

Kearny County Hospital
A Component Unit of Kearny County, Kansas
Independent Auditor's Report and Financial Statements
June 30, 2019 and 2018

Kearny County Hospital
A Component Unit of Kearny County, Kansas
June 30, 2019 and 2018

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Independent Auditor's Report

Board of Trustees
Kearny County Hospital
Lakin, Kansas

We have audited the accompanying financial statements of Kearny County Hospital (the Hospital), a component unit of Kearny County, Kansas, as of and for the years ended June 30, 2019 and 2018, and the related notes to the financial statements, which collectively comprise Kearny County Hospital's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the provisions of the Kansas Municipal Audit and Accounting Guide. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Kearny County Hospital as of June 30, 2019 and 2018, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

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

BKD, LLP

Wichita, Kansas
December 3, 2019

Kearny County Hospital
A Component Unit of Kearny County, Kansas
Balance Sheets
June 30, 2019 and 2018

Assets

	2019	2018
Current Assets		
Cash	\$ 99,419	\$ 255,800
Patient accounts receivable, net of allowance; 2019 - \$658,972; 2018 - \$365,657	2,303,223	2,741,235
Estimated amounts due from third-party payers	637,000	-
Other receivables	603,079	425,412
Employee receivables	58,297	122,567
Supplies	463,704	499,599
Prepaid expenses and other	273,994	283,255
Total current assets	4,438,716	4,327,868
Noncurrent Cash and Investments		
Designated by board of trustees	768,284	757,810
	768,284	757,810
Capital Assets, Net	6,520,134	7,101,146
Other Assets		
Employee receivables	48,331	58,057
Total assets	\$ 11,775,465	\$ 12,244,881

Liabilities and Net Position

	<u>2019</u>	<u>2018</u>
Current Liabilities		
Notes payable to bank	\$ 452,182	\$ -
Current maturities of long-term debt	267,615	235,344
Accounts payable	487,717	683,639
Accrued payroll	387,597	393,724
Accrued vacation	272,011	247,793
Other accrued expenses	403,272	494,317
Estimated amounts due to third-party payers	-	675,939
Unearned revenue	164,341	192,535
	<u>2,434,735</u>	<u>2,923,291</u>
Long-Term Debt	<u>330,077</u>	<u>386,981</u>
	<u>2,764,812</u>	<u>3,310,272</u>
Net Position		
Investment in capital assets	5,922,442	6,478,821
Unrestricted	3,088,211	2,455,788
	<u>9,010,653</u>	<u>8,934,609</u>
	<u>\$ 11,775,465</u>	<u>\$ 12,244,881</u>

Kearny County Hospital
A Component Unit of Kearny County, Kansas
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2019 and 2018

	2019	2018
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2019 - \$1,519,019; 2018 - \$1,182,083	\$ 21,603,905	\$ 21,901,170
Other	3,454,388	3,658,037
Total operating revenues	25,058,293	25,559,207
Operating Expenses		
Salaries and wages	13,642,755	13,456,374
Employee benefits	3,159,831	3,402,991
Purchased services and professional fees	2,306,009	2,086,616
Other supplies and expenses	6,090,747	6,061,924
Depreciation	1,211,754	1,202,824
Total operating expenses	26,411,096	26,210,729
Operating Loss	(1,352,803)	(651,522)
Nonoperating Revenues (Expenses)		
Noncapital appropriations - Kearny County	365,932	662,712
Interest income	23,201	16,462
Interest expense	(39,726)	(60,781)
Gain on disposal of capital assets	105,304	-
Noncapital grants and gifts	633,741	328,863
Total nonoperating revenues	1,088,452	947,256
Income (Loss) Before Capital Grants and Gifts	(264,351)	295,734
Capital Grants and Gifts	340,395	94,803
Increase in Net Position	76,044	390,537
Net Position, Beginning of Year	8,934,609	8,544,072
Net Position, End of Year	\$ 9,010,653	\$ 8,934,609

Kearny County Hospital
A Component Unit of Kearny County, Kansas
Statements of Cash Flows
Years Ended June 30, 2019 and 2018

