

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Independent Auditor's Report and Financial Statements
December 31, 2019 and 2018

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Independent Auditor's Report

Board of Trustees
The Lawrence Memorial Hospital
Lawrence, Kansas

We have audited the accompanying financial statements of The Lawrence Memorial Hospital (Hospital) and its discretely presented component unit (The Lawrence Memorial Hospital Endowment Association), collectively a component unit of the City of Lawrence, Kansas, as of and for the years ended December 31, 2019 and 2018, and the related notes to the financial statements, which collectively comprise the Hospital's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the financial statements of The Lawrence Memorial Hospital Endowment Association, which represent 100 percent of the assets, net assets and revenues of the discretely presented component unit. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for The Lawrence Memorial Hospital Endowment Association, is based solely on the report of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the *Kansas Municipal Audit and Accounting Guide*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The Lawrence Memorial Hospital and of its discretely presented component unit as of December 31, 2019 and 2018, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in *Note 2* to the financial statements, the 2018 financial statements of the business-type activities have been restated to correct a misstatement. Our opinion is not modified with respect to this matter.

As discussed in *Note 2* to the financial statements, in 2019 the Hospital adopted Governmental Accounting Standards Board Statement No. 90, *Majority Equity Interests, an amendment of GASB Statements No. 14 and No. 61*. Our opinion is not modified with respect to this matter.

We previously issued our report dated April 28, 2020, which included a typographical error which indicated our opinion was modified with respect to the adoption of Governmental Accounting Standards Board Statement No. 90, *Majority Equity Interests, an amendment of GASB Statements No. 14 and No. 61*. Our report has been corrected for this typographical error to indicate that our opinion is not modified in respect to this matter.

Required Supplementary Information

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

We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

BKD, LLP

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Management's Discussion and Analysis
Years Ended December 31, 2019 and 2018

Introduction

This management's discussion and analysis of the financial performance of The Lawrence Memorial Hospital (Hospital) provides an overview of the Hospital's financial activities for the years ended December 31, 2019 and 2018. It should be read in conjunction with the accompanying financial statements of the Hospital. Unless otherwise indicated, the information and financial data relates solely to the Hospital and does not include its discretely presented component unit, The Lawrence Memorial Hospital Endowment Association. Dollar amounts are in thousands.

Financial Highlights

- Cash and investments totaled \$126,585 on December 31, 2019, a decrease of \$55,536 or 30.5 percent from the balance reported at the end of 2018 due to expenditures from the Series 2018 Bond Project Fund for construction and capital asset acquisitions. Cash and investments totaled \$182,120 on December 31, 2018, an increase of \$66,424 or 57.4 percent from the 2017 balance as a result of funds available in the Series 2018 Bond Project Fund at year end.
- The Hospital's net position decreased \$5,937 (2.2 percent) in 2019 compared to an increase of \$14,942 (6.0 percent) in 2018.
- The Hospital reported an operating loss of \$14,809 in 2019 compared to operating income in 2018 of \$11,753 and in 2017 of \$14,325.
- Investment income of \$6,670 in 2019 increased by \$5,287 or 382.3 percent over the prior year investment income of \$1,383 in 2018 which represented a decrease of \$2,133 or 60.7 percent when compared to investment earnings of \$3,516 in 2017. The year-to-year-changes were impacted by unrealized market gains in 2019 and unrealized losses due to market declines experienced in December 2018.

Using This Annual Report

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

The Balance Sheet and Statement of Revenues, Expenses and Changes in Net Position

The Balance Sheet and the Statement of Revenues, Expenses and Changes in Net Position report information about the Hospital's resources and its activities in a way that helps the user determine its overall financial condition. These statements include all restricted and unrestricted assets, all liabilities and all deferred outflows of resources using the accrual basis of accounting. Under the accrual basis of accounting, all of the current year's revenues and expenses are considered regardless of when cash is received or paid.

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

The Statement of Cash Flows

The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. This statement provides the user an understanding of the various sources and uses of cash for the Hospital.

Net Position

The Hospital's net position as illustrated in Table 1 below is the difference between its assets, liabilities and deferred outflows of resources reported in the Balance Sheet. Changes in net position were due to negative or positive financial operating results for the respective years.

Table 1: Assets, Deferred Outflows of Resources, Liabilities and Net Position

	2019	2018**	2017
	<i>(As restated)</i>		
Assets			
Cash and cash equivalents	\$ 52,940	\$ 47,507	\$ 42,702
Patient accounts receivable, net	38,946	38,197	37,366
Other current assets	18,492	17,712	17,453
Total current assets	<u>110,378</u>	<u>103,416</u>	<u>97,521</u>
Noncurrent cash and investments	52,574	62,651	71,955
Held by trustee for debt service and capital acquisitions	19,208	69,696	-
Total noncurrent cash and investments	<u>71,782</u>	<u>132,347</u>	<u>71,955</u>
Capital assets, net	<u>210,307</u>	<u>156,409</u>	<u>112,118</u>
Other noncurrent assets	<u>845</u>	<u>840</u>	<u>823</u>
Total assets	393,312	393,012	282,417
Deferred Outflows of Resources			
Deferred amount on refunding	-	-	92
Total assets and deferred outflows of resources	<u>\$ 393,312</u>	<u>\$ 393,012</u>	<u>\$ 282,509</u>
Liabilities			
Long-term debt	\$ 94,803	\$ 95,668	\$ 7,795
Other current and noncurrent liabilities	<u>40,240</u>	<u>33,138</u>	<u>25,450</u>
Total liabilities	<u>135,043</u>	<u>128,806</u>	<u>33,245</u>
Net Position			
Net investment in capital assets	141,443	134,950	101,907
Restricted - expendable for			
Debt service	93	184	924
Capital acquisition	21	122	-
Specific operating activities	4	15	22
Unrestricted	<u>116,708</u>	<u>128,935</u>	<u>146,411</u>
Total net position	<u>258,269</u>	<u>264,206</u>	<u>249,264</u>
Total liabilities and net position	<u>\$ 393,312</u>	<u>\$ 393,012</u>	<u>\$ 282,509</u>

**During 2019, the Hospital retroactively corrected the classification of certain restricted cash and net position balances.

The December 31, 2019 balance of \$52,940 for Cash and cash equivalents reflects an increase of \$5,433 (11.4 percent) compared to the balance of \$47,507 in 2018. This increase continued a trend as Cash and cash equivalents increased by \$4,805 (11.3 percent) when compared to the balance of \$42,702 on December 31, 2017.

Net patient accounts receivable increased by \$749 (2.0 percent) at December 31, 2019 compared to December 31, 2018. Net patient accounts receivable increased by \$831 (2.2 percent) at December 31, 2018 compared to December 31, 2017.

Total noncurrent cash and investments decreased \$60,565 (45.8 percent) compared to the prior year end balance of \$132,347 on December 31, 2018. The decrease in total noncurrent cash and investments resulted from expenditures from the Series 2018 Bond Project Fund for construction and capital asset acquisitions. Total noncurrent cash and investments of \$132,347 on December 31, 2018 increased by \$60,392 (83.9 percent) when compared to the balance on December 31, 2017 due to the issuance of the Series 2018 revenue bonds.

Net capital assets of \$210,307 increased by \$53,898 or 34.5 percent in 2019 compared to net capital assets of \$156,409 at December 31, 2018. The increase is due to expenditures related to the LMH Health West construction and other capital building and equipment additions. Net capital assets at December 31, 2018 increased by \$44,291 or 39.5 percent when compared to the balance at the end of 2017.

In May 2018, the Hospital issued Series 2018 bonds resulting in an initial deposit of \$76,920 to the project fund. On December 31, 2019, a remaining balance of \$21,070 was held by the bond trustee for debt service and capital acquisitions authorized in the bond documents after reimbursements to the Hospital for project expenditures. The balance of \$21,070 compares to the balances on hand on December 31, 2018 and 2017 of \$71,962 and \$0, respectively. The majority of the project funds will be expended to construct the LMH Health West campus as described in the bond issuance documents.

Long-term debt of \$94,803 at December 31, 2019 reflected a decrease of \$865 or 0.9 percent when compared to the balance at December 31, 2018 due to principal payments on note and lease obligations. Long-term debt increased by \$87,873 in 2018 due to issuing the Series 2018 bonds and other debt obligations incurred for a medical building acquisition and new capital equipment leases.

Revenues Over (Under) Expenses and Changes in the Hospital's Net Position

The Hospital's Revenues under Expenses for 2019 reflected an operating loss of \$8,714, a decline of \$20,471 when compared to operating results from the prior year and a negative net margin of 3.1 percent. The Hospital's Revenues over Expenses for 2018 was \$11,757 for a net margin of 4.1 percent. The Revenues under Expenses is the principle factor in the decrease in net position of \$5,937, as shown in Table 2. The Hospital's increase in net position from 2017 to 2018 was \$14,942.

