



SOUTHWEST HEALTH SYSTEM, INC.

FINANCIAL STATEMENTS

DECEMBER 31, 2021 AND 2020

CPAs / ADVISORS



SOUTHWEST HEALTH SYSTEM, INC.

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REPORT OF INDEPENDENT AUDITORS

Board of Directors
Southwest Health System, Inc.
Cortez, Colorado

Report on the Audit of Financial Statements

Opinion

We have audited the accompanying financial statements of Southwest Health System, Inc. (the "Health System"), which comprise the balance sheets as of December 31, 2021 and 2020, and the related statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Health System as of December 31, 2021 and 2020, and 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.

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Accounting Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Health System and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Health System's ability to continue as a going concern within one year after the date that the financial statements are available to be issued.

Board of Directors
Southwest Health System, Inc.
Cortez, Colorado

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is substantial likelihood that, individually or in the aggregate, they would influence the judgement made by a reasonable user based on the financial statements.

In performing an audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Health System's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Health System's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Board of Directors
Southwest Health System, Inc.
Cortez, Colorado

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 14, 2022, on our consideration of the Health System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Health System's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Health System's internal control over financial reporting and compliance.

Blue & Co., LLC

Louisville, Kentucky
April 14, 2022

SOUTHWEST HEALTH SYSTEM, INC.

BALANCE SHEETS DECEMBER 31, 2021 AND 2020

ASSETS

	2021	2020
Current assets		
Cash and cash equivalents	\$ 11,924,325	\$ 10,604,094
Restricted cash	400,000	585,289
Short-term investments	2,296,299	2,216,936
Patient accounts receivable, net	6,879,467	5,650,993
Inventories	1,832,726	1,802,177
Prepaid expenses and other current assets	1,316,979	1,001,822
Other assets, current portion	13,168	24,197
Total current assets	24,662,964	21,885,508
Assets whose use is limited	4,650,135	4,398,200
Property and equipment, net	37,194,635	38,309,408
Other assets, net of current portion	223,005	244,129
Total assets	\$ 66,730,739	\$ 64,837,245

See accompanying notes to financial statements.

SOUTHWEST HEALTH SYSTEM, INC.

BALANCE SHEETS
DECEMBER 31, 2021 AND 2020

LIABILITIES AND NET ASSETS

	<u>2021</u>	<u>2020</u>
Current liabilities		
Accounts payable	\$ 4,443,891	\$ 4,391,977
Accrued personnel costs	2,651,420	2,800,979
Accrued expenses	12,131	7,264
Estimated third-party payor settlements	4,873,870	1,615,033
Refundable advances, current portion	3,066,925	2,594,128
Current portion of long-term obligations	<u>3,183,410</u>	<u>2,314,471</u>
Total current liabilities	18,231,647	13,723,852
Long-term liabilities		
Long-term debt, net of current portion	28,513,663	29,070,366
Deferred compensation liabilities	731,030	541,244
Refundable advances, net of current portion	<u>-0-</u>	<u>3,540,104</u>
Total long-term liabilities	<u>29,244,693</u>	<u>33,151,714</u>
Total liabilities	47,476,340	46,875,566
Net assets without donor restrictions	<u>19,254,399</u>	<u>17,961,679</u>
Total liabilities and net assets	<u>\$ 66,730,739</u>	<u>\$ 64,837,245</u>

See accompanying notes to financial statements.

SOUTHWEST HEALTH SYSTEM, INC.

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2021 AND 2020

	2021	2020
Operating revenues		
Net patient service revenue	\$ 63,931,761	\$ 52,811,742
Paycheck protection program revenue	-0-	5,038,044
Provider relief fund revenue	2,876,597	5,293,145
Other operating revenue	4,031,507	2,639,314
Total operating revenues	70,839,865	65,782,245
Operating expenses		
Salaries and wages	34,316,883	29,585,771
Employee benefits and payroll taxes	5,204,882	7,015,264
Professional fees	1,661,948	2,008,957
Purchased services	5,113,191	5,195,525
Drugs and medical supplies	9,052,471	7,462,062
Other supplies	1,136,365	1,006,297
Depreciation	4,214,098	4,421,176
Repairs and maintenance	2,389,293	2,542,953
Utilities	1,052,983	985,118
Insurance	952,727	1,052,137
Rent	1,182,372	1,439,282
Interest	1,599,069	1,657,204
Provider tax	2,032,856	2,055,511
Other operating expenses	1,914,084	1,369,260
Total operating expenses	71,823,222	67,796,517
Income (loss) from operations	(983,357)	(2,014,272)
Nonoperating revenues (expenses)		
Sales tax and proceeds	2,069,420	1,690,978
Investment income (loss), net	141,673	250,723
Gain (loss) on disposal of property and equipment	(143,681)	(20,618)
Contributions	208,665	879,989
Total nonoperating revenues (expenses)	2,276,077	2,801,072
Excess revenues (expenses) and change in net assets	1,292,720	786,800
Net assets, beginning of year	17,961,679	17,174,879
Net assets, end of year	\$ 19,254,399	\$ 17,961,679

See accompanying notes to financial statements.

SOUTHWEST HEALTH SYSTEM, INC.

