

# **Pratt Regional Medical Center Corporation**

Independent Auditor's Report and Financial Statements

September 30, 2015 and 2014



**Pratt Regional Medical Center Corporation**  
**September 30, 2015 and 2014**

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## Independent Auditor's Report

Board of Directors  
Pratt Regional Medical Center Corporation  
Pratt, Kansas

We have audited the accompanying financial statements of Pratt Regional Medical Center Corporation, which comprise the balance sheets as of September 30, 2015 and 2014, and the related statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the financial statements.

### *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. 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.

Board of Directors  
Pratt Regional Medical Center Corporation  
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***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pratt Regional Medical Center Corporation as of September 30, 2015 and 2014, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

*BKD, LLP*

Wichita, Kansas  
February 26, 2016

# Pratt Regional Medical Center Corporation

## Balance Sheets

September 30, 2015 and 2014

### Assets

	<u>2015</u>	<u>2014</u>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 1,611,352	\$ 1,688,021
Assets limited as to use, current	1,762,993	1,918,950
Patient accounts receivable, net of allowance; 2015 - \$4,958,000, 2014 - \$4,606,000	7,245,030	6,874,280
Estimated amounts due from third-party payers	745,000	265,000
Electronic health records incentive receivable	-	445,864
Stop-loss insurance receivable	73,000	-
Supplies	1,946,965	1,616,506
Prepaid expenses and other	429,455	638,374
	<u>13,813,795</u>	<u>13,446,995</u>
<b>Assets Limited As To Use</b>		
Held by trustee	3,750,003	2,327,252
Capital lease interest in unexpended bond proceeds	-	5,687,107
Internally designated	526,880	1,024,228
	<u>4,276,883</u>	<u>9,038,587</u>
Less amount required to meet current obligations	<u>(1,762,993)</u>	<u>(1,918,950)</u>
	<u>2,513,890</u>	<u>7,119,637</u>
<b>Investments</b>	<u>9,544,678</u>	<u>10,215,362</u>
<b>Property and Equipment</b>		
Land and land improvements	2,963,495	2,576,441
Buildings	47,218,012	21,133,350
Equipment	19,034,433	15,844,082
Construction in progress	4,061,276	22,997,006
	<u>73,277,216</u>	<u>62,550,879</u>
Less accumulated depreciation	<u>33,381,340</u>	<u>31,079,403</u>
	<u>39,895,876</u>	<u>31,471,476</u>
<b>Other Assets</b>		
Interest in net assets of Pratt Health Foundation	2,025,055	2,949,255
Deferred financing costs	327,302	349,600
Advances to physicians	234,684	313,810
	<u>2,587,041</u>	<u>3,612,665</u>
Total assets	<u>\$ 68,355,280</u>	<u>\$ 65,866,135</u>



**Pratt Regional Medical Center Corporation**  
**Statements of Operations**  
**Years Ended September 30, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
<b>Unrestricted Revenues, Gains and Other Support</b>		
Patient service revenue (net of contractual discounts and allowances)	\$ 49,840,822	\$ 46,487,923
Provision for uncollectible accounts	2,927,702	3,192,480
Net patient service revenue less provision for uncollectible accounts	46,913,120	43,295,443
Rental income	349,233	320,590
Electronic health records incentive	(32,550)	534,256
Other	463,625	381,328
Total unrestricted revenues, gains and other support	47,693,428	44,531,617
<b>Expenses</b>		
Salaries and wages	23,377,931	21,095,834
Employee benefits	3,628,309	4,592,028
Purchased services and professional fees	3,458,147	2,751,176
Supplies and other	9,813,670	8,893,867
Insurance	550,951	498,794
Utilities	1,309,505	1,136,748
Administrative	3,213,544	3,100,093
Depreciation and amortization	3,040,775	1,661,942
Interest	25,152	59,034
Total expenses	48,417,984	43,789,516
<b>Operating Income (Loss)</b>	<b>(724,556)</b>	<b>742,101</b>
<b>Other Income (Expense)</b>		
Investment return	64,374	804,015
Change in interest in net assets of Pratt Health Foundation	(925,268)	967,604
Total other income (expense)	(860,894)	1,771,619
<b>Excess (Deficiency) of Revenues Over Expenses</b>	<b>(1,585,450)</b>	<b>2,513,720</b>
Transfers from Pratt Health Foundation	1,347,568	19,749
Transfers from Pratt County, Kansas	1,487,790	152,800
Sales tax appropriations for acquisition of property and equipment	1,682,552	1,927,613
Change in defined benefit pension plan gains and losses	-	1,450,771
<b>Increase in Unrestricted Net Assets</b>	<b>\$ 2,932,460</b>	<b>\$ 6,064,653</b>

