WASHINGTON COUNTY HOSPITAL

A COMPONENT UNIT OF WASHINGTON COUNTY, KANSAS

FINANCIAL STATEMENTS

and

ADDITIONAL INFORMATION

with

INDEPENDENT AUDITOR'S REPORT

YEARS ENDED DECEMBER 31, 2017 AND 2016

George, Bowerman & Noel, P.A.
Certified Public Accountants

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George, Bowerman & Noel, P.A.
Certified Public Accountants
Business Consultants
Tax Advisors

Epic Center • 301 N. Main, Suite 1350 • Wichita, Kansas 67202 • Telephone (316) 262-6277 • Fax (316) 265-6150

INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Washington County Hospital
Washington, Kansas

Report on the Financial Statements

We have audited the financial statements of Washington County Hospital (Hospital), a component unit of Washington County, Kansas, as listed in the table of contents, at and for the years ended December 31, 2017 and 2016. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express opinions on these financial statements based on our audits.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Washington County Hospital as of December 31, 2017 and 2016, and the changes in financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Additional Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. 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 audit 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.

Our audits were made for the purpose of forming opinions on the basic financial statements taken as a whole. The additional information, as listed in the table of contents, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the additional information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

George, Bowerman & Noll, P.A.

Wichita, Kansas
August 15, 2018

WASHINGTON COUNTY HOSPITAL

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of Washington County Hospital's (Hospital's) financial performance provides an overview of the Hospital's financial activities for the fiscal years ended December 31, 2017 and 2016. Please read it in conjunction with the Hospital's financial statements, which begin on page 7.

Financial Highlights

- The Hospital's net position decreased by $211,700 and $33,640 or 6.57% and 1.03% in 2017 and 2016, respectively.
- Gross patient service revenue increased by $620,073 and $1,556,424 or 7.77% and 24.25% in 2017 and 2016, respectively.
- Contractual allowances and bad debts reduced gross patient service revenue by $3,168,090 and $2,659,213 or 36.86% and 33.34% of gross patient service revenue in 2017 and 216, respectively.
- The Hospital reported a loss from operations of $208,207 and $75,553 in 2017 and 2016, respectively.
- The Hospital recorded a deferred loss of $670,000 related to revisions to the capital lease for the hospital improvement project completed in 2015.

Financial Statements

The Hospital's financial statements are prepared using proprietary fund accounting that focuses on the determination of changes in net assets, financial position and cash flows in a manner similar to private-sector businesses. The financial statements are prepared on an accrual basis of accounting which recognizes revenue when earned and expenses when incurred. The basic financial statements include a *statement of net position*, *statement of revenue, expenses and changes in net position*, and *statement of cash flows*, followed by notes to the financial statements and schedules of certain additional information.

The *statement of net position* presents information on the Hospital's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may indicate whether the financial position of the Hospital is improving or deteriorating.

The *statement of revenues, expenses and changes in net position* presents both the operating revenues and expenses and nonoperating revenues and expenses along with other changes in net position for the year. This statement is an indication of the success of the Hospital's operations over the past year.

The *statement of cash flows* presents the change in cash and cash equivalents for the year resulting from operating activities, capital and related financing activities and investing activities. The primary purpose of this statement is to provide information about the Hospital's cash receipts and cash payments during the year.

Financial Position

The Hospital's net position is the difference between its assets and liabilities reported in the Statements of Net Position on pages 7 and 8 as shown in the following table:

	December 31,		
	2017	2016	2015
Assets:			
Current assets	$ 2,908,597	$ 2,822,675	$ 2,186,403
Capital assets, net	7,675,665	8,212,751	8,829,828
Total assets	$ 10,584,262	$ 11,035,426	$ 11,016,231
Deferred outflows of resources:			
Loss on lease revision	$ 644,743	$ –	$ –
Liabilities:			
Long-term liabilities	$ 7,231,948	$ 6,780,527	$ 6,997,802
Current liabilities	988,731	1,034,873	764,763
Total liabilities	$ 8,220,679	$ 7,815,400	$ 7,762,565
Net position:			
Net investment in capital assets	$ 801,250	$ 1,173,407	$ 1,602,031
Restricted	174,607	173,127	152,264
Unrestricted	2,032,469	1,873,492	1,499,371
Total net position	$ 3,008,326	$ 3,220,026	$ 3,253,666

Recent Financial Performance

The schedule below is a summary of the Hospital's revenues, expenses and changes in net position for the past three years.

	Year ended December 31,		
	2017	2016	2015
Operating revenue	$ 5,434,083	$ 5,324,792	$ 4,849,259
Operating expenses:			
Salaries	2,441,420	2,278,829	1,628,772
Employee benefits	410,313	348,663	329,106
Supplies and other	2,104,463	2,090,056	2,024,953
Depreciation and amortization	686,094	682,797	633,250
Total operating expenses	5,642,290	5,400,345	4,616,081
Loss from operations	(208,207)	(75,553)	233,178
Nonoperating revenues (expenses):			
Taxes	260,000	260,000	210,000
Investment income	3,669	788	1,970
Interest expense	(335,567)	(315,760)	(278,806)
Non-capital grants and contributions	49,259	41,626	57,856
Other, net	17,666	20,673	13,241
Total net nonoperating revenues (expenses)	(4,973)	7,327	4,261
Capital grants and contributions	1,480	34,586	251,131

	Year ended December 31,		
	2017	2016	2015
Increase (decrease) in net position	$ (211,700)	$ (33,640)	$ 488,570
Net position at end of year	$ 3,008,326	$ 3,220,026	$ 3,253,666

Overall, operating revenues increased approximately 2% from 2016 to 2017 and increased approximately 10% from 2015 to 2016.

