



SOUTHWEST HEALTH SYSTEM, INC.

FINANCIAL STATEMENTS

DECEMBER 31, 2023 AND 2022

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, 2023 and 2022, 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, 2023 and 2022, 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. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Health System and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

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

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

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

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards 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, 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.

Blue & Co., LLC

Louisville, Kentucky
April 24, 2024

SOUTHWEST HEALTH SYSTEM, INC.

BALANCE SHEETS DECEMBER 31, 2023 AND 2022

ASSETS

	<u>2023</u>	<u>2022</u>
Current assets		
Cash and cash equivalents	\$ 3,611,987	\$ 10,965,613
Short-term investments	8,980,662	2,025,892
Patient accounts receivable, net	6,198,557	6,321,242
Inventories	1,436,809	1,425,402
Prepaid expenses and other current assets	1,444,684	1,261,845
Other assets, current portion	<u>31,704</u>	<u>26,240</u>
Total current assets	21,704,403	22,026,234
Assets whose use is limited	5,686,656	4,275,302
Operating lease right-of-use assets, net	303,353	428,694
Finance lease right-of-use assets, net	32,918	-0-
Property and equipment, net	31,856,752	35,473,867
Other assets, net of current portion	<u>217,315</u>	<u>292,420</u>
Total assets	<u>\$ 59,801,397</u>	<u>\$ 62,496,517</u>

See accompanying notes to financial statements.

SOUTHWEST HEALTH SYSTEM, INC.

BALANCE SHEETS
DECEMBER 31, 2023 AND 2022

LIABILITIES AND NET ASSETS

	<u>2023</u>	<u>2022</u>
Current liabilities		
Accounts payable	\$ 6,554,251	\$ 6,364,935
Accrued personnel costs	2,122,344	2,561,996
Accrued expenses	14,954	12,401
Estimated third-party payor settlements	4,280,957	5,077,092
Deferred revenue	164,835	871
Current portion of long-term debt	1,658,426	3,391,061
Current portion of operating lease liabilities	91,954	125,341
Current portion of finance lease liabilities	<u>20,609</u>	<u>-0-</u>
Total current liabilities	14,908,330	17,533,697
Long-term liabilities		
Long-term debt, net of current portion	25,430,952	26,240,413
Operating lease liabilities, net of current portion	211,399	303,353
Finance lease liabilities, net of current portion	13,546	-0-
Deferred compensation liabilities	<u>873,662</u>	<u>668,146</u>
Total long-term liabilities	<u>26,529,559</u>	<u>27,211,912</u>
Total liabilities	41,437,889	44,745,609
Net assets without donor restrictions	<u>18,363,508</u>	<u>17,750,908</u>
Total liabilities and net assets	<u>\$ 59,801,397</u>	<u>\$ 62,496,517</u>

See accompanying notes to financial statements.

SOUTHWEST HEALTH SYSTEM, INC.

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2023 AND 2022

	2023	2022
Operating revenues		
Net patient service revenue	\$ 70,869,424	\$ 70,217,971
Federal grant revenue	-0-	400,000
Pharmacy revenue	5,335,317	2,991,733
Other operating revenue	672,120	718,127
Total operating revenues	76,876,861	74,327,831
Operating expenses		
Salaries and wages	37,718,679	38,783,186
Employee benefits and payroll taxes	7,092,568	6,789,000
Professional fees	1,539,351	1,469,380
Purchased services	5,767,077	4,769,578
Drugs and medical supplies	12,253,666	10,648,763
Other supplies	1,101,850	1,173,692
Depreciation	4,099,936	4,160,328
Repairs and maintenance	1,942,556	2,103,917
Utilities	1,121,304	1,140,773
Insurance	1,003,662	863,659
Rent	185,936	550,254
Interest	1,428,095	1,568,295
Provider tax	2,305,964	2,477,409
Other operating expenses	1,297,078	1,655,947
Total operating expenses	78,857,722	78,154,181
Income (loss) from operations	(1,980,861)	(3,826,350)
Nonoperating revenues (expenses)		
Sales tax and proceeds	2,147,305	2,255,554
Investment income (loss), net	115,469	(433,526)
Contributions	340,510	525,522
Other	(9,823)	(24,691)
Total nonoperating revenues (expenses)	2,593,461	2,322,859
Excess revenues (expenses) and change in net assets	612,600	(1,503,491)
Net assets, beginning of year	17,750,908	19,254,399
Net assets, end of year	\$ 18,363,508	\$ 17,750,908

See accompanying notes to financial statements.

