

DeSoto County Hospital District

Financial Report
September 30, 2019

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RSM US LLP

Independent Auditor's Report

To the Board of Directors
DeSoto County Hospital District

Report on the Financial Statements

We have audited the accompanying financial statements of DeSoto County Hospital District (the District) as of and for the years ended September 30, 2019 and 2018, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 the District as of September 30, 2019 and 2018, and the changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management Discussion and Analysis on pages 3 through 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated January 23, 2020, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

RSM US LLP

Davenport, Iowa
January 23, 2020

DeSoto County Hospital District

Management's Discussion and Analysis (Unaudited) Year Ended September 30, 2019

State law requires every Florida special district to publish within 9 months of the close of each fiscal year a complete set of audited financial statements. This report is published to fulfill that requirement for the fiscal year ended September 30, 2019.

Management assumes full responsibility for the completeness and reliability of the information contained in this report, based upon a comprehensive framework of internal control that it has established for this purpose. Because the cost of internal control should not exceed anticipated benefits, the objective is to provide reasonable, rather than absolute, assurance the financial statements are free of any material misstatements.

RSM US LLP, Certified Public Accountants, has audited the DeSoto County Hospital District's financial statements for the years ended September 30, 2019 and 2018. The independent auditor's report is located on pages 1-2 of this report.

As management of the DeSoto County Hospital District (the District), we offer the readers of our financial statements this discussion and analysis as an overview of the financial activities of the District for the years ended September 30, 2019 and 2018. Readers are encouraged to consider the information presented herein in conjunction with the accompanying financial statements and related footnote disclosures.

Background

Located in Arcadia, Florida, the District is a special-purpose government, as defined by the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, engaged only in business-type activities and has no other material operations. The District includes in its financial statements all organizations for which it is financially accountable (component units), as defined by the accounting standards, and as further described in this section.

Using This Report

This annual report includes the financial statements of the District, including the operations of DeSoto Memorial Hospital (the Hospital) and its two component units, of which the District is the sole member: 1) DCHD Health Care Professionals, LLC (Professionals), exists for the sole purpose of employing such health care professionals and physicians needed to staff the Hospital and other locations and 2) DMH Real Estate Holdings, Inc. (Holdings), a nonprofit corporation to hold title to property for the exclusive use of the District (collectively, the Blended Component Units). The financial statements of these entities have been reported as activities of the Hospital because of their relatively small financial impact on overall operations, or they provide services solely to the Hospital. See Note 1 to the audited financial statements for further description of the component units.

The enclosed financial statements are designed to provide readers with an overview of the District's finances. The statement of net position presents information on the District's assets, liabilities and net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

DeSoto County Hospital District

Management's Discussion and Analysis (Unaudited) Year Ended September 30, 2019

The statement of revenues, expenses, and changes in net position presents information indicating how the District's net position changed during the fiscal year. All changes in net position are reported when the event causing the change occurs, regardless of when related cash is given or received. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods, which reflects the accrual basis of accounting.

The final required statement is the statement of cash flows. This statement reports cash receipts, payments, and net changes in cash resulting from operating activities, noncapital financing activities, capital and related financing activities and investing activities. This statement highlights the sources and uses of cash and changes in cash balance over the reporting period.

In addition, the aforementioned statements contain notes to provide additional information integral to a full understanding of the information provided in the financial statements. These notes explain organizational matters about the District, its accounting policies and their application, and further detailed information about the components of the basic financial statements.

Profile of the District

The District provides a continuum of healthcare services to the community through a network of organizations. The District currently owns and operates 49 acute-care beds as a designated rural sole community hospital, a home health agency, and a hospital-based physician group. This network is commonly referred to as DeSoto Memorial Hospital (the Hospital). The Hospital provides services in southwest Florida, primarily in medically underserved areas, as classified by the United States Department of Agriculture, of DeSoto County and Hardee County.

In 1965, the District was legislatively created, pursuant to the laws of Florida, to own and operate medical facilities in DeSoto County. The District continued acute health care services established by local physicians in 1912. The District is governed by five directors appointed by the governor of the State of Florida for terms of four years each. The current enabling Act of the District was passed by a Special Act of the Florida Legislature as Chapter 2004-450, Laws of Florida (the Act), which codified all prior laws that established the District, a public body corporate and politic of the State of Florida.

In 1985, due to certain national regulatory changes and other industry factors, a tax exempt 501(c)3 organization was formed. Assets and the responsibility of operating the Hospital were transferred to this new organization. In 2010, due to various regulatory and other factors, the assets, except those accounts related to capital assets, were transferred back to the District. See Note 1 to the financial statements for additional information.

The financial performance over the previous 10 years has resulted in an average annual \$1.1 million net loss. Fiscal year 2009 incurred the largest loss of approximately \$4.2 million. The primary factors driving this lower financial performance are debt coverage needs associated with the opening in 2008 of a \$20 million facility addition and lower patient volumes due to the unexpected local and national economic downturn beginning in 2007. As compared to earlier years, fiscal years 2018 and 2019 both experienced significant increase in State and Federal government programs subsidizing facilities with extremely high charity care and other uncompensated services. Since the latter half of fiscal year 2009 management has implemented various cost controls and monitoring processes to improve the financial performance of the District.

DeSoto County Hospital District

Management's Discussion and Analysis (Unaudited) Year Ended September 30, 2019

Management has established an aggressive marketing focus to bring physician specialists to the Hospital. In fiscal year 2016 inpatient volumes began a rapid decrease. Several new surgical specialists and the transition of a new Emergency Services Physician group in January 2017 increased inpatient volume. Fiscal years 2018 and 2019 have experienced a reduction of inpatient volumes due to health plans aggressively challenging inpatient admissions and advancing technologies allowing services to be performed on an outpatient basis. The Hospital Strategic Plan has recruitment of physician specialists as a high priority.

Effective July 1, 2017, the Florida Medicaid program converted to an Ambulatory Payment Classification system. This new system had a number of processing issues during 2018 and 2019. The District reimbursement continues to be significantly below cost of services rendered.

Medicare has made a number of changes in reimbursement and reporting requirements. Continued CMS emphasis on formation of Accountable Care Organizations (ACO) to reduce services provided in a hospital setting adversely affects Hospital patient volumes. Regulatory mandates relating to "Pricing Transparency" have been revised. The regulations still do not bring a clear process to explaining a patient's health plan as it related to services provided by the District.

A number of proposed Federal legislative regulations might assist the Hospital with increased subsidies. The probability of these regulations being enacted in the future is fairly low. At the state level, a high probability exists of further reductions in payments or health plan coverage for Medicaid beneficiaries for the State Fiscal Year (SFY) beginning July 1, 2020.

In February 2018, the local Federally Qualified Health Clinic (FQHC), the provider of all OB physician services at the Hospital, terminated services in DeSoto County. As a result, in January 2018, the Board of Directors voted to terminate the provision of delivery services at the Hospital effective February 1, 2018. The District established a relationship with Bayfront Health Port Charlotte (Bayfront) to handle deliveries from the community. As part of this effort, Bayfront established a full time OB-GYN office location on the Hospital campus.