- Net patient service revenue increased 2.09% from 2016 to 2017 and increased 10.00% from 2015 to 2016.

- Contractual adjustments and bad debts deducted from gross patient service revenue increased from 33.34% to 36.86% from 2016 to 2017 and increased from 24.71% to 33.34% from 2015 to 2016.

Overall, operating expenses increased 4.48% in 2017 as compared to an increase of 16.99% in 2016.

- Salaries, wages, and employee benefits increased in 2017 by approximately 8.53% and increased approximately 34.20% in 2016. The change 2016 was due primarily to the initial employment of two physicians and their staff.

Nonoperating revenues/expenses consist primarily of property taxes levied by the County, investment earnings, interest expense, and grants and contributions.

Patient Volumes

Patient day volume statistics are summarized in the following table:

	2017	2016	2015
Inpatient acute days	456	504	387
Observation bed days	108	203	128
	564	707	515
Percent change	(20.23)%	37.28%	21.75%
Skilled swing bed days	686	305	343
Percent change	55.54%	(11.08)%	8.54%
Intermediate swing bed days	821	968	1,536
Percent change	(15.19)%	(36.98) %	0.59%

Capital Assets

At the end of 2017, the Hospital had $7,675,665 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. The Hospital acquired additional capital assets costing approximately $149,000, $65,000, and $2,940,000 in 2017, 2016 and 2015, respectively. The significant increase in 2015 was primarily related to the hospital facility improvement project completed in 2015.

Debt

In 2013 the Hospital entered into a capitalized lease arrangement for $7,000,000 to finance the hospital facility improvement project. The lease was revised in 2017 and $670,000 was added to the remaining lease principal

(Notes 6 and 9). Principal and interest payments of $458,500 and $458,000 were made in 2017 and 2016, respectively. The remaining lease payments on the improvement project are to be paid through the year 2042.

The Hospital also leases certain laboratory, imaging, surgical and information technology equipment under capital lease agreements, including new leases of $91.607 and $38,855 in 2017 and 2016, respectively, with remaining outstanding balances totaling $299,158 at December 31, 2017.

Other Economic Factors

Management expects the current economic conditions to continue over the next year. However, management expects a modest increase in service volumes primarily due to the attraction of the significantly improved facility and the addition of another physician practice in the community.

Issues Facing the Hospital

There are issues facing the Hospital that could result in material changes in its financial position in the long term. Among these issues are:

- Risks related to Medicare and Medicaid reimbursement. A significant portion of the Hospital's revenues are derived from the Medicare program, which provides certain healthcare benefits to beneficiaries who are over 65 years of age or disabled, and the Medicaid program, funded jointly by the federal government and the states, which provides medical assistance to certain needy individuals and families. The funding of these programs by the federal and state governments face increasing pressure due to the significant increases in the costs of providing healthcare services in recent years.

- Employment and labor issues. The Hospital is a major employer within the community, employing a complex mix of professional, technical, clerical, maintenance, dietary, and other workers. Risks include personal tort actions, work-related injuries and exposure to hazardous materials. A relative shortage of nursing and other medical professional/technical employees, is an issue that is causing salary and benefits costs to increase at significant rates.

- Technology and services. Scientific and technological advances, new procedures, drugs and appliances, preventive medicine, and outpatient healthcare delivery may reduce utilization and revenues for the Hospital in the future. Technological advances continue to accelerate the need to acquire sophisticated and expensive equipment and services for diagnosis and treatment of illnesses and diseases.

- Increasing numbers of uninsured and underinsured patients. Due to the significant increases and high cost of healthcare insurance premiums in recent years, increasing numbers of patients of the Hospital are finding it more and more difficult to obtain or maintain adequate health insurance coverage. This trend could increase the levels of uncompensated care provided by the Hospital.

Contacting The Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Hospital Administration Department, at Washington County Hospital, 304 E. Third, Washington, Kansas 66968.

WASHINGTON COUNTY HOSPITAL

STATEMENTS OF NET POSITION

ASSETS

	December 31, 2017	December 31, 2016
Current assets:		
Cash (Notes 1, 3 and 7)	$ 1,439,449	$ 1,172,671
Assets limited as to use (Notes 3 and 7)	174,607	173,127
Accounts receivable, net of allowance for doubtful accounts of $453,145 in 2017 and $471,724 in 2016	978,010	1,105,461
Inventories (Note 1)	229,616	278,280
Other	86,915	93,136
Total current assets	2,908,597	2,822,675
Property and equipment, at cost (Notes 1 and 5):		
Land and land improvements	38,524	38,524
Building and fixed equipment	9,462,772	9,462,772
Movable equipment	2,890,633	2,741,625
Projects in progress	62,942	62,942
	12,454,871	12,305,863
Less accumulated depreciation	4,779,206	4,093,112
Property and equipment net of accumulated depreciation	7,675,665	8,212,751
Total assets	10,584,262	11,035,426
Deferred outflows of resources – Loss on lease revision, net of accumulated amortization of $25,567 in 2017 and $ – in 2016 (Notes 1 and 6)	644,743	–
Total assets and deferred outflows of resources	$ 11,229,005	$ 11,035,426

The accompanying notes are an integral part of the financial statements.

