



# **SOUTHWEST HEALTH SYSTEM, INC.**

**FINANCIAL STATEMENTS**

**DECEMBER 31, 2022 AND 2021**

*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, 2022 and 2021, 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, 2022 and 2021, 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.

#### *Change in Accounting Principle*

As discussed in Note 3 to the financial statements, the Health System adopted Financial Accounting Standards Board Accounting Standards Update 2016-02, *Leases* (Topic 842). Our opinion is not modified with respect to this matter.

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

*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.

*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

*Supplementary Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards, as required by Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated July 26, 2023, 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  
July 26, 2023

## SOUTHWEST HEALTH SYSTEM, INC.

### BALANCE SHEETS DECEMBER 31, 2022 AND 2021

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	<u>2022</u>	<u>2021</u>
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 10,965,613	\$ 11,924,325
Restricted cash	-0-	400,000
Short-term investments	2,025,892	2,296,299
Patient accounts receivable, net	6,321,242	6,879,467
Inventories	1,425,402	1,832,726
Prepaid expenses and other current assets	1,261,845	1,316,979
Other assets, current portion	<u>26,240</u>	<u>13,168</u>
Total current assets	22,026,234	24,662,964
<b>Assets whose use is limited</b>	4,275,302	4,650,135
<b>Operating lease right-of-use assets, net</b>	428,694	-0-
<b>Property and equipment, net</b>	35,473,867	37,194,635
<b>Other assets, net of current portion</b>	<u>292,420</u>	<u>223,005</u>
Total assets	<u>\$ 62,496,517</u>	<u>\$ 66,730,739</u>

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See accompanying notes to financial statements.

## SOUTHWEST HEALTH SYSTEM, INC.

BALANCE SHEETS  
DECEMBER 31, 2022 AND 2021

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### LIABILITIES AND NET ASSETS

	<u>2022</u>	<u>2021</u>
<b>Current liabilities</b>		
Accounts payable	\$ 6,364,935	\$ 4,443,891
Accrued personnel costs	2,561,996	2,651,420
Accrued expenses	13,272	12,131
Estimated third-party payor settlements	5,077,092	4,873,870
Refundable advances, current portion	-0-	3,066,925
Current portion of operating lease liabilities	125,341	-0-
Current portion of long-term obligations	<u>3,391,061</u>	<u>3,183,410</u>
Total current liabilities	17,533,697	18,231,647
<b>Long-term liabilities</b>		
Long-term debt, net of current portion	26,240,413	28,513,663
Operating lease liabilities, net of current portion	303,353	-0-
Deferred compensation liabilities	<u>668,146</u>	<u>731,030</u>
Total long-term liabilities	<u>27,211,912</u>	<u>29,244,693</u>
Total liabilities	44,745,609	47,476,340
<b>Net assets without donor restrictions</b>	<u>17,750,908</u>	<u>19,254,399</u>
Total liabilities and net assets	<u>\$ 62,496,517</u>	<u>\$ 66,730,739</u>

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See accompanying notes to financial statements.

## SOUTHWEST HEALTH SYSTEM, INC.

### STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2022 AND 2021

	2022	2021
<b>Operating revenues</b>		
Net patient service revenue	\$ 70,217,971	\$ 63,931,761
Federal grant revenue	400,000	2,876,597
Other operating revenue	3,709,860	4,031,507
Total operating revenues	74,327,831	70,839,865
<b>Operating expenses</b>		
Salaries and wages	38,783,186	34,316,883
Employee benefits and payroll taxes	6,929,157	5,204,882
Professional fees	1,469,380	1,661,948
Purchased services	4,854,431	5,113,191
Drugs and medical supplies	10,211,489	9,052,471
Other supplies	1,173,692	1,136,365
Depreciation	4,160,328	4,214,098
Repairs and maintenance	2,103,917	2,389,293
Utilities	1,140,773	1,052,983
Insurance	863,659	952,727
Rent	550,254	1,182,372
Interest	1,568,295	1,599,069
Provider tax	2,477,409	2,032,856
Other operating expenses	1,868,211	1,914,084
Total operating expenses	78,154,181	71,823,222
Income (loss) from operations	(3,826,350)	(983,357)
<b>Nonoperating revenues (expenses)</b>		
Sales tax and proceeds	2,255,554	2,069,420
Investment income (loss), net	(433,526)	141,673
Gain (loss) on disposal of property and equipment	(24,691)	(143,681)
Contributions	525,522	208,665
Total nonoperating revenues (expenses)	2,322,859	2,276,077
Excess revenues (expenses) and change in net assets	(1,503,491)	1,292,720
<b>Net assets, beginning of year</b>	19,254,399	17,961,679
<b>Net assets, end of year</b>	\$ 17,750,908	\$ 19,254,399