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2021 AND 2020

	2021	2020
Operating activities		
Change in net assets	\$ 1,292,720	\$ 786,800
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	4,214,098	4,421,176
Amortization of bond issue costs included in interest expense	87,014	80,935
(Gain) loss on disposal of property and equipment	143,681	20,618
Net realized gains and losses and unrealized gains and losses on investments and assets whose use is limited	(69,993)	(102,604)
Changes in operating assets and liabilities		
Patient accounts receivable	(1,228,474)	(166,078)
Inventories	(30,549)	(142,379)
Prepaid expenses and other current assets	(315,157)	468,857
Accounts payable	51,914	(131,435)
Accrued personnel costs	(149,559)	(299,281)
Accrued expenses	4,867	(27,564)
Estimated third-party payor settlements	3,258,837	1,200,209
Refundable advances	(3,067,307)	6,134,232
Deferred compensation liabilities	189,786	122,603
Net cash flows from operating activities	4,381,878	12,366,089
Investing activities		
Purchases of property and equipment	(3,246,931)	(2,971,016)
Proceeds from sale of property and equipment	3,925	-0-
Change in investments and assets whose use is limited	(261,305)	(544,334)
Change in other assets	32,153	36,555
Net cash flows from investing activities	(3,472,158)	(3,478,795)
Financing activities		
Borrowings on long-term debt	2,657,623	342,376
Principal payments on long-term debt	(2,432,401)	(2,070,453)
Net cash flows from financing activities	225,222	(1,728,077)
Net change in cash and cash equivalents	1,134,942	7,159,217
Cash, restricted cash, and cash equivalents, beginning of year	11,189,383	4,030,166
Cash, restricted cash, and cash equivalents, end of year	\$ 12,324,325	\$ 11,189,383
Reconciliation of cash and cash equivalents to the balance sheets		
Cash and cash equivalents in current assets	\$ 11,924,325	\$ 10,604,094
Restricted cash	400,000	585,289
Total cash, restricted cash, and cash equivalents	\$ 12,324,325	\$ 11,189,383
Supplemental disclosure of cash flow information		
Cash paid during the year for interest	\$ 1,512,055	\$ 1,576,269

See accompanying notes to financial statements.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

1. NATURE OF OPERATIONS

Southwest Health System, Inc. (the "Health System") was incorporated on March 8, 1996, for the purpose of operating Southwest Memorial Hospital. The Health System operates an acute-care hospital and clinic located in Cortez, Colorado. Montezuma County Hospital District ("MCHD"), a political subdivision of the State of Colorado, on September 14, 1996, under the terms of a lease agreement, as amended, transferred the operations, including substantially all net operating assets, to the Health System.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed by the Health System in the preparation of the financial statements are summarized below:

Financial Statement Presentation

The Financial Accounting Standards Board ("FASB") is the independent, private-sector organization that establishes accounting and financial reporting standards for public and private companies and not-for-profit organizations that follow accounting principles generally accepted in the United States of America. The Health System follows FASB accounting and financial reporting standards in the preparation of their financial statements.

Basis of Accounting

The Health System prepares its financial statements using the accrual basis of accounting. Accrual accounting requires the recognition of revenues when its performance obligations are satisfied, and the recognition of expenses in the period in which they occur.

Basis of Presentation

The accompanying financial statements have been prepared on the accrual basis, and have been prepared with a focus on the entity as a whole. Net assets, revenue, support, gains, and losses are classified based on the existence or absence of donor restrictions. Accordingly, the net assets of the Health System are classified and reported as follows:

Net assets without donor restrictions: Net assets that are currently available for operating purposes under the direction of the board or designated by the board for specific use.

Net assets with donor restrictions: Net assets subject to donor stipulations for specific operating purposes or time restrictions. These include donor restrictions requiring the net assets be held in perpetuity or for a specified term with investment return available for operations or specific purposes.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

Management's Estimates

Management uses estimates and assumptions in preparing the financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, if any, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

Cash, Restricted Cash, and Cash Equivalents

Cash and cash equivalents include investments in highly liquid assets with maturity dates of three months or less when purchased, excluding amounts reported in assets whose use is limited. Restricted cash includes grant funding received prior to satisfaction of the associated terms and conditions present for use or repayment of the funds.

Patient Accounts Receivable and Net Patient Service Revenue

Net patient service revenue is reported at the amount that reflects the consideration to which the Health System expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payors (including health insurers and government programs), and others, and include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews, and investigations. Generally, the Health System bills the patients and third-party payors several days after the services are performed or the patient is discharged from the facility. Revenue is recognized as performance obligations are satisfied.

Performance obligations are determined based on the nature of the services provided by the Health System. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. The Health System believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the Health System receiving inpatient acute care services or patients receiving services in the outpatient center. The Health System measures the performance obligation from admission into the Health System, or the commencement of an outpatient service, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to our patients and customers in a retail setting (for example, pharmaceuticals and medical equipment) and the Health System does not believe it is required to provide additional goods or services related to that sale.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Health System has elected to apply the optional exemption provided in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 606-10-50-14a and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to previously are primarily related to inpatient acute care

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The Health System determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payors, discounts provided to uninsured patients in accordance with the Health System's policy, and implicit price concessions provided to uninsured patients. The Health System determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies, and historical experience. The Health System determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

Inventories

Inventories consist of medical supplies, pharmaceuticals, and office supplies and are valued at the lower of cost or net realizable value, with cost being determined on the first-in, first-out ("FIFO") method.

Investments and Assets Whose Use Is Limited

Assets limited as to use include annual proceeds from a 0.4% sales and use tax approved by voters of MCHD for facility expansion, assets held by trustee under indenture agreement, and a board-designated fund for future capital improvements and other long-term uses, over which the Board retains control and may at its discretion subsequently use for other purposes.

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair market value in the balance sheets. Investment income or loss, including unrealized gains and losses on securities, interest, and dividends is included in nonoperating gains of net assets without donor restrictions, unless the income is restricted by donor or law.

Property and Equipment

Property and equipment are recorded at cost, except for donations, which are recorded at the fair market value at the date of the donation. Property and equipment include expenditures for additions and repairs which substantially increase the useful lives of existing property and equipment. Maintenance, repairs, and minor improvements are expensed as incurred.

The property and equipment of the Health System are being depreciated using the straight-line method of depreciation over their estimated useful lives based upon the American Hospital Association's *Estimated Useful Lives of Depreciable Hospital Assets*.

Statements of Operations and Changes in Net Assets

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of healthcare services are reported as operating revenues and expenses and included within the

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

line *income (loss) from operations* in the statements of operations and changes in net assets. Peripheral and incidental transactions are reported as nonoperating revenues (expenses). Nonoperating revenues (expenses) which are excluded from *income (loss) from operations* include sales use and tax proceeds, contributions and donations, investment income or loss, and gain or loss on disposal of property and equipment.

Performance Indicator

The statements of operations and changes in net assets include *excess revenues (expenses)*. Consistent with industry practice, changes in net assets which are excluded from *excess revenues (expenses)* include, if any, permanent transfers of assets to and from affiliates for other than goods and services, and contributions of long-lived assets (including assets acquired using contributions which by donor restriction were to be used for the purposes of acquiring such assets).