**Pratt Regional Medical Center Corporation**  
**Statements of Changes in Net Assets**  
**Years Ended September 30, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
<b>Unrestricted Net Assets</b>		
Excess (deficiency) of revenues over expenses	\$ (1,585,450)	\$ 2,513,720
Transfers from Pratt Health Foundation	1,347,568	19,749
Transfers from Pratt County, Kansas	1,487,790	152,800
Sales tax appropriations for acquisition of property and equipment	1,682,552	1,927,613
Change in defined benefit pension plan gains and losses	-	1,450,771
Increase in unrestricted net assets	2,932,460	6,064,653
<b>Temporarily Restricted Net Assets</b>		
Investment return	1,068	500
Increase in temporarily restricted net assets	1,068	500
<b>Change in Net Assets</b>	2,933,528	6,065,153
<b>Net Assets, Beginning of Year</b>	29,132,153	23,067,000
<b>Net Assets, End of Year</b>	\$ 32,065,681	\$ 29,132,153

**Pratt Regional Medical Center Corporation**  
**Statements of Cash Flows**  
**Years Ended September 30, 2015 and 2014**

	<b>2015</b>	<b>2014</b>
<b>Operating Activities</b>		
Change in net assets	\$ 2,933,528	\$ 6,065,153
Items not requiring (providing) operating cash flow		
Loss on sale of property and equipment	13,309	9,000
Depreciation and amortization	3,040,775	1,661,942
Amortization of bond premium	(54,411)	(54,411)
Net unrealized loss on investments	218,747	252,563
Forgiveness of advances to physician	104,010	262,912
Change in interest in Pratt Health Foundation	924,200	(968,104)
Net transfer from Pratt Health Foundation	(1,347,568)	(19,749)
Net transfer from Pratt County, Kansas	(1,487,790)	(152,800)
Sales tax appropriations for acquisition of property and equipment	(1,682,552)	(1,927,613)
Change in accrued self funded insurance	175,000	(147,000)
Change in accrued pension liability	(128,991)	(107,449)
Provision for uncollectible accounts	2,927,702	3,192,480
Net realized (gain) loss on investments	139,262	(75,764)
Changes in		
Patient accounts receivable	(3,298,452)	(4,905,709)
Estimated amounts due to and from third-party payers	(34,136)	124,136
Accounts payable and accrued expenses	151,828	536,547
Other current and noncurrent assets	(219,424)	(205,742)
Net cash provided by operating activities	2,375,037	3,540,392
<b>Investing Activities</b>		
Purchase of investments	(13,044,055)	(10,642,561)
Proceeds from disposition of investments	9,787,743	8,441,896
Gross change in assets limited as to use	(1,422,751)	(1,152,219)
Purchase of property and equipment	(1,333,778)	(437,053)
Net cash used in investing activities	(6,012,841)	(3,789,937)
<b>Financing Activities</b>		
Net transfer from Pratt Health Foundation	1,347,568	19,749
Net transfer from Pratt County, Kansas	1,487,790	152,800
Sales tax proceeds for acquisition of property and equipment	1,682,552	1,927,613
Principal payments on long-term debt	(956,775)	(800,944)
Net cash provided by financing activities	3,561,135	1,299,218
<b>Increase (Decrease) in Cash and Cash Equivalents</b>	(76,669)	1,049,673
<b>Cash and Cash Equivalents, Beginning of Year</b>	1,688,021	638,348
<b>Cash and Cash Equivalents, End of Year</b>	\$ 1,611,352	\$ 1,688,021
<b>Supplemental Cash Flows Information</b>		
Interest paid	\$ 1,053,433	\$ 1,446,625
Capital lease obligation incurred for property and equipment	\$ 214,411	\$ 213,452
Property and equipment acquired with assets limited as to use	\$ 9,753,442	\$ 16,864,286
Property and equipment in accounts payable	\$ 331,045	\$ 453,124

**Pratt Regional Medical Center Corporation**  
**Notes to Financial Statements**  
**Years Ended September 30, 2015 and 2014**

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

***Nature of Operations***

Pratt Regional Medical Center Corporation (Medical Center) is a Kansas not-for-profit corporation. The Medical Center operates a hospital doing business as Pratt Regional Medical Center in Pratt, Kansas, under a lease agreement entered into, pursuant to K.S.A. 19-4601 et. seq., with the Board of Trustees of the Pratt County Hospital (Board), effective October 1, 1998.

The Board controls facilities, including buildings, a medical office building and a long-term care facility as well as equipment and other assets, which are owned by Pratt County, Kansas, and leased to the Medical Center by the Board. The lease agreement provides that the Medical Center will assume and continue the operations of the hospital and maintain all property and equipment in good operating condition. The lease term is for a period of 20 years through September 30, 2018. The Medical Center lease payments are \$1,250 per quarter as of September 30, 2015. All assets and liabilities were transferred to the Medical Center upon commencement of the original term, October 1, 1988. At the end of the lease term, all assets, including working capital and liabilities shall transfer back to the Board.