LIABILITIES AND NET POSITION

	December 31, 2017	December 31, 2016
Current liabilities:		
Accounts payable	$ 137,645	$ 165,632
Salaries and wages payable	57,034	45,083
Compensated absences payable (Notes 1 and 6)	60,384	62,198
Payroll taxes payable	3,351	2,241
Interest payable	124,521	126,458
Estimated third-party payer settlements (Note 2)	316,116	372,123
Current portion of capitalized lease obligations (Notes 1, 6 and 9)	289,680	261,138
Total current liabilities	988,731	1,034,873
Long-term liabilities:		
Capitalized lease obligations (Notes 1, 6 and 9)	7,229,478	6,778,202
Compensated absences payable (Notes 1 and 6)	2,470	2,325
Total long-term liabilities	7,231,948	6,780,527
Total liabilities	8,220,679	7,815,400
Net position (Notes 1 and 8):		
Net investment in capital assets	801,250	1,173,407
Restricted:		
Expendable for capital asset acquisitions	174,607	173,127
Unrestricted	2,032,469	1,873,492
Total net position	3,008,326	3,220,026
Total liabilities and net position	$ 11,229,005	$ 11,035,426

WASHINGTON COUNTY HOSPITAL

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

	Year ended December 31,	
	2017	2016
Operating revenues:		
Net patient service revenue (Note 1)	$ 5,427,823	$ 5,316,627
Other	6,260	8,165
Total operating revenues	5,434,083	5,324,792
Operating expenses:		
Salaries	2,441,420	2,278,829
Employee benefits	410,313	348,663
Supplies and other	2,104,463	2,090,056
Depreciation (Note 1)	686,094	682,797
Total operating expenses	5,642,290	5,400,345
Loss from operations	(208,207)	(75,553)
Nonoperating revenues (expenses):		
Taxes	260,000	260,000
Investment income	3,669	788
Interest expense	(335,567)	(315,760)
Noncapital grants and contributions	49,259	41,626
Other	17,666	20,673
Total nonoperating revenues (expenses)	(4,973)	7,327
Revenues over expenses before capital grants and contributions	(213,180)	(68,226)
Capital grants and contributions	1,480	34,586
Decrease in net position	(211,700)	(33,640)
Net position at beginning of year	3,220,026	3,253,666
Net position at end of year	$ 3,008,326	$ 3,220,026

The accompanying notes are an integral
part of the financial statements.

WASHINGTON COUNTY HOSPITAL

STATEMENTS OF CASH FLOWS

	Year ended December 31, 2017	Year ended December 31, 2016
Cash flows from operating activities:		
Receipts from and on behalf of patients	$ 5,499,267	$ 5,637,641
Payments to suppliers and contractors	(2,083,472)	(2,093,492)
Payments to employees	(2,431,138)	(2,279,985)
Payments for employee benefits	(409,203)	(348,484)
Other receipts and payments, net	6,260	8,165
Net cash flows provided by operating activities	581,714	923,845
Cash flows from noncapital financing activities:		
Property taxes for operations	260,000	260,000
Grants and contributions	49,259	41,626
Other	17,666	20,673
Net cash flows provided by noncapital financing activities	326,925	322,299
Cash flows from capital and related financing activities:		
Purchases of property and equipment	(51,494)	(18,076)
Contributions for capital assets	–	4,934
Principal payments on capitalized lease obligations	(281,789)	(227,312)
Interest payments on capitalized lease obligations	(312,247)	(317,635)
Net cash flows used by capital and related financing activities	(645,530)	(558,089)
Cash flows provided by investing activities – Investment income	3,669	788
Net increase in cash and cash equivalents	266,778	688,843
Cash and cash equivalents at beginning of year	1,172,671	483,828
Cash and cash equivalents at end of year	$ 1,439,449	$ 1,172,671

	Year ended December 31,	
	2017	2016
Reconciliation of operating income to net cash provided by operating activities:		
Loss from operations	$ (208,207)	$ (75,553)
Adjustments to reconcile operating income to net cash flows provided by operating activities:		
Depreciation and amortization	686,094	682,797
Provision for doubtful accounts	120,935	121,725
Other		
Net (increases) decreases in current assets:		
Accounts receivable	6,516	(23,984)
Inventories	48,664	(903)
Other	6,221	(23,404)
Net increases (decreases) in current liabilities:		
Accounts payable	(33,894)	20,871
Salaries and wages payable	11,951	17,492
Compensated absences payable	(1,669)	(18,648)
Payroll taxes payable	1,110	179
Estimated third-party payer settlements	(56,007)	223,273
Net cash provided by operating activities	$ 581,714	$ 923,845

The accompanying notes are an integral
part of the financial statements.