*See accompanying notes to financial statements.*



# SOUTHWEST HEALTH SYSTEM, INC.

## STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2022 AND 2021

	2022	2021
<b>Operating activities</b>		
Change in net assets	\$ (1,503,491)	\$ 1,292,720
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	4,160,328	4,214,098
Amortization of bond issue costs included in interest expense	73,903	87,014
(Gain) loss on disposal of property and equipment	24,691	143,681
Net realized gains and losses and unrealized gains and losses on investments and assets whose use is limited	541,758	(69,993)
Changes in operating assets and liabilities		
Patient accounts receivable	558,225	(1,228,474)
Inventories	407,324	(30,549)
Prepaid expenses and other current assets	55,134	(315,157)
Operating lease right-of-use assets, net	(428,694)	-0-
Accounts payable	1,503,195	51,914
Accrued personnel costs	(89,424)	(149,559)
Accrued expenses	1,141	4,867
Estimated third-party payor settlements	203,222	3,258,837
Refundable advances	(3,066,925)	(3,067,307)
Deferred compensation liabilities	(62,884)	189,786
Operating lease liabilities	428,694	-0-
Net cash flows from operating activities	2,806,197	4,381,878
<b>Investing activities</b>		
Purchases of property and equipment	(2,050,002)	(3,246,931)
Proceeds from sale of property and equipment	3,600	3,925
Change in investments and assets whose use is limited	103,482	(261,305)
Change in other assets	(82,487)	32,153
Net cash flows from investing activities	(2,025,407)	(3,472,158)
<b>Financing activities</b>		
Borrowings on long-term debt	1,077,849	2,657,623
Principal payments on long-term debt	(3,217,351)	(2,432,401)
Net cash flows from financing activities	(2,139,502)	225,222
Net change in cash and cash equivalents	(1,358,712)	1,134,942
<b>Cash, restricted cash, and cash equivalents, beginning of year</b>	<b>12,324,325</b>	<b>11,189,383</b>
<b>Cash, restricted cash, and cash equivalents, end of year</b>	<b>\$ 10,965,613</b>	<b>\$ 12,324,325</b>
<b>Reconciliation of cash and cash equivalents to the balance sheets</b>		
Cash and cash equivalents in current assets	\$ 10,965,613	\$ 11,924,325
Restricted cash	-0-	400,000
Total cash, restricted cash, and cash equivalents	<b>\$ 10,965,613</b>	<b>\$ 12,324,325</b>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid during the year for interest	\$ 1,494,392	\$ 1,512,055
Equipment acquired included in accounts payable	\$ 417,849	\$ -0-
Right-of-use assets acquired under operating lease liabilities	\$ 148,171	\$ -0-

*See accompanying notes to financial statements.*

# SOUTHWEST HEALTH SYSTEM, INC.

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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### 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, 2022 AND 2021

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### 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. For the years ended December 31, 2022 and 2021, the Hospital recognized \$70,217,971 and \$63,931,761, respectively, from services that transfer to the customers over a period of time.

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 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 services at the end of the reporting period. The

# SOUTHWEST HEALTH SYSTEM, INC.

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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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 line *income (loss) from operations* in the statements of operations and changes in net assets. Peripheral

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# SOUTHWEST HEALTH SYSTEM, INC.

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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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 \$39,530 and \$33,362 for the years ended December 31, 2022 and 2021, 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 statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted

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# **SOUTHWEST HEALTH SYSTEM, INC.**

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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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, 2022 and 2021, 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, 2022 AND 2021

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### Reclassifications

Certain 2021 amounts have been reclassified to provide for consistency with reporting of 2022 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 July 26, 2023.

### **3. CHANGE IN ACCOUNTING PRINCIPLE**

On January 1, 2022, the Health system adopted the new lease accounting standard issued by the FASB and Accounting Standards Update ("ASU") No. 2016-02, *Leases* (Topic 842). The lease standard is intended to improve financial reporting about leasing transactions by requiring entities to recognize on the consolidated 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 ASU No. 2016-02) of twelve months or less are not required to be reflected on an entity's balance sheets.

The Health System elected the available practical expedients to account for its existing operating leases as operating leases under the new guidance, without reassessing (a) whether any expired or existing contracts contain a lease, (b) whether classification of capital leases or operating leases would be different in accordance with the new guidance, or (c) whether the unamortized initial direct costs, if any, before transition adjustments would have met the definition of initial direct costs in the new guidance at lease commencement. In addition, the Health System elected the hindsight practical expedient to determine the lease term for existing leases. ASU No. 2016-02 was applied retrospectively to the beginning of the period of adoption through a cumulative-effective adjustment recognized as of January 1, 2022. The Health System has also elected to apply an exemption for short-term leases whereby leases with initial lease terms of one year or less are not recorded on the balance sheets. Prior period amounts have not been adjusted and continue to be reported in accordance with the previous accounting guidance. The adoption of ASU No. 2016-02 had a material impact on the balance sheets, but did not have a material impact on the of operations and change in net assets, or on statements of cash flows. As of January 1, 2022, the Health System's total assets and total liabilities increased by approximately \$758,820 as a result of adoption of ASU No. 2016-02.

# SOUTHWEST HEALTH SYSTEM, INC.

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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### 4. 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 (Note 9). 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 \$10,000 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.