The Medical Center primarily earns revenues by providing inpatient, outpatient, emergency and residential long-term care services to patients in the Pratt county area. The Medical Center also operates rural health clinics and physician satellites in the same geographic location.

***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 and Cash Equivalents***

The Medical Center considers all liquid investments with original maturities of three months or less to be cash equivalents. At September 30, 2015 and 2014, cash equivalents consisted primarily of money market accounts with brokers.

At September 30, 2015, the Medical Center's cash accounts exceeded federally insured limits by approximately \$1,132,000.

# Pratt Regional Medical Center Corporation

## Notes to Financial Statements

September 30, 2015 and 2014

### ***Investments and Investment Return***

Investments in equity securities having a readily determinable fair value and in all debt securities are carried at fair value. Investment return includes dividend, interest and other investment income and realized and unrealized gains and losses on investments carried at fair value. Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in unrestricted net assets. Other investment return is reflected in the statements of operations and changes in net assets as unrestricted, temporarily restricted or permanently restricted based upon the existence and nature of any donor or legally imposed restrictions.

### ***Assets Limited As To Use***

Assets limited as to use include (1) assets held by a trustee (2) capital lease interest in unexpended bond funds and (3) assets set aside by the Board of Directors for future capital improvements over which the Board retains control and may at its discretion subsequently use for other purposes. Amounts required to meet current liabilities of the Medical Center are included in current assets.

### ***Patient Accounts Receivable***

Accounts receivable are reduced by an allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, the Medical Center analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for uncollectible accounts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, the Medical Center analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for uncollectible accounts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payer has not yet paid, or for payers who are known to be having financial difficulties that make the realization of amounts due unlikely).

For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the Medical Center records a significant provision for uncollectible accounts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates if negotiated or provided by policy) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for doubtful accounts.

The Medical Center's allowance for doubtful accounts for self-pay patients was 75% at both September 30, 2015 and 2014. In addition, the Medical Center's write-offs decreased approximately \$210,000 from approximately \$3,152,000 for the year ended September 30, 2014, to approximately \$2,942,000 for the year ended September 30, 2015.

# Pratt Regional Medical Center Corporation

## Notes to Financial Statements

September 30, 2015 and 2014

### Supplies

The Medical Center states supply inventories at the lower of cost, determined using the first-in, first-out method, or market.

### Property and Equipment

Property and equipment acquisitions are recorded at cost and are depreciated on a straight-line basis over the estimated useful life of each asset. Assets under capital lease obligations are depreciated over the shorter of the lease term or their respective estimated useful lives.

The estimated useful lives for each major depreciable classification of property and equipment are as follows:

Land improvements	20 years
Buildings	10-50 years
Equipment	5-20 years

Donations of property and equipment are reported at fair value as an increase in unrestricted net assets unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as restricted support. The expiration of such restrictions is reported as an increase in unrestricted net assets when the donated asset is placed in service.

The Medical Center 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:

	<u>2015</u>	<u>2014</u>
Total interest expense incurred on borrowings for project	\$ 1,016,589	\$ 1,374,941
Interest income from investment of proceeds of borrowings for project	<u>52,047</u>	<u>136,560</u>
Net interest cost capitalized	<u>\$ 964,542</u>	<u>\$ 1,238,381</u>
Interest capitalized	\$ 964,542	\$ 1,238,381
Interest charged to expense	<u>25,152</u>	<u>59,034</u>
Total interest incurred	<u>\$ 989,694</u>	<u>\$ 1,297,415</u>

# **Pratt Regional Medical Center Corporation**

## **Notes to Financial Statements**

**September 30, 2015 and 2014**

### ***Long-lived Asset Impairment***

The Medical Center evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended September 30, 2015 and 2014.

### ***Interest in Net Assets of Pratt Health Foundation***

Pratt Health Foundation (Foundation) and the Medical Center are financially interrelated organizations. The Foundation seeks private support for and holds net assets on behalf of the Medical Center. The Medical Center accounts for its interest in the net assets of the Foundation (Interest) in a manner similar to the equity method. Changes in the Interest are included in change in net assets. Transfers of assets between the Foundation and the Medical Center are recognized as increases or decreases in the Interest.

### ***Deferred Financing Costs***

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method.

### ***Temporarily and Permanently Restricted Net Assets***

Temporarily restricted net assets are those whose use by the Medical Center has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Medical Center in perpetuity.

### ***Net Patient Service Revenue***

The Medical Center has agreements with third-party payers that provide for payments to the Medical Center at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments. 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.

# Pratt Regional Medical Center Corporation

## Notes to Financial Statements

September 30, 2015 and 2014

### **Charity Care**

The Medical Center provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. The Medical Center's direct and indirect costs for services furnished under its charity care policy aggregated to approximately \$105,000 and \$110,000 in 2015 and 2014, respectively. The Medical Center determines the cost of charity care by applying the overall cost to charge ratio from the Medicare cost report to gross charges for services that qualified as charity care.