Advertising and Marketing Costs

Advertising and marketing costs are charged to operations when incurred. Advertising and marketing costs charged to operations were \$33,362 and \$82,763 for the years ended December 31, 2021 and 2020, respectively.

Claims Reserves

The Health System provides for self-insurance reserves for estimated incurred but not reported claims for its employee health plan (Note 15). The gross liability, prior to insurance coverage, is reflected on the balance sheets within accrued personnel costs. The reserve is estimated based upon historical submission and payment data, cost trends, utilization history, and other relevant factors. Adjustments to reserves are reflected in the operating results in the period in which the change in estimate is identified.

Debt Issuance Costs

Debt issuance costs are amortized over the period of the related obligation is outstanding using the effective interest method. Debt issuance costs are included within the long-term debt on the balance sheets. Amortization of debt issuance costs is included in interest expense in the accompanying financial statements.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets to the Health System are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give, if any, are reported at fair value at the date the gift is received. The gifts are reported as revenue with donor restrictions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported in the

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as contributions without donor restrictions in the accompanying financial statements.

Income Taxes

The Health System is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. As such, the Health System is generally exempt from income taxes. However, the Health System is required to file Federal Form 990 – Return of Organization Exempt from Income Tax which is an informational return only.

Accounting principles generally accepted in the United States of America require management to evaluate tax positions taken by the Health System and recognize a tax liability if the Health System has taken an uncertain tax position that more likely than not would not be sustained upon examination by various federal and state taxing authorities. Management has analyzed the tax positions taken by the Health System, and has concluded that as of December 31, 2021 and 2020, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the accompanying financial statements. The Health System is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress.

Sales and Use Taxes

In November, 2015, MCHD levied a 0.4% sales and use tax for a period of 15 years with the proceeds designated for the Health System. The Health System recognizes the revenue as the taxes are collected by MCHD and records a receivable for the amounts collected that have not been received from MCHD.

Risk Management

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

Going Concern Evaluations

Management evaluates whether there are conditions or events that raise substantial doubt about the entity's ability to continue as a going concern for a period of one year from the date the financial statements were available to be issued.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

Reclassifications

Certain 2019 amounts have been reclassified to provide for consistency with reporting of 2020 information. These reclassifications have no effect on the previously reported total change in net assets or net assets.

Subsequent Events

The Health System has evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying financial statements through the date the financial statements were available to be issued, which is April 14, 2022.

3. LEASE OF HOSPITAL FACILITIES

The Health System leases the property and equipment of Southwest Memorial Hospital from MCHD under a lease, as amended on November 17, 2016. The lease provides that the property and equipment of the hospital facility be leased to the Health System and will expire on September 30, 2051. In the event of expiration, termination, or default of the lease, substantially all of the assets under the lease will revert to MCHD. Under this lease, the Health System is responsible for all costs, expenses, and obligations of every kind and nature relating to the use and occupancy of the leased premises. The Health System is required to comply with all covenants imposed on MCHD by the Bond Indenture and is required to meet certain financial covenants, as defined in the lease. As consideration for this lease, the Health System is required to pay the principal, premium, interest, and all other obligations required by the Bond Indenture in addition to \$3,500 annually. In November 2015, voters of the MCHD approved a sales and use tax of 0.4%, from which the annual proceeds are to be used to reimburse the Health System for the costs of the facility expansion project and related financing costs.

4. SHORT-TERM INVESTMENTS AND ASSETS WHOSE USE IS LIMITED

Total short-term investments consist of the following at December 31, 2021 and 2020:

	<u>2021</u>	<u>2020</u>
Money market funds	\$ 59,731	\$ 71,228
Mutual funds	1,694,596	1,624,393
Exchange-traded funds	<u>541,972</u>	<u>521,315</u>
Total short-term investments	<u>\$ 2,296,299</u>	<u>\$ 2,216,936</u>

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

Assets whose use is limited are reported at market value and cost that approximates market value, and consist of the following at December 31, 2021 and 2020:

	2021	2020
Certificates of deposit	\$ 382,270	\$ 377,792
Money market funds	1,852,908	1,858,305
Mutual funds	1,906,759	1,668,264
Exchange-traded funds	376,049	361,690
Sales and use tax receivable	132,149	132,149
Total assets whose use is limited	<u>\$ 4,650,135</u>	<u>\$ 4,398,200</u>

	2021	2020
Board-designated funds	\$ 1,972,164	\$ 1,910,221
Trustee-held under debt agreement	1,814,792	1,814,586
Sales and use tax receivable	132,149	132,149
Deferred compensation fund	731,030	541,244
Total assets whose use is limited	<u>\$ 4,650,135</u>	<u>\$ 4,398,200</u>

Investment income is comprised of the following for the years ended December 31, 2021 and 2020:

	2021	2020
Dividends and interest income	\$ 93,668	\$ 185,500
Realized gains (losses) on investments	(65,395)	(88,170)
Change in market value of investments	135,388	190,774
Investment fees	(21,988)	(37,381)
Total investment income (loss), net	<u>\$ 141,673</u>	<u>\$ 250,723</u>

Board-Designated Funds

The Health System's Board of Directors designated certain assets to meet the capital asset and other long-term needs of the facility. All income amounts earned by the Board-designated funds are left to accumulate as additions to the funds.

Trustee-Held Under Debt Agreement

The trustee-held funds are restricted for the payments of principal, interest, and construction costs related to certain long-term debt agreements.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

Deferred Compensation Funds

The deferred compensation funds represent assets that have accumulated under the deferred compensation plan. The Health System simply maintains the funds for the participants until they are withdrawn according to the specific terms of the deferred compensation agreement. The Health System records a liability equal to the deferred compensation assets.

Fair Value Measurements and Disclosures

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described as follows:

- Level 1: Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Health System has the ability to access.
- Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2021 and 2020.