In August 2017, the State of Florida notified the Hospital of rate changes due to recently audited cost reports. The rates from January 1, 2000 through June 30, 2016 were recomputed. The State recouped \$650,000. The Hospital believed significant errors were contained in the recomputed rates and successfully appealed to the State. The appeal resulted in a favorable recoupment of approximately \$750,000. The impact of the audit recoupment was recognized in fiscal year 2017 and the impact of the successful appeal was recognized in fiscal year 2018.

Most Florida Medicaid beneficiaries are now covered by commercial managed care organizations (Managed Medical Assistance program) and Medicare beneficiaries continue to steadily convert to Medicare Replacement Plans. These plans often have narrow physician networks or utilize non-hospital resources for plan beneficiary medical care. The Hospital services used by winter residents primarily have Medicare Health Plans. Based on recent volume levels, management estimates the fiscal year 2020 winter season volume to moderately increase compared to historical trends.

DeSoto County Hospital District

Management's Discussion and Analysis (Unaudited) Year Ended September 30, 2019

Continuing challenges facing the District and the health care industry include providing high-quality patient care in a competitive environment, contending with significant increases in complex regulatory requirements, attaining reasonable reimbursement rates for services provided, and managing costs. In 2019, Florida legislative action again declined the federal program to expand Medicaid plan benefits to a larger segment of the low-income uninsured/underinsured population. We estimate acceptance of this program would have increased cash flow to the District by approximately \$2.5 million to \$3.0 million. The State of Florida receives matching funds from the Federal Government under Section 1115 Waivers, commonly referred to as the Low Income Pool Program (LIP), to assist health care facilities who experience high levels of uncompensated care. The current waiver provides funding for a four year period through SFY2022. Expanding the coverage to low-income residents would most likely decrease the LIP fund allocation.

The LIP funds are computed on the cost of charity care rendered by healthcare providers, primarily acute care hospitals. For the Hospital, the 2019 funds allocated are \$1,990,000. These funds cover approximately 80% of the Hospital's total fiscal year 2019 charity care service costs of approximately \$2,400,000. The Florida legislature has approved an allocation to the Hospital of approximately \$1.9 million for SFY 2020 and is expected to approve a similar amount for SFY21. It is expected this annual level of funding will continue through June 30, 2022. Additional uncompensated service costs of approximately \$1,600,000 related to the provision of uncollectible accounts, generally referred to as bad debt, is not covered by any subsidies or other programs. A significant portion of bad debt accounts are incurred due to the inability to obtain proper documentation from patients who would otherwise be eligible to be classified as charity care services. The majority of these patients incur Emergency Services, wherein the Emergency Medical Treatment and Labor Act is applicable.

On November 4, 2014, the community approved a sales tax increase, effective January 1, 2015, designated solely for payment of debt outstanding as of August 12, 2014. The Hospital Board directed these funds be designated for funding the USDA Mortgage Debt Service. The Hospital receives monthly cash transfers from the County to the Designated Debt Service Account. Based on this years' experience, the Hospital projects the annual sales tax receipts for 2020 to be over \$1.7 million. Total Debt Service is approximately \$1.2 million per year. Collections in excess of the annual debt service are applied to the Debt Service Reserve Fund or outstanding mortgage principal balance. The increased sales tax segment may be terminated at any time by majority vote of the County Commissioners.

Although the sales tax assistance provides significant financial relief, the decreased Medicare reimbursement as defined in the Patient Protection and Affordable Care Act (ACA) and the State of Florida not participating in the expanded Medicaid benefit plan has over a \$3.5 million annual adverse impact on cash funds. The District is exploring various avenues to cover this adverse financial situation. Continued discussion with various governmental agencies and entities as well as with larger tertiary facilities and national health care systems will be used to formulate options to this funding shortfall.

Another significant challenge facing the District and the industry is the ongoing increase in labor costs due to shortage of nurses and other skilled health care professionals, especially in rural areas. Industry experts expect the labor shortage to continue for the foreseeable future. The District has implemented various initiatives to better position itself to attract and retain qualified physician, nursing and other personnel, improve productivity, and manage labor-cost pressures.

DeSoto County Hospital District

**Management's Discussion and Analysis (Unaudited)
Year Ended September 30, 2019**

The Hospital continues to upgrade components of its clinical electronic information system. The Hospital has fulfilled all requirements contained in the Health Information Technology for Economic and Clinical Health Act (HITECH), part of the American Recovery and Reinvestment Act (ARRA) of 2009. The requirements continue to be upgraded under the Office of the National Coordinator of Health Information Technology (ONC). We expect to fulfill all present and future CMS requirements. Failure to meet these requirements could lead to a 4% reduction in all Medicare reimbursement (approximately \$600,000 annual impact).

The following are condensed statements of net position as of September 30, 2019, 2018 and 2017:

	2019	2018	2017
Assets			
Current assets	\$ 10,250,966	\$ 10,069,328	\$ 10,219,032
Noncurrent assets	16,794,363	17,164,332	16,714,939
Total assets	\$ 27,045,329	\$ 27,233,660	\$ 26,933,971
Liabilities			
Current liabilities	\$ 4,321,878	\$ 4,103,487	\$ 6,406,181
Noncurrent liabilities:			
Professional liability accrual	449,315	600,000	501,000
Long-term debt	15,187,051	16,010,070	15,636,170
Total liabilities	19,958,244	20,713,557	22,543,351
Net position	7,087,085	6,520,103	4,390,620
Total liabilities and net position	\$ 27,045,329	\$ 27,233,660	\$ 26,933,971

The following are condensed statements of revenues, expenses and changes in net position for the years ended September 30, 2019, 2018 and 2017:

	2019	2018	2017
Operating revenues	\$ 33,984,481	\$ 34,804,341	\$ 38,828,874
Operating expenses:			
Labor expense	17,306,900	17,397,459	18,123,186
Physician fees	2,010,664	2,134,427	2,085,938
Supplies	4,466,206	4,472,490	3,928,478
Other	8,997,900	7,975,947	12,303,490
Depreciation	1,669,788	1,638,871	1,590,463
Total operating expenses	34,451,458	33,619,194	38,031,555
Operating income (loss)	(466,977)	1,185,147	797,319
Nonoperating revenues, net	1,033,959	944,336	850,387
Increase in net position	\$ 566,982	\$ 2,129,483	\$ 1,647,706

DeSoto County Hospital District

Management's Discussion and Analysis (Unaudited) Year Ended September 30, 2019

Business-Type Activities

The primary business activity of the District is the operation of the Hospital and other health care services, which is considered business-type activity and accounted for in a single proprietary fund. Other activities of the District are immaterial and are not reported in separate funds.

In fiscal year 2019, inpatient volumes decreased approximately 20% and outpatient services increased approximately 16%. Outpatient volumes increased due to increases in physical therapy, behavioral medicine and new wound care services.

In fiscal year 2018, net patient service revenue increased approximately \$2,033,000 or 6.3% compared to the prior year. In fiscal year 2018, inpatient and observation patient volumes decreased by 264 discharges (7%) compared to the prior year. With the termination of delivery services, OB volume decreased 162 inpatient discharges as compared to prior year. Outpatient volumes increased significantly in physical therapy, behavioral medicine, cardiac rehab and home health services.

In early fiscal year 2017, the Hospital expanded its lab outreach services by offering molecular tests to a wider geographic service area. Significant revenues were experienced. A dispute arose with a major health plan and the Hospital recorded an estimated settlement in 2017 as a reduction of operating revenue. The Hospital voluntarily ended the lab program in May 2017. Negotiations with the health plan reached a settlement in mid fiscal year 2018. As a result, an increase of approximately \$650,000 was recorded as operating revenues.