### **Contributions**

Unconditional gifts expected to be collected within one year are reported at their net realizable value. Gifts received with donor stipulations are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is, when a time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified and reported as an increase in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions. Conditional contributions are reported as liabilities until the condition is eliminated or the contributed assets are returned to the donor.

### **Professional Liability Claims**

The Medical Center recognizes an accrual for claim liabilities based on estimated ultimate losses and costs associated with settling claims and a receivable to reflect the estimated insurance recoveries, if any. Professional liability claims are described more fully in *Note 6*.

### **Income Taxes**

The Medical Center has been recognized as exempt from income taxes under Section 501 of the Internal Revenue Code and a similar provision of state law. However, the Medical Center is subject to federal income tax on any unrelated business taxable income.

The Medical Center files tax returns in the U.S. federal jurisdiction. With a few exceptions, the Medical Center is no longer subject to U.S. federal examinations by tax authorities for years before 2012.

### **Excess (Deficiency) of Revenues Over Expenses**

The statements of operations include excess (deficiency) of revenues over expenses. Changes in unrestricted net assets which are excluded from excess (deficiency) of revenues over expenses, consistent with industry practice, include transfers to and from the Foundation and Pratt County, Kansas and changes in defined benefit pension plan gains and losses.

# Pratt Regional Medical Center Corporation

## Notes to Financial Statements

September 30, 2015 and 2014

### **Self Insurance**

The Medical Center has elected to self-insure certain costs related to employee health and accident benefit programs. Costs resulting from noninsured losses are charged to income when incurred. The Medical Center has purchased insurance that limits its exposure for individual claims to \$120,000.

### **Transfers Between Fair Value Hierarchy Levels**

Transfers in and out of Level 1 (quoted market prices), Level 2 (other significant observable inputs) and Level 3 (significant unobservable inputs) are recognized on the actual transfer date.

### **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. Payment 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 Medical Center 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.

The Medical Center has recorded revenue of approximately \$(33,000) and \$534,000 in 2015 and 2014, respectively, which is included in operating revenues in the statement of operations.

### **Subsequent Events**

Subsequent events have been evaluated through the date of the Independent Auditor's Report, which is the date the financial statements were issued.

# Pratt Regional Medical Center Corporation

## Notes to Financial Statements

September 30, 2015 and 2014

### Note 2: Net Patient Service Revenue

The Medical Center recognizes patient service revenue associated with services provided to patients who have third-party payer coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the Medical Center recognizes revenue on the basis of its standard rates for services provided. On the basis of historical experience, a significant portion of the Medical Center's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the Medical Center records a significant provision for uncollectible accounts related to uninsured patients in the period the services are provided. This provision for uncollectible accounts is presented on the statement of operations as a component of net patient service revenue.

The Medical Center has agreements with third-party payers that provide for payments to the Medical Center 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. Inpatient skilled nursing services are paid at prospectively determined per diem rates that are based on the patients' acuity. Rural health clinic services are paid on a cost basis. Home health services are paid on a per-episode basis using clinical, diagnostic and other factors. The Medical Center is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicare Administrative Contractor.

*Medicaid.* Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a prospective reimbursement methodology. Services rendered for long-term care facility residents are reimbursed under a cost-based prospective reimbursement methodology. The Medical Center is reimbursed at a prospective rate with annual cost reports submitted to the Medicaid program. Rates are computed each calendar quarter using an average of the 2010, 2011 and 2012 cost reports and changes in the Medicaid resident case mix. The Medicaid cost reports are subject to audit by the State and adjustments to rates can be made retroactively.

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

# Pratt Regional Medical Center Corporation

## Notes to Financial Statements

September 30, 2015 and 2014

Patient service revenue, net of contractual allowances and discounts (but before the provision for bad debts), recognized in the years ended September 30, 2015 and 2014, was approximately:

	<b>2015</b>	<b>2014</b>
Medicare	\$ 20,819,967	\$ 18,168,225
Medicaid	2,629,118	2,875,924
Other third-party payers	22,417,171	22,266,277
Patients	3,974,566	3,177,497
	<u>\$ 49,840,822</u>	<u>\$ 46,487,923</u>

### Note 3: Concentration of Credit Risk

The Medical Center grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. The mix of receivables from patients and third-party payers at September 30, 2015 and 2014, is:

	<b>2015</b>	<b>2014</b>
Medicare	28%	36%
Medicaid	14%	6%
Blue Cross Blue Shield	20%	18%
Other third-party payers	27%	30%
Patients	11%	10%
	<u>100%</u>	<u>100%</u>

**Pratt Regional Medical Center Corporation**  
**Notes to Financial Statements**  
**September 30, 2015 and 2014**

**Note 4: Investments and Investment Return**

***Assets Limited As To Use***

Assets limited as to use, at September 30, include:

	<u><b>2015</b></u>	<u><b>2014</b></u>
Held by trustee under indenture agreement		
Cash and cash equivalents	<u>\$ 3,750,003</u>	<u>\$ 2,327,252</u>
Capital lease interest in unexpended bond funds		
Money market mutual funds	\$ -	\$ 54,283
Corporate bonds	-	3,532,317
U.S. Treasury obligations	-	2,100,507
	<u>\$ -</u>	<u>\$ 5,687,107</u>
Internally designated for capital improvements		
Money market mutual funds	\$ 46,284	\$ 33,044
Corporate bonds	48,015	241,750
Exchange traded funds	19,300	-
Common stock	-	26,475
Domestic mutual funds	413,281	722,959
	<u>\$ 526,880</u>	<u>\$ 1,024,228</u>

# Pratt Regional Medical Center Corporation

## Notes to Financial Statements

September 30, 2015 and 2014

### Investments

Investments classified as trading securities, at September 30, include:

	<u>2015</u>	<u>2014</u>
Corporate debt securities	\$ 2,238,995	\$ 2,238,626
U.S. Government obligations	770,392	493,463
Exchange traded funds	76,361	16,758
Common stock	1,854,477	2,327,797
Preferred stock	189,106	-
Domestic fixed mutual funds	2,650,288	4,145,751
Domestic equity mutual funds	299,884	-
International equity mutual funds	654,657	792,539
Real estate mutual funds	47,858	-
Real estate investment trusts	4,574	-
Foreign stock	32,099	-
Money market	725,987	200,428
	<u>\$ 9,544,678</u>	<u>\$ 10,215,362</u>

Total investment return is reflected in the statements of operations and changes in net assets as other nonoperating income and is comprised of the following:

	<u>2015</u>	<u>2014</u>
Interest and dividend income	\$ 422,383	\$ 980,814
Unrealized losses on trading securities	(218,747)	(252,563)
Realized gains (losses) on trading securities	(139,262)	75,764
	<u>\$ 64,374</u>	<u>\$ 804,015</u>

# Pratt Regional Medical Center Corporation

## Notes to Financial Statements

September 30, 2015 and 2014

### **Note 5: Interest in Net Assets of the Foundation**

The Foundation is a not-for-profit corporation and is the sole voting member of the Medical Center. It has the authority to elect all of the members of the Board of Directors of the Medical Center.

The Foundation was established to benefit the general public and the Medical Center. The Foundation's Board of Directors determines the amount, timing and purpose of the distribution of Foundation funds. The Medical Center's interest in the net assets of the Foundation is accounted for in a manner similar to the equity method. Changes in the interest are included in change in net assets. Transfers of assets between the Foundation and the Medical Center are recognized as increases or decreases in the interest in the net assets of the Foundation with corresponding decreases or increases in the assets transferred and have no effect on change in net assets. At September 30, 2015 and 2014, \$2,025,055 and \$2,949,255, respectively, is recognized as the Medical Center's interest in the net assets of the Foundation, which includes contributions received by the Foundation and pledges receivable by the Foundation that are donor-restricted to be used for Medical Center purposes.

The Foundation's cash transfers to the Medical Center for property and equipment additions during the years ended September 30, 2015 and 2014, were \$1,347,568 and \$19,749, respectively.

### **Note 6: Professional Liability Claims**

The Medical Center purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Under such a policy, only claims made and reported to the insurer during the policy term, regardless of when the incidents giving rise to the claims occurred, are covered. The Medical Center also purchases excess umbrella liability coverage, which provides additional coverage above the basic policy limits up to the amount specified in the umbrella policy.

Based upon the Medical Center's claims experience, no accrual has been made for the Medical Center's estimated medical malpractice costs, including costs associated with litigating or settling claims, under its malpractice insurance policy, as of September 30, 2015 and 2014. It is reasonably possible that this estimate could change materially in the near term.

### **Note 7: Employee Health Claims**

Substantially all of the Medical Center's employees and their dependents are eligible to participate in the Medical Center's employee health insurance plan. The Medical Center is self-insured for health claims of participating employees and dependents up to an annual aggregate amount of \$100,000 per covered employee. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured employee health claims including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is reasonably possible that the Medical Center's estimate will change by a material amount in the near term.

