St. Mark's Medical Center

Independent Auditor's Report and Financial Statements

June 30, 2018 and 2017

BKD
CPAs & Advisors

St. Mark's Medical Center
June 30, 2018 and 2017

Contents

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CPAs & Advisors

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Independent Auditor's Report

Board of Directors
St. Mark's Medical Center
La Grange, Texas

We have audited the accompanying financial statements of St. Mark's Medical Center, which comprise the balance sheets as of June 30, 2018 and 2017, 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.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of St. Mark’s Medical Center as of June 30, 2018 and 2017, and the results of its operations, the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

BKD, LLP

Dallas, Texas
March 11, 2019

St. Mark's Medical Center

Balance Sheets

June 30, 2018 and 2017

Assets

	2018	2017
Current Assets		
Cash	$ 385,264	$ 172,653
Patient accounts receivable, net of allowance; 2018 – $3,311,000, 2017 – $3,379,000	2,548,152	3,283,982
Estimated amounts due from third-party payers	648,324	-
Supplies	619,387	618,789
Prepaid expenses and other	402,899	747,961
Total current assets	4,604,026	4,823,385
Assets Limited As To Use		
Held by trustee	2,727,220	2,919,588
Internally designated	8,179	8,179
	2,735,399	2,927,767
Property and Equipment, At Cost		
Land	1,060,000	1,066,000
Buildings and improvements	22,733,061	22,629,973
Equipment	15,024,675	15,186,384
	38,817,736	38,882,357
Less accumulated depreciation	18,128,173	16,056,262
	20,689,563	22,826,095
Other Assets		
Trade name	496,000	496,000
Other	55,669	55,675
	551,669	551,675
Total assets	$ 28,580,657	$ 31,128,922

Liabilities and Net Assets

	2018	2017
Current Liabilities		
Current maturities of long-term debt	$ 1,528,671	$ 1,529,771
Advance from St. Mark's Medical Center Foundation	355,000	275,000
Estimated amounts due to third-party payers	143,135	59,303
Due to related party	1,789,042	271,611
Accounts payable	3,962,735	4,142,207
Accrued expenses	1,899,654	2,904,585
Total current liabilities	9,678,237	9,182,477
Long-term Debt	14,261,947	15,686,481
Other Long-term Liabilities	618,749	628,534
Total liabilities	24,558,933	25,497,492
Unrestricted Net Assets	4,021,724	5,631,430
Total liabilities and net assets	$ 28,580,657	$ 31,128,922

St. Mark's Medical Center
Statements of Operations and Changes in Net Assets
Years Ended June 30, 2018 and 2017

	2018	2017
Unrestricted Revenues, Gains and Other Support		
Patient service revenue (net of contractual discounts and allowances)	$ 29,648,698	$ 32,158,436
Provision for uncollectible accounts	3,922,050	5,462,038
Net patient service revenue less provision for uncollectible accounts	25,726,648	26,696,398
Insurance recovery	403,863	-
Contributions	62,558	148,622
Other	328,246	257,290
Total unrestricted revenues, gains and other support	26,521,315	27,102,310
Expenses and Losses		
Salaries and wages	9,894,692	11,286,559
Employee benefits	2,100,072	2,594,348
Purchased services and professional fees	5,025,137	5,299,858
Supplies and other	8,392,343	9,849,896
Depreciation and amortization	2,102,929	3,203,946
Interest	599,752	624,095
Impairment of trade name	-	254,000
Loss on disposal of equipment	16,096	198,278
Total expenses and losses	28,131,021	33,310,980
Decrease in Net Assets	(1,609,706)	(6,208,670)
Net assets, Beginning of Year	5,631,430	11,840,100
Net Assets, End of Year	$ 4,021,724	$ 5,631,430