Table 2: Operating Results and Changes in Net Position

	2019	2018	2017
Operating Revenues			
Net patient service revenue	\$ 278,616	\$ 277,964	\$ 250,730
Other operating revenues	3,768	3,644	2,275
Total operating revenues	<u>282,384</u>	<u>281,608</u>	<u>253,005</u>
Operating Expenses			
Salaries and wages and employee benefits	153,045	139,117	118,136
Purchased services and professional fees	44,899	37,636	33,808
Depreciation and amortization	9,234	8,881	11,342
Other operating expenses	90,015	84,221	75,394
Total operating expenses	<u>297,193</u>	<u>269,855</u>	<u>238,680</u>
Operating Income (Loss)	<u>(14,809)</u>	<u>11,753</u>	<u>14,325</u>
Nonoperating Revenues (Expenses)			
Investment income	6,670	1,383	3,516
Contributions and other	148	122	105
Interest expense	(1,185)	(1,880)	(258)
Gain on investment in equity investees	462	379	372
Total nonoperating revenues, net	<u>6,095</u>	<u>4</u>	<u>3,735</u>
Revenues Over (Under) Expenses	(8,714)	11,757	18,060
Contributions Restricted for Acquisition of Capital Assets	<u>2,777</u>	<u>3,185</u>	<u>908</u>
Increase (Decrease) in Net Position	<u>\$ (5,937)</u>	<u>\$ 14,942</u>	<u>\$ 18,968</u>

Operating Income

The first component of the overall change in the Hospital's net position is its operating income or loss—generally, the difference between operating revenues and the expenses incurred to perform those services.

The Hospital realized a net operating loss of \$14,809 compared to net operating income of \$11,753 achieved in 2018, a decrease of \$26,562 or 226.0 percent change from prior year results. Net patient service revenue of \$278,616 increased by \$652 (0.2 percent) when compared to net patient service revenue generated in the prior year.

In 2019, Hospital inpatient gross revenue increased 1.5 percent when compared to 2018. Adult, pediatric and rehabilitation inpatient days of 24,097 denoted a decrease of 1,655 or 6.4 percent when compared to inpatient days in 2018 of 25,752. A mild flu season was a key contributing factor to the decrease in patient census from what was experienced in the prior year. Despite the volume decline, overall revenue increased due to increased cardiac catheterization procedures provided to inpatients and associated implantable devices such as pacemakers and stents following the successful recruitment of an interventional cardiologist with specialized training to perform procedures not previously provided in the community.

Gross income from Hospital outpatient ancillary services provided in 2019 increased by 13.5 percent when compared to prior year activities. Outpatient imaging services revenues increased 11.5 percent due to greater numbers of specialized imaging procedures such as CT scan and MRI. Physical and occupational therapy services continued to grow as gross revenues increased 25.8 percent over the prior year and pharmacy revenues increased 14.2 percent in 2019 due to the utilization of higher cost chemotherapy and infusion drugs as needed to treat patients with severe illnesses.

Physician division gross revenue grew 9.6 percent in 2019 when compared to the prior year. Due to successful recruitment efforts for the orthopedic group in 2018 to add a major joint surgeon and a sports medicine physician and the addition of a foot and ankle surgeon in mid-2019, patient encounters increased 23 percent over the prior year contributing to the revenue increase. The obstetrics and gynecology group experienced gross revenue growth of 9.7 percent also due to recruiting a new physician to the group in late 2019. Many of the physicians recruited to the community in 2018 were still in the process of building their practices throughout the year and more significant growth is anticipated going forward.

While the Hospital and physician division achieved gross revenue increases, greater payment reductions than expected from a major payer resulted in more than \$10 million in reduced payments for 2019. Negotiations are underway with payers to help improve reimbursement from our contracted arrangements with a leading major payer already agreeing to a material improvement from 2019 rates.

Total operating expenses in 2019 increased by 10.1 percent when compared to the prior year expenses. The largest increase was for salaries and wages and employee benefits which increased 10.0 percent over the prior year due to recruitment of more than 30 providers over the past two years to meet the growing need for specialty, surgical and primary care services for the Lawrence community. After more than four years of low expense growth, the Hospital's self-funded employee health plan ended the year with very high claims experience resulting in a \$6 million increase over the prior year. There were double the number of high-cost claims from the plan's historical experience. Other benefit expenses for employment taxes and retirement plan benefits increased due to additional providers and staff in the physician division.

In anticipation of the move from volume to value and with a goal of sustained, strong financial performance, the Hospital engaged an outside consultant to perform a thorough review of operations with a goal of improving revenue and reducing expenses. One-time professional fees of \$7.6 million were incurred in 2019 for this engagement which identified operational efficiencies and areas to improve revenues and intervention has begun in over a dozen areas. Significant efforts are now underway to help ensure the identified long-term revenue opportunities and cost savings are achieved. Many initiatives were implemented late in the year so full benefits have not yet been realized. Although not guaranteed, management believes it can achieve over \$12 million in benefits for fiscal year 2020 with greater savings opportunities in future years.

Increased pharmacy costs for oncology and other patient billable drugs make up 49 percent of the supply increase included in other operating expenses for the year. The necessary utilization of very expensive oncology and infusion therapy drugs not only impacted expense growth, it also negatively impacted net patient revenue due to significant reductions in reimbursement from payers.

The Hospital ended 2019 with a net operating loss of \$14,809 compared to net operating income of \$11,753 achieved in 2018. Although subject to change, management expects positive trends over the next year. Management continues work to implement identified opportunities from the consulting engagement, having already modified benefit plans, reduced staffing costs and reduced costs of care. Technological changes are being implemented to enhance revenue cycle management and improve patient satisfaction to help maintain favorable market share in the community and surrounding areas. While subject to standard industry variables and headwinds, management remains optimistic about further financial improvements in 2020.

Hospital inpatient gross revenue in 2018 increased 8.8 percent over the prior year. Adult, pediatric and rehabilitation inpatient days of 25,752 increased by 1,379 or 5.7 percent when compared to inpatient days in 2017 of 24,373. Inpatient surgery cases grew by 7.2 percent in 2018 due to successful recruiting efforts to bring new surgeons to the community to perform orthopedic, spine, and plastic surgeries. Many orthopedic and spine surgeries require the use of surgical implants contributing to the 11.2 percent increase in inpatient revenue from medical supplies and implants in 2018. Laboratory inpatient revenue grew by 14.9 percent in 2018 and Pharmacy revenues increased 8.4 percent due to the higher inpatient census as these services are typically utilized by all inpatients.

Hospital outpatient ancillary services gross revenue grew by 13.5 percent in 2018 due to increased surgical volumes, pharmaceutical drug utilization and growth in physical therapy services. Outpatient surgery cases of 4,477 were 13.1 percent greater than the number of cases experienced in 2017 resulting in higher revenue for the surgery, recovery room and anesthesia departments. Pharmacy outpatient drug utilization, particularly for intravenous infusion and oncology purposes, contributed to an increase of 21.9 percent over the prior year generating a favorable revenue variance of more than \$28,572. Physical therapy services increased significantly due to affiliating with and hiring the physical therapy staff of OrthoKansas. The new therapy clinic at the Sixth and Maine Street location in Lawrence provided 50,016 outpatient physical therapy treatments in 2018 contributing to the 57.2 percent increase in overall physical therapy service revenues from all outpatient locations. Emergency department revenues increased 9.3 percent when compared to the prior year due to increased patient visits.

Physician division revenue experienced overall gross revenue growth of \$34,213 or 33.6 percent compared to 2017. In January 2018, the OrthoKansas orthopedic clinic physicians, therapists and other providers along with support staff became Hospital employees to become an integral piece of the musculoskeletal service line offered by the Hospital. In addition to the OrthoKansas physicians hired in January, the physician division recruited a record number of new providers in 2018 including twelve physicians with commencement dates in 2018 and another three physicians slated to start in 2019. New physicians were hired to provide additional orthopedic surgery, oncology, spine surgery, gastroenterology, plastic surgery, endocrinology and primary care services.

In February 2018, the Hospital purchased the Lawrence Medical Plaza, which currently houses the Lawrence Surgery Center, and several independent physician clinics as well as other medical related businesses. Located near the Hospital at Sixth and Maine Streets in Lawrence, this building will allow for expansion of outpatient services. The acquisition increased rental income by more than \$900,000 per year from outside sources.

Total operating expenses increased \$31,175 or 13.1 percent in 2018 compared to the prior year. The largest increase was in Salaries and wages and employee benefits which increased by 17.8 percent over 2017 expenses. The OrthoKansas affiliation added approximately sixty-five new associates to the Hospital payroll on January 1, 2018. Those new positions along with a full year of employment of the large internal medicine group associates hired in July 2017 contributed significantly to the higher employment cost. Physician recruitment activities and employee health insurance costs also impacted the variance from the prior year. Purchased services and professional fees increased \$3,828 or 11.3 percent over the prior year due in part to increased physician fees paid for anesthesia, hospitalist and emergency department services. Contract labor was utilized to fill staffing needs in critical areas including sterile processing, surgery compliance management and invasive cardiology. In 2018, the Hospital engaged industry experts to evaluate the methodology and asset values used to calculate depreciation expense for the Hospital. As a result of implementing recommended changes, overall depreciation expense for 2018 decreased 21.7 percent compared to expense recorded in 2017. Other operating expenses increased 11.7 percent when compared to the prior year and includes increased costs of pharmaceuticals, surgical implants, and software maintenance expenses.

The Hospital ended 2018 with operating income of \$11,753 a decrease of \$2,572 (18.0 percent) when compared to 2017 operating income.

Nonoperating Revenues and Expenses

Non-operating revenues and expenses consist primarily of investment earnings on its fixed income and equity portfolios, income from the Hospital's investment in the Lawrence Surgery Center, LLC, Mid-America Service Solutions, LLC and interest expense on bond financing.

Total Non-operating Revenues (Expenses) for 2019 increased \$6,091 compared to the 2018 decrease of \$3,731. Investment income of \$6,670 in 2019 increased by \$5,287 or 382.3 percent compared to investment income of \$1,383 in 2018 primarily due to recording unrealized gains and losses on investments in marketable securities in each of the years. Investment income in 2018 decreased \$2,133 when compared to investment income of \$3,516 recorded in 2017. Interest expense decreased by \$695 or 37.0 percent in 2019 due to capitalizing interest as part of the LMH Health West construction project. Interest expense increased \$1,622 or 628.7 percent in 2018 due to interest related to the Series 2018 bonds and other capital asset financing activities.