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of operations and reporting entity

Washington County Hospital (Hospital) is owned by Washington County, Kansas and provides acute inpatient, outpatient, rural health clinic, and swing bed services. The Board of County Commissioners appoints the members of the Board of Trustees and provides tax levy support to the Hospital. For these reasons, the Hospital is considered to be a component unit of Washington County, Kansas.

Basis of accounting and presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place. Property taxes, investment income, interest on capital asset-related debt are included in nonoperating revenues and expenses.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Use of estimates

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

Operating revenues and expenses

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

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Patient accounts receivable

The Hospital reports patient accounts receivable (Note 4) 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, payer mix trends, and existing economic conditions. As a service to patients, the Hospital bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are generally due in full when billed. If the patient is unable to pay the full amount at the time the patient is billed, the Hospital negotiates a payment plan whereby monthly payments are made by the patient on the account. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account. If future actual default rates on accounts receivable differ from those currently anticipated, the Hospital may have to adjust its allowance for doubtful accounts, which would affect earnings in the period the adjustments are made.

Inventories

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

Capital assets

The Hospital's capital assets that are $5,000 or greater, are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. All capital assets other than land are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using the following estimated useful lives:

Land improvements	4 years
Buildings	10-40 years
Equipment	5-20 years

The costs of maintenance and repairs are charged to operating expenses as incurred. The costs of significant additions, renewals and betterments to depreciable properties are capitalized and depreciated over the remaining or extended estimated useful lives of the item or the properties. When depreciable property is retired or otherwise disposed of, the related costs and accumulated depreciation are removed from the accounts and any gain or loss is reflected as non-operating revenue (expense).

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. Payment arrangements include reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers, and a provision for uncollectible accounts. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Grants and contributions

From time to time, the Hospital receives grants and contributions from government agencies, private organizations, and individuals. Revenues from grants and contributions are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenue. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses. When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Net position

Net position of the Hospital is classified into three components. *Net investment in capital assets* consists of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted – expendable for capital asset acquisitions* are net assets that must be used for the acquisition of capital assets, as specified by grantors, contributors, creditors, or debt agreements. *Unrestricted net position* are remaining assets plus deferred outflows of resources less remaining liabilities that do not meet the definition of *net investment in capital assets* or *restricted expendable*.

Compensated absences

Employees of the Hospital are entitled to paid vacation depending on length of service and whether they are full or part time. Upon resignation, termination or retirement from service with the Hospital, employees are entitled to payment for all accrued vacation, up to the allowable maximum. The Hospital accrues vacation benefits as earned.

Cash and cash equivalents

Cash and cash equivalents include cash, certificates of deposit, money market and interest bearing checking accounts with maturities of three months or less, excluding those cash and investment accounts related to the facility improvement project (Notes 7 and 9).

Taxation

The Hospital is a component unit of Washington County, a political subdivision of the State of Kansas and as such, is exempt from Federal income taxes under Section 115 of the Internal Revenue Code.

Risk management

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

Workers' compensation coverage is provided through a fund managed by the Kansas Hospital Association. The premiums are subject to retrospective adjustment based upon the overall performance of the fund. Management believes adequate reserves are in place to cover claims incurred but not reported.

The Hospital pays fixed premiums for annual medical malpractice coverage under an occurrence-basis policy. The Hospital accrues the expenses of its share of malpractice claim costs, if any, of reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate cost of any incident. Based on the Hospital's own claims experience, no accrual, for medical malpractice costs has been made in the accompanying financial statements.

Deferred inflows of resources/Deferred outflows of resources

In addition to assets, the statements of net position reports a separate section for deferred outflows of resources. This separate financial statement element represents a consumption of net position that applies to a future period and is not recognized as an outflow of resources (expense/expenditure) until the future period. The Hospital reports amounts related to a deferred loss on lease revisions (Note 6) on the statement of net position as a deferred outflow of resources in 2017.

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Deferred inflows of resources/Deferred outflows of resources (continued)

A deferred inflow of resources is the acquisition of net position that applies to a future period and is not recognized as an inflow of resources (revenue) until that time. There were no items that met the definition of a deferred inflow of resources in 2017 or 2016.

Other reclassifications

Certain other reclassifications have been made to the 2016 financial statements to conform to the 2017 presentation. These other reclassifications had no effect on the change in net position.

Subsequent events

Subsequent events have been evaluated through August 15, 2018, which is the date the financial statements were available to be issued.

2. ESTIMATED THIRD-PARTY PAYER SETTLEMENTS

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

- **Medicare** – The Hospital is recognized as a Critical Access Hospital (CAH) under the Medicare program. As such, inpatient acute care, skilled swing-bed and certain outpatient services rendered to program beneficiaries are paid at 101% of allowable cost subject to certain limitations. Certain other outpatient services are paid based on fee schedules. The Hospital is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and reviews thereof by the Medicare administrative contractor. The Hospital's Medicare cost reports have been reviewed by the Medicare fiscal intermediary through December 31, 2015. Beginning in 2013, a mandatory payment reduction, known as sequestration, of 2% of program cost went into effect. Under current legislation, sequestration is scheduled to last until 2023.