St. Mark's Medical Center

Statements of Cash Flows

Years Ended June 30, 2018 and 2017

	2018	2017
Operating Activities		
Change in net assets	$ (1,609,706)	$ (6,208,670)
Items not requiring (providing) cash		
Depreciation and amortization	2,102,929	3,203,946
Amortization of debt issuance costs	21,463	277,252
Provision for uncollectible accounts	3,922,050	5,462,038
Loss on disposal of equipment	16,096	198,278
Forgiveness of amounts due to related party	(83,333)	-
Changes in		
Patient accounts receivable	(3,186,220)	(4,870,624)
Estimated amounts due from and to third-party payers	(564,492)	119,772
Supplies	(598)	128,930
Accounts payable and accrued expenses	(1,184,403)	2,808,084
Other assets and liabilities	1,953,554	321,052
Net cash provided by operating activities	1,387,340	1,440,058
Investing Activities		
Purchase of property and equipment	-	(1,647,878)
Proceeds from disposition of assets limited as to use	192,368	64,864
Net cash provided by (used in) investing activities	192,368	(1,583,014)
Financing Activities		
Proceeds from note payable to Foundation	80,000	275,000
Principal payments on long-term debt	(1,132,438)	(1,205,156)
Principal payments on capital lease obligations	(314,659)	(286,782)
Net cash used in financing activities	(1,367,097)	(1,216,938)
Increase (Decrease) in Cash	212,611	(1,359,894)
Cash, Beginning of Year	172,653	1,532,547
Cash, End of Year	$ 385,264	$ 172,653
Supplemental Cash Flows Information		
Interest paid	$ 596,373	$ 624,095
Capital lease obligation incurred for equipment	$ -	$ 1,428,547

St. Mark's Medical Center

Notes to Financial Statements

June 30, 2018 and 2017

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

Nature of Operations

St. Mark's Medical Center (Medical Center) is a not-for-profit organization whose mission and principal activities are to provide health care services to the residents of Fayette and Lee Counties in Texas. The Medical Center was organized in 2002 to construct and operate a new hospital facility in La Grange, Texas.

On January 1, 2011, VHA Southwest Community Health Corporation d/b/a Community Hospital Corporation (CHC), a Texas nonprofit corporation became the sole member of the Medical Center through a master agreement dated December 17, 2010. The master agreement was amended on February 1, 2016. Pursuant to the amendment, during January 2018, and every January thereafter, the Medical Center has the option to unwind CHC's membership in the Medical Center. Unless the Medical Center and CHC otherwise agree, the master agreement will terminate and the corporate relationship will unwind on January 31, 2026.

Use of Estimates

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

Investments and Investment Return

Investments in equity securities having a readily determinable fair value and in all debt securities are carried at fair value. Other investments are valued at the lower of cost (or fair value at time of donation, if acquired by contribution) or fair value. Investment return includes dividend, interest and other investment income; realized and unrealized gains and losses on investments carried at fair value; and realized gains and losses on other investments.

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in unrestricted net assets. Other investment return is reflected in the statements of operations and changes in net assets as unrestricted, temporarily restricted or permanently restricted based upon the existence and nature of any donor or legally imposed restrictions.

Assets Limited as to Use

Assets limited as to use include: (1) assets held by trustees and (2) assets set aside by the Board for future claims payments under a self-insurance program over which the Board retains control and may, at its discretion, subsequently use for other purposes. Amounts required to meet current liabilities of the Medical Center, if any, are included in current assets.

Patient Accounts Receivable

The Medical Center reports patient accounts receivable at net realizable amounts. In evaluating the collectability of accounts receivable, the Medical Center analyzes its past history and identifies trends for each of its major payer sources of revenue to estimate the appropriate allowance for doubtful accounts and provision for uncollectible accounts. Management regularly reviews data about these major payer sources of revenue in evaluating the sufficiency of the allowance for doubtful accounts.

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

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

The Medical Center's allowance for doubtful accounts for self-pay patients was approximately 80% of self-pay accounts receivable as of June 30, 2018 and 2017. Patient account write-offs were approximately $3,990,000 and $8,460,000 for the years ended June 30, 2018 and 2017, respectively. The decrease in patient account write-offs resulted from an increase in 2017 write-offs resulting from a conversion in patient accounting systems in 2017 and a write-off of accounts for which the Medical Center had recorded significant reserves.