	2019	2018
Cash Flows From Operating Activities		
Receipts from and on behalf of patients	\$ 20,728,978	\$ 21,918,232
Payments to suppliers and contractors	(8,528,822)	(8,208,709)
Payments to employees	(16,766,295)	(16,578,341)
Other receipts, net	3,276,721	3,463,400
Net cash provided by (used in) operating activities	(1,289,418)	594,582
Cash Flows From Noncapital Financing Activities		
Noncapital appropriations - Kearny County	365,932	662,712
Noncapital grants and gifts	633,741	328,863
Proceeds from issuance of notes payable to bank	6,293,870	10,326,177
Principal paid on notes payable to bank	(5,841,688)	(11,110,615)
Interest paid on notes payable to bank	(5,014)	(29,046)
Net cash provided by noncapital financing activities	1,446,841	178,091
Cash Flows From Capital and Related Financing Activities		
Capital grants and gifts	340,395	94,803
Purchases of capital assets	(405,338)	(274,131)
Proceeds from disposal of capital assets	110,300	-
Principal paid on long-term debt	(273,733)	(245,537)
Interest paid on long-term debt	(34,712)	(31,735)
Net cash used in capital and related financing activities	(263,088)	(456,600)
Cash Flows From Investing Activities		
Interest income received	23,201	16,462
Change in certificates of deposit	(5,640)	(6,508)
Advances to employees	(63,443)	(85,000)
Net cash used in investing activities	(45,882)	(75,046)
Increase (Decrease) in Cash	(151,547)	241,027
Cash, Beginning of Year	471,844	230,817
Cash, End of Year	\$ 320,297	\$ 471,844

Kearny County Hospital
A Component Unit of Kearny County, Kansas
Statements of Cash Flows (Continued)
Years Ended June 30, 2019 and 2018

	2019	2018
Reconciliation of Cash to the Balance Sheets		
Cash	\$ 99,419	\$ 255,800
Designated by board of trustees	220,878	216,044
	\$ 320,297	\$ 471,844
Reconciliation of Operating Loss to Net Cash Provided by (Used in) Operating Activities		
Operating loss	\$ (1,352,803)	\$ (651,522)
Depreciation	1,211,754	1,202,824
Provision for uncollectible accounts	1,519,019	1,182,083
Forgiveness of employee receivables	137,439	127,165
Changes in operating assets and liabilities		
Patient accounts receivable	(1,081,007)	(1,575,960)
Estimated amounts due from and to third-party payers	(1,312,939)	410,939
Other receivables	(177,667)	(194,637)
Supplies	35,895	(135,414)
Prepaid expenses and other	9,261	(47,538)
Accounts payable and accrued expenses	(278,370)	276,642
Net cash provided by (used in) operating activities	\$ (1,289,418)	\$ 594,582
Noncash Investing, Capital and Financing Activities		
Capital lease obligations incurred for capital assets	\$ 249,100	\$ 106,954
Capital assets acquisitions included in accounts payable	\$ -	\$ 18,700

Kearny County Hospital
A Component Unit of Kearny County, Kansas
Notes to Financial Statements
June 30, 2019 and 2018

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

Nature of Operations and Reporting Entity

Kearny County Hospital (Hospital) is an acute care hospital located in Lakin, Kansas. The Hospital is a component unit of Kearny County (County), and governed by a Board of Trustees. The Board of County Commissioners appoints the members of the Board of Trustees. The Hospital primarily earns revenues by providing inpatient, outpatient, emergency care, long-term care and rural health clinic services to patients in the Kearny County area. The Hospital is licensed as a critical access hospital (CAH).

Basis of Accounting and Presentation

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

Use of Estimates

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

Cash Equivalents

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

Kearny County Hospital
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June 30, 2019 and 2018

Patient Accounts Receivable

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

Supplies

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

Noncurrent Investments

Noncurrent investments include assets consisting of certificates of deposit, which are carried at amortized cost. The Board of Trustees has designated these certificates of deposit for future capital acquisitions, which may at its discretion later use these designated certificates of deposit for other purposes.

Capital Assets

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

Land improvements	10 – 20 years
Buildings	5 – 40 years
Equipment	5 – 20 years

Capital Asset Impairment

The Hospital evaluates capital assets for impairment whenever events or circumstances indicate a significant, unexpected decline in the service utility of a capital asset has occurred. If a capital asset is tested for impairment and the magnitude of the decline in service utility is significant and unexpected, accumulated depreciation is increased by the amount of the impairment loss.

No asset impairment was recognized during the years ended June 30, 2019 and 2018.

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Compensated Absences

Hospital policies permit most employees to accumulate paid time off that may be realized as paid time off or, in limited circumstances (*i.e.*, resignation), as a cash payment, up to the allowable maximum. Expense and the related liability are recognized as paid time off benefits when earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

Risk Management

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

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

Net Position

Net position of the Hospital is classified in two components on its balance sheets.

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

Net Patient Service Revenue

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

Kearny County Hospital
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Notes to Financial Statements
June 30, 2019 and 2018

Charity Care

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

Noncapital Appropriations – Kearny County

The Hospital received approximately 1% and 2% in 2019 and 2018, respectively, of its financial support from proceeds of noncapital appropriations for property taxes.