- **Medicaid** – Inpatient and outpatient services rendered to program beneficiaries are reimbursed on a prospective payment methodology, which includes a hospital specific add-on percentage that is based on previously filed cost reports.

Approximately 61% and 53% of net patient service revenue is from participation in the Medicare program for the years ended December 31, 2017 and 2016, respectively. Laws and regulations governing the Medicare program 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 and other third-party payer programs. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges and cost reimbursement.

3. CASH AND INVESTED CASH

Cash and invested cash consisted of the following:

	December 31,	
	2017	2016
Cash and cash equivalents:		
Cash on hand	$ 1,115	$ 407
Interest bearing checking accounts	362,389	286,850
Certificates of deposit	1,075,945	885,414
	1,439,449	1,172,671

3. CASH AND INVESTED CASH (continued)

	December 31, 2017	December 31, 2016
Assets whose use is limited (Note 7):		
Checking account (Improvement Project)	174,607	173,127
Totals	$ 1,614,056	$ 1,345,798

Deposits

Custodial credit risk for deposits is the risk that in the event of bank failure, the Hospital's deposits may not be returned or the Hospital will not be able to recover collateral securities in the possession of an outside party. The Hospital's policy follows applicable State statutes and requires deposits to be 100% secured by collateral (pledged securities) valued at market, less the amount of the Federal Deposit Insurance Corporation (FDIC) insurance. State statutes define the allowable types of pledged securities.

At December 31, 2017, the carrying amount of the Hospital's deposits, which approximates fair value, was $1,612,941 with the bank balances of such accounts being $1,621,761. Of the bank balances, $262,813 was secured by federal depository insurance and the remaining balance of $1,358,948 was covered by collateral held by the Hospital's custodial banks in joint custody in the name of the Hospital and its banks. The fair value of those pledged securities held by the Hospital's custodial banks was $1,959,165 at December 31, 2017.

The remaining carrying amount of the Hospital's cash and investments at December 31, 2017 consisted of cash on hand of $1,115.

Investment policies

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation. The Hospital's investing activities are managed under the custody of the Hospital Chief Executive Officer. Investing is performed in accordance with investment policies adopted by the Board of Trustees and in compliance with State statutes.

Applicable state statutes authorize the Hospital to invest in (1) temporary notes or no-fund warrants issued by the Hospital; (2) savings deposits, time deposits, open accounts, certificates of deposit, or time certificates of deposit with maturities of not more than two years, in commercial banks, savings and loan associations, and savings banks; (3) repurchase agreements with commercial banks, savings and loan associations, and savings banks for direct obligations of, or obligations that are insured as to principal and interest by, the United States government or any agency thereof; (4) United States treasury bills or notes with maturities as the governing body shall determine, but not exceeding two years; (5) the municipal investment pool maintained by the State Treasurer's office.

4. CONCENTRATIONS OF CREDIT RISK

The Hospital is a provider of health care services and is located in the City of Washington, Kansas. The Hospital grants credit without collateral to its patients, most of whom are local area residents and some are insured under third-party payer agreements. The mix of receivables from patients and third-party payers is as follows:

4. CONCENTRATIONS OF CREDIT RISK (continued)

	December 31, 2017	December 31, 2016
Medicare	$ 581,543	$ 527,401
Medicaid	75,013	76,589
Commercial	515,363	613,390
Other	259,236	359,805
Gross accounts receivable	1,431,155	1,577,185
Less allowance for doubtful accounts	453,145	471,724
	$ 978,010	$ 1,105,461

5. CAPITAL ASSETS

Capital asset additions, disposals, and balances for the years ended December 31, 2017 and 2016 were as follows:

	Balance At December 31, 2016	Additions	Disposals	Transfers	Balance At December 31, 2017
Capital assets not being depreciated:					
Land	$ 24,636	$ –	$ –	$ –	$ 24,636
Projects in progress	62,942	–	–	–	62,942
Total capital assets not being depreciated:	87,578	–	–	–	87,578
Capital assets being depreciated:					
Land improvements	13,888	–	–	–	13,888
Building and fixed equipment	9,462,772	–	–	–	9,462,772
Movable equipment	2,741,625	149,008	–	–	2,890,633
Total capital assets being depreciated	12,218,285	149,008	–	–	12,367,293
Less accumulated depreciation for:					
Land improvements	13,860	28	–	–	13,888
Building and fixed equipment	1,859,579	541,583	–	–	2,401,162
Movable equipment	2,219,673	144,483	–	–	2,364,156
Total accumulated depreciation	4,093,112	686,094	–	–	4,779,206

5. CAPITAL ASSETS (continued)

	Balance At December 31, 2016	Additions	Disposals	Transfers	Balance At December 31, 2017
Total capital assets being depreciated, net	$ 8,125,173	$ (537,086)	$ –	$ –	$ 7,588,087
Total capital assets, net	$ 8,212,751	$ (537,086)	$ –	$ –	$ 7,675,665