### 5. SHORT-TERM INVESTMENTS AND ASSETS WHOSE USE IS LIMITED

Total short-term investments consist of the following at December 31, 2022 and 2021:

	2022	2021
Money market funds	\$ 75,963	\$ 59,731
Mutual funds	1,383,505	1,694,596
Exchange-traded funds	566,424	541,972
Total short-term investments	<u>\$ 2,025,892</u>	<u>\$ 2,296,299</u>

Assets whose use is limited are reported at market value and cost that approximates market value, and consist of the following at December 31, 2022 and 2021:

	2022	2021
Certificates of deposit	\$ 235,836	\$ 382,270
Money market funds	1,886,284	1,852,908
Mutual funds	1,627,935	1,906,759
Exchange-traded funds	393,098	376,049
Sales and use tax receivable	132,149	132,149
Total assets whose use is limited	<u>\$ 4,275,302</u>	<u>\$ 4,650,135</u>

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## SOUTHWEST HEALTH SYSTEM, INC.

### NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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	2022	2021
Board-designated funds	\$ 1,638,103	\$ 1,972,164
Trustee-held under debt agreement	1,836,904	1,814,792
Sales and use tax receivable	132,149	132,149
Deferred compensation fund	<u>668,146</u>	<u>731,030</u>
Total assets whose use is limited	<u>\$ 4,275,302</u>	<u>\$ 4,650,135</u>

Investment income is comprised of the following for the years ended December 31, 2022 and 2021:

	2022	2021
Dividends and interest income	\$ 120,909	\$ 93,668
Realized gains (losses) on investments	103,482	(65,395)
Change in market value of investments	(645,240)	135,388
Investment fees	<u>(12,677)</u>	<u>(21,988)</u>
Total investment income (loss), net	<u>\$ (433,526)</u>	<u>\$ 141,673</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.

#### 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:

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## SOUTHWEST HEALTH SYSTEM, INC.

### NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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- 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, 2022 and 2021.

- *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.
- *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.

## SOUTHWEST HEALTH SYSTEM, INC.

### NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2022 are as follows:

	Level 1	Level 2	Level 3	Total
<b>Investments and assets whose use is limited</b>				
Money market funds	\$ -0-	\$ 1,962,247	\$ -0-	\$ 1,962,247
Exchange-traded funds	959,522	-0-	-0-	959,522
Mutual funds				
Consumer cyclical	1,093,662	-0-	-0-	1,093,662
Diversified emerging markets	130,439	-0-	-0-	130,439
Financial services	211,199	-0-	-0-	211,199
Foreign	164,762	-0-	-0-	164,762
High-yield bond	12,015	-0-	-0-	12,015
Institutional	176,705	-0-	-0-	176,705
Intermediate core-plus bond	25,535	-0-	-0-	25,535
Large cap	645,776	-0-	-0-	645,776
Mid cap	41,421	-0-	-0-	41,421
Nontraditional bond	93,526	-0-	-0-	93,526
Short-term bond	6,080	-0-	-0-	6,080
Small cap	164,769	-0-	-0-	164,769
Target date	245,551	-0-	-0-	245,551
Total mutual funds	<u>3,011,440</u>	<u>-0-</u>	<u>-0-</u>	<u>3,011,440</u>
Total assets at fair value	<u>\$ 3,970,962</u>	<u>\$ 1,962,247</u>	<u>\$ -0-</u>	<u>5,933,209</u>
Certificates of deposit				235,836
Sales and use tax receivable				132,149
<b>Total investments and assets whose use is limited</b>				<u>\$ 6,301,194</u>

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
<b>Investments and assets whose use is limited</b>				
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
<b>Total investments and assets whose use is limited</b>				<u>\$ 6,946,434</u>

# SOUTHWEST HEALTH SYSTEM, INC.

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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### 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.

### **6. PROPERTY AND EQUIPMENT, NET**

Property and equipment, net consists of the following at December 31, 2022 and 2021:

	<u>2022</u>	<u>2021</u>
Land and land improvements	\$ 1,047,048	\$ 1,047,048
Buildings and improvements	53,096,048	53,046,329
Fixtures and equipment	32,551,972	30,737,958
Vehicles	1,083,070	839,723
Construction in progress	<u>72,952</u>	<u>-0-</u>
	87,851,090	85,671,058
Less accumulated depreciation	<u>(52,377,223)</u>	<u>(48,476,423)</u>
Property and equipment, net	<u>\$ 35,473,867</u>	<u>\$ 37,194,635</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, 2022 and 2021, 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

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## SOUTHWEST HEALTH SYSTEM, INC.

### NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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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, 2022 and 2021, the Health System cannot reasonably estimate a liability related to these potential asset retirement activities nor determine conclusively that a liability exists.