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Activity in the Medical Center's accrued employee health claims liability during 2015 and 2014 is summarized as follows:

	<b>2015</b>	<b>2014</b>
Balance, beginning of year	\$ 130,000	\$ 277,000
Current year claims incurred and changes in estimates for claims incurred in prior years	1,897,503	959,275
Claims and expenses paid	<u>(1,722,503)</u>	<u>(1,106,275)</u>
Balance, end of year	<u>\$ 305,000</u>	<u>\$ 130,000</u>

**Note 8: Long-term Debt**

At September 30, 2015 and 2014, long-term debt consisted of the following:

	<b>2015</b>	<b>2014</b>
4.75% to 5.75% Hospital Revenue Bonds, Series 2007A and Series 2007B, issued by Pratt County, Kansas Public Building Commission with principal payments due annually and interest payments due semiannually	\$ -	\$ 610,000
1.75% to 2.25% Hospital Revenue Bonds, Series 2011, issued by Pratt County, Kansas Public Building Commission with principal payments due annually and interest payments due semiannually to December 1, 2018	2,980,000	2,980,000
3.25% note payable to employed physician payable in monthly installments through June 1, 2015, collateralized by certain moveable equipment	-	37,530
0% note payable to Pratt County, Kansas Hospital Board payable in yearly installments to February 2019, uncollateralized	51,133	63,917
0% note payable to Pratt Internal Medicine Group, P.A., payable in monthly installments to September 2015, uncollateralized	-	79,520
Capital lease obligations	<u>27,722,451</u>	<u>27,833,803</u>
	30,753,584	31,604,770
Less current maturities	<u>756,586</u>	<u>739,833</u>
	<u>\$ 29,996,998</u>	<u>\$ 30,864,937</u>

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**Capital Lease Obligations**

In 2012, the Medical Center entered into an agreement with the Public Building Commission (PBC) of Pratt County, Kansas and Pratt County, Kansas to issue bonds to finance construction of a renovation of the facility. The bonds bear interest ranging from 3.00% to 5.00% and are due semiannually in increasing principal amounts with final bonds maturing December 1, 2032. Bonds issued with maturities in 2022 and thereafter may be redeemed in advance of their maturity at 100% of face value beginning December 1, 2017.

In 2015, the Medical Center entered into a capital lease to purchase surgical equipment. Assets under capital leases at September 30, 2015 and 2014, totaled \$32,281,338 and \$22,526,282, net of accumulated depreciation of \$150,920 and \$0, respectively. The capital lease bears interest at 4.22% and matures in 2018.

Aggregate annual maturities of long-term debt at September 30, 2015, are:

	<b>Hospital Revenue Bonds</b>	<b>Notes Payable</b>	<b>Capital Leases</b>
2016	\$ 480,000	\$ 12,783	\$ 1,378,966
2017	765,000	12,783	1,406,749
2018	775,000	12,783	1,390,757
2019	960,000	12,784	1,232,743
2020	-	-	2,218,683
Thereafter	-	-	31,444,160
	<u>\$ 2,980,000</u>	<u>\$ 51,133</u>	39,072,058
Less amount representing interest			11,349,607
Present value of future minimum			27,722,451
lease payments			263,803
Less current maturities			<u>263,803</u>
Noncurrent portion			<u>\$ 27,458,648</u>

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**Note 9: Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are available for the following purpose:

	<b>2015</b>	<b>2014</b>
Financial assistance for patients	\$ 11,230	\$ 10,162

Permanently restricted net assets are restricted to:

	<b>2015</b>	<b>2014</b>
Investments to be held in perpetuity, the income is unrestricted	\$ 88,623	\$ 88,623

**Note 10: Functional Expenses**

The Medical Center provides health care services primarily to residents within its geographic area. Expenses related to providing these services are as follows:

	<b>2015</b>	<b>2014</b>
Health care services	\$ 40,278,057	\$ 37,332,905
General and administrative	8,139,927	6,456,611
	\$ 48,417,984	\$ 43,789,516

**Note 11: Profit-sharing Plan**

The Medical Center has a defined contribution profit-sharing plan covering substantially all employees. Employees must meet certain age and service requirements before they are eligible to participate in the plan. The Medical Center matches employee contributions at the following rate: (1) Employees with 10 years of service or greater will be matched 50 cents for every dollar the participant contributes up to 6% of the participant's compensation and (2) employees with less than 10 years of service will be matched 25 cents for every dollar the participant contributes up to 6% of the participant's compensation. Participants must work 501 hours during the plan year and must be employed on the last day of the plan year to receive a profit-sharing contribution. Profit-sharing expense was \$277,099 and \$257,106 for September 30, 2015 and 2014, respectively.

# Pratt Regional Medical Center Corporation

## Notes to Financial Statements

September 30, 2015 and 2014

### Note 12: Pension Plan

The Medical Center has a noncontributory defined benefit pension plan covering all employees who meet the eligibility requirements. Effective December 31, 2001, the plan was frozen. No new participants will be permitted entry into the plan and no additional benefits will accrue after December 31, 2001. The Medical Center made contributions to the plan based on the funding recommendations of the plan's actuary to meet the minimum funding requirements under the *Employee Retirement Income Security Act* (ERISA) and the Internal Revenue Code to satisfy benefit obligations. The Plan was fully funded and all distributions were made to participants during the Medical Center's fiscal year ending September 30, 2015.