For fiscal year 2019, labor costs remained consistent as compared to the prior year (decrease of 1%). For fiscal year 2018, salaries, wages, and employee benefits (including contract labor) decreased \$725,000 or 4%, primarily due to the reduced OB costs. Full-time-equivalent employee level (FTEs) decreased 9% from the prior year. For fiscal year 2017, salaries, wages, and employee benefits (including contract labor) increased \$897,000, or 5% compared to the prior year. Increased inpatient, surgical, lab and pharmacy services as well as rate increases to meet market demands are the primary reasons for the increase. The full-time-equivalent employee level (FTEs) increased 2.5% from the prior year.

For fiscal year 2019, physician fees remained consistent with the prior year and other fees increased 19% (\$848,000) from the prior year due to the addition of the wound care services. For fiscal year 2018, physician fees remained consistent with prior year and other fees decreased 39% (\$4,305,000) from the prior year, due primarily to management fees related to lab outreach services discussed above. For fiscal year 2017, fees increased 78% (\$4,776,000) from the prior year, which was mostly due to management fees related to lab outreach services discussed above. Also, in January 2017 the Hospital transitioned the Emergency Services Physicians to a private company. All professional fee revenues and expenses are the sole responsibility of that group.

For fiscal year 2019, supplies remained consistent with the prior year. For fiscal year 2018, supplies increased 14% (\$544,000) primarily due to increased purchases of orthopedic implants and certain pharmacy items (manufacturer shortage items). For fiscal year 2017, supplies increased 18% (\$601,000) primarily due to increased purchases of orthopedic implants and pharmacy items.

For fiscal year 2019, net nonoperating revenue increased 9% (\$90,000) from 2018 primarily due to increased sales tax revenue. For fiscal year 2018, net nonoperating revenue increased 11% (\$94,000) from 2017 primarily due to increased sales tax revenue. For fiscal year 2017, net nonoperating revenue decreased 28%, (\$339,000) from 2016 primarily due to the decrease in funds received for meaningful use (2016 was the final year).

DeSoto County Hospital District

Management's Discussion and Analysis (Unaudited) Year Ended September 30, 2019

Operating Statistics

The table below sets forth certain selected historical operating statistics for the District for the years ended September 30, 2019, 2018 and 2017:

	2019	2018	2017
Net patient service revenue	\$ 33,952,795	\$ 34,107,313	\$ 32,074,606
Net patient service revenue per adjusted admission	\$ 7,357	\$ 6,510	\$ 5,473
Net patient expense per adjusted admission	\$ 7,465	\$ 6,417	\$ 6,489
Admissions	877	1,268	1,744
Nursery	-	91	261
Surgery cases	621	774	859
Admissions through emergency services	651	782	892
Adjusted admissions (1)	4,615	5,239	5,861
Case mix index—all inpatients (2)	1.2732	1.1570	1.0236

- (1) Adjusted admissions is an equivalency metric representing patient hospital admissions adjusted to include outpatient and emergency room services by multiplying inpatient admissions by the sum of gross inpatient revenues and outpatient revenues and dividing the result by gross inpatient revenues.
- (2) Case mix index represents the acuity level of inpatient services rendered. Changes generally reflect the level of resources required. For Medicare and certain commercial insurance payors, this relative value weighting system directly affects the reimbursement level.

Revenue and Volume Trends

The District's revenues depend upon inpatient occupancy levels, ancillary services, volume of outpatient procedures, mix of services provided and reimbursement rates for such services. The District has agreements with third-party payors, including government programs and managed-care health plans, whereby the District is paid based upon predetermined rates per diagnosis, fixed per diem inpatient rates or discounts from established charges. Although efforts continue toward improving reimbursement rates with contracted payors, there are no assurances the District will continue to achieve increases in the future. The District believes it will realize rate increases from commercial payors approximately equal to inflationary cost increases. Given budget concerns at both the federal and state levels, further government plan rate reductions are highly probable and would be a significant financial detriment.

For next fiscal year, management believes, based on specific federal government rate changes for rural hospitals and state Medicaid subsidies, the government plan rates will decrease significantly from current levels. The State Medicaid System has moved most of the Medicaid population to privatized HMO vendors. Many of these vendors make utilization of hospital services very difficult to obtain. Based upon current Federal legislative actions and discussions, significant adverse changes in government plan reimbursement are very likely to continue into ensuing years, especially in areas where aggressive managed care is utilized.

DeSoto County Hospital District

Management's Discussion and Analysis (Unaudited) Year Ended September 30, 2019

The percentage of patient service revenue related to Medicare, Medicaid, discounted arrangements, and other follows for the years ended September 30, 2019, 2018 and 2017:

	2019	2018	2017
Medicare	55%	52%	50%
Medicaid	15%	17%	21%
Insurance (primarily Blue Cross)	20%	21%	19%
Self-pay	10%	10%	10%

The District provides significant health care to the indigent population within its primary service area. Uncompensated charges for care provided to this population included charity care of approximately \$9,651,000, \$7,800,000 and \$7,500,000, and bad debts of approximately \$5,885,000, \$5,419,000 and \$6,127,000 for the years ended September 30, 2019, 2018 and 2017, respectively. These patients represent approximately 10% of total patient revenues for each of the fiscal years 2019, 2018 and 2017. Management's projection for the ensuing year is to decrease uncompensated services as a percentage of total services through continued thorough credit reviews at the time of service and to increase service volume to patients covered by commercial and government health care reimbursement plans. The impact that federal legislative action in the next year will have on the local economic environment and ability of residents to obtain Health Plan coverage is unknown.

Liquidity and Capital Resources

The District's cash and investment accounts are held in Qualified Public Depositories and Local Government Surplus Trust Fund Investment Pools, as allowed by Florida Statute. Cash, cash equivalents and current unrestricted investments totaled approximately \$4,193,000 and \$4,943,000 as of September 30, 2019 and 2018, respectively. The District established a \$1,000,000 line of credit with a local financial institution in November 2015 collateralized by the District's Certificates of Deposit. The line of credit was not renewed in October 2019.

As of September 30, 2019, the District's current ratio, which compares current assets to current liabilities, was 2.4 compared to 2.5 as of September 30, 2018. The District's days net patient service revenue in accounts receivable of 30 increased 25% from 2018. The increase is due to taking more time to properly document and code accounts before claims are submitted. Capital asset additions totaled approximately \$1,714,000 and \$2,116,000 in 2019 and 2018, respectively. The majority of acquired capital is from the acquisition of various surgery and radiology equipment.

At September 30, 2019, the District had approximately \$14,508,000 outstanding in a mortgage payable to the USDA for a 2008 facility expansion/renovation and \$1,789,000 outstanding on leases payable and equipment debt. Maturities and other information regarding the current bond obligations are presented in Note 6 to the District's financial statements.