- *Certificate of deposits*: Valued at cost which approximates fair value.
 - *Money market funds*: Generally transact subscription and redemption activity at a \$1 stable net asset value (NAV). However, on a daily basis the funds are valued at their daily NAV calculated using the amortized cost of the securities held in the fund.
 - *Mutual funds*: Valued at the daily closing price as reported by the fund. Mutual funds held by the Health System are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value and to transact at that price. The mutual funds held by the Health System are deemed to be actively traded.
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SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

- *Exchange-traded funds (ETFs):* Valued at the closing price on the active exchange on which the individual securities are traded. Unlike mutual funds, ETFs trade like common stocks and are not required to publish and transact their daily net asset value. The ETFs held by the Health System are deemed to be actively traded.

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2021 are as follows:

	Level 1	Level 2	Level 3	Total
Investments and assets whose use is limited				
Money market funds	\$ -0-	\$ 1,912,639	\$ -0-	\$ 1,912,639
Exchange-traded funds	918,021	-0-	-0-	918,021
Mutual funds				
Consumer cyclical	1,096,567	-0-	-0-	1,096,567
Diversified emerging markets	79,674	-0-	-0-	79,674
Financial services	222,026	-0-	-0-	222,026
Foreign	210,265	-0-	-0-	210,265
High-yield bond	396,319	-0-	-0-	396,319
Intermediate core-plus bond	26,230	-0-	-0-	26,230
Large cap	597,588	-0-	-0-	597,588
Mid cap	42,820	-0-	-0-	42,820
Nontraditional bond	459,657	-0-	-0-	459,657
Short-term bond	6,245	-0-	-0-	6,245
Small cap	198,985	-0-	-0-	198,985
Target date	264,979	-0-	-0-	264,979
Total mutual funds	<u>3,601,355</u>	<u>-0-</u>	<u>-0-</u>	<u>3,601,355</u>
Total assets at fair value	<u>\$ 4,519,376</u>	<u>\$ 1,912,639</u>	<u>\$ -0-</u>	<u>6,432,015</u>
Certificates of deposit				382,270
Sales and use tax receivable				132,149
Total investments and assets whose use is limited				<u><u>\$ 6,946,434</u></u>

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2020 are as follows:

	Level 1	Level 2	Level 3	Total
Investments and assets whose use is limited				
Money market funds	\$ -0-	\$ 1,929,533	\$ -0-	\$ 1,929,533
Exchange-traded funds	883,005	-0-	-0-	883,005
Mutual funds				
Basic materials	17,668	-0-	-0-	17,668
Consumer cyclical	25,641	-0-	-0-	25,641
Diversified emerging markets	83,079	-0-	-0-	83,079
Domestic core taxable	1,507,624	-0-	-0-	1,507,624
Financial services	184,965	-0-	-0-	184,965
Foreign	187,229	-0-	-0-	187,229
High-yield bond	209,095	-0-	-0-	209,095
Industrials	2,180	-0-	-0-	2,180
Intermediate core-plus bond	9,688	-0-	-0-	9,688
Large cap	451,559	-0-	-0-	451,559
Managed futures	219,770	-0-	-0-	219,770
Mid cap	18,594	-0-	-0-	18,594
Small cap	135,004	-0-	-0-	135,004
Target date	239,350	-0-	-0-	239,350
Technology	1,211	-0-	-0-	1,211
Total mutual funds	<u>3,292,657</u>	<u>-0-</u>	<u>-0-</u>	<u>3,292,657</u>
Total assets at fair value	<u>\$ 4,175,662</u>	<u>\$ 1,929,533</u>	<u>\$ -0-</u>	<u>6,105,195</u>
Certificates of deposit				377,792
Sales and use tax receivable				132,149
Total investments and assets whose use is limited				<u><u>\$ 6,615,136</u></u>

The Health System's policy is to recognize transfers between levels as of the end of the reporting period. There were no significant transfers between levels 1 and 2 during 2021 and 2020.

Risks and Uncertainties

The national and world-wide investment market conditions can be volatile. The Health System holds investment in certificates of deposit, money market funds, mutual funds, and exchange-traded funds. Such investments are exposed to various risks such as interest rate, market, and credit. Due to the level of risk associated with these securities and the level of uncertainty related to changes in value, it is at least reasonable possible that changes in the various risk factors will occur in the near term that could materially affect the amounts reported in the accompanying financial statements. The Health System's management is currently unable to determine the effect, if any, the decline in the market conditions may ultimately have on the Health System's investment portfolio and ability to fund certain projects.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

5. PROPERTY AND EQUIPMENT, NET

Property and equipment, net consists of the following at December 31, 2021 and 2020:

	<u>2021</u>	<u>2020</u>
Land and land improvements	\$ 1,047,048	\$ 1,049,233
Buildings and improvements	53,046,329	52,473,500
Fixtures and equipment	30,737,958	29,206,087
Vehicles	839,723	799,649
Construction in progress	-0-	92,763
	<u>85,671,058</u>	<u>83,621,232</u>
Less accumulated depreciation	<u>(48,476,423)</u>	<u>(45,311,824)</u>
Property and equipment, net	<u>\$ 37,194,635</u>	<u>\$ 38,309,408</u>

Impairment of Property and Equipment

The Health System 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 estimate 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. The Health System did not recognize a loss on impairment of property and equipment for the years ended December 31, 2021 and 2020, respectively.

Conditional Asset Retirement Obligation

FASB ASC Topic 410 ("Topic 410") clarified when an entity is required to recognize a liability for a conditional asset retirement obligation. The Health System has considered Topic 410, specifically as it relates to its legal obligation to perform asset retirement activities, such as asbestos removal, on its existing properties. The Health System believes there is an indeterminate settlement date for the asset retirement obligations, if any, because the range of time over which the Health System may settle the obligations is unknown and cannot be estimated. As a result, as of December 31, 2021 and 2020, the Health System cannot reasonably estimate a liability related to these potential asset retirement activities nor determine conclusively that a liability exists.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

6. OTHER ASSETS

Other assets consist of the following at December 31, 2021 and 2020:

	<u>2021</u>	<u>2020</u>
Interest in net assets of Foundation	\$ 186,173	\$ 190,505
Employee notes receivable	<u>50,000</u>	<u>77,821</u>
Total other assets	236,173	268,326
Other assets, current portion	<u>(13,168)</u>	<u>(24,197)</u>
Other assets, net of current portion	<u>\$ 223,005</u>	<u>\$ 244,129</u>

The Health System records a 100 percent interest in the net assets of Southwest Memorial Hospital Foundation, Inc. (the "Foundation"). The Foundation was established to solicit contributions from the general public for the funding of capital acquisitions by the Health System. Funds are distributed to the Health System as determined by the Foundations' Board of Directors.