The Medical Center used a September 30 measurement date for the plan. Information about the plan's funded status follows:

	2015	2014
<b>Change in Fair Value of Plan Assets</b>		
Beginning of year	\$ 6,834	\$ 3,263,290
Actual return on plan assets	-	(52,204)
Employer contribution	-	445,000
Benefits paid and expenses	(6,834)	(3,649,252)
End of year	-	6,834
<b>Change in Benefit Obligation</b>		
Beginning of year	135,825	3,499,730
Interest cost	-	103,497
Actuarial loss	-	181,850
Benefits paid and expenses	(135,825)	(3,649,252)
End of year	-	135,825
Funded status	\$ -	\$ (128,991)

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Amounts recognized in the balance sheets:

	<u>2015</u>	<u>2014</u>
Accrued pension liability - current	<u>\$ -</u>	<u>\$ 128,991</u>

Amounts recognized in unrestricted net assets but not yet recognized as components of net periodic benefit cost consist of:

	<u>2015</u>	<u>2014</u>
Net loss	<u>\$ -</u>	<u>\$ 49,042</u>

Information for pension plans with an accumulated benefit obligation in excess of plan assets:

	<u>2015</u>	<u>2014</u>
Accumulated benefit obligation	<u>\$ -</u>	<u>\$ 135,825</u>
Fair value of plan assets	<u>\$ -</u>	<u>\$ 6,834</u>
Components of net periodic benefit cost		
Interest cost	\$ -	\$ 103,497
Amortization of net loss	-	1,678,722
Expected return on plan assets	-	<u>(24,622)</u>
Net periodic benefit cost	<u>\$ -</u>	<u>\$ 1,757,597</u>

The following amounts have been recognized in the statements of operations and changes in net assets for the years ended September 30, 2015 and 2014:

	<u>2015</u>	<u>2014</u>
Amounts arising during the period		
Net loss	\$ -	\$ 227,951
Amounts reclassified as components of net periodic benefit cost of the period		
Net loss	-	1,678,722

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Significant assumptions include:

	2015	2014
Weighted-average assumptions used to determine benefit obligations		
Discount rate	0.00%	4.00%
Rate of compensation increase	0%	0%
Weighted-average assumptions used to determine benefit costs		
Discount rate	0.00%	4.00%
Expected return on plan assets	0.00%	1.00%
Rate of compensation increase	0%	0%

Effective December 31, 2013, the Plan was terminated. All participants' benefits were paid out prior to December 31, 2014.

**Note 13: Related Party Transactions**

A physician employed by the Medical Center operates an imaging company that provides services to the Medical Center. Amounts paid by the Medical Center to the imaging company were \$544,000 and \$521,000 in 2015 and 2014, respectively.

**Note 14: 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
- Level 3** Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

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**Recurring Measurements**

The following table presents the fair value measurements of assets and liabilities recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2015 and 2014:

	<b>2015</b>			
	<b>Fair Value Measurements Using</b>			
	<b>Fair Value</b>	<b>Quoted Prices in Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>
Fixed income investments				
Corporate bonds	\$ 48,015	\$ -	\$ 48,015	\$ -
Exchange traded funds	19,300	19,300	-	-
Domestic mutual funds	413,281	413,281		
Equity investments				
Money market mutual funds	46,284	46,284	-	-
Total internally designated assets limited as to use for capital improvements	<u>526,880</u>	<u>478,865</u>	<u>48,015</u>	<u>-</u>
Fixed income investments				
Corporate bonds	2,238,995	-	2,238,995	-
U.S. Government obligations	770,392	-	770,392	-
Exchange traded funds	76,361	76,361	-	-
Domestic mutual funds	2,650,288	2,650,288		
Equity investments				
Domestic mutual funds	299,884	299,884	-	-
International mutual funds	654,657	654,657	-	-
Common stock	1,854,477	1,854,477	-	-
Preferred stock	189,106	-	189,106	-
Real estate mutual funds	47,858	-	47,858	-
Real estate investment trusts	4,574	-	4,574	-
Foreign stock	32,099	32,099	-	-
Money market mutual funds	4,475,990	4,475,990	-	-
Total long-term investments	<u>13,294,681</u>	<u>10,043,756</u>	<u>3,250,925</u>	<u>-</u>
Total assets measured at fair value on a recurring basis	<u>\$ 13,821,561</u>	<u>\$ 10,522,621</u>	<u>\$ 3,298,940</u>	<u>\$ -</u>