DeSoto County Hospital District

Management's Discussion and Analysis (Unaudited) Year Ended September 30, 2019

In October 2013, the District Board determined the liquidity level was trending toward a perilously low level. In order to maintain a reasonable level of liquidity, the Board approved utilization of the mortgage note debt service reserve fund. In July 2014, the Board determined the projected liquidity levels would continue to be below reasonable levels. As such, the District terminated the supplementary payment agreement with USDA related to the mortgage note, as allowed by the terms of the agreement, which ceased monthly payments to the debt service reserve fund. With the passage of the January 2015 increased DeSoto County Sales Tax restricted specifically to the District's mortgage debt and efforts to improve the financial operations of the District Hospital operations, it is expected the next mortgage debt service payment due in June 2020 will be fulfilled. An increase in the Debt Service Reserve Fund of approximately \$427,000 was accomplished as of September 30, 2019. Continued efforts necessary to fulfill the calculated debt service reserve levels will continue to be made.

Effects of Inflation and Changing Prices

Various federal and state laws have been enacted, severely limiting the amount the District will receive for patient care. Revenues for acute-care hospital services rendered to Medicare patients are established under the federal government's prospective payment system. Medicare periodically updates hospital rates based upon specific cost report years. The last update for the Hospital was in 2006. At the state level, revenues for outpatient services rendered to Medicaid patients are now based on a state wide cost-based reimbursement program set by the state and can be modified based on the state's current budgetary conditions. Florida legislative action in 2017 moved Medicaid cost based outpatient reimbursement to an average payment method. In 2018, Medicaid inpatient reimbursement was reduced by about 20%. These both have had a significant adverse impact on District reimbursement. In February, 2018 the District ceased OB services primarily due to decreased payments for services rendered. Patients covered by government plans constitute approximately 70% of the District's services provided to the community. Commercial Health Plans continue to either deny or place heavy financial out of pocket burdens on its members for services performed in a hospital setting.

Management believes hospital industry operating margins have been, and will continue to be, under significant pressure because of changes in health plan benefit design, reimbursement rates, and growth in operating expenses. Recent Federal legislation regarding Medicare payments and impact on access to health plan coverage due to changes in the Federal Tax regulations will have a negative financial impact on the Hospital. As a result of increasing regulatory and competitive pressures, including additional measures being considered under various federal health care reform proposals, the District's ability to maintain operating margins through price increases to nongovernmental payors and patients is extremely limited.

Health Care Reform

In the United States, significant changes have occurred in the health care system as a result of the Health Care Reform Act of 2010 and subsequent Acts. Substantially all of the key provisions of the Health Care Reform Act are now effective. While federal agencies have published interim and final regulations with respect to certain requirements, many issues remain uncertain.

The Federal Administration and the U.S. Congress may seek to modify, repeal or replace all or part of this health care reform legislation. These efforts began when President Trump signed an executive order in January 2017 that instructs agencies to waive, defer, grant exemptions from, or delay the implementation of any provision of the Health Care Reform Act that poses a financial burden. As a result, it is difficult to predict the continuing impact of the Health Care Reform Act on the Hospital's business. In addition, the continuing development of implementing regulations and interpretive guidance and legal challenges has contributed to this uncertainty. The Hospital is unable to predict how these events will develop and what impact they will have on the various acts impacting health care, and in turn, on the Hospital.

DeSoto County Hospital District

**Management's Discussion and Analysis (Unaudited)
Year Ended September 30, 2019**

Contact Information

DeSoto County Hospital District
Attn: Administration
900 North Roberts Avenue
Arcadia, FL 34266
www.dmh.org

DeSoto County Hospital District

**Statements of Net Position
September 30, 2019 and 2018**

	2019	2018
Assets		
Current assets:		
Cash and cash equivalents	\$ 3,192,759	\$ 3,943,331
Certificates of deposit	1,000,000	1,000,000
Patient accounts receivable, net of allowances for contractual adjustments and doubtful accounts of 2019 \$10,131,000; 2018 \$8,468,000	2,768,951	2,325,150
Other receivables	270,499	415,211
Inventories	1,029,580	951,590
Prepaid expenses	544,036	531,172
Due from third-party payors	122,209	108,128
Assets limited as to use:		
Restricted for debt service (Note 6)	1,086,850	659,564
Self-insurance trust fund (Note 4)	236,082	135,182
Total current assets	10,250,966	10,069,328
Capital assets (Note 5):		
Non-depreciable	390,997	420,064
Depreciable	16,403,366	16,744,268
Capital assets, net	16,794,363	17,164,332
Total assets	\$ 27,045,329	\$ 27,233,660
Liabilities and Net Position		
Current liabilities:		
Accounts payable	\$ 1,026,944	\$ 1,018,900
Accrued payroll and benefits	1,524,809	1,358,223
Current portion of professional liability accrual (Note 4)	269,000	220,000
Other current liabilities	391,237	422,172
Current portion of long-term debt (Note 6)	1,109,888	1,084,192
Total current liabilities	4,321,878	4,103,487
Professional liability accrual, net of current portion (Note 4)	449,315	600,000
Long-term debt, net of current portion (Note 6)	15,187,051	16,010,070
Total liabilities	19,958,244	20,713,557
Commitments and contingencies (Note 8)		
Net position:		
Invested in capital assets, net of related debt	497,424	70,070
Restricted	1,200,251	832,899
Unrestricted	5,389,410	5,617,134
Total net position	7,087,085	6,520,103
Total liabilities and net position	\$ 27,045,329	\$ 27,233,660

See notes to financial statements.

DeSoto County Hospital District

**Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2019 and 2018**

	2019	2018
Operating revenues:		
Net patient service revenue, net of provision for bad debts 2019 \$5,885,000; 2018 \$5,419,000	\$ 33,952,795	\$ 34,107,313
Lab outreach services revenue	-	643,966
Other revenue	31,686	53,062
Total operating revenues	33,984,481	34,804,341
Operating expenses:		
Salaries and wages	13,667,174	13,292,417
Benefits	2,708,055	3,115,297
Contract labor	931,671	989,745
Fees—physician	2,010,664	2,134,427
Fees—other	5,314,622	4,466,152
Supplies	4,466,206	4,472,490
Utilities	807,495	849,960
Repairs and maintenance	1,085,489	1,066,889
Rentals and leases	843,309	639,836
Insurance (Note 4)	194,082	313,657
Other expenses	752,903	639,453
Depreciation	1,669,788	1,638,871
Total operating expenses	34,451,458	33,619,194
Operating income (loss)	(466,977)	1,185,147
Nonoperating revenues (expenses):		
Sales tax revenue	1,573,577	1,421,955
Noncapital grants and contributions	61,465	128,835
Investment income	34,090	32,037
Other	98,342	105,904
Interest expense	(733,515)	(744,395)
Total nonoperating revenues, net	1,033,959	944,336
Increase in net position	566,982	2,129,483
Net position, beginning of year	6,520,103	4,390,620
Net position, end of year	\$ 7,087,085	\$ 6,520,103

See notes to financial statements.