Capital Gifts

The Hospital received contributions restricted for acquisition of capital assets of \$2,777 from The LMH Health Foundation during 2019 compared to \$3,185 in 2018 and \$908 in 2017. The funds were used to fund capital equipment purchases for clinical and support departments throughout the Hospital and toward expenditures related to the LMH Health West development. These contributions were expended and are reflected in unrestricted net position as of December 31, 2019 and 2018.

The Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with changes in operating income and non-operating revenues and expenses for 2019 and 2018, discussed earlier.

Capital Assets

The Hospital ended 2019 with \$210,307 invested in capital assets, net of accumulated depreciation as detailed in *Note 7* to the financial statements, and increase of \$53,898 or 34.5 percent compared to the balance at the end of 2018.

Construction and related equipment expenditures for the LMH Health West facility contributed more than \$46,897 to the increase in capital assets for 2019. The Hospital also completed renovations to the cardiac catheterization lab to upgrade and modernize both the equipment and the facility. Construction was completed for the new \$4.6 million central sterilization space added near the Hospital's surgical suites to update equipment and provide space to meet current infection control standards for patient safety. Relocating sterilization services near the surgical space from the former location in the basement of the facility improved operational processes to move supplies between the sterilization area and the surgery and clinical units that require sterile supplies.

Net Capital Assets of \$156,409 on December 31, 2018 showed an increase of \$44,291 or 39.5 percent over capital assets on the books at the end of 2017 due to significant acquisitions during the year. Capital assets, net of accumulated depreciation are detailed in *Note 7* to the financial statements.

In January 2018, as part of the affiliation agreement with OrthoKansas, the Hospital acquired the existing assets of that practice. In February 2018, the Hospital closed on the purchase of the Lawrence Medical Plaza at Sixth and Maine Streets housing the Lawrence Surgery Center, the OrthoKansas clinic, and numerous other physician clinics and medical related businesses. In March 2018, as part of the internal medicine affiliation agreement from 2017, the Hospital purchased the medical office building at 347 Maine Street, across from the main hospital campus which houses the Hospital owned Reed Internal Medicine clinic.

In mid-2018, the Hospital acquired land in west Lawrence and began construction on the new LMH Health West campus expending approximately \$17 million for land and other construction costs related to this project by the end of the year. Other notable additions for the year included a main campus parking lot expansion, new three-dimensional mammography machines, computerized intravenous medication pumps, upgrades to the Hospital's nurse call system, and significant investments in information technology and equipment throughout the organization.

Debt

In May 2018, the Hospital issued \$77,520 in Series 2018 revenue bonds to finance the LMH Health West construction project and other capital assets acquisitions. The bonds were issued with an \$8 million premium. The total amount remained outstanding on December 31, 2019 as principal payments on this outstanding debt will not be due until 2021. A long-term note payable of \$10 million was signed to finance the purchases of the Sixth and Maine Street medical office building. The Hospital also utilized capital lease financing to acquire imaging technology for the operating rooms and the Tonganoxie physician clinic. At the end of 2019, the Hospital had \$94,803 in long-term debt obligations outstanding compared to \$95,668 in 2018, a decrease of \$865 or 0.9 percent.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional information should be directed to the Chief Financial Officer by telephoning 785.505.6133.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Balance Sheets
December 31, 2019 and 2018

Assets

	2019	2018
		<i>(As restated)</i>
		<i>- Note 2</i>
Current Assets		
Cash and cash equivalents	\$ 52,940,327	\$ 47,506,789
Current portion of assets held by trustee	1,862,407	2,265,928
Patient accounts receivable, net of allowance for doubtful accounts; 2019 – \$17,875,169, 2018 – \$16,074,174	38,946,228	38,197,017
Due from third-party payers	1,395,773	2,336,386
Accounts receivable – other	1,685,003	768,190
Supplies	5,235,597	4,309,694
Prepaid expenses and other	8,312,929	8,032,657
Total current assets	110,378,264	103,416,661
Noncurrent Cash and Investments		
Held by trustee for debt service and capital acquisitions	21,070,474	71,962,007
Restricted by donors for capital acquisitions and specific operating activities	24,724	136,704
Other long-term investments	52,549,267	62,514,519
	73,644,465	134,613,230
Less amount required to meet current obligations	1,862,407	2,265,928
	71,782,058	132,347,302
Capital Assets, net of accumulated depreciation	210,307,456	156,408,581
Other Assets	844,628	840,401
Total assets	\$ 393,312,406	\$ 393,012,945

Liabilities and Net Position

	2019	2018
		<i>(As restated)</i>
		<i>- Note 2</i>
Current Liabilities		
Current maturities of long-term debt	\$ 448,093	\$ 386,592
Accounts payable	15,484,090	11,946,039
Accrued expenses	20,031,328	16,699,249
Accrued interest payable	1,862,406	2,265,928
Retirement plan obligation	1,166,376	840,931
Due to third-party payers	<u>1,247,666</u>	<u>1,000,098</u>
Total current liabilities	40,239,959	33,138,837
Long-term Debt	<u>94,803,199</u>	<u>95,667,817</u>
Total liabilities	<u>135,043,158</u>	<u>128,806,654</u>
Net Position		
Net investment in capital assets	141,443,214	134,950,472
Restricted – expendable for		
Debt service	92,947	183,769
Capital acquisition	20,610	121,638
Specific operating activities	4,114	15,066
Unrestricted	<u>116,708,363</u>	<u>128,935,346</u>
Total net position	<u>258,269,248</u>	<u>264,206,291</u>
Total liabilities and net position	<u>\$ 393,312,406</u>	<u>\$ 393,012,945</u>

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Statements of Revenues, Expenses and Changes in Net Position
Years Ended December 31, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2019 – \$21,795,125, 2018 – \$16,736,400	\$ 278,616,068	\$ 277,963,624
Other	3,768,247	3,644,606
	<u>282,384,315</u>	<u>281,608,230</u>
Operating Expenses		
Salaries and wages	121,144,838	115,100,023
Employee benefits	31,900,527	24,017,178
Professional fees	28,223,582	21,286,795
Purchased services	16,675,518	16,349,559
Supplies	64,432,035	59,602,196
Utilities	3,121,039	3,198,659
Miscellaneous expenses	2,134,456	1,976,189
Licenses, taxes and Kansas provider assessment	509,637	1,349,878
Repairs and maintenance	15,809,371	14,625,367
Depreciation	9,233,632	8,881,314
Loss on sale or disposal of property and equipment	35,872	213,858
Insurance	1,137,820	1,093,571
Other capital costs	2,834,322	2,160,809
	<u>297,192,649</u>	<u>269,855,396</u>
Operating Income (Loss)	<u>(14,808,334)</u>	<u>11,752,834</u>
Nonoperating Revenues (Expenses)		
Investment income	6,669,737	1,383,548
Contributions and other	148,070	122,131
Interest expense	(1,185,199)	(1,879,701)
Gain on investment in equity investees	461,621	378,620
	<u>6,094,229</u>	<u>4,598</u>
Revenues Over (Under) Expenses	(8,714,105)	11,757,432
Contributions Restricted for Acquisition of Capital Assets	<u>2,777,062</u>	<u>3,184,352</u>
Increase (Decrease) in Net Position	(5,937,043)	14,941,784
Net Position, Beginning of Year	<u>264,206,291</u>	<u>249,264,507</u>
Net Position, End of Year	<u>\$ 258,269,248</u>	<u>\$ 264,206,291</u>

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Statements of Cash Flows
Years Ended December 31, 2019 and 2018

	2019	2018
		<i>(As restated)</i>
		<i>- Note 2</i>
Operating Activities		
Receipts from and on behalf of patients	\$ 279,055,038	\$ 277,180,109
Payments to suppliers and contractors	(135,242,936)	(119,367,002)
Payments to employees	(149,387,841)	(135,336,692)
Other receipts, net	2,851,434	3,317,287
Net cash provided by (used in) operating activities	(2,724,305)	25,793,702
Noncapital Financing Activities		
Noncapital gifts	148,070	122,131
Net cash provided by noncapital financing activities	148,070	122,131
Capital and Related Financing Activities		
Proceeds from issuance of long-term debt	-	95,616,929
Principal paid on long-term debt	(387,342)	(9,906,773)
Interest paid on long-term debt	(4,550,099)	(580,157)
Purchase of capital assets	(57,930,243)	(48,700,934)
Capital gifts	2,777,062	3,184,352
Proceeds from sale of capital assets	4,499	9,098
Net cash provided by (used in) capital and related financing activities	(60,086,123)	39,622,515
Investing Activities		
Interest and dividends on investments	4,562,046	2,345,661
Purchase of investments	(45,729,968)	(69,088,184)
Sale of investments	93,463,281	23,100,827
Distributions from affiliates	457,394	360,866
Net cash provided by (used in) investing activities	52,752,753	(43,280,830)
Increase (Decrease) in Cash and Cash Equivalents	(9,909,605)	22,257,518
Cash and Cash Equivalents, Beginning of Year	65,997,527	43,740,009
Cash and Cash Equivalents, End of Year	\$ 56,087,922	\$ 65,997,527
Reconciliation of Cash and Cash Equivalents to the Balance Sheets		
Cash and cash equivalents in current assets	\$ 52,940,327	\$ 47,506,789
Cash and cash equivalents in noncurrent cash and investments	3,147,595	18,490,738
	\$ 56,087,922	\$ 65,997,527