SOUTHWEST HEALTH SYSTEM, INC.

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2023 AND 2022

	2023	2022
Operating activities		
Change in net assets	\$ 612,600	\$ (1,503,491)
Adjustments to reconcile change in net assets to net cash flows from operating activities		
Depreciation	4,099,936	4,160,328
Amortization of bond issue costs included in interest expense	68,052	73,903
(Gain) loss on disposal of property and equipment	9,823	24,691
Net realized gains and losses and unrealized gains and losses on investments and assets whose use is limited	60,274	541,758
Changes in operating assets and liabilities		
Patient accounts receivable	122,685	558,225
Inventories	(11,407)	407,324
Prepaid expenses and other current assets	(182,839)	55,134
Accounts payable	586,638	1,503,195
Accrued personnel costs	(439,652)	(89,424)
Accrued expenses	2,553	270
Estimated third-party payor settlements	(796,135)	203,222
Deferred revenue	163,964	(3,066,054)
Deferred compensation liabilities	205,516	(62,884)
Net cash flows from operating activities	4,502,008	2,806,197
Investing activities		
Purchases of property and equipment	(909,495)	(2,050,002)
Proceeds from sale of property and equipment	28,191	3,600
Change in investments and assets whose use is limited	(8,426,398)	103,482
Change in other assets	69,641	(82,487)
Net cash flows from investing activities	(9,238,061)	(2,025,407)
Financing activities		
Borrowings on long-term debt	-0-	1,077,849
Principal payments on long-term debt	(2,610,148)	(3,217,351)
Principal payments on finance lease obligations	(7,425)	-0-
Net cash flows from financing activities	(2,617,573)	(2,139,502)
Net change in cash and cash equivalents	(7,353,626)	(1,358,712)
Cash and cash equivalents, beginning of year	10,965,613	12,324,325
Cash and cash equivalents, end of year	\$ 3,611,987	\$ 10,965,613
Supplemental disclosure of cash flow information		
Cash paid during the year for interest	\$ 1,360,043	\$ 1,494,392
Right-of-use assets acquired under operating lease liabilities	\$ -0-	\$ 148,171
Right-of-use assets acquired under finance lease liabilities	\$ 41,580	\$ -0-
Property and equipment acquired included in accounts payable	\$ (397,322)	\$ 417,849

See accompanying notes to financial statements.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

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, 2023 AND 2022

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 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.

Patient Accounts Receivable and Net Patient Service Revenue

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

Performance obligations are determined based on the nature of the services provided by the Health System. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected (or actual) charges. The Health System believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the Health System receiving inpatient acute care services or patients receiving services in the outpatient center. The Health System measures the performance obligation from admission into the Health System, or the commencement of an outpatient service, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to our patients and customers in a retail setting (for example, pharmaceuticals) and the Health System does not believe it is required to provide additional goods or services related to that sale. For the years ended December 31, 2023 and 2022, the Health System recognized \$70,869,424 and \$70,217,971, 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, 2023 AND 2022

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*.

Deferred Revenue

Deferred revenue consists of grant funding received from the state of Colorado for which specific performance obligations have not been met as of December 31, 2023 and 2022, and must be met to keep the funding received.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

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 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, and investment income or loss.

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 \$64,214 and \$39,530 for the years ended December 31, 2023 and 2022, respectively.

Claims Reserves

The Health System provides for self-insurance reserves for estimated incurred but not reported claims for its employee health plan (Note 13). 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

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

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 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, 2023 and 2022, 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 owed 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 Evaluation

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, 2023 AND 2022

Reclassifications

Certain 2022 amounts have been reclassified to provide for consistency with reporting of 2023 information. These reclassifications have no effect on the previously reported total change in net assets or net assets.

Subsequent Events

The Health System has evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying financial statements through the date the financial statements were available to be issued, which is April 24, 2024.

3. LEASE OF HOSPITAL FACILITIES

The Health System leases the property and equipment of Southwest Memorial Hospital from MCHD under a lease, as amended on November 17, 2016. The lease provides that the property and equipment of the hospital facility be leased to the Health System and will expire on September 30, 2051 (Note 8). 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. 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 addition, 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. In November 2015, voters of the MCHD approved a sales and use tax of 0.4%, from which the annual proceeds are to be used to reimburse the Health System for the costs of the facility expansion project and related financing costs.