	Balance At December 31, 2015	Additions	Disposals	Transfers	Balance At December 31, 2016
Capital assets not being depreciated:					
Land	$ 24,636	$ –	$ –	$ –	$ 24,636
Projects in progress	62,942	–	–	–	62,942
Total capital assets not being depreciated:	87,578	–	–	–	87,578
Capital assets being depreciated:					
Land improvements	13,888	–	–	–	13,888
Building and fixed equipment	9,462,772	–	–	–	9,462,772
Movable equipment	2,675,905	65,720	–	–	2,741,625
Total capital assets being depreciated	12,152,565	65,720	–	–	12,218,285
Less accumulated depreciation for:					
Land improvements	13,824	36	–	–	13,860
Building and fixed equipment	1,316,328	543,251	–	–	1,859,579
Movable equipment	2,080,163	139,510	–	–	2,219,673
Total accumulated depreciation	3,410,315	682,797	–	–	4,093,112
Total capital assets being depreciated, net	8,742,250	(617,077)	–	–	8,125,173
Total capital assets, net	$ 8,829,828	$ (617,077)	$ –	$ –	$ 8,212,751

6. LONG-TERM DEBT AND OTHER NONCURRENT LIABILITIES

The following is a summary of changes in long-term debt and other noncurrent liabilities for the years ended December 31, 2017 and 2016:

	Balance At December 31, 2016	Additions	Reductions	Balance At December 31, 2017	Amounts Due Within One Year
Capital lease obligations	$ 7,039,340	$ 761,607	$ 281,789	$ 7,519,158	$ 289,680
Compensated absences payable	64,523	68,129	69,798	62,854	60,384
Total long-term liabilities	$ 7,103,863	$ 829,736	$ 351,587	$ 7,582,012	$ 350,064

	Balance At December 31, 2015	Additions	Reductions	Balance At December 31, 2016	Amounts Due Within One Year
Capital lease obligations	$ 7,227,797	$ 38,855	$ 227,312	$ 7,039,340	$ 261,138
Compensated absences payable	83,171	58,855	77,503	64,523	62,198
Total long-term liabilities	$ 7,310,968	$ 97,710	$ 304,815	$ 7,103,863	$ 323,336

The Hospital leases certain assets under capital lease agreements, including new equipment leases of $91,607 and $38,855 in 2017 and 2016, respectively. Interest expense incurred on the leases and the interest expense portion capitalized as part of the hospital improvement project were as follows:

	December 31, 2017	December 31, 2016
Hospital improvement project interest expense incurred....	$ 326,819	$ 306,125
Equipment leases interest expense incurred	8,748	9,635
Total interest expense	$ 335,567	$ 315,760

These leases qualify as capital leases for accounting purposes and, accordingly, have been recorded at the present value of the minimum lease payments at the date of lease inception. The following is an analysis of the financial presentation of the capital leases:

	December 31, 2017	December 31, 2016
Buildings and fixed equipment	$ 7,000,000	$ 7,000,000
Movable equipment	600,190	508,583
Accumulated depreciation	(1,533,564)	(999,567)
Net property and equipment	$ 6,066,626	$ 6,509,016

6. LONG-TERM DEBT AND OTHER NONCURRENT LIABILITIES (continued)

During 2017, the lease for the hospital improvement project was revised pursuant to the refunding of certain of the related revenue bonds of the County (Note 9).

The following is a schedule by years of future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2017:

Year ending December 31,	
2018	$ 596,303
2019	569,571
2020	495,065
2021	470,104
2022	458,496
2023	453,944
2024	456,594
2025	453,944
2026	456,144
2027	458,044
2028	454,644
2029	456,094
2030	452,244
2031	458,244
2032	458,794
2033	448,638
2034	448,481
2035	457,594
2036	456,056
2037	453,738
2038	451,081
2039	452,125
2040	457,625
2041	457,400
2042	171,628
Total minimum lease payments	11,402,595
Less executory costs	16,000
Less amount representing interest	3,867,437
Present value of net minimum lease payments	7,519,158
Less current portion	289,680
Long-term portion	$ 7,229,478

7. ASSETS WHOSE USE IS LIMITED

The assets whose use is limited consists of checking account (Note 3) for contributions received, net of related expenses, and is restricted for the improvement project and equipment (Note 9).

8. RESTRICTED NET ASSETS

Temporarily restricted net assets are comprised of assets whose use by the Hospital has been limited by donors to specific purposes and is available for the following:

	December 31,	
	2017	2016
Held in assets whose use is limited:		
Facility improvement project and equipment	$ 174,607	$ 173,127

8. RESTRICTED NET ASSETS (continued)

Net assets were released from donor restrictions by incurring expenditures satisfying the restricted purposes for the following:

	December 31,	
	2017	2016
SHIP grants	$ 8,112	$ 8,580
Rural health program grant	–	15,366
Healthcare collaborative grant	500	2,500
Capital asset acquisitions	11,460	13,723
Total	$ 20,072	$ 40,169

9. HOSPITAL FACILITY IMPROVEMENT PROJECT

In March 2013, Washington County, Kansas (County) entered into a lease agreement (Base Lease) with the Washington County Public Building Commission (PBC) to lease the existing land and Hospital facility to the PBC in consideration of the PBC issuing $7,000,000 in revenue bonds to finance the acquisition of the Hospital facility and to make improvements thereof. In conjunction with the Base Lease, the PBC and County entered into another lease agreement (Hospital Lease) under which the County will provide rental payments to the PBC sufficient to pay the principal and interest on the revenue bonds.