Supplies

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

Property and Equipment

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

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

Buildings	15 – 40 years
Equipment	3 – 7 years
Software	3 – 10 years

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

Long-lived Asset Impairment

The Medical Center evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value. No asset impairment was recognized during the years ended June 30, 2018 and 2017.

Trade Name

The trade name is tested annually for impairment. If the implied fair value of the trade name is lower than its carrying amount, an impairment is indicated and the trade name is written down to its implied fair value. Subsequent increases in the trade name value are not recognized in the financial statements. No impairment loss was recognized during the year ended June 30, 2018. During the year ended June 30, 2017, an impairment loss of $254,000 was recognized due to declines in the Medical Center's revenue. The loss is recognized as an impairment loss on trade name in the accompanying statements of operations and changes in net assets.

Debt Issuance Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the effective interest method, and are presented as a reduction of long-term debt.

Net Patient Service Revenue

The Medical Center has agreements with third-party payers, including government programs and managed-care plans that provide for payments to the Medical Center at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The Medical Center provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue.

Contributions

Unconditional promises to give cash and other assets are accrued at estimated fair value at the date each promise is received. Gifts received with donor stipulations are reported as either temporarily or permanently restricted support. When a donor restriction expires, that is when a time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified and reported as an increase in unrestricted net assets. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions. Conditional contributions are reported as liabilities until the condition is eliminated or the contributed assets are returned to the donor.

Income Taxes

The Medical Center has been recognized as exempt from income taxes under Section 501 of the Internal Revenue Code and a similar provision of state law. However, the Medical Center is subject to federal income tax on any unrelated business taxable income. There was no material unrelated business income in 2018 and 2017.

Excess of Revenues Over Expenses

The accompanying statements of operations and changes in net assets include excess of revenues over expenses. Changes in unrestricted net assets which are excluded from excess of revenues over expenses, consistent with industry practice, include contributions for capital acquisitions. The Medical Center had no contributions for capital acquisitions in 2018 or 2017.

Subsequent Events

On November 29, 2018, the Medical Center received short-term loans from the Foundation for $245,000 and from a subsidiary of CHC for $470,000, to assist with supplemental Medicaid funding requirements. These loans were fully repaid on December 26, 2018.

Subsequent events have been evaluated through March 11, 2019, which is the date the financial statements were available to be issued.

Note 2: Net Patient Service Revenue

The Medical Center has agreements with third-party payers, including government programs and managed-care plans that provide for payments to the Medical Center at amounts different from its established rates. Payment arrangements for government programs include:

Medicare. Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The Medical Center is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicare administrative contractor.

Medicaid. Inpatient services are reimbursed under a prospective payment methodology. Most outpatient services rendered to Medicaid program beneficiaries are paid under a cost reimbursement methodology. The Medical Center is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicaid administrative contractor.

Laws and regulations governing these programs are complex and subject to interpretation and change. Settlements under reimbursement agreements with Medicare and Medicaid programs are estimated and recorded in the period the related services are rendered and are adjusted in future periods as adjustments become known or as the service years are no longer subject to audit, review or investigation. Annual cost reports required under the Medicare and Medicaid programs are subject to routine audits, which may result in adjustments to the amounts ultimately determined to be due under the reimbursement programs.

These audits often require several years to reach their final determination of amounts earned under the programs. As a result, it is reasonably possible that recorded estimates could change materially in the near term.

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

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

Patient service revenue, net of contractual allowances and discounts (but before the provision for uncollectible accounts), recognized in the years ended June 30, 2018 and 2017, respectively, is as follows:

	2018	2017
Medicare	41%	35%
Medicaid	3%	4%
Other third-party payers	42%	48%
Patients	14%	13%
	100%	100%

On December 12, 2011, the United States Department of Health & Human Services approved a new Medicaid section 1115(a) demonstration entitled "Texas Health Transformation and Quality Improvement Program." This demonstration expanded existing Medicaid managed-care programs and established two funding pools that assist providers with uncompensated care costs and promote health system transformation. During 2018 and 2017, the Medical Center recognized revenue of approximately $671,000 and $381,000 in funding from the uncompensated care funding pool, respectively. This funding is not necessarily representative of funding the Medical Center will receive in future years. The Medical Center has not yet recognized any revenue from the funding pool designed to promote health system transformation.