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

Total short-term investments consist of the following at December 31, 2023 and 2022:

	2023	2022
Money market funds	\$ 15,849	\$ 75,963
Mutual funds	-0-	1,383,505
Exchange-traded funds	-0-	566,424
U.S. treasury notes	8,964,813	-0-
Total short-term investments	<u>\$ 8,980,662</u>	<u>\$ 2,025,892</u>

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

Assets whose use is limited are reported at market value and cost that approximates market value, and consist of the following at December 31, 2023 and 2022:

	2023	2022
Certificates of deposit	\$ 237,444	\$ 235,836
Money market funds	3,056,421	1,886,284
Mutual funds	873,662	1,627,935
Exchange-traded funds	-0-	393,098
U.S. treasury notes	1,386,980	-0-
Sales and use tax receivable	132,149	132,149
Total assets whose use is limited	\$ 5,686,656	\$ 4,275,302
	2023	2022
Board-designated funds	\$ 1,632,544	\$ 1,638,103
Trustee-held under debt agreement	3,048,301	1,836,904
Sales and use tax receivable	132,149	132,149
Deferred compensation fund	873,662	668,146
Total assets whose use is limited	\$ 5,686,656	\$ 4,275,302

Investment income is comprised of the following for the years ended December 31, 2023 and 2022:

	2023	2022
Dividends and interest income	\$ 212,826	\$ 120,909
Realized gains (losses) on investments	-0-	103,482
Change in market value of investments	(60,274)	(645,240)
Investment fees	(37,083)	(12,677)
Total investment income (loss), net	\$ 115,469	\$ (433,526)

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.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

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. It also includes a capital improvement fund from which funds can be used for qualifying expenditures under the debt agreement.

Deferred Compensation Funds

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

Fair Value Measurements and Disclosures

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

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

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

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 2023 and 2022.

- *Certificates of deposit*: 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.
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SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

- *U.S. treasury notes:* Valued using pricing models maximizing the use of observable inputs for similar securities.
- *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.

Assets measured at fair value on a recurring basis as of December 31, 2023 are as follows:

	Level 1	Level 2	Level 3	Total
Investments and assets whose use is limited				
Money market funds	\$ -0-	\$ 3,072,270	\$ -0-	\$ 3,072,270
U.S. treasury notes	-0-	10,351,793	-0-	10,351,793
Mutual funds	873,662	-0-	-0-	873,662
Total assets at fair value	<u>\$ 873,662</u>	<u>\$ 13,424,063</u>	<u>\$ -0-</u>	14,297,725
Certificates of deposit				237,444
Sales and use tax receivable				132,149
Total investments and assets whose use is limited				<u>\$ 14,667,318</u>

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

	Level 1	Level 2	Level 3	Total
Investments and assets whose use is limited				
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>	3,011,440
Total assets at fair value	<u>\$ 3,970,962</u>	<u>\$ 1,962,247</u>	<u>\$ -0-</u>	5,933,209
Certificates of deposit				235,836
Sales and use tax receivable				132,149
Total investments and assets whose use is limited				<u>\$ 6,301,194</u>

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

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.

5. PROPERTY AND EQUIPMENT, NET

Property and equipment, net consists of the following at December 31, 2023 and 2022:

	<u>2023</u>	<u>2022</u>
Land and land improvements	\$ 1,047,048	\$ 1,047,048
Buildings and improvements	53,156,396	53,096,048
Fixtures and equipment	32,632,329	32,551,972
Vehicles	1,313,728	1,083,070
Construction in progress	<u>14,064</u>	<u>72,952</u>
	88,163,565	87,851,090
Less accumulated depreciation	<u>(56,306,813)</u>	<u>(52,377,223)</u>
Property and equipment, net	<u>\$ 31,856,752</u>	<u>\$ 35,473,867</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, 2023 and 2022, 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

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

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, 2023 and 2022, the Health System cannot reasonably estimate a liability related to these potential asset retirement activities nor determine conclusively that a liability exists.