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Statements of Cash Flows (Continued)
Years Ended December 31, 2019 and 2018

	2019	2018
		<i>(As restated)</i>
		<i>- Note 2</i>
Reconciliation of Net Operating Revenues to		
Net Cash Provided by (Used in) Operating Activities		
Operating income (loss)	\$ (14,808,334)	\$ 11,752,834
Depreciation	9,233,632	8,881,314
Loss on sale or disposal of property and equipment	35,872	213,858
Changes in operating assets and liabilities		
Patient accounts receivable, net	(749,211)	(831,453)
Other accounts receivable	(916,813)	(327,319)
Estimated amounts due from and to third-party payers	1,188,181	47,938
Accounts payable and accrued expenses	4,498,543	4,544,580
Supplies	(925,903)	(478,895)
Prepaid expenses	(280,272)	1,990,845
	\$ (2,724,305)	\$ 25,793,702
Supplemental Cash Flows Information		
Capital asset acquisitions included in accounts payable	\$ 5,455,886	\$ 2,758,854
Capital assets acquired through capital lease obligation	-	958,338
Amortization of original bond premium	(415,775)	(254,085)
Increase (decrease) in fair value of investments	2,410,848	(1,146,482)

The Lawrence Memorial Hospital Endowment Association
A Component Unit of The Lawrence Memorial Hospital
Statements of Financial Position
December 31, 2019 and 2018

Assets

	2019	2018
Current Assets		
Cash and cash equivalents	\$ 716,628	\$ 665,170
Pledges receivable – current portion	1,361,477	532,826
Total current assets	2,078,105	1,197,996
Noncurrent Assets		
Pledges receivable, net of current portion	531,830	408,573
Investments	12,302,376	10,353,082
Total assets	\$ 14,912,311	\$ 11,959,651

Liabilities and Net Assets

Current Liabilities		
Accounts payable	\$ 4,563	\$ 4,565
Liability to beneficiaries of split-interest agreements	274	2,276
Total current liabilities	4,837	6,841
Net Assets		
Without donor restrictions		
Undesignated	1,123,235	1,008,118
Designated by the board for endowment	6,016,771	5,035,965
	7,140,006	6,044,083
With donor restrictions		
Purpose restrictions	5,945,350	4,331,939
Perpetual in nature	1,822,118	1,588,516
Underwater endowment	-	(11,728)
	7,767,468	5,908,727
Total net assets	14,907,474	11,952,810
Total liabilities and net assets	\$ 14,912,311	\$ 11,959,651

The Lawrence Memorial Hospital Endowment Association
A Component Unit of The Lawrence Memorial Hospital
Statements of Activities
Year Ended December 31, 2019 and 2018

	2019			2018
	Without Donor Restrictions	With Donor Restrictions	Total	Total
Support and Gains				
Special event revenue	\$ 191,053	\$ 73,024	\$ 264,077	\$ 476,232
Contributions	116,410	3,763,894	3,880,304	2,769,425
In-kind contributions	670,935	54,811	725,746	854,555
Interest and dividend income	174,426	144,007	318,433	339,268
Realized and unrealized gains (losses), net	1,011,319	807,462	1,818,781	(1,191,618)
Total support and revenue	<u>2,164,143</u>	<u>4,843,198</u>	<u>7,007,341</u>	<u>3,247,862</u>
Amount released from restrictions	2,984,457	(2,984,457)	-	-
Total support, revenue and reclassifications	<u>5,148,600</u>	<u>1,858,741</u>	<u>7,007,341</u>	<u>3,247,862</u>
Expenses				
Program	3,484,446	-	3,484,446	3,942,716
General and administrative	268,205	-	268,205	256,308
Fundraising	300,026	-	300,026	381,194
Total expenses	<u>4,052,677</u>	<u>-</u>	<u>4,052,677</u>	<u>4,580,218</u>
Change in Net Assets	1,095,923	1,858,741	2,954,664	(1,332,356)
Net Assets, Beginning of Year	<u>6,044,083</u>	<u>5,908,727</u>	<u>11,952,810</u>	<u>13,285,166</u>
Net Assets, End of Year	<u>\$ 7,140,006</u>	<u>\$ 7,767,468</u>	<u>\$ 14,907,474</u>	<u>\$ 11,952,810</u>

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2019 and 2018

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

Nature of Operations and Reporting Entity

The Lawrence Memorial Hospital (the Hospital), is a component unit of the City of Lawrence, Kansas (the City), which operates a hospital, clinics and other health care facilities for the residents of Lawrence, Kansas and surrounding communities. The Hospital is governed by a board of trustees composed of nine members who are appointed by the Mayor and confirmed by the City Commission.

Lawrence Physicians, LLC (LP LLC) is considered a blended component unit and operates exclusively for the benefit of, to perform the functions of, and to carry out the purposes of the board of trustees of The Lawrence Memorial Hospital.

The Lawrence Memorial Hospital is the sole member of a nonprofit nonstock corporation, Reed Medical Group MDVIP Affiliate, Corporation (MDVIP). MDVIP is considered a blended component unit of the Hospital and was created to employ the two physicians associated with the Hospital's Reed Medical Group Physician Practice.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining Whether Certain Organizations are Component Units*, The Lawrence Memorial Hospital Endowment Association (the Endowment Association) is presented as a discretely presented component unit of the Hospital. See *Note 15* for additional information about the Endowment Association.

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. Operating revenues and expenses include exchange transactions. Investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net position when an expense or outlay is incurred for purposes for which both restricted and unrestricted net position are available. The financial statements include the accounts of The Lawrence Memorial Hospital, Lawrence Physicians, LLC and Reed Medical Group MDVIP Affiliate, Corporation (collectively known as the Hospital). All significant inter-company balances and transactions have been eliminated.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2019 and 2018

Use of Estimates

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

Cash Equivalents

The Hospital considers all liquid investments, with maturities at the date of purchase of three months or less, to be cash equivalents. Cash equivalents consist primarily of repurchase agreements and money market mutual funds.

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; and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters, other than employee health care claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

The Hospital is self-insured for a portion of its exposure to risk of loss 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.

The Hospital purchases medical malpractice insurance under a claims-made policy. Under such policy, only claims made and reported to the insurer are covered during the policy term, regardless of when the incident giving rise to the claim occurred. Under Kansas law, the Kansas Insurance Department provides excess liability insurance through the Kansas Healthcare Stabilization Fund.

Investments and Investment Income

Investment in all debt obligations and equity securities with readily determinable fair values are carried at fair value. Fair value is determined using quoted market prices. Investments in nonnegotiable certificates of deposit are carried at amortized cost.

Investment income includes dividends and interest and the net change in the fair value of investments carried at fair value.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2019 and 2018

Noncurrent Cash and Investments

Noncurrent cash and investments include (1) assets held by trustees under bond indenture agreements, (2) assets restricted by donors for capital acquisitions and specific purposes, (3) internally designated unrestricted assets set aside by the board of trustees for future capital improvements over which the board retains control and may, at its discretion, subsequently use for other purposes and (4) undesignated and unrestricted investments. Amounts required to meet current liabilities of the Hospital are included in current assets. Such funds are primarily invested in U.S. agencies obligations, U.S. Treasury obligations, corporate bonds and money market mutual funds.

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 or market. Costs are determined using the first-in, first-out (FIFO) method.

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset following guidelines of the American Hospital Association. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. Amortization of assets subject to capital leases is reported as part of depreciation expense. The following estimated useful lives are being used by the Hospital:

Land improvements	15 – 20 years
Buildings and leasehold improvements	20 – 40 years
Equipment	3 – 7 years

During 2018, the Hospital elected to change its depreciation methodology to reflect the most current expected economic useful lives of the Hospital's infrastructure and equipment. The election was made to better match the Hospital's usage of these fixed assets with the revenues generated over their economic useful lives. The effect of the change during 2018 was a decrease in depreciation expense and an increase in change in net position of \$3.2 million.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2019 and 2018

The Hospital capitalizes interest costs as a component of construction in progress, based on interest costs of borrowing specifically for the project, net of interest earned on investments acquired with the proceeds of the borrowing. Total interest capitalized and incurred was:

	2019	2018
Total interest expense incurred on borrowings for project	\$ 2,545,604	\$ 1,547,687
Interest income from investment of proceeds of borrowings for project	(979,645)	(436,214)
Net interest cost capitalized	\$ 1,565,959	\$ 1,111,473
Interest capitalized	\$ 1,565,959	\$ 1,111,473
Interest charged to expense	1,185,199	1,879,701
Total interest incurred	\$ 2,751,158	\$ 2,991,174

Compensated Absences

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

Net Position

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

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

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2019 and 2018

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 include estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges excluded from revenue under the Hospital's charity care policy were approximately \$11,200,000 and \$15,460,000 in 2019 and 2018, respectively.

Income Taxes

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

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records (EHR) technology. Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payments under both programs are contingent on the Hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the fiscal intermediary. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2019 and 2018

The Hospital recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

In 2018, the Hospital completed the requirements under the Medicare program and recorded revenue of approximately \$10,000, which is included in other revenue within operating revenues in the statements of revenues, expenses and changes in net position. No revenue was recorded in relation to the EHR Incentive Program in 2019.

Note 2: Change in Accounting Principles and Restatement of Prior Years' Financial Statements

Adoption of Governmental Accounting Standards Board Statement No. 84

In 2019, the Hospital adopted GASB Statement No. 84, *Fiduciary Activities*. The statement provides guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. Criteria for identifying activities of a government, including Business-Type Activities (BTA), should report as fiduciary focus on whether the government is controlling the assets and the nature of the asset of the beneficiaries. Upon evaluation by the Hospital, it was determined that there are no circumstances in which the Hospital should be considered the fiduciary of assets of a beneficiary for accounting and reporting purposes.