The demonstration was originally effective from December 12, 2011 to September 30, 2016 and extended through December 2017, as the Texas Health and Human Services Commission (HHSC) and the Center for Medicare and Medicaid Services (CMS) negotiated a longer term extension. On December 21, 2017, HHSC received an approved extension from CMS for the period of January 1, 2018 through September 30, 2022. Among other changes, the approved plan requires a change in the methodology used to allocate uncompensated care funding and a phase out of the pool designed to promote health system transformation over the five year period. Changes in the funding mechanics of these programs could have an adverse impact on operating results.

These programs are subject to review and scrutiny by both the Texas Legislature and CMS and the programs could be modified or terminated based on new legislation or regulations in future periods. The funding received is also subject to audit by the Medicaid Administrative Contractor. As a result, it is reasonably possible that recorded estimates could change materially in the near term.

Note 3: Concentration of Credit Risk

Patient Accounts Receivable

The Medical Center grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. The mix of net receivables from patients and third-party payers at June 30, 2018 and 2017, is:

	2018	2017
Medicare	40%	37%
Medicaid	6%	8%
Other third-party payers	35%	35%
Self-pay patients	19%	20%
	100%	100%

Bank Balances

At June 30, 2018, the Medical Center's cash accounts, including cash accounts classified in assets limited as to use, exceeded federally insured limits by approximately $2,788,000.

Note 4: Assets Limited As to Use

Assets limited as to use at June 30 include:

	2018	2017
Held by trustee under indenture agreement:		
Cash	$ 2,727,220	$ 2,919,588
Internally designated for self-insurance program:		
Cash	$ 8,179	$ 8,179

Total investment return is comprised of interest and dividend income and approximately $9,000 and $16,000, was recognized in the accompanying statements of operations and changes in net assets as revenues, gains and other support for the years ended June 30, 2018 and 2017, respectively.

Note 5: Long-term Debt

	2018	2017
Mortgage note payable (A)	$ 14,853,452	$ 15,751,897
Note payable (B)	261,469	360,710
Note payable (C)	-	134,753
Capital lease obligations (D)	935,097	1,249,755
	16,050,018	17,497,115
Less unamortized debt issuance costs	259,400	280,863
Less current maturities	1,528,671	1,529,771
Total long-term debt	$ 14,261,947	$ 15,686,481

A. Matures September 1, 2030; payable in monthly installments of $120,406, including interest at an annual rate of 3.03 % to Lancaster Pollard Mortgage Company. Unamortized debt issuance costs were $259,400 and $280,863 at June 30, 2018 and 2017, respectively.

The Note is secured by the revenues of the Medical Center and a partial guarantee by the Federal Housing Administration (FHA) under Section 242 of the National Housing Act and funds held in trust. The FHA guarantee was transferred to Lancaster Pollard Mortgage Company upon defeasance of the Revenue Bonds.

B. Note payable to National Bank and Trust, due in equal monthly installments of principal plus interest at 3% from January 14, 2017 through December 13, 2020.

C. Note payable to St. David's Healthcare Partnership, L.P., LLP, due in equal monthly installments of principal plus interest at 1% from August 1, 2016 through January 1, 2018. As of June 30, 2018 the note was fully paid.

D. Capital leases include leases covering equipment expiring at various dates through September 1, 2021. Interest imputed at rates ranging from 5.35% to 5.85%.