6. OTHER ASSETS

Other assets consist of the following at December 31, 2023 and 2022:

	<u>2023</u>	<u>2022</u>
Interest in net assets of Foundation	\$ 192,698	\$ 186,173
Employee notes receivable	<u>56,321</u>	<u>132,487</u>
Total other assets	249,019	318,660
Other assets, current portion	<u>(31,704)</u>	<u>(26,240)</u>
Other assets, net of current portion	<u>\$ 217,315</u>	<u>\$ 292,420</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, 2023 AND 2022

7. LONG-TERM DEBT

At December 31, 2023 and 2022, the Health System was obligated for long-term debt agreements as follows:

	<u>2023</u>	<u>2022</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.	\$ 25,874,384	\$ 27,491,295
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 \$1,569,057 at December 31, 2023).	1,425,313	2,409,538
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 \$408,837 at December 31, 2023.	<u>408,837</u>	<u>417,849</u>
	27,708,534	30,318,682
Less current portion	(1,658,426)	(3,391,061)
Less debt issuance costs	<u>(619,156)</u>	<u>(687,208)</u>
Total long-term debt, net of current portion	<u>\$ 25,430,952</u>	<u>\$ 26,240,413</u>

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

Maturities of long-term debt subsequent to December 31, 2023, are as follows:

<u>Year Ending December 31,</u>	<u>Principal</u>
2024	\$ 1,658,426
2025	1,481,454
2026	920,096
2027	1,310,305
2028	1,269,466
Thereafter	<u>21,068,787</u>
Total long-term debt	<u>\$ 27,708,534</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.

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, 2023 or 2022.

Effective August, 2023, the bond agreement was amended, changing the calculation for the Health System's minimum liquidity ratios, as well as creating a requirement for a new capital improvement fund, which allows for use of funds for qualifying expenditures, as defined within the amended bond agreement.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

8. 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.

The Health System leases various property and equipment from MCHD that expires during 2051 (Note 3). The Health System also has various finance and 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 in 2025. 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 3). The leases have remaining terms of 1 to 28 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.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

The components of the Health System's lease costs for the years ended December 31, 2023 and 2022, respectively, is as follows:

	2023	2022
Operating lease costs	\$ 146,267	\$ 507,881
Short-term lease costs	39,669	42,373
Finance lease costs:		
Amortization expense	8,662	-0-
Interest on lease liabilities	2,097	-0-
	\$ 185,936	\$ 550,254

The cost of equipment held under operating and finance lease obligations at December 31, 2023 and 2022, respectively, is as follows:

	2023	2022
Right-of-use assets under operating leases	\$ 487,128	\$ 906,990
Less: accumulated amortization	(183,775)	(478,296)
Right-of-use operating lease assets, net	\$ 303,353	\$ 428,694
	2023	2022
Right-of-use assets under finance leases	\$ 41,580	\$ -0-
Less: accumulated amortization	(8,662)	-0-
Right-of-use operating lease assets, net	\$ 32,918	\$ -0-

At December 31, 2023 and 2022, respectively, the weighted average lease term and weighted-average discount rate on the Health System's operating and finance lease liabilities is as follows:

	2023	2022
Weighted-average remaining lease term		
Operating leases	15.61 years	12.53 years
Finance leases	1.5 years	Not applicable
	2023	2022
Weighted-average discount rate		
Operating leases	4.25%	4.25%
Finance leases	9.25%	Not applicable

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

Additional information regarding cash payments under the Health System's operating and finance leases during 2023 and 2022, as well as the inputs used in determining the ROU assets and liabilities at December 31, 2023 and 2022, respectively, as are follows:

	2023	2022
Cash paid for amounts included in the measurement of lease liabilities		
Operating cash flows from operating activities	\$ 146,267	\$ 507,881
Operating cash flows arising from finance lease activities	2,097	-0-
Financing cash flows from finance leases	7,425	-0-

Future payments of operating and finance lease liabilities as of December 31, 2023, are as follows:

Year ended December 31,	Operating Leases	Finance Leases
2024	\$ 102,956	\$ 22,852
2025	62,656	13,947
2026	9,996	-0-
2027	9,996	-0-
2028	9,996	-0-
Thereafter	227,409	-0-
Total lease payments	423,009	36,799
Less: imputed interest	119,656	2,644
Present value of minimum lease payments	\$ 303,353	\$ 34,155

9. 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.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

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 2023 and 2022.