DeSoto County Hospital District

**Statements of Cash Flows
Years Ended September 30, 2019 and 2018**

	2019	2018
Cash flows from operating activities:		
Cash received from third-party payors, patients and other	\$ 33,935,553	\$ 32,475,303
Cash paid to employees	(16,208,643)	(16,398,830)
Cash paid for supplies, purchased services and other	(16,710,604)	(15,667,141)
Net cash provided by operating activities	1,016,306	409,332
Cash flows from noncapital financing activities:		
Sales tax proceeds	1,309,335	1,382,684
Noncapital grants, contributions and other revenue received	159,807	234,739
Net cash provided by noncapital financing activities	1,469,142	1,617,423
Cash flows from capital and related financing activities:		
Purchase of capital assets	(887,626)	(376,728)
Principal payments on long-term debt	(1,114,598)	(1,113,550)
Cash paid for interest	(739,700)	(750,334)
Net cash used in capital and related financing activities	(2,741,924)	(2,240,612)
Cash flows from investing activities:		
Increase in assets limited as to use	(528,186)	(169,731)
Investment income received	34,090	32,037
Net cash used in investing activities	(494,096)	(137,694)
Net change in cash and cash equivalents	(750,572)	(351,551)
Cash and cash equivalents:		
Beginning	3,943,331	4,294,882
Ending	\$ 3,192,759	\$ 3,943,331

(Continued)

DeSoto County Hospital District

**Statements of Cash Flows (Continued)
Years Ended September 30, 2019 and 2018**

	2019	2018
Reconciliation of operating income (loss) to net cash provided by operating activities:		
Operating income (loss)	\$ (466,977)	\$ 1,185,147
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	1,684,490	1,656,191
Loss on disposal of capital assets	7,468	10,604
Changes in assets and liabilities:		
(Increase) decrease in patient accounts receivable, net	(443,801)	302,409
(Increase) decrease in other receivables	408,954	(8,429)
(Increase) in inventories and prepaid expenses	(90,854)	(178,697)
Increase (decrease) in accounts payable	(109,044)	119,873
Increase in accrued payroll and benefits	166,586	8,884
(Decrease) in due to/from third-party payors	(14,081)	(2,623,018)
(Decrease) in other current liabilities	(24,750)	(63,632)
(Decrease) in professional liability insurance accrual	(101,685)	-
Net cash provided by operating activities	\$ 1,016,306	\$ 409,332
Supplemental schedules of noncash capital and related financing activities:		
Capital lease obligation incurred for purchase of equipment	\$ 76,339	\$ 327,969
Other long-term debt incurred for purchase of equipment	\$ 240,936	\$ 1,411,491
Increase in accounts payable for purchase of equipment	\$ 117,088	\$ -

See notes to financial statements.

DeSoto County Hospital District

Notes to Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies

Organization: DeSoto County Hospital District (the District) was originally formed as a special tax district in order to provide comprehensive health care for the citizens of DeSoto County, which included the operation of DeSoto Memorial Hospital (the Hospital). On September 25, 1985, a nonprofit organization, DeSoto Memorial Hospital, Inc. (DMHI) was formed, and on December 20, 1985, the assets and the responsibility for the operation of the Hospital were transferred from the District to DMHI, while the District remained in existence to assume responsibility for any new undertakings compatible with its enabling legislation pursuant to Chapter 65-1450 of the laws of Florida. On July 1, 2010, by unanimous authorization of the governing members of both the District and DMHI, the Hospital operations and certain assets and liabilities were transferred from DMHI back to the District.

The District is governed by a five-member Board of Directors that is appointed by the governor of the state of Florida. The District established a seven-member Board, the Subagency Board, to govern the Hospital. The Subagency Board consists of the five-member District Board of Directors and two members from the community. The Subagency Board has the authority to appoint the Hospital and related entities' chief executive officer, determine final action on all matters relating to medical staff membership or affiliation, and oversee Hospital-related operational and patient-care issues.

Also on July 1, 2010, the District formed DCHD Health Care Professionals, LLC (Professionals), of which it owns 100%. Professionals exists for the sole purpose of employing such health care professionals as deemed appropriate by the District Board, including, but not limited to, those health care professionals and physicians needed to staff the Hospital and other locations. Professionals had no operations in 2019 or 2018.

In 2017, the DMHI articles of incorporation and bylaws were amended to allow the District to appoint the DMHI Board of Directors. The name of DMHI was changed to DMH Real Estate Holdings, Inc. (Holdings). Holdings owns the property and equipment and is responsible for the mortgage payable (see Notes 5 and 6) that were previously held by DMHI. Holdings leases the property to the District under a long-term lease, which requires monthly payments of \$101,500 through June 30, 2036, also known as the "option period." The lease allows the District to acquire the property at any time during the option period for the price of full satisfaction of the mortgage payable. The District and Holdings account for this as a capital lease.

The District is a special-purpose government engaged only in business-type activities and has no other material operations. The District includes in its financial statements all organizations for which it is financially accountable (component units), as defined by the accounting standards. Holdings and Professionals are blended component units as the District is either the sole member of all or appoints their boards and these organizations provide benefits exclusively or almost exclusively to the District.

The District has not included the required disclosures and condensed information for component units in accordance with GASB Statement 61, as management concluded that the nature of these activities and transactions are already transparent in these statements, and amounts are immaterial. All inter-entity transactions between the Hospital and its blended component units have been eliminated in consolidation.

The Hospital, located in Arcadia, Florida, is an acute-care hospital that provides inpatient, outpatient and emergency care services for residents of the area. Admitting physicians are primarily practitioners in the local area. The Hospital is a Sole Community Hospital and a Disproportionate Share Hospital. Its Rural Health Clinics (RHC) are Hospital Based Clinics.

DeSoto County Hospital District

Notes to Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies (Continued)

Basis of accounting: The primary purpose of the District is the provision of health care services through the Hospital, and as such, it utilizes accounting practices of health care organizations as defined in the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide, *Health Care Organizations*, and follows accounting principles generally accepted in the United States of America. The District follows applicable GASB principles.

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

Cash and cash equivalents: Cash and cash equivalents include all cash and investments in highly liquid debt instruments purchased with an original maturity of three months or less, excluding amounts in assets limited as to use.

Deposits: The District maintains cash in checking, savings, money market savings and certificates of deposit accounts. The District maintains an investment policy in accordance with Florida Statutes, which authorizes the District to maintain its cash in Qualified Public Depositories covered by federal insurance or posted collateral. It may also invest surplus funds in the following:

- a) The Local Government Surplus Trust Fund or any intergovernmental investment pool authorized pursuant to the Florida Interlocal Cooperation Act as provided in Section 163.01, Florida Statutes.
- b) Securities and Exchange Commission registered money market funds with the highest credit quality rating from a nationally recognized rating agency.
- c) Interest-bearing time deposits or savings accounts in state-certified Qualified Public Depositories as defined in Section 280.02, Florida Statutes.
- d) Direct obligations of the U.S. Treasury.

Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it in full. In accordance with the Florida Statutes, the District maintains deposits at Qualified Public Depositories that are covered by federal depository insurance or posted collateral. At September 30, 2019 and 2018, the carrying amount of the cash deposits, including the certificates of deposit, was approximately \$5,516,000 and \$5,738,000 and the bank balance was approximately \$5,830,000 and \$6,365,000, respectively.

Patient accounts receivable: Patient receivables, where a third-party payor is responsible for paying the amount, are carried at a net amount determined by the original charge for the service provided, less an estimate made for contractual adjustments or discounts provided to third-party payors.

Patient receivables due directly from the patients are carried at the original charge for the service provided less an estimated allowance for doubtful receivables. Management determines the allowance for doubtful accounts by identifying troubled accounts and by historical experience applied to an aging of accounts. Patient receivables are written off when deemed uncollectible. Recoveries of receivables previously written off are recorded when received.