Property and equipment includes equipment under capital leases at June 30, 2018 and 2017, as shown:

	2018	2017
Equipment	$ 1,427,760	$ 1,427,760
Less accumulated amortization	372,173	235,693
	$ 1,055,587	$ 1,192,067

Aggregate annual maturities of long-term debt and payments on capital lease obligations at June 30, 2018, are:

	Long-term Debt (Excluding Capital Lease Obligations)	Capital Lease Obligations
2019	$ 1,196,441	$ 376,524
2020	1,147,723	309,966
2021	1,128,222	243,408
2022	1,107,389	89,073
2023	1,141,413	-
Thereafter	9,393,733	-
	$ 15,114,921	1,018,971
Less amount representing interest		83,874
Present value of future minimum lease payments		935,097
Less current maturities		332,230
Noncurrent portion		$ 602,867

The mortgage note payable and U.S. Department of Housing and Urban Development (HUD) mortgage agreement, require the Medical Center to meet certain financial performance levels and place restrictions on the incurrence of additional debt. The mortgage note payable also requires certain funds be held in trust. Such funds are included in assets limited as to use – held by trustee on the balance sheets.

Note 6: Charity Care

In support of its mission, the Medical Center voluntarily provides free care to patients who lack financial resources and are deemed to be medically indigent. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported in net patient service revenue. The cost associated with the Medical Center's charity care program was approximately $269,000 and $270,000 for 2018 and 2017, respectively.

The cost of charity care is estimated by applying the overall ratio of the Medical Center's cost to charges to the gross charges related to services provided to patients qualifying for the Medical Center's charity care program.

In addition, the Medical Center provides services to other medically indigent patients under certain government-reimbursed public aid programs. Such programs pay providers amounts which are less than established charges for services provided to the recipients and many times the payments are less than the cost of rendering the services provided.

The Medical Center also commits significant time and resources to endeavors and critical services, which meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. Such programs include health screening and assessments, community educational services and various support groups.

Note 7: Related Party Transactions

The Medical Center and Foundation are related parties that are not financially interrelated organizations. The Medical Center authorizes the Foundation to solicit contributions on its behalf. In the absence of donor restrictions, the Foundation has discretionary control over the amounts and time of its distributions to the Medical Center.

The Foundation advanced the Medical Center $275,000 in 2017 and additional $80,000 in 2018. The advances from the Foundation are interest free and there are no repayment terms. Outstanding balances of $355,000 and $275,000 have been recognized as a current liability in the balance sheet at June 30, 2018 and 2017, respectively.

CHC provides management services to the Medical Center. Under this agreement, CHC provides the Medical Center's Chief Executive Officer and performs the oversight of the day-to-day administration, management and direction of the operations of the Medical Center.

Ultimate authority for the management of the Medical Center and appointment of the Medical Center's Chief Executive Officer rests with the Medical Center's board. The Medical Center paid $170,000 and $140,000 in management fees to CHC for the years ended June 30, 2018 and 2017, respectively, which are included in purchased services and professional fees in the accompanying statements of operations and changes in net assets.

CHC has provided $575,000 in funding to the Medical Center to assist with the purchase of capital assets and other costs. The Medical Center has recognized the payment as a payable back to CHC which is included in other long-term liabilities in the balance sheet. Under the terms of the related agreements, $500,000 of the amount due will be forgiven in six equal annual installments beginning in April 2018 and $75,000 of the amount due will be forgiven in six equal annual installments beginning in March 2019. The amount payable under this agreement is due to CHC upon termination of the master agreement between the Medical Center and CHC. The unforgiven balance of this payable is $492,000 and $575,000 at June 30, 2018 and 2017, respectively.

Note 8: Functional Expenses

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

	2018	2017
Program services	$ 26,516,300	$ 30,852,630
General and administrative	1,614,721	2,458,350
	$ 28,131,021	$ 33,310,980

Note 9: Medical Malpractice Claims

The Medical Center purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Medical Center's claim experience, no such accrual was necessary. It is reasonably possible that this estimate could change materially in the near term.

The Medical Center was self-insured for the first $1,000,000 per occurrence of medical malpractice risks for service dates through June 30, 2008, and purchased commercial coverage above the self-insurance limits. The Medical Center had no amounts accrued related to this self-insured program as of June 30, 2018 and 2017.