Adoption of Governmental Accounting Standards Board Statement No. 90

In 2019, the Hospital adopted GASB Statement No. 90, *Majority Equity Interests, and amendment of GASB Statements No. 14 and No. 61*. GASB No. 90 states that for holdings of a majority equity interest in a legally separate organization, which does not meet the definition of an investment under GASB Statement No. 72, *Fair Value Measurement and Application*, a government should report the legally separate organization as a component unit, and the government or fund that holds the equity interest should report an asset related to the majority equity interest using the equity method.

The Hospital's 100 percent ownership of Lawrence Physicians, LLC qualifies for the application of GASB Statement No. 90. However, as Lawrence Physicians, LLC is treated as a blended component unit, the asset and net position associated with the equity interest held by the government are eliminated in the blending process. Thus, changes to the financial statements due to GASB Statement No. 90 are only apparent in *Note 19 – Condensed Combining Information*.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2019 and 2018

Restatement Due to Correction of Errors

In the prior year, certain amounts in net position were incorrectly classified. Investment in capital assets is a component of net position which consists of capital assets, net of accumulated depreciation, reduced by the outstanding bonds, notes or other borrowings that are attributional to the acquisition, construction, or improvement of those assets. The portion of unspent related debt proceeds should not be included in the calculation of net investment in the capital assets. As of December 31, 2018, due to errors in calculation, the investment in capital assets was understated by \$3,870,578. Correspondingly, the net position component of restricted – expendable for capital acquisitions was overstated by \$3,870,578. The report was restated to correct these calculation errors.

Additionally, certain other items on the balance sheets and statement of cash flows were incorrectly classified. The statements have been restated to correct these errors. The errors and the corresponding corrections are summarized below.

Finally, corrections were made to *Note 19* regarding the condensed combining information as certain balances of the blended component unit, Lawrence Physicians, LLC, were included within The Lawrence Memorial Hospital. The condensed combining statements were corrected to properly show this activity between the components. The errors and corresponding corrections are summarized below.

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2019 and 2018

Changes to the 2018 financial statements did not impact the change in net position as a whole. The following financial statement line items for fiscal 2018 were affected by adjustments:

	As Previously Reported	Effect of Change in Accounting Principle	Changes Due to Restatement	As Restated
Balance Sheets				
Cash	\$ 47,643,493	\$ -	\$ (136,704)	\$ 47,506,789
Total current assets	103,553,365	-	(136,704)	103,416,661
Restricted by donors for capital acquisitions and specific operating activities	-	-	136,704	136,704
Total Noncurrent Cash and Investments	132,210,598	-	136,704	132,347,302
Net Position				
Net investment in capital assets	131,079,894	-	3,870,578	134,950,472
Restricted - expendable for capital acquisition	3,992,216	-	(3,870,578)	121,638
Statements of Cash Flows				
Principal paid on long-term debt	(10,160,858)	-	254,085	(9,906,773)
Interest paid on long-term debt	(748,116)	-	167,959	(580,157)
Purchase of capital assets	(49,137,147)	-	436,213	(48,700,934)
Net cash provided by capital and financing activities	38,764,258	-	858,257	39,622,515
(Purchase) sale of investments, net	(45,129,100)	-	45,129,100	-
Purchase of investments	-	-	(69,088,184)	(69,088,184)
Sale of investments	-	-	23,100,827	23,100,827
Net cash provided by (used in) investing activities	(42,422,573)	-	(858,257)	(43,280,830)
Cash and cash equivalents in current assets	47,643,493	-	(136,704)	47,506,789
Cash and cash equivalents in noncurrent cash and investments	18,354,034	-	136,704	18,490,738
Amortization of original bond premium	-	-	(254,085)	(254,085)
Condensed Combining Information - The Lawrence Memorial Hospital - Note 19				
Current assets	95,770	-	(136)	95,634
Other assets	133,051	7,605	136	140,792
Total assets	385,230	7,605	-	392,835
Restricted - expendable for capital acquisition	3,992	-	(3,870)	122
Net investment in capital assets	131,080	-	3,870	134,950
Unrestricted	121,341	7,605	-	128,946
Nonoperating revenues	4	1,272	-	1,276
Revenues over expenses	36,484	1,272	-	37,756
Transfers from Hospital	(32,321)	-	6,333	(25,988)
Increase in Net Position	7,348	1,272	6,333	14,953
Ending Net Position	256,612	7,605	-	264,217
Net Cash Provided by Operating Activities	57,965	-	56	58,021
Net Cash Provided by Capital and Financing Activities	38,764	-	858	39,622
Net Cash Used in Investing Activities	(42,423)	-	(858)	(43,281)
Cash in Cash and Cash Equivalents	22,107	-	56	22,163
Condensed Combining Information - Lawrence Physicans, LLC - Note 19				
Transfers from Hospital	32,321	-	(6,333)	25,988
Increase (Decrease) in Net Position	7,605	-	(6,333)	1,272
Beginning Net Position	-	-	6,333	6,333
Condensed Combining Information - Reed Medical Group - Note 19				
Net Cash Provided by (Used in) Operating Activities	150	-	(56)	94
Change in Cash in Cash and Cash Equivalents	150	-	(56)	94
Cash and Cash Equivalents, Beginning of Year	-	-	56	56
Condensed Combining Information - Eliminations - Note 19				
Other assets	-	(7,605)	-	(7,605)
Unrestricted	-	(7,605)	-	(7,605)
Total net position	-	(7,605)	-	(7,605)
Total liabilities and net position	-	(7,605)	-	(7,605)
Nonoperating revenues	-	(1,272)	-	(1,272)
Increase (Decrease) in Net Position	-	(1,272)	-	(1,272)
Beginning Net Position	-	(6,333)	-	(6,333)
Ending Net Position	-	(7,605)	-	(7,605)

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2019 and 2018

Note 3: 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.** Inpatient acute care services and substantially all outpatient services rendered to Medicare 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. 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 under a prospective reimbursement system.

Approximately 29 percent of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2019 and 2018. 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 4: Deposits, Investments and Investment Income

Deposits

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

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

At December 31, 2019 and 2018, none of the Hospital's bank deposit balances of \$5,307,563 and \$15,228,885, respectively, were exposed to custodial credit risk.

Investments

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

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
December 31, 2019 and 2018

At December 31, 2019 and 2018, the Hospital had the following investments and maturities:

Type	December 31, 2019		
	Fair Value	Maturities in Years	
		Less Than 1	1 – 5
U.S. agencies obligations	\$ 12,996,771	\$ 12,996,771	\$ -
Corporate bonds	14,576,937	3,016,509	11,560,428
Repurchase agreements	54,332,083	54,332,083	-
U.S. Treasury obligations	17,864,927	17,864,927	-
Money market mutual funds	3,122,871	3,122,871	-
Accrued interest	325,053	325,053	-
	103,218,642	<u>\$ 91,658,214</u>	<u>\$ 11,560,428</u>
Equity securities	<u>19,733,182</u>		
	<u>\$ 122,951,824</u>		
Type	December 31, 2018		
	Fair Value	Maturities in Years	
		Less Than 1	1 – 5
U.S. agencies obligations	\$ 7,841,472	\$ -	\$ 7,841,472
Corporate bonds	23,346,759	11,924,479	11,422,280
Repurchase agreements	50,601,021	50,601,021	-
U.S. Treasury obligations	53,455,821	35,823,950	17,631,871
Money market mutual funds	18,354,034	18,354,034	-
Accrued interest	628,210	628,210	-
	154,227,317	<u>\$ 117,331,694</u>	<u>\$ 36,895,623</u>
Equity securities	<u>15,702,509</u>		
	<u>\$ 169,929,826</u>		

Interest Rate Risk. As a means of limiting its exposure to fair value losses arising from rising interest rates, the Hospital's investment policy limits its investment portfolio to maturities of five years. The money market mutual funds are presented as investments with a maturity of less than one year because they are immediately redeemable in full.

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Credit Risk. Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. It is the Hospital's policy to limit its investments in corporate bonds to those that are rated Baa, or better, by Moody's Investor Services, Inc. and to equity securities included in the Russell 1000 Value Index. At December 31, 2019 and 2018, ratings of the Hospital's investments in U.S. agencies obligations not directly guaranteed by the U.S. government, corporate bonds and money market mutual funds ranged from Baa to AAA as rated by Moody's Investor Services, Inc.

Custodial Credit Risk. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. All of the underlying securities for the Hospital's investments in repurchase agreements at December 31, 2019 and 2018 are held by the third-party custodians in the Hospital's name. The Hospital's investment policy requires that a third-party safekeeping agreement be obtained for all third-party custodians.

Concentration of Credit Risk. The Hospital places a limit on the amount that may be invested in any single non-federal debt issuer or holdings of equity securities of a single company to no more than 6 percent of the Hospital's portfolio value. At December 31, 2019 and 2018, the Hospital's investments not directly guaranteed by the U.S. government that constituted more than 5 percent of its total investments are as follows:

	<u>2019</u>	<u>2018</u>
Federal National Mortgage Association	7%	5%
Morgan Stanley	5%	3%
Citigroup	5%	6%
Repurchase agreements with Commerce Bank, n.a.	44%	30%
Fidelity Treasury Fund	3%	11%

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Summary of Carrying Values

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

	<u>2019</u>	<u>2018</u>
Carrying value		
Deposits ⁽¹⁾	\$ 3,632,968	\$ 12,190,193
Investments	<u>122,951,824</u>	<u>169,929,826</u>
	<u>\$ 126,584,792</u>	<u>\$ 182,120,019</u>
Included in the following balance sheet captions		
Cash and cash equivalents	\$ 52,940,327	\$ 47,506,789
Current portion of assets held by trustee	1,862,407	2,265,928
Noncurrent cash and investments	<u>71,782,058</u>	<u>132,347,302</u>
	<u>\$ 126,584,792</u>	<u>\$ 182,120,019</u>

⁽¹⁾The Hospital utilizes an overnight repurchase agreement for its bank deposits to maximize investment return. At December 31, 2019 and 2018, the overnight repurchase agreement amounted to \$54,332,083 and \$50,601,021, respectively, and its carrying value is included in the investments above. The repurchase agreement balance is included as a cash equivalent on the balance sheets at year end.