#### 7. OTHER ASSETS

Other assets consist of the following at December 31, 2022 and 2021:

	<u>2022</u>	<u>2021</u>
Interest in net assets of Foundation	\$ 186,173	\$ 186,173
Employee notes receivable	<u>132,487</u>	<u>50,000</u>
Total other assets	318,660	236,173
Other assets, current portion	<u>(26,240)</u>	<u>(13,168)</u>
Other assets, net of current portion	<u>\$ 292,420</u>	<u>\$ 223,005</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 2025. 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.

# SOUTHWEST HEALTH SYSTEM, INC.

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

### 8. LONG-TERM DEBT

At December 31, 2022 and 2021, the Health System was obligated for long-term debt agreements as follows:

	<u>2022</u>	<u>2021</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.	\$ 27,491,295	\$ 29,743,458
Various promissory notes under a resolution to borrow with Vectra Bank, with maturity dates ranging from November 2023 to December 2025; fixed interest rates ranging from 4.75% to 7.37%. Monthly payments of principal and interest ranging from \$10,618 to 19,765. Collateralized by various equipment (carrying amounts totaling \$2,113,560 at December 31, 2022).	2,409,538	2,714,726
Financing agreement with a vendor; fixed interest rate of 4.95%, due July 2027. Monthly payments of principal and interest ranging from \$9,428 to \$10,428. Collateralized by equipment with a net book value of \$417,849 at December 31, 2022.	<u>417,849</u>	<u>-0-</u>
	30,318,682	32,458,184
Less current portion	(3,391,061)	(3,183,410)
Less debt issuance costs	<u>(687,208)</u>	<u>(761,111)</u>
Total long-term debt, net of current portion	<u>\$ 26,240,413</u>	<u>\$ 28,513,663</u>

## SOUTHWEST HEALTH SYSTEM, INC.

### NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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Maturities of long-term debt subsequent to December 31, 2022, are as follows:

<u>Year Ending December 31,</u>	<u>Principal</u>
2023	\$ 3,391,061
2024	3,396,708
2025	3,296,264
2026	2,699,792
2027	1,280,397
Thereafter	<u>16,254,460</u>
Total long-term debt	<u>\$ 30,318,682</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. The Health System is in violation of the audit submission covenant and has obtained a waiver for this violation.

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, 2022 or 2021.

## 9. LEASES

The Health System recognizes right-of-use ("ROU") assets and lease liabilities for leases with terms greater than 12 months or leases that contain a purchase option that is reasonably certain to be exercised. ROU assets represent the Health System's right to use an underlying asset for the lease term and lease liabilities represent the Health System's obligation to make lease payments arising from the lease. Leases are classified as either finance or operating leases. This classification dictates whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease.

# SOUTHWEST HEALTH SYSTEM, INC.

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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The Health System has various operating leases for residential living space and commercial storage space that expire at various times through 2025, as well as an equipment lease that expires during 2023. The Health System also leases various property and equipment from MCHD that expires during 2051 (Note 4). The interest rates used in determining the carrying value of lease liabilities are determined using the incremental borrowing rate based on the estimated rate of interest for collateralized borrowing at transition date. Leasing arrangements required fixed payments, and may also include an amount that is probable will be owed under residual value guarantees, if applicable. Lease payments also include payments related to purchase or termination options when the lessee is reasonably certain to exercise the option or is reasonably certain not to exercise the option, respectively. The Health System's lease agreements do not contain any material restrictive covenants, other than those required in connection with the lease agreement with MCHD (Note 4). The leases have remaining terms of 1 to 3 years. Lease and non-lease components within any lease agreements the Health System has are accounted for separately.

The Health System's ROU assets and lease liabilities are recognized on the lease commencement date in an amount that represents the present value of future lease payments over the lease term. The Health System utilizes its collateralized incremental borrowing rate commensurate to the lease term as the discount rate for its leases unless the Health System can specifically determine the lessor's implicit rate. The operating lease ROU asset also includes any lease payments made and excludes lease incentives, if any.

Short-term leases (leases with an initial term of 12 months or less, or leases that are cancelable by the lessee and the lessor without significant penalties) are not capitalized, but are expensed on a straight-line basis over the lease term. The Health System's short-term lease costs are related to various medical equipment that is rented on an as-needed basis, and varies month-to-month.

In evaluating contracts to determine if they qualify as a lease, the Health System considers factors such as if it has obtained substantially all of the rights to the underlying asset through exclusivity, if the Health System can direct the use of the asset by making decisions about how and for what purpose the asset will be used and if the lessor has substantive substitution rights. Furthermore, the Health System assesses whether it is reasonably certain to exercise options to extend or terminate a lease considering all relevant factors that create economic incentive to exercise such options, including asset, contract, market, and entity-based factors. These evaluations may require significant judgment.

The components of the Health System's lease costs for the year ended December 31, 2022 are as follows:

Operating lease costs	\$	507,881
Short-term lease costs		<u>42,373</u>
	\$	<u>550,254</u>



## SOUTHWEST HEALTH SYSTEM, INC.

### NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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Rental expense under both cancelable and noncancelable agreements for the Health System was \$1,182,372 during 2021.