Property taxes are levied by Kearny County in November of one year and are received beginning in January of the following year. Revenue from noncapital appropriations – Kearny County is recognized in full in the year in which use is first permitted.

Income Taxes

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

Note 2: Deposits

Deposits

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

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

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At June 30, 2019 and 2018, \$1,610,563 and \$777,119 of the Hospital's bank balances of \$1,860,563 and \$1,027,119, respectively, were exposed to custodial credit risk as follows:

	2019	2018
Uninsured and collateral held by pledging financial institution	\$ 1,610,563	\$ 777,119

Summary of Carrying Values

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

	2019	2018
Carrying value		
Deposits	\$ 320,297	\$ 471,844
Certificates of deposit	547,406	541,766
	\$ 867,703	\$ 1,013,610
Included in the following balance sheet captions		
Cash	\$ 99,419	\$ 255,800
Designated by board of trustees	768,284	757,810
	\$ 867,703	\$ 1,013,610

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Notes to Financial Statements
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Note 3: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at June 30 consisted of:

	<u>2019</u>	<u>2018</u>
Medicare	\$ 334,468	\$ 802,035
Medicaid	547,851	463,907
Other third-party payers	872,588	721,860
Patients	<u>1,207,288</u>	<u>1,119,090</u>
	2,962,195	3,106,892
Less allowance for uncollectible accounts	<u>658,972</u>	<u>365,657</u>
	<u>\$ 2,303,223</u>	<u>\$ 2,741,235</u>

Note 4: Capital Assets

Capital assets activity for the years ended June 30 was:

	<u>2019</u>				
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Disposals</u>	<u>Transfers</u>	<u>Ending Balance</u>
Land	\$ 97,298	\$ -	\$ -	\$ -	\$ 97,298
Land improvements	634,019	-	-	-	634,019
Buildings	18,277,369	23,327	-	-	18,300,696
Equipment	6,161,823	606,019	(128,992)	265,092	6,903,942
Construction in progress	<u>341,799</u>	<u>6,392</u>	<u>-</u>	<u>(265,092)</u>	<u>83,099</u>
	<u>25,512,308</u>	<u>635,738</u>	<u>(128,992)</u>	<u>-</u>	<u>26,019,054</u>
Less accumulated depreciation					
Land improvements	519,333	28,657	-	-	547,990
Buildings	13,042,902	661,802	-	-	13,704,704
Equipment	<u>4,848,927</u>	<u>521,295</u>	<u>(123,996)</u>	<u>-</u>	<u>5,246,226</u>
	<u>18,411,162</u>	<u>1,211,754</u>	<u>(123,996)</u>	<u>-</u>	<u>19,498,920</u>
Capital assets, net	<u>\$ 7,101,146</u>	<u>\$ (576,016)</u>	<u>\$ (4,996)</u>	<u>\$ -</u>	<u>\$ 6,520,134</u>

Kearny County Hospital
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Notes to Financial Statements
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	2018				Ending Balance
	Beginning Balance	Additions	Disposals	Transfers	
Land	\$ 97,298	\$ -	\$ -	\$ -	\$ 97,298
Land improvements	634,019	-	-	-	634,019
Buildings	18,277,369	-	-	-	18,277,369
Equipment	6,103,837	57,986	-	-	6,161,823
Construction in progress	-	341,799	-	-	341,799
	<u>25,112,523</u>	<u>399,785</u>	<u>-</u>	<u>-</u>	<u>25,512,308</u>
Less accumulated depreciation					
Land improvements	490,522	28,811	-	-	519,333
Buildings	12,358,466	684,436	-	-	13,042,902
Equipment	<u>4,359,350</u>	<u>489,577</u>	<u>-</u>	<u>-</u>	<u>4,848,927</u>
	<u>17,208,338</u>	<u>1,202,824</u>	<u>-</u>	<u>-</u>	<u>18,411,162</u>
Capital assets, net	<u>\$ 7,904,185</u>	<u>\$ (803,039)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,101,146</u>

Note 5: Employee Receivables

The Hospital has entered into loan agreements with certain employees in amounts ranging from \$500 to \$90,000. The loans are to be forgiven ratably over certain time periods following the employees' commencement of employment at the Hospital, by forgiving each installment as it becomes due. Notwithstanding the foregoing, the balances due and owing under the notes shall become immediately due and payable if the employees' terminate employment at the Hospital. As of June 30, 2019 and 2018, the balances of the loan receivables were \$106,628 and \$180,624, respectively. The Hospital forgave \$137,439 and \$127,165 of the loan receivables for the years ended June 30, 2019 and 2018, respectively.