Investment Income

Investment income for the years ended December 31, 2019 and 2018 consisted of:

	<u>2019</u>	<u>2018</u>
Interest and dividend income	\$ 4,258,889	\$ 2,530,030
Net increase (decrease) in fair value of investments	<u>2,410,848</u>	<u>(1,146,482)</u>
	<u>\$ 6,669,737</u>	<u>\$ 1,383,548</u>

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Note 5: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at December 31, 2019 and 2018 consisted of:

	<u>2019</u>	<u>2018</u>
Medicare	\$ 6,783,640	\$ 6,298,597
Medicaid	1,329,758	1,025,424
Other third-party payers	30,414,582	25,868,523
Patients	<u>18,293,417</u>	<u>21,078,647</u>
	56,821,397	54,271,191
Less allowance for uncollectible accounts	<u>17,875,169</u>	<u>16,074,174</u>
	<u>\$ 38,946,228</u>	<u>\$ 38,197,017</u>

Note 6: Other Assets

Investment in Lawrence Surgery Center, LLC

The Hospital has a 50 percent membership interest in Lawrence Surgery Center, LLC (LSC). The net investment totaled \$602,998 and \$551,589 at December 31, 2019 and 2018, respectively. The remaining 50 percent membership interest is held by several physicians who are on the Hospital's active medical staff.

Investment in Mid-America Service Solutions, LLC

On September 1, 2017, the Hospital purchased a 9.09 percent interest in Mid-America Service Solutions, LLC. The net investment totaled \$184,563 and \$174,679 at December 31, 2019 and 2018, respectfully. The remaining membership interest is held by 10 other health care organizations in the Mid-West United States.

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Note 7: Capital Assets

Capital assets activity for the years ended December 31, 2019 and 2018 was:

	2019				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	\$ 12,512,364	\$ 115,989	\$ -	\$ -	\$ 12,628,353
Land improvements	3,467,033	36,632	(190,554)	100,956	3,414,067
Buildings and leasehold improvements	148,616,061	2,913,622	(421,236)	5,984,195	157,092,642
Fixed equipment	10,152,240	36,762	(1,236,566)	20,729	8,973,165
Major movable equipment	82,516,722	3,394,810	(2,240,995)	2,201,011	85,871,548
Construction in progress	24,643,014	56,675,063	-	(8,306,891)	73,011,186
	<u>281,907,434</u>	<u>63,172,878</u>	<u>(4,089,351)</u>	<u>-</u>	<u>340,990,961</u>
Less accumulated depreciation					
Land improvements	2,501,331	163,087	(190,554)	-	2,473,864
Buildings and leasehold improvements	52,952,269	3,548,078	(409,369)	-	56,090,978
Fixed equipment	8,123,031	451,583	(1,229,346)	-	7,345,268
Major movable equipment	61,922,222	5,070,884	(2,219,711)	-	64,773,395
	<u>125,498,853</u>	<u>9,233,632</u>	<u>(4,048,980)</u>	<u>-</u>	<u>130,683,505</u>
Capital assets, net	<u>\$ 156,408,581</u>	<u>\$ 53,939,246</u>	<u>\$ (40,371)</u>	<u>\$ -</u>	<u>\$ 210,307,456</u>
	2018				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	\$ 3,940,591	\$ 8,571,773	\$ -	\$ -	\$ 12,512,364
Land improvements	3,097,713	369,320	-	-	3,467,033
Buildings and leasehold improvements	133,785,987	17,022,143	(3,471,464)	1,279,395	148,616,061
Fixed equipment	15,304,870	8,833	(5,169,907)	8,444	10,152,240
Major movable equipment	87,830,212	6,017,104	(11,481,008)	150,414	82,516,722
Construction in progress	4,675,668	21,405,599	-	(1,438,253)	24,643,014
	<u>248,635,041</u>	<u>53,394,772</u>	<u>(20,122,379)</u>	<u>-</u>	<u>281,907,434</u>
Less accumulated depreciation					
Land improvements	2,345,434	155,897	-	-	2,501,331
Buildings and leasehold improvements	52,987,118	3,386,373	(3,421,222)	-	52,952,269
Fixed equipment	12,943,991	321,582	(5,142,542)	-	8,123,031
Major movable equipment	68,240,419	5,017,462	(11,335,659)	-	61,922,222
	<u>136,516,962</u>	<u>8,881,314</u>	<u>(19,899,423)</u>	<u>-</u>	<u>125,498,853</u>
Capital assets, net	<u>\$ 112,118,079</u>	<u>\$ 44,513,458</u>	<u>\$ (222,956)</u>	<u>\$ -</u>	<u>\$ 156,408,581</u>

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The increase in construction in progress is primarily attributable to the LMH Health West construction project. Total estimated cost of the project is \$90,000,000. The project is expected to be completed in the summer of 2020. The project will be paid for with the proceeds from the Series 2018 Bonds and internal resources.

Note 8: Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses included in current liabilities at December 31, 2019 and 2018 consisted of:

	2019	2018
Payable to suppliers and contractors	\$ 15,484,090	\$ 11,946,039
Payable to employees (including payroll taxes and benefits)	17,055,896	15,993,989
Other	2,975,432	705,260
	\$ 35,515,418	\$ 28,645,288

Note 9: Medical Malpractice Claims

The Hospital purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents based upon the Hospital's claims experience, as well as other considerations, including the nature of each claim. It is reasonably possible that this estimate could change materially in the near term.

Note 10: Employee Health Claims

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance plan. The Hospital is self-insured for health claims of participating employees and dependents up to specific claim amounts of \$200,000 per individual in both 2019 and 2018. There was no aggregate stop loss coverage in 2019 or 2018. Commercial stop-loss insurance coverage is purchased for claims in excess of the amounts. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is reasonably possible that the Hospital's estimate will change by a material amount in the near term.

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

	2019	2018
Balance, beginning of year	\$ 1,247,979	\$ 1,351,005
Claims incurred	16,075,077	10,066,962
Claims and expenses paid	(15,134,691)	(10,169,988)
Balance, end of year	\$ 2,188,365	\$ 1,247,979

Note 11: Long-term Debt

The following is a summary of long-term obligation transactions for the Hospital for the years ended December 31, 2019 and 2018:

	2019				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Revenue bonds payable					
Series 2018	\$ 77,520,000	\$ -	\$ -	\$ 77,520,000	\$ -
Unamortized premiums	7,842,844	-	415,775	7,427,069	-
Note from direct borrowing	9,782,445	-	246,595	9,535,850	256,642
Capital lease obligations	909,120	-	140,747	768,373	191,451
Total long-term debt	\$ 96,054,409	\$ -	\$ 803,117	\$ 95,251,292	\$ 448,093

	2018				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Revenue bonds payable					
Series 2012	\$ 8,275,000	\$ -	\$ 8,275,000	\$ -	\$ -
Series 2013	1,365,000	-	1,365,000	-	-
Series 2018	-	77,520,000	-	77,520,000	-
	9,640,000	77,520,000	9,640,000	77,520,000	-
Unamortized premiums	-	8,096,929	254,085	7,842,844	-
Note from direct borrowing	-	10,000,000	217,555	9,782,445	246,595
Capital lease obligations	-	958,338	49,218	909,120	139,997
Total long-term debt	\$ 9,640,000	\$ 96,575,267	\$ 10,160,858	\$ 96,054,409	\$ 386,592

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Revenue Bonds Payable

The City issued Series 2012, Series 2013, and Series 2018 Hospital Revenue Bonds (Bonds) under a Bond Indenture dated June 1, 1994, as amended and supplemented, to finance expansion and renovation of Hospital facilities, acquire equipment and property, refinance prior bond issues and reimburse the Hospital for certain capital expenditures. Under related Lease and Guaranty Agreements dated June 1, 1994, as amended and supplemented, the Hospital leases its facilities and substantially all equipment from the City. The Bonds and interest thereon are special, limited obligations of the City payable solely from: (i) lease payments from the Hospital, (ii) a pledge of the Hospital's gross revenues, (iii) a pledge of most Hospital facilities and equipment and (iv) amounts on deposit with the Bond Trustee. Therefore, both the Hospital facilities and equipment and Bonds payable are recorded in the accompanying financial statements.

In 2018, the Hospital retired bond Series 2012 and bond Series 2013, effectively paying off all principal and interest.

The indenture agreements require that certain funds be established with the trustee. Accordingly, these funds are included as assets held by trustee for debt service and capital acquisitions in the balance sheets. The indenture agreements also require the Hospital to comply with certain restrictive covenants including minimum insurance coverage, maintaining a historical debt-service coverage ratio of at least 1.10 to 1.00, and restrictions on incurrence of additional debt.