The cost of equipment held under operating lease obligations at December 31, 2022 is as follows:

Right-of-use assets under operating leases	\$	906,990
Less: accumulated amortization		<u>(478,296)</u>
Right-of-use operating lease assets, net	\$	<u>428,694</u>

At December 31, 2022, the weighted average lease term and weighted-average discount rate on the Health System's operating lease liabilities are as follows:

<b>Weighted-average remaining lease term</b>	
Operating leases	12.53 years
<b>Weighted-average discount rate</b>	
Operating leases	4.25%

Future payments of operating lease liabilities as of December 31, 2022 are as follows:

Year ended December 31,	Operating Leases
2023	\$ 140,836
2024	102,956
2025	62,656
2026	9,996
2027	9,996
Thereafter	<u>237,405</u>
Total lease payments	563,845
Less: imputed interest	<u>135,151</u>
Present value of minimum lease payments	<u>\$ 428,694</u>

# SOUTHWEST HEALTH SYSTEM, INC.

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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Future minimum lease payments on all noncancelable leases as of December 31, 2021, was 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>

### 10. 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 2022 and 2021.

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

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## SOUTHWEST HEALTH SYSTEM, INC.

### NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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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, 2022 and 2021, 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 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, 2022 and 2021 is as follows:

	<u>2022</u>	<u>2021</u>
Medicare	\$ 27,411,131	\$ 25,912,072
Medicaid	22,740,403	16,559,506
Commercial, managed care, and other	19,058,987	20,572,304
Self pay patients	<u>1,007,450</u>	<u>887,879</u>
	<u>\$ 70,217,971</u>	<u>\$ 63,931,761</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, 2022 AND 2021

The composition of net patient service revenue based on its lines of business and timing of revenue recognition for the years ended December 31, 2022 and 2021, are as follows:

	2022	2021
<b>Service Lines</b>		
Inpatient	\$ 15,958,427	\$ 18,801,364
Outpatient	33,345,282	29,705,025
Clinical services	15,483,604	9,924,598
Ambulance	5,430,658	5,500,774
	\$ 70,217,971	\$ 63,931,761

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, 2022 and 2021 is as follows:

	2022		2021	
	Revenues	Receivables	Revenues	Receivables
Medicare	44 %	25 %	42 %	22 %
Medicaid	30	12	29	10
Commercial, managed care, and other	23	23	24	27
Self Pay	3	40	5	41
	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 reimbursement from these programs are recorded as deductions from revenue. Outpatient services

## SOUTHWEST HEALTH SYSTEM, INC.

### NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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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 \$2,477,409 and \$2,032,856 in provider fees for the years ended December 31, 2022 and 2021, respectively, which are recorded as a part of operating expenses. The Health System recorded \$11,437,245 and \$8,878,809 of supplemental payments for the years ended December 31, 2022 and 2021, 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, 2022 and 2021, the Health System incurred estimated charity costs of \$614,684 and \$659,183, 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, 2022 AND 2021

### 11. 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, 2022 and 2021, the amount of retirement expense was \$500,854 and \$348,591, 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.

### 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, 2022 and 2021:

	2022		
	Healthcare Services	General and Administrative	Total
Salaries and wages	\$ 36,048,038	\$ 2,735,148	\$ 38,783,186
Employee benefits and payroll taxes	6,444,060	485,097	6,929,157
Professional fees	1,469,380	-0-	1,469,380
Purchased services	4,559,611	294,820	4,854,431
Drugs and medical supplies	10,211,489	-0-	10,211,489
Other supplies	1,090,294	83,398	1,173,692
Depreciation	3,869,105	291,223	4,160,328
Repairs and maintenance	1,956,642	147,275	2,103,917
Utilities	1,052,892	87,881	1,140,773
Insurance	800,247	63,412	863,659
Rent	511,736	38,518	550,254
Interest	1,458,514	109,781	1,568,295
Provider tax	2,477,409	-0-	2,477,409
Other operating expenses	1,353,684	514,527	1,868,211
Total operating expenses	<u>\$ 73,303,101</u>	<u>\$ 4,851,080</u>	<u>\$ 78,154,181</u>

## SOUTHWEST HEALTH SYSTEM, INC.

### NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

	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

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:

	2022	2021
Cash and cash equivalents	\$ 10,965,613	\$ 11,924,325
Short-term investments	2,025,892	2,296,299
Patient accounts receivable, net	6,321,242	6,879,467
Other receivables	351,129	503,445
	\$ 19,663,876	\$ 21,603,536

# SOUTHWEST HEALTH SYSTEM, INC.

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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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 2022 and 2021, 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 2022 compared with calendar year 2019, calendar year 2021 compared with calendar year 2019, and 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 were not met before December 31, 2022 for phase four.

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 continued 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 were withheld to reduce the balance of the accelerated advance payments over a 6 month period through September 2022.