Pursuant to the lease agreements discussed above, the Hospital Board, the County, and the PBC entered into a Pledge of Revenues and Operating Agreement. Under the agreement, the Hospital Board is charged with the management, control, and operation of the Hospital. In addition, the Hospital Board has pledged the Hospital revenues to the County as security for the rental payments to the PBC under the Hospital Lease agreement.

The Hospital Lease and the Pledge of Revenues and Operating Agreement requires the Hospital to transfer to a trustee, on a monthly basis, specified amounts which, when combined with interest earned on the respective funds held by the trustee, will provide sufficient funds to pay the next principal, interest, and processing fees due for the PBC revenue bonds on the appropriate due dates. If insufficient Hospital funds are available to make such payments, the deficiency will be transferred to the County. The County has the right to deduct the amount of any such deficiency from ad valorem property tax appropriations otherwise payable to the Hospital. In determining whether the Hospital has funds lawfully available to make the required payments, the Hospital has the right to maintain a funded depreciation account in an amount it deems sufficient to maintain efficient Hospital operations based on then current requirements.

The Pledge of Revenues and Operating Agreement also includes certain restrictive covenants relating to the acquisition and disposition of property, incurrence of additional indebtedness, insurance coverage, efficient and economical operation, and the level of fees and rates charged. The covenant regarding the level of fees and rates charged requires fees and rates for services be set at levels to produce revenues sufficient to: (a) pay the debt service requirements on the PBC revenue bonds when they become due; (b) pay the expenses of the Hospital; (c) enable the Hospital to have in each fiscal year a debt service coverage ratio of not less than 125 percent of the current year debt service on the PBC revenue bonds outstanding and 100 percent of other outstanding lien obligations. At December 31, 2017, the Hospital was in compliance with the rate covenants relating to the debt service requirements.

In 2017, the lease agreement with the PBC (Note 6) was revised pursuant to the issuance of Refunding Revenue Bonds, Series 2017 by the PBC to refund a portion of the Hospital's portion of the PBC's outstanding Series 2013 Revenue Bonds maturing on and after September 1, 2024. The lease revisions resulted in a net loss on revision of the lease of $670,000 which is being amortized over the remaining lease term. The refunding was undertaken to decrease the total payments over the remaining life of the bonds. As a result, the total hospital lease payments to the PBC over the remaining lease term will be reduced by approximately $320,000. The schedule of the net minimum lease payments in Note 6 include the lease payments for 2018 through 2042 under the revised lease agreement.

10. OTHER POST EMPLOYMENT BENEFITS

As provided by K.S.A. 12-5040, the Hospital is required to allow retirees to participate in its group health insurance plan. While each retiree is required to pay the full amount of the applicable premium, conceptually, the Hospital would be subsidizing the retirees because each participant is charged a level premium regardless of age. However, the cost of this subsidy, if any, has not been quantified in these financial statements. The Hospital provides no other post-employment benefits, other than a retirement plan, for former employees. It is management's opinion that the effect on the Hospital's financial statements is not significant.

Under the Consolidated Omnibus Budget Reconciliation Act (COBRA), the Hospital makes health care benefits available to eligible former employees and their eligible dependents. Certain requirements are outlined by the federal government for this coverage.

11. RETIREMENT PLAN

The Hospital maintains a defined contribution simple IRA retirement plan. Employees who have received at least $5,000 in compensation during the preceding calendar year are eligible to participate. Participants can annually contribute up to $12,500 if under age 50 and up to $15,500 if age 50 or older. The Hospital matches each employee's contribution up to 3% of an employee's compensation. The total expense under the plan was $34,157 and $18,802 for 2017 and 2016, respectively.

12. CONTINGENCIES

The Hospital provides for annual medical malpractice coverage under a claims-made policy. The policy only covers claims made and reported to the insurer during the policy term, regardless of when the incident giving rise to the claim occurred. The Kansas Health Care Stabilization Fund provides additional claims-made coverage for each medical incident. No claims have been asserted through the date of the financial statements and based on the Hospital's own claims experience, no accrual, for medical malpractice costs has been made in the accompanying financial statements. It is reasonably possible that this estimate could change materially in the near term.

