	\$11,927,118	\$ 9,857,928	\$ 9,366,352
Hospital's covered-employee payroll	\$13,650,477	\$12,419,941	\$12,820,000	\$12,724,778	\$12,373,292
Hospital's proportionate share of the net pension liability as a percentage of its covered-employee payroll	73.71%	83.94%	93.04%	77.47%	75.70%
Plan fiduciary net position as a percentage of the total pension liability	74.22%	72.15%	68.55%	71.98%	72.56%

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS

SCHEDULE OF HOSPITAL CONTRIBUTIONS TO

DEFINED PENSION PLAN

December 31,

	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Contractually required contribution	\$ 1,145,275	\$ 1,050,727	\$ 1,176,876	\$ 1,206,309	\$ 1,093,799	\$ 980,318	\$ 846,955	\$ 708,487	\$ 564,790	\$ 432,545
Contributions in relation to the contractually required contribution	<u>(1,145,275)</u>	<u>(1,050,727)</u>	<u>(1,176,876)</u>	<u>(1,206,309)</u>	<u>(1,093,799)</u>	<u>(980,318)</u>	<u>(846,955)</u>	<u>(708,487)</u>	<u>(564,790)</u>	<u>(432,545)</u>
Contribution deficiency (excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Hospital's covered-employee payroll	\$13,650,477	\$12,419,941	\$12,820,000	\$12,724,778	\$12,373,292	\$12,346,727	\$11,539,034	\$ 10,511,925	\$9,198,578	\$7,807,682
Contributions as a percentage of covered-employee payroll	8.39%	8.46%	9.18%	9.48%	8.84%	7.94%	7.34%	6.74%	6.14%	5.54%

MEMORIAL HOSPITAL OF HOSPITAL DISTRICT #1 OF DICKINSON COUNTY, KANSAS
SCHEDULE OF CHANGES IN
TOTAL OPEB LIABILITY AND RELATED RATIOS
December 31,

	<u>2018</u>	<u>2017</u>
Service cost	\$ 45,849	\$ 49,024
Interest on total OPEB liability	8,266	5,996
Effect of economic/demographic gains or losses	(79,785)	
Effect of assumption changes or inputs	(1,117)	(3,836)
Benefit payments	<u>(37,897)</u>	<u>(17,313)</u>
Net change in total OPEB liability	<u>(64,684)</u>	<u>33,871</u>
Total OPEB liability, beginning	<u>203,824</u>	<u>169,953</u>
Total OPEB liability, ending	<u>\$ 139,140</u>	<u>\$ 203,824</u>
Covered payroll	\$ 12,194,000	\$ 12,341,000
Total OPEB liability as a % of covered payroll	1.14%	1.65%