Employee notes receivable amounts include balances due from employees as part of a loan program offered to reimburse employees for tuition costs. Under the terms of the program, employees notes are forgiven as long as they remained employed by the Health System during the note term. The notes bear no interest and mature on various dates through April, 2023. If the employees meet the period-of-service requirement, the Health System will forgive these notes. If the employees do not meet the period-of-service requirement, the notes will be repaid on a prorata basis.

7. LONG-TERM DEBT

At December 31, 2021 and 2020, the Health System was obligated for long-term debt agreements as follows:

	<u>2021</u>	<u>2020</u>
Privately placed Montezuma County, Colorado Revenue Bonds, Southwest Memorial Hospital Project Series 2016A, due in varying monthly principal and interest payments ranging from \$46,000 to \$300,000, fixed interest rate of 4.72%, due December 2046. Secured by substantially all assets of the Health System.	\$ 29,743,458	\$ 31,890,586

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

	2021	2020
Various promissory notes under a resolution to borrow with Vectra Bank, with maturity dates ranging from December 2022 to December 2025; fixed interest rates ranging from 4.50% to 5.10%. Monthly payments of principal and interest ranging from \$10,618 to 19,765. Collateralized by various equipment (carrying amounts totaling \$2,073,057 at December 31, 2021).	2,714,726	342,376
	32,458,184	32,232,962
Less current portion	(3,183,410)	(2,314,471)
Less debt issuance costs	(761,111)	(848,125)
Total long-term debt, net of current portion	<u>\$ 28,513,663</u>	<u>\$ 29,070,366</u>

Maturities of long-term debt subsequent to December 31, 2021, are as follows:

Year Ending December 31,	Principal
2022	\$ 3,183,410
2023	3,140,590
2024	3,072,430
2025	2,997,334
2026	2,592,761
Thereafter	17,471,659
Total long-term debt	<u>\$ 32,458,184</u>

Under the terms of the bond agreement, the Health System is required to maintain certain deposits with a trustee. These deposits are included with assets whose use is limited on the balance sheets. The agreement also requires that the Health System maintain various restrictive covenants, including limits on additional indebtedness, submission of audited financial statements, minimum days cash on hand ratio, minimum debt service coverage ratio, and maximum debt to capitalization ratio. The Health System did not meet the financial covenants related to debt service coverage as of December 31, 2018, which was considered an event of default, and also did not meet the financial covenant related to minimum liquidity for four consecutive quarters during 2018. In November, 2018, the Health System entered into a forbearance agreement with the lenders and engaged a financial consultant, as required by the covenants, to provide recommendations for operational improvement. The forbearance agreement revised the debt service and minimum liquidity covenants, which increased at intervals through June 30, 2021. Management believes the Health System was in compliance with all restrictive covenants at December 31, 2021.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

Effective December 31, 2019, the forbearance agreement was amended. As part of the amendment, the Health System was extended a \$3,000,000 lease guidance facility that is to be utilized for capital improvements. In addition, the Health System was extended a \$250,000 commercial line of credit. There was no outstanding balance on the line of credit as December 31, 2021 or 2020.

8. NET PATIENT SERVICE REVENUE

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigation and/or allegations concerning possible violations of fraud and abuse statutes and/or regulations by health care providers. Laws and regulations concerning government programs, including Medicare and Medicaid, are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. The Health System believes that it is in compliance with all applicable laws and regulations.

Settlements with third-party payors for retroactive adjustments due to audits, reviews, or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payor, correspondence from the payor, and the Health System's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known (that is, new information becomes available), or as years are settled or are no longer subject to such audits, reviews, and investigations. Adjustments arising from a change in the transaction price were not significant in 2021 and 2020.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Health System also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. The Health System estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to net patient service revenue in the period of the change. For the years ended December 31, 2021 and 2020, adjustments were recognized due to changes in the Health System's estimates of implicit price concessions, discounts, and contractual adjustments for performance obligations satisfied in prior years were not significant. Subsequent changes that are significant and

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

determined to be the result of an adverse change in the patient's ability to pay are recorded as bad debt expense.

Consistent with the Health System's mission, care is provided to patients regardless of their ability to pay. Therefore, the Health System has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances (for example, copays and deductibles). The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts the Health System expects to collect based on its collection history with those patients.

Patients who meet the Health System's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

The Health System has determined that the nature, amount, timing, and uncertainty of revenue and cash flows are affected by the following factors: payors, geography, service lines, method of reimbursement, and timing of when revenue is recognized. The following tables provide details of these factors.

The composition of net patient service revenue by primary payor for the years ended December 31, 2021 and 2020 is as follows:

	<u>2021</u>	<u>2020</u>
Medicare	\$ 25,912,072	\$ 20,414,240
Medicaid	16,559,506	14,883,771
Commercial, managed care, and other	20,572,304	16,832,382
Self pay patients	<u>887,879</u>	<u>681,349</u>
	<u>\$ 63,931,761</u>	<u>\$ 52,811,742</u>

Revenue from patient's deductibles and coinsurance are included in the preceding categories based on the primary payor.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

The composition of net patient service revenue based on its lines of business and timing of revenue recognition for the years ended December 31, 2021 and 2020, are as follows:

	2021	2020
Service Lines		
Inpatient	\$ 18,801,364	\$ 16,188,609
Outpatient	29,705,025	23,650,649
Clinical services	9,924,598	8,880,993
Ambulance	5,500,774	4,091,491
	\$ 63,931,761	\$ 52,811,742

The Health System grants credit without collateral to its patients, most of who are local residents and insured under third-party payor agreements. The mix and concentration of gross patient service revenue and patient accounts receivable at December 31, 2021 and 2020 is as follows:

	2021		2020	
	Revenues	Receivables	Revenues	Receivables
Medicare	42 %	22 %	42 %	23 %
Medicaid	29	10	29	10
Commercial, managed care, and other	24	27	24	25
Self Pay	5	41	5	42
	100 %	100 %	100 %	100 %

The Health System has agreements with third-party payors that provide for payments to the Health System at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

- **Medicare.** The Health System is a provider of services to patients entitled to coverage under Title XVIII ("Medicare") of the Health Insurance Act. The Health System is designated as a Critical Access Hospital ("CAH") by Medicare and is paid for Medicare services based upon a cost reimbursement methodology. The Health System is reimbursed for cost reimbursable items at an interim rate, with final settlement determined after submission of annual cost reports. Differences between the total program billed charges and the payments received are reflected as deductions from revenue. At the Health System's year-end, a cost report is filed with the Medicare program computing reimbursement amounts related to Medicare patients. Clinical services are paid on a cost basis or fixed fee schedule.
- **Medicaid.** The Health System is a provider of services to patients entitled to coverage under Title XIX ("Medicaid") of the Health Insurance Act. After November 1, 2016, the Health System is reimbursed for Medicaid inpatient and outpatient services under prospectively determined rates-per-discharge and is not subject to retroactive adjustment. The differences between standard charges and

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

reimbursement from these programs are recorded as deductions from revenue. Outpatient services prior to November 1, 2016 related to Medicaid beneficiaries are paid at interim rates based on the Medicaid cost-to-charge ratio. Retrospective settlements based on audited cost-to-charge ratios are made periodically.

The Health System participates in the State of Colorado provider fee program, approved by the Centers for Medicare and Medicaid Services ("CMS"), under which all hospitals in the state are assessed a fee based on bed size and payor mix. The state of Colorado uses the fees to supplement state budget funds for the Medicaid program, which brings matching federal monies into the program, enabling the state of Colorado to fund Medicaid payments to hospitals at a higher rate than would otherwise be possible. The Health System recorded \$2,032,856 and \$2,055,511 in provider fees for the years ended December 31, 2021 and 2020, respectively, which are recorded as a part of operating expenses. The Health System recorded \$8,878,809 and \$7,848,659 of supplemental payments for the years ended December 31, 2021 and 2020, respectively, which are recorded as part of net patient service revenue.

- **Other.** The Health System has also entered into preferred provider agreements with certain commercial insurance carriers. The basis for payment to the Health System under these arrangements includes prospectively determined rates per discharge, discounts from established charges, and fee schedule payments.
- **Charity Care and Uninsured Discounts.** The Health System provides care without charge or at less than its established rates to patients who meet certain criteria under its charity care policy. Because the Health System does not collect amounts deemed to be charity care, they are not reported as revenue. The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associating with providing care to charity patients. The ratio of cost to charges is calculated based on the Health System's total operating expenses divided by gross patient service revenue. For the years ended December 31, 2021 and 2020, the Health System incurred estimated charity costs of \$659,183 and \$873,890, respectively.

The Centers for Medicare and Medicaid Services ("CMS") has been granted authority to suspend payments, in whole or in part, to Medicare providers if CMS possess reliable information on overpayment, fraud or if willful misrepresentation exists. If CMS suspects payments are being made as the result of fraud or misrepresentation, CMS may suspend payment at any time without providing prior notice to the Health System. The initial suspension period is limited to 180 days. However, the payment suspension period can be extended indefinitely if the matter is under investigation by the United States Department of Health and Human Services Office of Inspector General or the United States Department of Justice. Therefore, the Health System is unable to predict if or when it may be subject to a suspension of payments by the Medicare and/or Medicaid programs, the possible length of the suspension period, or the potential cash flow impact of a payment suspension. Any such suspension would adversely impact the Health System's financial position, results of operations, and cash flows.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

9. DEFINED CONTRIBUTION RETIREMENT PLANS

The Health System offers its employees a 403(b) tax deferred annuity plan. Employees are eligible to receive employer contributions on January 1 or July 1 following the date that the employee has completed one year of service and reached the age of 21. Participating employees may authorize the Health System to deduct a portion of their pay to contribute to the plan. Employee contributions are matched by the Health System up to 2% of the qualified employee salaries. For the years ended December 31, 2021 and 2020, the amount of retirement expense was \$348,591 and \$467,207, respectively.

The Health System also offers a 457 deferred compensation plan to employees meeting certain criteria. Eligible employees may elect to defer a percentage of their compensation into the plan. As the assets of the plan are still considered to be those of the Health System under IRS regulations, the balance in these accounts is included in assets whose use is limited on the balance sheets and a corresponding liability has been recorded in deferred compensation liabilities on the balance sheets.

10. OPERATING LEASES

The Health System leases certain equipment and building space under noncancelable operating leases expiring through 2026. Minimum future rental payments under these noncancelable operating leases as of December 31, 2021, are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2022	\$ 620,613
2023	559,212
2024	479,740
2025	440,004
2026	<u>440,004</u>
Total	<u>\$ 2,539,573</u>

The Health System incurred \$1,182,372 and \$1,439,282 in total rent expense for the years ended December 31, 2021 and 2020, respectively, under both cancelable and noncancelable leases.