## SOUTHWEST HEALTH SYSTEM, INC.

### NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

At December 31, 2022 and 2021, and for the years ended, payments received, revenue recognized, and refundable advances were as follows:

December 31, 2022				
	Refundable Advances December 31, 2021	Payments Received / (Refunded)	Revenue Recognized	Refundable Advances December 31, 2022
Medicare Accelerated and Advance Payment Program	\$ 2,666,925	\$ (2,666,925)	\$ -0-	\$ -0-
Other COVID-19 federal funding	400,000	-0-	(400,000)	-0-
	\$ 3,066,925	\$ (2,666,925)	\$ (400,000)	\$ -0-

  

December 31, 2021				
	Refundable Advances December 31, 2020	Payments Received	Revenue Recognized	Refundable Advances 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

## 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, 2022 and 2021, respectively, and these amounts are included in accrued expenses on the balance sheets.

### Property and Equipment Commitments

Project	Expected Date of Completion	Estimated Total Cost of Project	Costs Incurred As of December 31, 2022
Power generators	December 2023	\$ 61,528	\$ 38,868
HVAC replacement	December 2023	266,780	34,084
Total		\$ 328,308	\$ 72,952

# SOUTHWEST HEALTH SYSTEM, INC.

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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### 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 \$330,000 and \$359,364 as of December 31, 2022 and 2021, 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, 2022 and 2021, 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.

### 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.

# **SOUTHWEST HEALTH SYSTEM, INC.**

## NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2022 AND 2021

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### **16. 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.

### **17. 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 \$1,430,844 and \$1,586,869 for the years ended December 31, 2022 and 2021, respectively. As of December 31, 2022 and 2021, respectively, the Health System recognized a liability included in accounts payable on the balance sheets of approximately \$257,000 and \$201,000 to CHC.



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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, 2022, 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 July 26, 2023.

**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, and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We identified a certain deficiency in internal control, described in the accompanying schedule of findings and questioned costs as item 2022-001, that we consider to be a significant deficiency.

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*.

**Management’s Response to Finding**

*Government Auditing Standards* requires the auditor to perform limited procedures on the Health System’s response to the findings identified in our audit and described in the accompanying schedule of findings and questioned costs. The Health System’s response was not subjected to the other auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on the response.

**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  
July 26, 2023



Blue & Co., LLC / 2650 Eastpoint Parkway, Suite 300 / Louisville, KY 40223  
 main 502.992.3500 fax 502.992.3509 email blue@blueandco.com

blueandco.com

## **Report of Independent Auditors on Compliance for Each Major Program and on Internal Control Over Compliance Required by the Uniform Guidance**

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

### **Report on Compliance for Each Major Federal Program**

#### *Opinion on Each Major Federal Program*

We have audited Southwest Health System, Inc.'s (the "Health System") compliance with the types of compliance requirements identified as subject to audit in the OMB *Compliance Supplement* that could have a direct and material effect on each of the Health System's major federal programs for the year ended December 31, 2022. The Health System's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

In our opinion, the Health System complied, in all material respects, with the compliance requirements referred to above is that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2022.

#### *Basis for Opinion on Each Major Program*

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Our responsibilities under those standards and the Uniform Guidance are further described in the Auditor's Responsibilities for the Audit of Compliance section of our report.

We are required to be independent of the Health System and to meet our other ethical responsibilities, in accordance with relevant ethical requirements relating to our audit. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. Our audit does not provide a legal determination of the Health System's compliance with the compliance requirements referred to above.

#### *Responsibilities of Management for Compliance*

Management is responsible for compliance with the requirements referred to above and for the design, implementation, and maintenance of effective internal control over compliance with the requirements of laws, statutes, regulations, rules, and provisions of contracts or grant agreements applicable to the Health System's federal programs.

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

### *Auditor's Responsibilities for the Audit of Compliance*

Our objectives are to obtain reasonable assurance about whether material noncompliance with the compliance requirements referred to above occurred, whether due to fraud or error, and express an opinion on the Health System's compliance based on our audit. 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, *Government Auditing Standards*, and the Uniform Guidance will always detect material noncompliance when it exists. The risk of not detecting material noncompliance resulting from fraud is higher than for that resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Noncompliance with the compliance requirements referred to above is considered material if there is a substantial likelihood that, individually or in the aggregate, it would influence the judgement made by a reasonable user of the report on compliance about the Health System's compliance with the requirements of each major federal program as a whole.

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

- Exercise professional judgement and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material noncompliance, 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 Health System's compliance with the compliance requirements referred to above and performing such other procedures as we considered necessary in the circumstances.
- Obtain an understanding of the Health System's internal control over compliance relevant to the audit in order to design audit procedures that are appropriate in the circumstances and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of the Health System's internal control over compliance. Accordingly, no such opinion is expressed.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and any significant deficiencies and material weaknesses in internal control over compliance that we identified during the audit.

### **Other Matters**

The results of our auditing procedures disclosed an instance of noncompliance which is required to be reported in accordance with the Uniform Guidance and which is described in the accompanying schedule of findings and questioned costs as item 2022-002. Our opinion on each major federal program is not modified with respect to this matter.