In 2019, the Hospital's debt coverage service ratio was less than 1.10 to 1.00. The indenture agreements state that, should the Hospital's debt service coverage ratio fall below the requirement, the Hospital must retain a consultant and take into consideration recommendations made by such consultant. During 2019, prior to the debt-service coverage ratio requirement not being met, the Hospital retained outside professional services, wherein operational efficiencies and areas to improve revenues were to be identified. As a result of these professional services, management intervention has begun. Management will provide the consultant report to the Bond Trustee.

In the event that the debt service coverage ratio is less than 1.00 to 1.00, the Hospital must have a minimum of 100 days cash on hand. At the end of fiscal year 2019, the Hospital's days cash on hand was approximately 114 days.

Bond premiums are amortized over the life of the bonds using the effective interest method.

Additional information about the bond Series 2018 is as follows:

	Original Balance	Interest Rates	Final Maturity
Series 2018	\$ 77,520,000	3.50% - 5.00%	7/1/2048

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Note from Direct Borrowing

The Hospital's outstanding note from direct borrowing of \$9,535,850 is secured by, among other things, the Assignment, Mortgage, and other Loan Documents (Security Instruments). This outstanding note contains (1) a provision that in an event of default, the timing of repayment of outstanding amounts become immediately due if any payment of principal and interest or any other required payment is not received by the lender on or before five days after the date that such payment is due; and (2) a provision that if the Hospital is unable to make payment, outstanding amounts are due immediately. The note also contains a subjective acceleration clause that allows the lender to accelerate payment of the entire principal amount to become immediately due if the lender determines that a material adverse change occurs.

Debt service requirements on long-term debt other than capital lease obligations as of December 31, 2019, are as follows:

Year Ending December 31,	Total to be Paid	Bonds		Direct Borrowings	
		Principal	Interest	Principal	Interest
2020	\$ 3,724,813	\$ -	\$ 3,724,813	\$ 256,642	\$ 376,763
2021	5,019,813	1,295,000	3,724,813	267,097	366,307
2022	5,020,063	1,360,000	3,660,063	277,979	355,425
2023	5,022,063	1,430,000	3,592,063	289,305	344,100
2024	5,020,563	1,500,000	3,520,563	301,091	332,313
2025-2029	25,104,815	8,705,000	16,399,815	1,699,767	1,467,255
2030-2034	25,105,065	11,110,000	13,995,065	2,075,409	1,091,612
2035-2039	25,106,552	13,695,000	11,411,552	2,534,067	632,954
2040-2044	26,322,500	18,375,000	7,947,500	1,834,493	118,504
2045-2048	22,617,500	20,050,000	2,567,500	-	-
	<u>\$ 148,063,747</u>	<u>\$ 77,520,000</u>	<u>\$ 70,543,747</u>	<u>\$ 9,535,850</u>	<u>\$ 5,085,233</u>

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Capital Lease Obligations

The Hospital is obligated under leases for equipment that are accounted for as capital leases. The capital leases are secured by the related assets as collateral. Assets under capital leases totaled \$716,854 and \$908,521, net of accumulated depreciation of \$241,484 and \$49,817, at December 31, 2019 and 2018, respectfully. The following is a schedule by year of future minimum lease payments under the capital lease including interest at rates of 4 percent to 6.81 percent together with the present value of the future minimum lease payments as of December 31, 2019:

	<u>Capital Lease Obligations</u>
2020	\$ 220,403
2021	242,376
2022	233,772
2023	<u>131,643</u>
	<u>828,194</u>
Less amount representing interest	(59,821)
Less current maturities	<u>(191,451)</u>
Noncurrent portion	<u><u>\$ 576,922</u></u>

Note 12: Assets Held in Trust

The Hospital is the recipient of investment income from a perpetual endowment fund created under the last will and testament of Elizabeth M. Watkins. The will stipulated that the corpus is to be maintained inviolate under the administration of a trustee and the net investment income is to be distributed each year to the Hospital as long as the Hospital continues to be a charitable institution. The market value of the trust approximated \$2,384,183 and \$2,025,604 at December 31, 2019 and 2018, respectively. Assets of this trust are not included in the accompanying financial statements. Trust income received is reported as other nonoperating income.

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Note 13: Operating Leases

Future minimum lease payments for equipment under leases with an initial term greater than one year at December 31, 2019 are as follows:

	<u>Rental Expense</u>
2020	\$ 451,212

Rental expense for equipment amounted to \$683,154 and \$669,812 in 2019 and 2018, respectively.

Office Rental Income and Expense

The Hospital leases and rents office space to and from various third parties as a normal part of its operations. The leases to third parties are generally on a month-to-month basis. Future minimum operating lease expense at December 31, 2019 is as follows:

	<u>Rental Expense</u>
2020	\$ 600,912
2021	355,652
2022	85,673
2023	85,673
2024	87,264
Thereafter	<u>117,172</u>
	<u><u>\$ 1,332,346</u></u>

Rental income for office space amounted to \$1,245,957 and \$1,210,285 in 2019 and 2018, respectively. Rental expense for office space amounted to \$571,404 and \$648,776 in 2019 and 2018, respectively.

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Note 14: Defined Contribution Plan

The Hospital sponsors a defined contribution retirement plan covering substantially all employees over age 21 with one year of service. Retirement expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by a committee appointed by the board of trustees. The plan provides retirement benefits to plan members. Benefit provisions are contained in the plan document and were established and can be amended by action of the board of trustees. Contributions actually made by plan members totaled \$6,245,247 and \$5,502,134 in 2019 and 2018, respectively, and the Hospital contributions aggregated \$2,985,364 and \$2,268,914 during 2019 and 2018, respectively. Employer contributions to the plan are based on the following contribution types:

Employer Basic Contributions

<u>Years of Service</u>	<u>Percent of Compensation</u>
Fewer than 5	1.5%
5 – 10 years	2.0
10 – 15 years	2.5
15 – 20 years	3.0
20 – 25 years	3.5
> 25 years	4.0

Employer Matching Contributions

The Hospital contributes a matching percentage for all participating plan participants equal to 50 percent of the participant's pre-tax elective deferral contribution not to exceed 2 percent of the participant's compensation for the plan year.

Note 15: The Lawrence Memorial Hospital Endowment Association

The Lawrence Memorial Hospital Endowment Association (Endowment Association) is a legally separate tax-exempt component unit of the Hospital. The Endowment Association is exclusively dedicated to the support of the Hospital. The Endowment Association's operations are managed by a board of directors separate from the Hospital's board.

In October 1984, the City, upon request of the Hospital, passed an ordinance granting the Hospital's board of trustees the power to transfer personal property and funds previously donated to the Hospital to the Endowment Association to be held in trust for the benefit of the Hospital. A trust agreement was established between the Hospital and the Endowment Association.

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Although the Hospital does not control the timing or amount of receipts from the Endowment Association, substantially all of the Endowment Association's resources and related income are restricted by donors for the benefit of the Hospital. Because these restricted resources held by the Endowment Association can only be used by, or for the benefit of, the Hospital, the Endowment Association is considered a component unit of the Hospital and is discretely presented in the Hospital's financial statements.

During the years ended December 31, 2019 and 2018, the Endowment Association provided \$2,777,062 and \$3,184,352 of support to the Hospital, respectively. Complete financial statements of the Endowment Association may be obtained from its Administrative Office at the following address: Lawrence Memorial Hospital Endowment Association, 325 Maine Street, Lawrence, Kansas 66044.

The Endowment Association reports under the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the Endowment Association's statements in the Hospital's financial reporting entity for these differences.

Note 16: Contingencies

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Hospital's 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 17: Disclosures About Fair Value of Assets and Liabilities

Fair value is 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 measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

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Level 3 Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

Recurring Measurements

The following tables present the fair value measurements of assets and liabilities recognized in the accompanying financial statements measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2019 and 2018:

December 31, 2019				
Type	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. agencies obligations	\$ 12,996,771	\$ -	\$ 12,996,771	\$ -
Corporate bonds	14,576,937	-	14,576,937	-
Repurchase agreements	54,332,083	54,332,083	-	-
U.S. Treasury obligations	17,864,927	17,864,927	-	-
Money market mutual funds	3,122,871	3,122,871	-	-
Equity securities	19,733,182	19,733,182	-	-
	122,626,771	<u>\$ 95,053,063</u>	<u>\$ 27,573,708</u>	<u>\$ -</u>
Accrued interest	325,053			
	<u>\$ 122,951,824</u>			

December 31, 2018				
Type	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. agencies obligations	\$ 7,841,472	\$ -	\$ 7,841,472	\$ -
Corporate bonds	23,346,759	-	23,346,759	-
Repurchase agreements	50,601,021	50,601,021	-	-
U.S. Treasury obligations	53,455,821	53,455,821	-	-
Money market mutual funds	18,354,034	18,354,034	-	-
Equity securities	15,702,509	15,702,509	-	-
	169,301,616	<u>\$ 138,113,385</u>	<u>\$ 31,188,231</u>	<u>\$ -</u>
Accrued interest	628,210			
	<u>\$ 169,929,826</u>			

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Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. If quoted market prices are not available, then fair values are estimated by using quoted prices of securities with similar characteristics or independent asset pricing services and pricing models, the inputs of which are market-based or independently sourced market parameters, including, but not limited to, yield curves, interest rates, volatilities, prepayments, defaults, cumulative loss projections and cash flows. Such securities are classified in Level 2 of the valuation hierarchy. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy.

The Hospital invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the accompanying balance sheets.

Note 18: Subsequent Events

As a result of the spread of the COVID-19 coronavirus, economic uncertainties have arisen which may negatively affect the financial position, results of operations and cash flows of the Hospital. The Hospital most likely will experience changes in its patient volume due to changes to scheduling of elective patient procedures as well as treating patients with COVID-19 coronavirus. These changes will have an impact on the financial operations of the Hospital. The duration of these uncertainties and the ultimate financial effects cannot be reasonably estimated at this time.