Kearny County Hospital
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Notes to Financial Statements
June 30, 2019 and 2018

Note 6: Notes Payable to Bank

The Hospital has a revolving line of credit agreement with a local bank. The maximum principal that can be borrowed is \$1,000,000, and the line of credit carries an interest rate of 5.5%. Interest is payable monthly. The line of credit is collateralized by patient accounts receivable. The line of credit expires March 2, 2020. Management intends to renew the line of credit on comparable terms at or near the maturity date and believes it is probable such renewal will be successful. The following is a summary of this revolving line of credit for the years ended June 30:

	<u>2019</u>	<u>2018</u>
Beginning balance	\$ -	\$ 284,438
Additions	6,293,870	10,326,177
Deductions	<u>(5,841,688)</u>	<u>(10,610,615)</u>
Ending balance	<u>\$ 452,182</u>	<u>\$ -</u>

The Hospital has a bulge line of credit agreement with a local bank. The maximum principal that can be borrowed is \$500,000, and the line of credit carries an interest rate of 4.5%. Interest is payable monthly. The line of credit is collateralized by patient accounts receivable. The line of credit expired on June 5, 2018. Management did not renew the line of credit. The following is a summary of this bulge line of credit for the years ended June 30:

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

Kearny County Hospital
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Notes to Financial Statements
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Note 7: Long-Term Obligations

The following is a summary of long-term obligation transactions for the Hospital for the years ended June 30:

	2019				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Capital lease obligations	\$ 622,325	\$ 249,100	\$ 273,733	\$ 597,692	\$ 267,615
	2018				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Capital lease obligations	\$ 760,908	\$ 106,954	\$ 245,537	\$ 622,325	\$ 235,344

Capital Lease Obligations

The Hospital is obligated under leases for equipment that are accounted for as capital leases. Assets under capital leases at June 30, 2019 and 2018, totaled \$1,344,165 and \$1,192,848, respectively, net of accumulated depreciation of \$759,009 and \$613,019, respectively. The following is a schedule by year of future minimum lease payments under the capital lease including interest at rates of 1.11% to 14.29% together with the present value of the future minimum lease payments as June 30, 2019:

Year Ending June 30,	
2020	\$ 287,204
2021	200,156
2022	80,736
2023	45,810
2024	18,331
Total minimum lease payments	632,237
Less amounts representing interest	34,545
	\$ 597,692

Kearny County Hospital
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Note 8: Professional Liability Coverage and Claims

The Hospital purchases professional liability insurance which provides \$200,000 of coverage for each medical incident and \$600,000 of aggregate coverage for each policy year. The policy only covers claims made and reported to the insurer during the policy term, regardless of when the incident giving rise to the claim occurred. The Kansas Health Care Stabilization Fund provides an additional \$300,000 of coverage for each medical incident and \$900,000 of aggregate coverage for each policy year.

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

Note 9: Employee Health Claims

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance plan. The Hospital is self-insured for health claims of participating employees and dependents up to an annual aggregate amount of \$35,000. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is reasonably possible that the Hospital's estimate will change by a material amount in the near term.

Activity in the Hospital's accrued employee health claims liability during 2019 and 2018 is summarized as follows:

	2019	2018
Balance, beginning of year	\$ 182,620	\$ 182,620
Current year claims incurred and changes in estimates for claims incurred in prior years	1,632,868	1,878,066
Claims and expenses paid	(1,700,893)	(1,878,066)
	\$ 114,595	\$ 182,620

Kearny County Hospital
A Component Unit of Kearny County, Kansas
Notes to Financial Statements
June 30, 2019 and 2018

Note 10: Net Patient Service Revenue

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

Medicare. The Hospital is recognized as a CAH, and is paid for inpatient acute care, skilled, swing-bed and outpatient services rendered to Medicare program beneficiaries at one hundred one percent (101%) of actual cost subject to certain limitations. Medicare Rural Health Clinic services are reimbursed under a cost-based methodology. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare Administrative Contractor.

Medicaid. Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed on a prospective payment methodology, which includes a hospital specific add-on percentage based on prior filed cost reports. The add-on percentage may be rebased at some time in the future. Services rendered for long-term care facility residents are reimbursed at a prospective rate, with annual cost reports submitted to the Medicaid program. Effective July 1, 2016, rates are computed using an average of the three most recent filed calendar cost reports and changes in the Medicaid resident case mix. The Medicaid cost reports are subject to audit by the State and adjustments to rates can be made retroactively. Due to certain financial and clinical criteria, the Hospital also receives Medicaid Disproportionate Share (DSH) funding. DSH payments received were \$548,988 and \$538,118 in 2019 and 2018, respectively.