ADDITIONAL INFORMATION

WASHINGTON COUNTY HOSPITAL

SCHEDULE OF PATIENT SERVICE REVENUE

	Year ended December 31,					
	2017			2016		
	Inpatient	Outpatient	Total	Inpatient	Outpatient	Total
Routine service	$ 421,315	$ 206,783	$ 628,098	$ 430,985	$ 192,552	$ 623,537
Swing beds	456,403	–	456,403	286,321	–	286,321
Nursery	15,419	–	15,419	20,150	–	20,150
Operating room	59,239	773,638	832,877	137,222	720,958	858,180
Delivery room	21,962	–	21,962	25,100	–	25,100
Anesthesiology	14,950	110,416	125,366	26,325	111,670	137,995
Radiology	256,423	1,910,955	2,167,378	197,474	1,894,513	2,091,987
Laboratory	206,105	813,882	1,019,987	176,131	740,294	916,425
Physical therapy	135,789	643,300	779,089	28,046	762,695	790,741
Occupational therapy	14,006	2,336	16,342	–	3,395	3,395
Speech therapy	3,730	756	4,486	148	–	148
Electrocardiology	8,199	220,153	228,352	2,838	153,538	156,376
Medical supplies	178,945	218,616	397,561	159,667	184,993	344,660
Pharmacy	195,728	371,739	567,467	179,711	330,046	509,757
Cardiac rehabilitation	–	33,295	33,295	–	48,395	48,395
Emergency room	3,115	276,328	279,443	1,541	280,993	282,534
Clinic	69,051	953,337	1,022,388	30,312	849,827	880,139
Gross patient service revenue	$ 2,060,379	$ 6,535,534	8,595,913	$ 1,701,971	$ 6,273,869	7,975,840
Contractual adjustments			(3,047,155)			(2,537,488)
Bad debts			(120,935)			(121,725)
Net patient service revenue			$ 5,427,823			$ 5,316,627

WASHINGTON COUNTY HOSPITAL

SCHEDULE OF OPERATING EXPENSES BY FUNCTIONAL DIVISION

Department	Salaries	Supplies and other	Depreciation	Total	Percent of total operating expenses
	Year ended December 31, 2017				
Routine service:					
Adult and pediatrics	$ 650,738	$ 19,495	$ 13,257	$ 683,490	12.12 %
Nursery	3,210	(526)	1,690	4,374	0.08
	653,948	18,969	14,947	687,864	12.20
Ancillary services:					
Operating room	18,873	66,051	23,617	108,541	1.92
Delivery room	1,715	(4)	2,422	4,133	0.07
Anesthesiology	–	116,700	–	116,700	2.07
Radiology	128,939	192,402	81,720	403,061	7.14
Laboratory	145,869	148,722	3,083	297,674	5.28
Physical therapy	–	399,531	–	399,531	7.08
Occupational therapy	–	10,554	–	10,554	0.19
Speech therapy	–	2,199	–	2,199	0.04
Electrocardiology	6,468	547	1,109	8,124	0.14
Medical supplies	426	148,403	–	148,829	2.64
Pharmacy	–	253,430	–	253,430	4.49
Cardiac rehabilitation	–	297	–	297	0.01
Emergency room	292,866	9,064	1,110	303,040	5.37
Clinic	677,012	61,825	–	738,837	13.09
	1,272,168	1,409,721	113,061	2,794,950	49.53
General services:					
Nursing administration	43,162	(4)	–	43,158	0.76
Operation of plant	65,718	140,144	2,858	208,720	3.70
Laundry	25,304	4,376	1,274	30,954	0.55
Housekeeping	45,972	799	–	46,771	0.83
Dietary	76,353	61,262	–	137,615	2.44
Medical records	140,835	24,785	9,255	174,875	3.10
Administration and general	117,960	444,411	3,088	565,459	10.02
Employee benefits	–	410,313	–	410,313	7.27
Depreciation - building	–	–	541,611	541,611	9.60
	515,304	1,086,086	558,086	2,159,476	38.27
	$ 2,441,420	$ 2,514,776	$ 686,094	$ 5,642,290	100.00 %

Department	Salaries	Supplies and other	Depreciation	Total	Percent of total operating expenses
	Year ended December 31, 2016				
Routine service:					
Adult and pediatrics	$ 607,064	$ 32,298	$ 16,797	$ 656,159	12.16 %
Nursery	2,718	1,030	1,695	5,443	0.10
	609,782	33,328	18,492	661,602	12.26
Ancillary services:					
Operating room	46,635	31,103	22,622	100,360	1.86
Delivery room	2,614	(4)	2,429	5,039	0.09
Anesthesiology	–	126,660	–	126,660	2.35
Radiology	128,592	150,583	81,226	360,401	6.67
Laboratory	129,330	153,310	6,499	289,139	5.35
Physical therapy	–	402,591	–	402,591	7.45
Occupational therapy	–	4,622	–	4,622	0.09
Speech therapy	–	1,781	–	1,781	0.03
Electrocardiology	4,239	274	119	4,632	0.09
Medical supplies	1,103	142,618	–	143,721	2.66
Pharmacy	–	294,725	–	294,725	5.46
Cardiac rehabilitation	22	124	–	146	–
Emergency room	247,045	25,116	1,113	273,274	5.06
Clinic	608,208	56,646	–	664,854	12.31
	1,167,788	1,390,149	114,008	2,671,945	49.47
General services:					
Nursing administration	44,609	411	–	45,020	0.83
Operation of plant	63,973	139,854	2,563	206,390	3.82
Laundry	23,683	11,577	1,065	36,325	0.67
Housekeeping	46,263	2,436	–	48,699	0.90
Dietary	74,785	52,047	85	126,917	2.35
Medical records	129,936	41,126	1,192	172,254	3.19
Administration and general	118,010	419,128	2,105	539,243	9.99
Employee benefits	–	348,663	–	348,663	6.46
Depreciation - building	–	–	543,287	543,287	10.06
	501,259	1,015,242	550,297	2,066,798	38.27
	$ 2,278,829	$ 2,438,719	$ 682,797	$ 5,400,345	100.00 %