**Pratt Regional Medical Center Corporation**  
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	2014			
	Fair Value Measurements Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Fixed income investments				
Corporate bonds	\$ 3,532,317	\$ -	\$ 3,532,317	\$ -
U.S. Treasury obligations	2,100,507	-	2,100,507	-
Equity investments				
Money market mutual funds	54,283	54,283	-	-
Total capital lease interest in unexpended bond funds	5,687,107	54,283	5,632,824	-
Fixed income investments				
Corporate bonds	241,750	-	241,750	-
Equity investments				
Domestic mutual funds	722,959	722,959	-	-
Common stock	26,475	26,475	-	-
Money market mutual funds	33,044	33,044	-	-
Total internally designated assets limited as to use for capital improvements	1,024,228	782,478	241,750	-
Fixed income investments				
Corporate bonds	2,238,626	-	2,238,626	-
U.S. Government obligations	493,463	-	493,463	-
Exchange traded funds	16,758	16,758	-	-
Equity investments				
Domestic mutual funds	4,145,751	4,145,751	-	-
International mutual funds	792,539	792,539	-	-
Common stock	2,327,797	2,327,797	-	-
Money market mutual funds	2,527,680	2,527,680	-	-
Total long-term investments	12,542,614	9,810,525	2,732,089	-
Total assets measured at fair value on a recurring basis	\$ 19,253,949	\$ 10,647,286	\$ 8,606,663	\$ -

Following is a description of the valuation methodologies and inputs used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended September 30, 2015.

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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.

**Fair Value of Financial Instruments**

The following table presents estimated fair values of the Medical Center's financial instruments and the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2015 and 2014.

	Carrying Amount	2015 Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Financial assets</b>				
Cash and cash equivalents	\$ 1,611,352	\$ 1,611,352	\$ -	\$ -
Assets limited as to use - held by trustee	3,750,003	3,750,003	-	-
Assets limited as to use for capital improvements (see breakout by type in table above)	526,880	478,865	48,015	-
Long-term investments (see breakout by type in table above)	9,544,678	10,043,756	3,250,925	-
Interest in net assets of Foundation	2,025,055	-	2,025,055	-
	<u>\$ 17,457,968</u>	<u>\$ 15,883,976</u>	<u>\$ 5,323,995</u>	<u>\$ -</u>
<b>Financial liabilities</b>				
Revenue bonds - Series 2007	\$ 2,980,000	\$ -	\$ 2,862,707	\$ -
Capital lease obligations	27,722,451	-	27,415,298	-
Note payable - Pratt County	51,133	-	47,235	-
	<u>\$ 30,753,584</u>	<u>\$ -</u>	<u>\$ 30,325,240</u>	<u>\$ -</u>

**Pratt Regional Medical Center Corporation**  
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	Carrying Amount	2014 Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Financial assets</b>				
Cash and cash equivalents	\$ 1,688,021	\$ 1,688,021	\$ -	\$ -
Assets limited as to use - held by trustee	2,327,252	2,327,252	-	-
Assets limited as to use for capital improvements (see breakout by type in table above)	6,711,335	836,761	5,874,574	-
Long-term investments (see breakout by type in table above)	10,215,362	9,810,525	2,732,089	-
Interest in net assets of Foundation	2,949,255	-	2,949,255	-
	<u>\$ 23,891,225</u>	<u>\$ 14,662,559</u>	<u>\$ 11,555,918</u>	<u>\$ -</u>
<b>Financial liabilities</b>				
Revenue bonds - Series 2007	\$ 3,590,000	\$ -	\$ 3,446,369	\$ -
Capital lease obligations	27,833,803	-	27,737,123	-
Note payable - Pratt County	63,917	-	68,678	-
Note payable - employed physician	37,530	-	36,843	-
Note payable - PIMG	79,520	-	77,017	-
	<u>\$ 31,604,770</u>	<u>\$ -</u>	<u>\$ 31,366,030</u>	<u>\$ -</u>

**Cash and Cash Equivalents**

The carrying amount approximates fair value.

**Interest in Net Assets of the Foundation**

Fair value is estimated at the present value of the future distributions expected to be received over the term of the agreement.

**Notes Payable and Long-term Debt**

Fair value is estimated based on the borrowing rates currently available to the Medical Center for bank loans with similar terms and maturities.

# Pratt Regional Medical Center Corporation

## Notes to Financial Statements

September 30, 2015 and 2014

### **Note 15: Significant Estimates and Concentrations**

Accounting principles generally accepted in the United States of America require disclosure of certain significant estimates and current vulnerabilities due to certain concentrations. Those matters include the following:

#### ***Allowance for Net Patient Service Revenue Adjustments***

Estimates of allowances for adjustments included in net patient service revenue are described in *Notes 1* and *2*.

#### ***Medical Malpractice Claims***

Estimates related to the accrual for medical malpractice claims are described in *Note 6*.

#### ***Admitting Physicians***

The Medical Center is served by 18 admitting physicians whose patients comprise approximately 79% of the Medical Center's net patient service revenue.

#### ***Litigation***

In the normal course of business, the Medical Center 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 Medical Center's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Medical Center evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

#### ***Investments***

The Medical Center 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 change could materially affect the amounts reported in the accompanying balance sheets.