Generally, patients who are covered by third-party payors are responsible for related deductibles and coinsurance, which vary in amount. The Health System also provides services to uninsured patients, and offers those uninsured patients a discount, either by policy or law, from standard charges. The Health System estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts, and implicit price concessions. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to net patient service revenue in the period of the change. For the years ended December 31, 2023 and 2022, 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.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

The composition of net patient service revenue by primary payor for the years ended December 31, 2023 and 2022 is as follows:

	2023	2022
Medicare	\$ 26,665,614	\$ 27,411,131
Medicaid	22,847,730	22,740,403
Commercial, managed care, and other	20,898,930	19,058,987
Self pay patients	457,150	1,007,450
	\$ 70,869,424	\$ 70,217,971

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

The composition of net patient service revenue based on its lines of business and timing of revenue recognition for the years ended December 31, 2023 and 2022, are as follows:

	2023	2022
Service Lines		
Inpatient	\$ 17,354,882	\$ 15,958,427
Outpatient	33,527,823	33,345,282
Clinical services	14,205,568	15,483,604
Ambulance	5,781,151	5,430,658
	\$ 70,869,424	\$ 70,217,971

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, 2023 and 2022 is as follows:

	2023		2022	
	Revenues	Receivables	Revenues	Receivables
Medicare	45 %	26 %	44 %	25 %
Medicaid	29	10	30	12
Commercial, managed care, and other	23	21	23	23
Self pay	3	43	3	40
	100 %	100 %	100 %	100 %

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

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 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 \$2,305,964 and \$2,477,409 in provider fees for the years ended December 31, 2023 and 2022, respectively, which are recorded as a part of operating expenses. The Health System recorded \$12,027,087 and \$11,437,245 of supplemental payments for the years ended December 31, 2023 and 2022, 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
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SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

expenses divided by gross patient service revenue. For the years ended December 31, 2023 and 2022, the Health System incurred estimated charity costs of \$482,378 and \$614,684, 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.

10. 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, 2023 and 2022, the amount of retirement expense was \$517,851 and \$500,854, 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.

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

11. 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, 2023 and 2022:

	2023		
	Healthcare Services	General and Administrative	Total
Salaries and wages	\$ 35,058,462	\$ 2,660,217	\$ 37,718,679
Employee benefits and payroll taxes	6,596,031	496,537	7,092,568
Professional fees	1,539,351	-0-	1,539,351
Purchased services	5,255,230	511,847	5,767,077
Drugs and medical supplies	12,253,666	-0-	12,253,666
Other supplies	1,023,303	78,547	1,101,850
Depreciation	3,812,940	286,996	4,099,936
Repairs and maintenance	1,806,563	135,993	1,942,556
Utilities	1,034,923	86,381	1,121,304
Insurance	929,971	73,691	1,003,662
Rent	174,460	11,476	185,936
Interest	1,328,174	99,921	1,428,095
Provider tax	2,305,964	-0-	2,305,964
Other operating expenses	938,897	358,181	1,297,078
Total operating expenses	\$ 74,057,935	\$ 4,799,787	\$ 78,857,722
	2022		
	Healthcare Services	General and Administrative	Total
Salaries and wages	\$ 36,048,038	\$ 2,735,148	\$ 38,783,186
Employee benefits and payroll taxes	6,303,903	485,097	6,789,000
Professional fees	1,469,380	-0-	1,469,380
Purchased services	4,479,911	289,667	4,769,578
Drugs and medical supplies	10,648,763	-0-	10,648,763
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	1,141,420	514,527	1,655,947
Total operating expenses	\$ 73,308,254	\$ 4,845,927	\$ 78,154,181

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

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

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.

12. 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:

	2023	2022
Cash and cash equivalents	\$ 3,611,987	\$ 10,965,613
Short-term investments	8,980,662	2,025,892
Patient accounts receivable, net	6,198,557	6,321,242
Other receivables	598,435	351,129
	<u>\$ 19,389,641</u>	<u>\$ 19,663,876</u>

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

13. 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, 2023 and 2022, respectively, and these amounts are included in accrued expenses on the balance sheets.

Property and Equipment Commitments

<u>Project</u>	<u>Expected Date of Completion</u>	<u>Estimated Total Cost of Project</u>	<u>Costs Incurred as of December 31, 2023</u>
Air handler	June 2024	\$ 266,780	\$ 14,064

Employee Health Self-Insured Plan

SOUTHWEST HEALTH SYSTEM, INC.

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2023 AND 2022

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 \$479,958 and \$330,000 as of December 31, 2023 and 2022, 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 \$-0- and \$119,542 at December 31, 2023 and 2022, respectively, 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.

14. 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.

15. 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. Effective July 1, 2021, the agreement was amended to extend the term through June 30, 2026. Management fees and reimbursement for salaries and benefits of key executives of the Health System totaled \$1,294,808 and \$1,430,844 for the years ended December 31, 2023 and 2022, respectively. As of December 31, 2023 and 2022, respectively, the Health System recognized a liability included in accounts payable on the balance sheets of approximately \$98,000 and \$257,000 to CHC.