DeSoto County Hospital District

Notes to Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies (Continued)

As of September 30, 2019 and 2018, estimated allowances for contractual adjustments were approximately \$9,080,000 and \$7,516,000, respectively, and allowances for doubtful accounts were approximately \$1,051,000 and \$952,000, respectively.

The Hospital has entered into a service arrangement to sell certain patient receivable balances to a third party. The balances are sold with recourse; therefore, the Hospital is obligated to repurchase any uncollected receivables after 95 days of service by the service provider. The Hospital records a liability for the estimated recourse payable for all accounts being serviced at period-end. As of September 30, 2019 and 2018, the accounts receivable sold to the third party were approximately \$119,000 and \$113,000, respectively, and the estimated recourse liability recorded by the Hospital was approximately \$49,000 and \$47,000, respectively, which is included in the allowance for doubtful accounts.

Assets limited as to use: Assets limited as to use consist of certificates of deposit and money market funds (see Deposits above) designated for the professional liability self-insurance trust, and designated as restricted for debt service reserve (see Note 6) as required by the terms of the mortgage payable and from a DeSoto County Ordinance for use of the sales tax revenues. Amounts available to meet the related current liabilities have been classified as current assets in the statement of net position.

Inventories: Inventories, consisting primarily of medical and pharmaceutical supplies, are stated at the lower of cost or market, determined using the first-in, first-out method.

Capital assets: Purchases of land, buildings and equipment are stated at cost, if purchased, or fair value at the date of donation, if donated. Depreciation is provided using the straight-line method, half-year convention, over the estimated useful life of each class of depreciable assets. The depreciable lives of capital assets for financial statement purposes are as follows:

	<u>Life</u>
Land improvements	10–20 years
Buildings and improvements	10–40 years
Fixed equipment	5–20 years
Major movable equipment	3–15 years

Capital assets are reviewed for impairment when events or changes in circumstances suggest that the service utility of the capital asset may have significantly and unexpectedly declined. No asset impairment charges were recorded in 2019 or 2018.

Compensated absences: Paid time-off benefits are recognized as expense as the benefits are earned.

Risk management: The District is exposed to various risks of loss from theft of, damage to and destruction of assets; malpractice; workers' compensation; employee medical; and other matters for which the District has self-insured a portion of and purchased commercial insurance coverage for the remaining risk. Settled claims have not exceeded commercial coverage in any of the three preceding years.

Provisions for estimated professional liability costs include estimates of the ultimate costs for both reported claims and claims incurred but not reported.

DeSoto County Hospital District

Notes to Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies (Continued)

Net patient service revenue: The Hospital has agreements with third-party payors that provide for reimbursements to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others as services are rendered. Retroactive adjustments under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The 2019 net patient service revenue decreased approximately \$155,000, and the 2018 net patient service revenue increased approximately \$569,000, which excludes the lab services settlement discussed in Note 2.

Net patient service revenue is reported net of contractual adjustments and provision for bad debts for the years ended September 30, 2019 and 2018 as follows:

	2019	2018
Gross patient charges	\$ 135,292,150	\$ 120,708,556
Charity adjustments	9,650,841	7,786,262
Contractual adjustments	85,803,989	73,395,874
Net patient service revenue before provision for bad debts	39,837,320	39,526,420
Provision for bad debts	5,884,525	5,419,107
Net patient service revenue	<u>\$ 33,952,795</u>	<u>\$ 34,107,313</u>

Charity care: The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collections of amounts determined to qualify as charity care, they are not reported as revenue.

Operating revenues and expenses: The District's statement of revenues, expenses and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, the District's principal activity. Operating expenses are all expenses incurred to provide health care services other than financing costs. Investment income, noncapital contributions and grants are reported as nonoperating revenues.

Grant and contribution income: Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or restricted for specific operating purposes are reported as nonoperating revenues. Amounts restricted for capital purposes are reported as capital grants and contributions and are included in nonoperating revenues and expenses.

Sales tax revenue: Sales tax revenue is recognized when measurable and the underlying exchange has occurred. Revenues are restricted by County ordinance for the payment of debt service. Sales tax receivable for years ended September 30, 2019 and 2018 are approximately \$264,000 and \$330,000, respectively, and are recorded in other receivables on the statement of net position.

DeSoto County Hospital District

Notes to Financial Statements

Note 1. Nature of Organization and Summary of Significant Accounting Policies (Continued)

Income taxes: As a governmental entity, the District is not subject to federal or state income taxes. Holdings (and previously DMHI) is a nonprofit corporation described in Section 501(c)(3) of the Code and under the provisions of Chapter 220.13 of the Florida income tax code and are exempt from federal and state income taxes on related income pursuant to Section 501(a) of the Code. Accordingly, no provision for income taxes is made in the accompanying financial statements. The Code provides for taxation of unrelated business income under certain circumstances. The District does not have any significant unrelated business income that would be subject to tax.

Holdings files a Form 990 (Return of Organization Exempt from Income Tax) annually. When the returns are filed, it is certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would ultimately be sustained. Examples of tax positions common to health systems include such matters as the tax-exempt status of each entity and various positions relative to potential sources or amounts of unrelated business taxable income.

Tax positions are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50% likely to be realized on settlement with the applicable taxing authority. There were no unrecognized tax benefits identified and recorded as a liability as of September 30, 2019 and 2018.

Forms 990 and 990T filed by Holdings are generally subject to examination by the Internal Revenue Service (IRS) up to three years from the extended due date of each return. Forms 990 and 990T filed by this entity is generally no longer subject to examination for the fiscal years ended September 30, 2015, and prior.

Net position: Net position is classified as one of three components. These classifications are defined as follows:

Invested in capital assets, net of related debt: This component of net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any borrowings that are attributable to the acquisition, construction or improvement of those assets.

Restricted: This component of net position consists of external constraints placed on net position use by contributors due to time or use restrictions, or restrictions by grantors, creditors (such as through debt covenants), or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

Unrestricted: This component of net position consists of net position that does not meet the definition of restricted or invested in capital assets.

Reclassifications: Certain items on the statement of revenue, expenses and changes in net position for the year ended September 30, 2018 have been reclassified to be consistent with classifications adopted for the year ended September 30, 2019. The reclassifications had no effect on the change in net position.

Subsequent events: The District has considered subsequent events through January 23, 2020, the date the financial statements were available to be issued, in preparing the financial statements and notes thereto. There were no subsequent events requiring disclosure subsequent to year-end, except for the events disclosed in Note 6.

DeSoto County Hospital District

Notes to Financial Statements

Note 2. Patient Service Revenue

The Hospital has agreements with third-party payors that provide for reimbursements to the Hospital at amounts different from its established rates. A summary of the basis of reimbursement from major third-party payors follows:

Medicare and Medicaid: Inpatient acute-care services rendered to Medicare program beneficiaries are primarily paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Outpatient services and defined capital costs related to Medicare beneficiaries are paid on a prospective reimbursement. The Hospital is reimbursed on an interim basis at a tentative rate, which is recalculated and adjusted to actual claims, with final settlement determined after submission of annual cost reports by the Hospital and audits by the Medicare fiscal intermediary.

The Hospital's Medicare cost reports have been audited and final settlements have been determined by the fiscal intermediary for all years through September 30, 2017.

Effective July 1, 2013, inpatient services rendered to Medicaid program beneficiaries were reimbursed under an inpatient payment method that utilizes Diagnosis-Related Groups (DRGs). For outpatient services, the Hospital reimbursement was on prospective rate setting methodology. Effective July 1, 2017, the Florida Medicaid program converted to an Ambulatory Payment Classification system.