Note 10: Retirement Plan

The Medical Center had a defined contribution pension plan covering substantially all employees. The board annually determines the amount, if any, of the Medical Center's contributions to the retirement plan. Effective January 1, 2011, the Medical Center retirement plan was merged into the CHC retirement plan. The Medical Center's pension expense was approximately $132,000 and $153,000 for the years ended June 30, 2018 and 2017, respectively.

Note 11: Operating Leases

Noncancellable operating leases for certain equipment and a medical office building expire in various years through 2023. The medical building lease requires the Medical Center to pay a *pro rata* share of the building operating expenses in addition to the base rent. The medical building master lease agreement also requires the Medical Center to assume lease payments for all unused office space. Rental expense for the years ended June 30, 2018 and 2017, was approximately $767,000 and $747,000, respectively.

Future minimum lease payments as of June 30, 2018, are as follows:

2019	$	478,789
2020		485,629
2021		452,122
2022		418,810
2023		373,819
Thereafter		608,116
	$	2,817,285

Minimum future rentals receivable under operating subleases at June 30, 2018, were approximately $327,000. Of this future rental receivable, approximately $222,000 of the future lease payments are cancellable by either the Medical Center or renter with 90 days notice.

Note 12: Management's Consideration of Going Concern Matters

Due to operating losses recognized in 2018 and 2017, the Medical Center has a deficiency of working capital and a weakened cash position.

Management is considering several alternatives for mitigating these conditions during the next year. These include taking measures to reduce salaries expenses through the reduction of overtime worked by employees, renegotiate pricing contracts with significant vendors, and closure of unprofitable service lines. Management expects the measures to reduce salaries expense and renegotiate more favorable prices with vendors to reduce supplies expense will ultimately reduce operating expenses and improve operating cash flows. The OB service line has historically been unprofitable for the Medical Center and was closed in September 2017. The Medical Center has also closed two unprofitable clinics. Management expects these measure will reduce and ultimately help reverse the historical operating losses. These and other measures have been implemented to the extent that expenses have been reduced and thus the operating losses.

Management also anticipates payment of obligations to related parties will be delayed until the Medical Center's cash position allows for repayment of those obligations.

Note 13: Significant Estimates and Concentrations

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

Allowance for Net Patient Service Revenue Adjustments

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

Litigation

In the normal course of business, the Medical Center is, from time to time, subject to claims and lawsuits that arise in the ordinary course of its activities. It is the opinion of management that the disposition or ultimate resolution of any such claims and lawsuits will not have a material adverse effect on the financial position, change in net assets and cash flows of the Medical Center. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Note 14: Insurance Recovery

In August 2017, the Medical Center experienced property damage and an interruption in operations due to Hurricane Harvey. The Medical Center had insurance to mitigate the risk of such events and recognized a gain on the recovery from the proceeds of its insurance coverage of $403,863, which is included in the statement of operations and changes in net assets as a component of other operating revenues.

Note 15: Future Changes in Accounting Principles

On May 28, 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers*. The goal of this standard is to improve consistency of requirements, comparability of revenue recognition practices and usefulness of disclosures. The Medical Center expects to first apply this ASU in fiscal year 2020.

On February 25, 2016, FASB issued ASU 2016-02, *Leases* (Topic 842). Under this ASU, lessees will recognize lease assets and liabilities on their balance sheet for all leases with terms of more than 12 months. Additional qualitative and quantitative disclosures are also required. The Medical Center expects to first apply this ASU in fiscal year 2021.

On August 28, 2016, FASB released ASU 2016-14, *Not-For-Profit Entities* (Topic 958): *Presentation of Financial Statements of Not-For-Profit Entities*. Upon adoption of this ASU, Cook Children's will distinguish between two new classes of net assets – those with donor-imposed restrictions and those without. The ASU also requires enhanced qualitative and quantitative disclosures to provide additional information regarding liquidity and cash flows and also requires disclosures on amounts and purposes of governing board or self-imposed designations and appropriations. The Medical Center expects to first apply this ASU in fiscal year 2019.

The impact of applying these new standards has not yet been determined.