*Government Auditing Standards* requires the auditor to perform limited procedures on the Health System's response to the noncompliance findings identified in our compliance audit described in the accompanying schedule of findings and questioned costs. The Health System's response was not subjected to the other auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

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

### **Report on Internal Control Over Compliance**

Our consideration of internal control over compliance was for the limited purpose described in the Auditor's Responsibilities for the Audit of Compliance section above and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies in internal control over compliance, and therefore, material weaknesses or significant deficiencies in internal control over compliance may exist that were not identified. However, as discussed below, we did identify a certain deficiency in internal control over compliance that we consider to be a material weakness.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

*A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2022-002 to be a material weakness.

Our audit was not designed for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, no such opinion is expressed.

*Government Auditing Standards* requires the auditor to perform limited procedures on the Health System's response to internal control over compliance findings identified in our compliance audit described in the accompanying schedule of findings and questioned costs. The Health System's response was not subjected to the other auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

*Blue & Co., LLC*

Louisville, Kentucky  
July 26, 2023Fina



**SOUTHWEST HEALTH SYSTEM, INC.**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED DECEMBER 31, 2022

**Section I – Summary of Auditor’s Results**

**Financial Statements**

Type of auditor's report issued Unmodified

Internal control over financial reporting

    Material weakness(es) identified? \_\_\_\_\_ yes     X     none reported

    Significant deficiency(ies) identified that are not  
    considered to be material weaknesses? \_\_\_\_\_     X     yes \_\_\_\_\_ none reported

Noncompliance material to financial statements noted? \_\_\_\_\_ yes     X     none reported

**Federal Awards**

Internal control over major programs:

    Material weakness(es) identified? \_\_\_\_\_     X     yes \_\_\_\_\_ none reported

    Significant deficiency(ies) identified that are not  
    considered to be material weaknesses? \_\_\_\_\_ yes \_\_\_\_\_     X     none reported

Type of auditor's report issued on compliance for  
    major programs: Unmodified

Any audit findings disclosed that are required  
    to be reported in accordance with the Uniform  
    Guidance? \_\_\_\_\_     X     yes \_\_\_\_\_ no

Identification of major programs:

<u>Assistance Listing Number</u>	<u>Name of Federal Program</u>
93.498	COVID-19 - Provider Relief Fund and American Rescue Plan (ARP) Rural Distribution

Dollar threshold used to distinguish between  
    type A and type B programs: \$750,000

Auditee qualified as low-risk auditee? \_\_\_\_\_ yes \_\_\_\_\_     X     no

# SOUTHWEST HEALTH SYSTEM, INC.

## SCHEDULE OF FINDINGS AND QUESTIONED COSTS YEAR ENDED DECEMBER 31, 2022

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### Section II – Financial Statement Findings

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#### SIGNIFICANT DEFICIENCY

##### **2022-001**

##### **Grant Revenue Recognition**

*Criteria* – The Health System’s internal control processes should ensure that grant revenues are recognized in the period the Health System meets program requirements.

*Condition* – During our audit procedures, we noted that the Health System did not evaluate program requirements to determine its eligibility to recognize grant revenue when it was earned under the terms of the program.

*Cause* – The cause of this deficiency is due to a lack of internal control processes for evaluation of grant programs.

*Effect* – The effect was an audit adjustment of \$400,000.

*Recommendation* – We recommend that the Health System implement internal control processes to ensure the proper recognition of grant revenue when it is earned.

*Management’s Response* – We will implement internal control processes to ensure the proper recognition of grant revenue when it is earned.

# SOUTHWEST HEALTH SYSTEM, INC.

## SCHEDULE OF FINDINGS AND QUESTIONED COSTS YEAR ENDED DECEMBER 31, 2022

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### Section III – Federal Award Findings and Questioned Costs

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#### MATERIAL WEAKNESS

**Federal Agency:** U.S. Department of Health and Human Services

**Assistance Listing Number:** 93.498 – COVID-19 – Provider Relief Fund and American Rescue Plan (ARP) Rural Distribution

#### **2022-002: Reporting of Lost Revenues Attributable to Coronavirus**

*Compliance Requirement(s):* Reporting

*Criteria:* Reporting requirements stipulate that when submitting information related to lost revenues attributable to coronavirus on the Health Resources and Services Administration (“HRSA”) Provider Relief Funding reporting portal, patient service revenues must be entered on a quarterly basis from the first quarter of 2019 through the fourth quarter of 2022.

*Condition* – During our testing of the underlying information supporting lost revenue reported by the Health System, we noted two years where patient service revenue per the filing did not reconcile to the audited financial statements.

*Cause* – The cause of this deficiency is due to the lack of internal controls to ensure proper reporting of lost revenues on the reporting portal.

*Effect* – The effect is misstatement of quarterly and annual revenues for 2022 and 2021 reported to HRSA on the reporting portal.

*Recommendation* – We recommend that the Health System implement internal control procedures to ensure proper reporting on the HRSA reporting portal in future reporting periods.

*Management’s Response* – We will implement internal control procedures to ensure proper reporting of lost revenues, as is required under the reporting guidelines stipulated by HRSA, in future reporting periods.