11. CONCENTRATIONS OF CREDIT RISK

The Health System's cash balances are maintained in various bank deposit accounts. At various times during the year, the balance of these deposits may be in excess of federally insured limits. To date, the Health System has not experienced losses in any of these accounts. The Health System believes it is not exposed to any significant credit risk on cash.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

12. FUNCTIONAL EXPENSES

The Health System provides general healthcare services to residents within its geographic area. Expenses related to providing these services are broken down as follows for the years ended December 31, 2021 and 2020:

	2021		
	Healthcare Services	General and Administrative	Total
Salaries and wages	\$ 31,914,701	\$ 2,402,182	\$ 34,316,883
Employee benefits and payroll taxes	4,840,540	364,342	5,204,882
Professional fees	1,661,948	-0-	1,661,948
Purchased services	4,755,268	357,923	5,113,191
Drugs and medical supplies	9,052,471	-0-	9,052,471
Other supplies	1,056,819	79,546	1,136,365
Depreciation	3,919,111	294,987	4,214,098
Repairs and maintenance	2,222,042	167,251	2,389,293
Utilities	979,274	73,709	1,052,983
Insurance	886,036	66,691	952,727
Rent	1,099,606	82,766	1,182,372
Interest	1,487,134	111,935	1,599,069
Provider tax	2,032,856	-0-	2,032,856
Other operating expenses	1,780,098	133,986	1,914,084
Total operating expenses	\$ 67,687,904	\$ 4,135,318	\$ 71,823,222
	2020		
	Healthcare Services	General and Administrative	Total
Salaries and wages	\$ 27,514,767	\$ 2,071,004	\$ 29,585,771
Employee benefits and payroll taxes	6,524,196	491,068	7,015,264
Professional fees	2,008,957	-0-	2,008,957
Purchased services	4,831,838	363,687	5,195,525
Drugs and medical supplies	7,462,062	-0-	7,462,062
Other supplies	935,856	70,441	1,006,297
Depreciation	4,111,694	309,482	4,421,176
Repairs and maintenance	2,364,946	178,007	2,542,953
Utilities	916,160	68,958	985,118
Insurance	978,487	73,650	1,052,137
Rent	1,338,532	100,750	1,439,282
Interest	1,541,200	116,004	1,657,204
Provider tax	2,055,511	-0-	2,055,511
Other operating expenses	1,273,412	95,848	1,369,260
Total operating expenses	\$ 63,857,618	\$ 3,938,899	\$ 67,796,517

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

The financial statements report certain categories of expenses that are attributable to one or more program or supporting functions of the Health System. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include salaries and wages, employee benefits and payroll taxes, purchased services, other supplies, depreciation, repairs and maintenance, utilities, insurance, rent, interest, and other operating expenses, which are allocated based on square footage.

13. LIQUIDITY AND AVAILABILITY OF RESOURCES

Financial assets available for general expenditures, that is, without donor or other restrictions limiting their use, within one year of the balance sheet date, comprise the following:

	<u>2021</u>	<u>2020</u>
Cash and cash equivalents	\$ 11,924,325	\$ 10,604,094
Short-term investments	2,296,299	2,216,936
Patient accounts receivable, net	6,879,467	5,650,993
Other receivables	<u>503,445</u>	<u>351,835</u>
	<u>\$ 21,603,536</u>	<u>\$ 18,823,858</u>

As part of a liquidity management plan, cash in excess of daily requirements is invested in marketable securities which may be drawn upon, if necessary, to meet unexpected liquidity needs.

14. REFUNDABLE ADVANCES

During the Health System's fiscal year 2021 and 2020, Provider Relief Fund grants authorized under the Coronavirus Aid, Relief, and Economic Security ("CARES") Act were distributed in various phases to healthcare providers impacted by the outbreak of the COVID-19 pandemic (the "Pandemic") under Catalog of Federal Domestic Assistance ("CFDA") #93.498. The Health System received qualifying grants during phase one and phase four of the Provider Relief Fund grant program. Revenues from Provider Relief Fund grants are recognized to the extent of a combination of expenses incurred to directly respond to the Pandemic, and patient revenues lost as a result of the pandemic, and are included in the statements of operations and changes in net assets as provider relief fund revenue within operating revenues. Patient revenues lost represent the deficiency of net patient service revenues recognized over the period impacted by the pandemic when compared with net patient service revenues recognized over the same period in the previous year. Per the terms of the program, the applicable time period for measurement of lost revenues must be calendar year 2021 compared with calendar year 2019, as well as calendar year 2020 compared with calendar year 2019. Provider Relief Fund grants included in refundable advances on the balance sheets represent grant funds received in excess of expenses incurred to directly respond to the Pandemic. These qualifying funds the Health System received were subject to recoupment by the grantor in the event that the conditions for recognition were not met before June 30, 2021 for phase one, and are not met before December 31, 2022 for phase four.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

The passage of the CARES Act also authorized CMS to expand the Medicare Accelerated and Advance Payment Program to a broader group of Medicare Part A providers and Part B suppliers. For the acute care hospital and the critical access hospital, the Health System was eligible to request up to 100% and 125% of the Medicare payments amount for a six-month period, respectively. The Health System was issued the accelerated/advance payment in April 2020. Recoupment of the advance payment began in 2021 following a one-year deferral period. During the one-year period, Medicare claims submitted by the Health System continued to be reimbursed at standard rates, after which, the recoupment process began and 25% of payments for submitted claims will continue to reduce the balance of the accelerated or advance payment over an 11 month period through March 2022. Following the initial 11 month recoupment period, 50% of payments for submitted claims will be withheld to reduce the balance of the accelerated advance payments over a 6 month period through September 2022. Any outstanding balance that has not been recouped in September 2022 will be due in full from the Health System to CMS. The portion of the advance payment that has not been recouped is included in refundable advances on the balance sheets.

During April 2020, the Health System received low interest loans in the amount of \$5,038,000 under the Paycheck Protection Program (PPP) administered by the Small Business Administration. The PPP loans are unsecured, bear interest at 1%, and funds advanced under the program are subject to forgiveness, if certain criteria are met, with the remaining balance repayable within two years of disbursement. The PPP loans may be forgivable to the extent that employers incur and spend the funds on qualified expenditures, which include payroll, employee health insurance, rent, utilities, and interest costs during the covered period as defined by the PPP guidance. In addition, employers must maintain specified employment and wage levels during the pandemic and submit adequate documentation of such expenditures to qualify for loan forgiveness. The Health System has elected to account for these loans as conditional government grants, and recognized forgiveness of the loans as grant revenue in the statements of operations and changes in net assets as of December 31, 2020. During 2021, the Health System received notice that their application for forgiveness was accepted and will not be required to repay any amounts received back under the terms of the program, as the Health System substantially met all requirements necessary for forgiveness.