Approximately 51% and 54% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for years ended June 30, 2019 and 2018, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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

Note 11: Charity Care

The costs of charity care provided under the Hospital's charity care policy were approximately \$188,000 and \$101,000 for 2019 and 2018, respectively. The cost of charity care is estimated by applying the ratio of cost to gross charges to the gross uncompensated charges.

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Notes to Financial Statements
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Note 12: 340B Drug Pricing Program

The Hospital participates in the 340B Drug Pricing Program (340B Program) enabling the Hospital to receive discounted prices from drug manufactures on outpatient pharmaceutical purchases. The Hospital recorded revenues of \$2,806,706 and \$3,131,449 for the years ended June 30, 2019 and 2018, respectively, which is included in other operating revenues in the accompanying statements of revenues, expenses and changes in net position. The Hospital recorded expenses of \$1,207,719 and \$1,615,195 for the years ended June 30, 2019 and 2018, respectively, which is included in supplies and other expenses in the accompanying statements of revenues, expenses and changes in net position. This program is overseen by the Health Resources and Services Administration (HRSA) Office of Pharmacy Affairs (OPA). HRSA is currently conducting routine audits of this program at health care organizations and increasing its compliance monitoring processes. Laws and regulations governing the 340B Program are complex and subject to interpretation and change. As a result, it is reasonably possible that material changes to financial statement amounts related to the 340B Program could occur in the near term.

Note 13: Pension Plan

The Hospital maintains a contributory defined contribution pension plan covering substantially all employees in lieu of social security. Prior to July 1, 1997, employees made contributions equal to 5% of their gross compensation. The Hospital contribution was 10% of the employees' gross compensation for those employed for two years or more and 5% for all others. Effective July 1, 1997, employees are required to contribute the same percentage required under the Social Security laws (OASDI). The Hospital is required to make a matching contribution in the same amount. An additional 3% contribution is made by the Hospital on behalf of all employees continuously employed for three years or more. Voluntary employee contributions may be made up to a specified percent of eligible compensation as specified in the plan document. Employee and employer contributions vest immediately. Benefits are funded by an annuity contract with an insurance company. Contributions made by plan members was \$803,503 and \$788,180 for the years ended June 30, 2019 and 2018, respectively. Contributions made by the Hospital was \$1,063,719 and \$1,036,237 for the years ended June 30, 2019 and 2018, respectively.

Note 14: Contingencies

Professional Liability Claims

Estimates related to the accrual for professional liability claims are described in *Notes 1 and 8*.

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General Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's self-insurance program (discussed elsewhere in these notes) or by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Note 15: Future Changes in Accounting Principles

Leases

Governmental Accounting Standards Board (GASB) Statement No. 87, *Leases* (GASB 87) provides a new framework for accounting for leases under the principle that leases are financings. No longer will leases be classified between capital and operating. Lessees will recognize an intangible asset and a corresponding liability. The liability will be based on the payments expected to be paid over the lease term, which includes an evaluation of the likelihood of exercising renewal or termination options in the lease. Lessors will recognize a lease receivable and related deferred inflow of resources. Lessors will not derecognize the underlying asset. An exception to the general model is provided for short-term leases that cannot last more than 12 months. Contracts that contain lease and nonlease components will need to be separated so each component is accounted for accordingly. GASB 87 is effective for financial statements for fiscal years beginning after December 15, 2019. Governments will be allowed to transition using the facts and circumstances in place at the time of adoption, rather than retroactive to the time each lease was begun. The Hospital is evaluating the impact the statement will have on the financial statements.

Fiduciary Activities

GASB Statement No. 84 (GASB 84), *Fiduciary Activities* establishes criteria for identifying fiduciary activities. It presents separate criteria for evaluating component units, pension and other postemployment benefit arrangements, and other fiduciary activities. The focus is on a government controlling the assets of the fiduciary activity and identification of the beneficiaries of those assets. Fiduciary activities are reported in one of four types of funds: pension (and other employee benefit) trust funds, investment trust funds, private-purpose trust funds or custodial funds. Custodial funds are used to report fiduciary activities that are not held in a trust. The agency fund designation will no longer be used. GASB 84 also provides guidance on fiduciary fund statements and timing of recognition of a liability to beneficiaries.

GASB 84 is effective for financial statements for fiscal years beginning after December 15, 2018. The Hospital is evaluating the impact the statement will have on the financial statements.