In an effort to lessen the extent of the economic downturn caused by the virus, the U.S. Department of Health and Human Services (HHS) issued payments to Medicare-enrolled providers, totaling \$30 billion. As a result, on April 10, 2020, The Lawrence Memorial Hospital received \$3,994,734 and Lawrence Physicians, LLC received \$913,107 from HHS.

In addition, there has been significant volatility in the investment markets both nationally and globally since December 31, 2019, resulting in an overall market decline in certain market segments which has resulted in a substantial decline in the value of the Hospital's investment portfolio.

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Note 19: Condensed Combining Information

The following table (*in thousands*) includes condensed information for the Hospital and its blended component unit as of December 31, 2019 and 2018.

Condensed Balance Sheet – 2019

	The Lawrence Memorial Hospital	Lawrence Physicians, LLC	Reed Medical Group MDVIP	Eliminations	Combined
Assets					
Current assets	\$ 103,616	\$ 6,654	\$ 108	\$ -	\$ 110,378
Capital assets	210,307	-	-	-	210,307
Other assets	79,281	-	-	(6,654)	72,627
Total assets	<u>\$ 393,204</u>	<u>\$ 6,654</u>	<u>\$ 108</u>	<u>\$ (6,654)</u>	<u>\$ 393,312</u>
Liabilities					
Current liabilities	\$ 40,121	\$ -	\$ 119	\$ -	\$ 40,240
Noncurrent liabilities	94,803	-	-	-	94,803
Total liabilities	<u>134,924</u>	<u>-</u>	<u>119</u>	<u>-</u>	<u>135,043</u>
Net Position					
Net investment in capital assets	141,443	-	-	-	141,443
Restricted - expendable for					
Debt service	93	-	-	-	93
Capital acquisition	21	-	-	-	21
Specific operating activities	4	-	-	-	4
Unrestricted	116,719	6,654	(11)	(6,654)	116,708
Total net position	<u>258,280</u>	<u>6,654</u>	<u>(11)</u>	<u>(6,654)</u>	<u>258,269</u>
Total liabilities and net position	<u>\$ 393,204</u>	<u>\$ 6,654</u>	<u>\$ 108</u>	<u>\$ (6,654)</u>	<u>\$ 393,312</u>

The Lawrence Memorial Hospital
A Component Unit of the City of Lawrence, Kansas
Notes to Financial Statements
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Condensed Statement of Revenues, Expenses and Changes in Net Position – 2019

	The Lawrence Memorial Hospital	Lawrence Physicians, LLC	Reed Medical Group MDVIP	Eliminations	Combined
Operating Revenues					
Net patient service revenue	\$ 232,734	\$ 44,893	\$ 989	\$ -	\$ 278,616
Other operating revenues	80,165	510	-	(76,907)	3,768
Total operating revenues	<u>312,899</u>	<u>45,403</u>	<u>989</u>	<u>(76,907)</u>	<u>282,384</u>
Operating Expenses					
Salaries and wages and employee benefits	152,434	-	847	(236)	153,045
Purchased services and professional fees	44,899	76,625	21	(76,646)	44,899
Other operating expenses	99,153	-	121	(25)	99,249
Total operating expenses	<u>296,486</u>	<u>76,625</u>	<u>989</u>	<u>(76,907)</u>	<u>297,193</u>
Operating Income (Loss)	16,413	(31,222)	-	-	(14,809)
Nonoperating Revenues	5,144	-	-	951	6,095
Revenues Over (Under) Expenses	21,557	(31,222)	-	951	(8,714)
Contributions Restricted for Acquisition of Capital Assets	2,777	-	-	-	2,777
Transfers from Hospital	(30,271)	30,271	-	-	-
Decrease in Net Position	(5,937)	(951)	-	951	(5,937)
Beginning Net Position	264,217	7,605	(11)	(7,605)	264,206
Ending Net Position	<u>\$ 258,280</u>	<u>\$ 6,654</u>	<u>\$ (11)</u>	<u>\$ (6,654)</u>	<u>\$ 258,269</u>

Condensed Statement of Cash Flows – 2019

	The Lawrence Memorial Hospital	Lawrence Physicians, LLC	Reed Medical Group MDVIP	Eliminations	Combined
Net Cash Provided by (Used in) Operating Activities	\$ 95,968	\$ (30,271)	\$ (68,421)	\$ (68,421)	\$ (2,724)
Net Cash Provided by (Used in) Noncapital Financing Activities	(30,123)	30,271	-	68,421	148
Net Cash Used in Capital and Related Financing Activities	(60,086)	-	-	-	(60,086)
Net Cash Provided by Investing Activities	52,753	-	-	-	52,753
Change in Cash and Cash Equivalents	58,512	-	(68,421)	-	(9,909)
Cash and Cash Equivalents, Beginning of Year	65,847	-	150	-	65,997
Cash and Cash Equivalents, End of Year	<u>\$ 124,359</u>	<u>\$ -</u>	<u>\$ 82</u>	<u>\$ -</u>	<u>\$ 56,088</u>

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Condensed Balance Sheet – 2018 – As restated

	The Lawrence Memorial Hospital	Lawrence Physicians, LLC	Reed Medical Group MDVIP	Eliminations	Combined
Assets					
Current assets	\$ 95,634	\$ 7,605	\$ 178	\$ -	\$ 103,417
Capital assets	156,409	-	-	-	156,409
Other assets	140,792	-	-	(7,605)	133,187
Total assets	<u>\$ 392,835</u>	<u>\$ 7,605</u>	<u>\$ 178</u>	<u>\$ (7,605)</u>	<u>\$ 393,013</u>
Liabilities					
Current liabilities	\$ 32,950	\$ -	\$ 189	\$ -	\$ 33,139
Noncurrent liabilities	95,668	-	-	-	95,668
Total liabilities	<u>128,618</u>	<u>-</u>	<u>189</u>	<u>-</u>	<u>128,807</u>
Net Position					
Net investment in capital assets	134,950	-	-	-	134,950
Restricted - expendable for					
Debt service	184	-	-	-	184
Capital acquisition	122	-	-	-	122
Specific operating activities	15	-	-	-	15
Unrestricted	<u>128,946</u>	<u>7,605</u>	<u>(11)</u>	<u>(7,605)</u>	<u>128,935</u>
Total net position	<u>264,217</u>	<u>7,605</u>	<u>(11)</u>	<u>(7,605)</u>	<u>264,206</u>
Total liabilities and net position	<u>\$ 392,835</u>	<u>\$ 7,605</u>	<u>\$ 178</u>	<u>\$ (7,605)</u>	<u>\$ 393,013</u>

Condensed Statement of Revenues, Expenses and Changes in Net Position – 2018 – As restated

	The Lawrence Memorial Hospital	Lawrence Physicians, LLC	Reed Medical Group MDVIP	Eliminations	Combined
Operating Revenues					
Net patient service revenue	\$ 232,155	\$ 44,815	\$ 994	\$ -	\$ 277,964
Other operating revenues	73,481	365	-	(70,202)	3,644
Total operating revenues	<u>305,636</u>	<u>45,180</u>	<u>994</u>	<u>(70,202)</u>	<u>281,608</u>
Operating Expenses					
Salaries and wages and employee benefits	138,479	-	871	(233)	139,117
Purchased services and professional fees	37,636	69,896	21	(69,917)	37,636
Other operating expenses	93,041	-	113	(52)	93,102
Total operating expenses	<u>269,156</u>	<u>69,896</u>	<u>1,005</u>	<u>(70,202)</u>	<u>269,855</u>
Operating Income (Loss)	36,480	(24,716)	(11)	-	11,753
Nonoperating Revenues	<u>1,276</u>	<u>-</u>	<u>-</u>	<u>(1,272)</u>	<u>4</u>
Revenues Over (Under) Expenses	37,756	(24,716)	(11)	(1,272)	11,757
Contributions Restricted for Acquisition of Capital Assets	3,185	-	-	-	3,185
Transfers from Hospital	<u>(25,988)</u>	<u>25,988</u>	<u>-</u>	<u>-</u>	<u>-</u>
Increase (Decrease) in Net Position	14,953	1,272	(11)	(1,272)	14,942
Beginning Net Position	<u>249,264</u>	<u>6,333</u>	<u>-</u>	<u>(6,333)</u>	<u>249,264</u>
Ending Net Position	<u>\$ 264,217</u>	<u>\$ 7,605</u>	<u>\$ (11)</u>	<u>\$ (7,605)</u>	<u>\$ 264,206</u>

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Condensed Statement of Cash Flows – 2018 – As restated

	The Lawrence Memorial Hospital	Lawrence Physicians, LLC	Reed Medical Group MDVIP	Eliminations	Combined
Net Cash Provided by (Used in) Operating Activities	\$ 58,021	\$ (32,321)	\$ 94	\$ -	\$ 25,794
Net Cash Provided by (Used in) Noncapital Financing Activities	(32,199)	32,321	-	-	122
Net Cash Provided by Capital and Related Financing Activities	39,622	-	-	-	39,622
Net Cash Used in Investing Activities	(43,281)	-	-	-	(43,281)
Change in Cash and Cash Equivalents	22,163	-	94	-	22,257
Cash and Cash Equivalents, Beginning of Year	43,740	-	56	-	43,796
Cash and Cash Equivalents, End of Year	<u>\$ 65,847</u>	<u>\$ -</u>	<u>\$ 150</u>	<u>\$ -</u>	<u>\$ 65,997</u>