At December 31, 2021 and 2020, and for the years ended, payments received, revenue recognized, and refundable advances were as follows:

	December 31, 2021			
	Refundable Advances	Payments	Revenue	Refundable Advances
	December 31, 2020	Received / (Refunded)	Recognized	December 31, 2021
Provider Relief Fund	\$ 585,289	\$ 2,291,308	\$ 2,876,597	\$ -0-
Medicare Accelerated and Advance Payment Program	5,548,943	(2,882,018)	-0-	2,666,925
Other COVID-19 federal funding	-0-	400,000	-0-	400,000
	\$ 6,134,232	\$ (190,710)	\$ 2,876,597	\$ 3,066,925

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

	December 31, 2020			
	Refundable Advances December 31, 2019	Payments Received	Revenue Recognized	Refundable Advances December 31, 2020
	December 31, 2019	Received	Recognized	December 31, 2020
Paycheck Protection Program	\$ -0-	\$ 5,038,044	\$ 5,038,044	\$ -0-
Provider Relief Fund	-0-	5,878,434	5,293,145	585,289
Medicare Accelerated and Advance Payment Program	-0-	5,548,943	-0-	5,548,943
	\$ -0-	\$ 16,465,421	\$ 10,331,189	\$ 6,134,232

15. CONTINGENCIES AND COMMITMENTS

Professional Liability

The Health System carries professional liability coverage to provide protection for professional liability losses on a claims-made basis subject to a limit of \$1,000,000 per claim and an annual aggregate limit of \$3,000,000. There is additional umbrella coverage above these limits up to \$6,000,000 under a commercial insurance policy. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, would be insured. The Health System has accrued professional liability reserves of \$5,000 at both December 31, 2021 and 2020, respectively, and these amounts are included in accrued expenses on the balance sheets.

Employee Health Self-Insured Plan

The Health System is partially self-insured for health insurance. The claims under the plan continue to be accrued as the incidents that give rise to them occur. Unpaid claim accruals are based on the estimated ultimate costs of the claims, including claims administration expenses, in accordance with the Health System's past experience. The Health System has entered into reinsurance agreements with insurance companies to limit its losses on claims for health insurance. Reserves for self-insured plans were \$359,364 and \$705,943 as of December 31, 2021 and 2020, respectively, and are included in accrued personnel costs on the balance sheets. Receivable amounts have been recorded for expected insurance recoveries related to the professional liability claims in the amount of \$119,542 at both December 31, 2021 and 2020, and are included in prepaid expenses and other current assets, on the balance sheets.

Litigation, Claims, and Disputes

The Health System is susceptible to a variety of legal proceedings and claims by others against the Health System in a variety of matters arising out of the conduct of the Health System's business. The ultimate resolution of such claims would not, in the opinion of management, have a material adverse effect on the financial statements.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2021 AND 2020

HIPAA

Management continues to implement policies, procedures, and a compliance–monitoring organizational structure to enforce and monitor compliance with the Health Insurance Portability and Accountability Act of 1996 (“HIPAA”) and other government statutes and regulations. The Health System’s compliance with such laws and regulations is subject to future government review and interpretations, as well as regulatory actions which are unknown or unasserted at this time.

COVID-19

On March 11, 2020, the World Health Organization declared Coronavirus (COVID-19) a pandemic. The continued spread of COVID-19, or any similar outbreaks in the future, may adversely impact the local, regional, national and global economies. The extent to which COVID-19 impacts the Health System’s operating results is dependent on the breadth and duration of the pandemic and could be affected by other factors management is not currently able to predict. Potential impacts include, but are not limited to, additional costs for responding to COVID-19, shortages of healthcare personnel, shortages of clinical supplies, increased demand for services, delays, loss of, or reduction to, revenue, contributions and funding, and investment portfolio declines. Management believes the Health System is taking appropriate actions to respond to the pandemic, however, the full impact is unknown and cannot be reasonably estimated at the date the financial statements were available to be issued.

16. RELATED PARTY TRANSACTIONS

The Health System has a management agreement with Community Hospital Consulting, Inc. (“CHC”) to provide management services. The term of the agreement was signed effective July 1, 2018 with a term of five years. Management fees and reimbursement for salaries and benefits of key executives of the Health System totaled \$1,586,869 and \$1,242,192 for the years ended December 31, 2021 and 2020, respectively. As of December 31, 2021 and 2020, respectively, the Health System recognized a liability included in accounts payable on the balance sheets of approximately \$201,000 and \$93,000 to CHC.

17. NEW ACCOUNTING STANDARDS

On February 25, 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*. This new standard, which the Health System is not required to adopt until its year ending December 31, 2022, is intended to improve financial reporting about leasing transactions by requiring entities that lease assets to recognize on their balance sheet the assets and liabilities for the rights and obligations created by those leases, and to provide additional disclosures regarding the leases. Leases with terms (as defined in the ASU) of twelve months or less are not required to be reflected on an entity’s balance sheet. The Health System is presently evaluating the effect that this ASU will have on its future financial statements, including related disclosures.



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**Report of Independent Auditors on Internal Control Over Financial Reporting and on
 Compliance and Other Matters Based on an Audit of Financial Statements
 Performed in Accordance with *Government Auditing Standards***

Board of Directors
 Southwest Health System, Inc.
 Cortez, Colorado

Report on the Financial Statements

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Southwest Health System, Inc. (the "Health System") (a nonprofit corporation), which comprise the balance sheet as of December 31, 2021, and the related statements of operations and changes in net assets, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 14, 2022.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Health System's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Health System's internal control. Accordingly, we do not express an opinion on the effectiveness of the Health System's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Health System's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention with those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Board of Directors
Southwest Health System, Inc.
Cortez, Colorado

Report on Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Health System’s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Health System’s internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Health System’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Blue & Co., LLC

Louisville, Kentucky
April 14, 2022

SOUTHWEST HEALTH SYSTEM, INC.

SCHEDULE OF FINDINGS AND RESPONSES
DECEMBER 31, 2021 AND 2020

No findings were noted during 2021.

SOUTHWEST HEALTH SYSTEM, INC.

SCHEDULE OF PRIOR YEAR FINDINGS AND RESPONSES
DECEMBER 31, 2021 AND 2020

No findings were noted during 2020.