**SOUTHWEST HEALTH SYSTEM, INC.**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED DECEMBER 31, 2022

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**Section IV – Prior Year Financial Statement Findings**

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No findings were noted during 2021.

**SOUTHWEST HEALTH SYSTEM, INC.**

SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
YEAR ENDED DECEMBER 31, 2022

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**Section V – Prior Year Federal Award Findings and Questioned Costs**

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No findings were noted during 2021.

**SOUTHWEST HEALTH SYSTEM, INC.**

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
YEAR ENDED DECEMBER 31, 2022

Federal Grantor/Pass-through/Program Title	Assistance Listing Number	Pass-Through Entity Identifying Number	Passed Through to Subrecipients	Total Federal Expenditures
<b>Major programs</b>				
U.S. Department of Health and Human Services COVID-19 - Provider Relief Fund	93.498	N/A	\$ -0-	\$ 2,291,308
Total major programs			-0-	2,291,308
<b>Non-major programs</b>				
U.S. Department of Health and Human Services COVID-19 - Testing for Rural Health Clinics	93.697	N/A	-0-	400,000
Total non-major programs			-0-	400,000
<b>Total Expenditures of Federal Awards</b>			\$ -0-	\$ 2,691,308

*See report on schedule of expenditures of federal awards as required by the Uniform Guidance on pages 1-3.*

# **SOUTHWEST HEALTH SYSTEM, INC.**

## NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS YEAR ENDED DECEMBER 31, 2022

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### **1. BASIS OF PRESENTATION**

The accompanying schedule of expenditures of federal awards (the "Schedule") includes the federal grant activity of Southwest Health System, Inc. (the "Health System") under programs of the federal government for the year ended December 31, 2022. The information in this Schedule is presented in accordance with requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* ("Uniform Guidance"). Because the schedule presents only a selected portion of the operations of the Health System it is not intended to and does not present the financial position, changes in net assets, or cash flows of the Health System.

### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

### **3. PROVIDER RELIEF FUNDS**

Expenditures reported on the Schedule for the Provider Relief Fund ("PRF") under CFDA Number 93.498 are based on the Health System's December 31, 2022 report to the PRF Reporting Portal. Under terms and conditions of the Provider Relief Funds established by the Coronavirus Aids, Relief, and Economic Security ("CARES") Act, the Health System is required to report COVID-19 related expenses and lost revenue to the U.S. Department of Health and Human Services ("HHS"). Guidance from HHS has required the reporting of the COVID-19 related expenses and lost revenue within certain reporting timetables based on the date that funds were received. For the years ended December 31, 2022 and 2021, the Health System recognized \$-0- and \$2,876,597, respectively, as provider relief fund revenue in the statements of operations and changes in net assets as the terms and conditions of the PRF grant were satisfied by the Health System. The 2022 Schedule includes PRF of \$2,291,308 which was received by the Health System from January 1, 2021 to December 31, 2021, the dates designated by HHS for its third and fourth PRF reporting periods.

### **4. DONATED PERSONAL PROTECTIVE EQUIPMENT (UNAUDITED)**

During 2022, the Health System did not receive material donated personal protective equipment from federal sources.

### **5. INDIRECT COST RATE**

The Health System has elected not to use the 10% de minimis indirect cost rate as allowed under the Uniform Guidance.

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*See report on schedule of expenditures of federal awards as required by the Uniform Guidance on pages 1-3.*



## CORRECTIVE ACTION PLAN

July 26, 2023

U.S. Department of Health and Human Services

Southwest Health System, Inc. respectively submits the following corrective action plan for the year ended December 31, 2022.

Name and address of independent public accounting firm:

Blue & Co., LLC  
2650 Eastpoint Pkwy., Suite 300  
Louisville, Kentucky 40223

Audit period: Year ended December 31, 2022.

The findings from the schedule of findings and questioned costs for the year ended December 31, 2022 are discussed below. The findings are numbered consistently with the numbers assigned in the Schedule.

### FINDINGS – FINANCIAL STATEMENT AUDIT

2022-001 Condition: We did not evaluate program requirements to determine our eligibility to recognize grant revenue when it was earned under the terms of the program.

Action: We will implement internal control processes to ensure the proper recognition of grant revenue when it is earned.

### FINDINGS – FEDERAL AWARD PROGRAM AUDITS

2022-002 Condition: During our testing of the underlying information supporting lost revenue reported by the Health System, we noted two years where patient service revenue per the filing did not reconcile to the audited financial statements.

Action: Management will implement internal control procedures to ensure proper reporting of lost revenues, as is required under the reporting guidelines stipulated by HRSA, in future reporting periods.



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If the U.S. Department of Health and Human Services has questions regarding this plan, please call Shelle Diehm, Interim CFO, at (970) 564-2145.

Sincerely,

A handwritten signature in blue ink that reads "Shelle Diehm". The signature is written in a cursive style with a large initial "S".

Shelle Diehm  
Interim CFO