The Hospital's Medicaid cost reports have been audited, and final settlements have been determined by the fiscal intermediary for all years through September 30, 2017.

Retroactive adjustments for Medicare and Medicaid cost report settlements are accrued on an estimated basis in the period when the related services are rendered and adjusted in future periods when final settlements are determined.

Other payors: The Hospital has also entered into payment arrangements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Hospital under these arrangements includes prospectively determined rates per discharge and discounts from established charges. Some of these arrangements provide for review of paid claims for compliance with the terms of the contract and result in retroactive settlement with third parties. Retroactive adjustments for other third-party claims are recorded in the period when final settlement is determined.

A dispute arose in 2017, with a major health plan related to the discontinued lab outreach services provided and the Hospital estimated a settlement of approximately \$2.4 million as of September 30, 2017, which reduced net revenues and was included in due to third-party payors on the accompanying statements of net position. Negotiations were resolved during fiscal year 2018 and the Hospital recorded an increase in net revenues of approximately \$650,000 related to the settlement, which is included in operating revenue on the accompanying statements of revenue, expenses, and changes in net position.

The Hospital's patient acceptance policy is based on its mission statement and its charitable purposes. Accordingly, the Hospital accepts patients in immediate need of care, regardless of their ability to pay. The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor arrangements.

DeSoto County Hospital District

Notes to Financial Statements

Note 2. Patient Service Revenue (Continued)

To the extent the Hospital realizes additional losses resulting from higher credit risk for patients that are not insured under third-party payors and not identified as meeting or do not meet the previously described charity definition, such additional losses are included in the provision for bad debts. For the years ended September 30, 2019 and 2018, bad-debt adjustments of \$5,885,000 and \$5,419,000, respectively, were recognized as a reduction of patient revenue.

Net patient service revenue and accounts receivable as of and for the years ended September 30, 2019 and 2018, include amounts from the following payors:

	Net Patient Service Revenue		Net Patient Receivables	
	2019	2018	2019	2018
Medicare	55%	52%	26%	29%
Medicaid	15%	17%	5%	5%
Insurance	20%	21%	62%	59%
Self-pay	10%	10%	7%	7%
Total	100%	100%	100%	100%

Note 3. Charity Care

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy of approximately \$9,651,000 and \$7,786,000 for the years ended September 30, 2019 and 2018, respectively.

A patient is classified as a charity patient based on established policies of the Hospital. These policies define charity services as those services for which no payment is due for all or a portion of the patient's bill from either the patient or other third parties. The Hospital utilizes an application process that includes certain financial information from the requesting patient. Under this policy, in assessing a patient's ability to pay, the patient's financial information is evaluated in comparison to federal poverty income levels as well as the relationship between the charges and the patient's income. For financial reporting purposes, such amounts are classified as charity care and excluded from patient service revenue.

The cost of charity care is based on a cost accounting calculation applying a ratio of expenses to charges multiplied by the gross charges associated with charity care patients. Expense is determined by Hospital total expenses adjusted by an offset for nonpatient care revenue as well as eliminating bad-debt expense. The cost of charity care was approximately \$2,500,000 and \$2,200,000 for the years ended September 30, 2019 and 2018, respectively.

Note 4. Risk Management

Professional liability: The District purchases general liability and excess professional liability insurance to cover medical malpractice claims. There are known claims and incidents that may result in the assertion of additional claims, as well as claims from unknown incidents that may be asserted, arising from services provided to patients.

DeSoto County Hospital District

Notes to Financial Statements

Note 4. Risk Management (Continued)

The District, as a subdivision of the State of Florida, has sovereign immunity in tort actions. Therefore, in accordance with Florida laws, the District is not liable to pay a claim by or judgment to any individual that exceeds the sum of \$200,000 or any claim and judgment, or portions thereof that, when totaled with all other claims or judgments paid by the state or its agencies and subdivisions arising out of the same incidence or occurrence, exceeds the sum of \$300,000. Judgments and claims rendered in excess of these limits must be approved by the Florida legislature.

Operations are charged with the cost of claims reported and an estimate of claims incurred but not reported. A liability for unpaid claims and the associated claim expenses, including incurred but not reported losses, is actuarially determined and reflected in the statement of net position as an accrued liability.

The District has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims. Accrued malpractice losses have been discounted using a discount rate of 5% for both 2019 and 2018 and, in management's opinion, provide an adequate reserve for loss contingencies. The determination of such claims and expenses and the appropriateness of the related liability is continually reviewed and updated.

Expenses under the program were approximately \$20,000 and \$17,000 for the years ended September 30, 2019 and 2018, respectively. The self-insurance trust of the District was funded at approximately \$236,000 and \$135,000 as of September 30, 2019 and 2018, respectively.

Health insurance: The District is self-insured for employee group health insurance. The District maintains reinsurance through a commercial excess coverage policy, which covers annual individual employee claims paid in excess of \$75,000.

Total gross expenses under this program amounted to approximately \$1,163,000 and \$1,981,000 for the years ended September 30, 2019 and 2018, respectively. Group health insurance claims payable, including an estimate for incurred but not reported claims, was approximately \$175,000 and \$200,000 as of September 30, 2019 and 2018, respectively, and is reported in other current liabilities in the statements of net position. Based on historical experience, management believes that the established liabilities are sufficient to cover reported claims and incurred but not reported claims.

General insurance: The District maintains premium-based insurance policies for workers' compensation, director and officer liability, property and casualty, crime, automobile, cyber-security, environmental, fiduciary and executive risk.

DeSoto County Hospital District

Notes to Financial Statements

Note 4. Risk Management (Continued)

A schedule of changes in the estimated liabilities for professional liability and employee health claims, including those held by Holdings, for the years ended September 30, 2019 and 2018, is as follows:

	September 30, 2018	Claims Payment	Claims Expense and Change in Accrual	September 30, 2019	Amounts Due Within One Year
Professional liability	\$ 820,000	\$ -	\$ (101,685)	\$ 718,315	\$ 269,000
Employee health liability	200,000	(957,686)	932,686	175,000	175,000
Total	<u>\$ 1,020,000</u>	<u>\$ (957,686)</u>	<u>\$ 831,001</u>	<u>\$ 893,315</u>	<u>\$ 444,000</u>

	September 30, 2017	Claims Payment	Claims Expense and Change in Accrual	September 30, 2018	Amounts Due Within One Year
Professional liability	\$ 820,000	\$ -	\$ -	\$ 820,000	\$ 220,000
Employee health liability	250,000	(1,690,254)	1,640,254	200,000	200,000
Total	<u>\$ 1,070,000</u>	<u>\$ (1,690,254)</u>	<u>\$ 1,640,254</u>	<u>\$ 1,020,000</u>	<u>\$ 420,000</u>

Note 5. Capital Assets

Capital asset additions, retirements and balances for the years ended September 30, 2019 and 2018, are as follows:

	September 30, 2018	Additions/ Transfers	Retirements	September 30, 2019
Land and improvements	\$ 803,850	\$ -	\$ -	803,850
Buildings and improvements	27,446,369	370,264	-	27,816,633
Fixed equipment	7,327,618	446,333	(91,250)	7,682,701
Major movable equipment	12,030,066	534,459	(125,979)	12,438,546
Construction in process	169,370	(29,067)	-	140,303
Total	<u>47,777,273</u>	<u>1,321,989</u>	<u>(217,229)</u>	<u>48,882,033</u>
Less accumulated depreciation for:				
Land improvements	536,607	3,960	-	540,567
Buildings and improvements	15,422,415	615,653	-	16,038,068
Fixed equipment	5,497,516	287,179	(91,250)	5,693,445
Major movable equipment	9,156,403	777,698	(118,511)	9,815,590
Total	<u>30,612,941</u>	<u>1,684,490</u>	<u>(209,761)</u>	<u>32,087,670</u>
Capital assets, net	<u>\$ 17,164,332</u>	<u>\$ (362,501)</u>	<u>\$ (7,468)</u>	<u>\$ 16,794,363</u>

DeSoto County Hospital District

Notes to Financial Statements

Note 5. Capital Assets (Continued)

	September 30, 2017	Additions/ Transfers	Retirements	September 30, 2018
Land and improvements	\$ 803,850	\$ -	\$ -	\$ 803,850
Buildings and improvements	27,407,318	39,051	-	27,446,369
Fixed equipment	7,882,356	19,967	(574,705)	7,327,618
Major movable equipment	11,300,890	1,887,800	(1,158,624)	12,030,066
Construction in process	-	169,370	-	169,370
Total	<u>47,394,414</u>	<u>2,116,188</u>	<u>(1,733,329)</u>	<u>47,777,273</u>
Less accumulated depreciation for:				
Land improvements	529,065	7,542	-	536,607
Buildings and improvements	14,790,168	632,247	-	15,422,415
Fixed equipment	5,721,888	350,333	(574,705)	5,497,516
Major movable equipment	9,638,354	666,069	(1,148,020)	9,156,403
Total	<u>30,679,475</u>	<u>1,656,191</u>	<u>(1,722,725)</u>	<u>30,612,941</u>
Capital assets, net	<u>\$ 16,714,939</u>	<u>\$ 459,997</u>	<u>\$ (10,604)</u>	<u>\$ 17,164,332</u>

Depreciation expense included in operating expenses for the years ended September 30, 2019 and 2018, was approximately \$1,670,000 and \$1,639,000, respectively. Depreciation expense for the medical plaza and a specialty clinic of approximately \$15,000 and \$17,000 was reported as an expense with other rental expenses included in other nonoperating revenues (expenses) for the years ended September 30, 2019 and 2018, respectively.

Note 6. Long-Term Debt

A schedule of changes in long-term debt as of and for the years ended September 30, 2019 and 2018, consists of the following:

	September 30, 2018	Additions	Reductions	September 30, 2019	Amounts Due Within One Year
USDA mortgage	\$ 15,102,604	\$ -	\$ (594,445)	\$ 14,508,159	\$ 618,000
Capital leases payable	812,321	76,339	(250,814)	637,846	202,024
Other	1,179,337	240,936	(269,339)	1,150,934	289,864
Total	<u>\$ 17,094,262</u>	<u>\$ 317,275</u>	<u>\$ (1,114,598)</u>	<u>\$ 16,296,939</u>	<u>\$ 1,109,888</u>
	September 30, 2017	Additions	Reductions	September 30, 2018	Amounts Due Within One Year
USDA mortgage	\$ 15,673,858	\$ -	\$ (571,254)	\$ 15,102,604	\$ 595,000
Capital leases payable	782,944	327,969	(298,592)	812,321	240,508
Other	11,550	1,411,491	(243,704)	1,179,337	248,684
Total	<u>\$ 16,468,352</u>	<u>\$ 1,739,460</u>	<u>\$ (1,113,550)</u>	<u>\$ 17,094,262</u>	<u>\$ 1,084,192</u>

DeSoto County Hospital District

Notes to Financial Statements

Note 6. Long-Term Debt (Continued)

USDA mortgage: The U.S. Department of Agriculture (USDA) Rural Development provided funds for a renovation and construction project, which was completed in March 2009. After project completion, a promissory note was finalized for a total of \$20 million. Annual payments of \$1,217,800 are made including interest at 4.125% through June 2036.

The mortgage payable is secured by a first mortgage security interest on real estate, improvements, a purchase money lien on all equipment, furniture and fixtures and a first lien on all revenues and accounts receivable of the Hospital.

The mortgage payable, resulting from direct borrowings, contains provisions that, in the event of default, the lender may (a) declare the entire amount unpaid under the note, and any indebtedness to lender, immediately due and payable, (b) declare the District incur and pay reasonable expenses for repair or maintenance of and take possession of, operate or rent the property under borrowing, (c) foreclose and sell the property and use the proceeds in accordance with the agreement, and (d) enforce any and all other rights and remedies provided within the agreement or by present or future laws.

A loan resolution security agreement contains certain provisions, including a requirement that a reserve account be funded at \$121,800 per annum until such reserve account has a balance the equivalent of one year's principal and interest payment of approximately \$1,218,000. As of September 30, 2019 and 2018, the balance in the reserve account was approximately \$614,000 and \$302,000, respectively, and is included in assets limited as to use; restricted for debt service on the statement of net position. The District opted to cease funding of the reserve account in July of 2014 which was allowed under terms of the agreement, but the District does fund the reserve account with any excess cash available from the sales taxes levied. Also included in assets limited as to use are the unspent proceeds of the sales tax revenues restricted for debt in the amount of approximately \$473,000 and \$357,000 as of September 30, 2019 and 2018, respectively.

Scheduled principal and interest payments on the USDA mortgage are as follows:

	Principal	Interest	Total
Years ending September 30:			
2020	\$ 618,000	\$ 599,800	\$ 1,217,800
2021	631,944	585,856	1,217,800
2022	658,510	559,290	1,217,800
2023	686,193	531,607	1,217,800
2024	715,040	502,760	1,217,800
2025-2029	4,052,176	2,036,824	6,089,000
2030-2034	4,978,608	1,110,392	6,089,000
2035-2036	2,167,688	150,378	2,318,066
	<u>\$ 14,508,159</u>	<u>\$ 6,076,907</u>	<u>\$ 20,585,066</u>

Capital leases payable: During and prior to 2018, the District had capital lease obligations for medical equipment, copiers and a new voicemail software system which are payable in monthly installments of approximately \$180-\$17,600, discounted at rates ranging from 4.5% to 18.5%. As of September 30, 2019 and 2018, these assets had a net book value of approximately \$576,000 and \$773,000, respectively.

During 2019, the District entered into a capital lease obligation for medical equipment which is payable in monthly installments of approximately \$1,500, discounted at a rate of 6.5%. As of September 30, 2019, these assets had a net book value of approximately \$65,000.

DeSoto County Hospital District

Notes to Financial Statements

Note 6. Long-Term Debt (Continued)

The capital lease obligations, resulting from direct borrowings, contain provisions that, in the event of default, lenders may (a) declare the entire amount unpaid lease payments due and payable, (b) assess interest and late charge fees in accordance with the agreements, and (c) require the District to return the leased property.

The schedule of the future minimum lease payments under the capital leases together with the present value of the net minimum lease payments is as follows:

Years ending September 30:		
2020		\$ 226,530
2021		207,284
2022		168,432
2023		89,049
2024		5,254
		<u>696,549</u>
Less amount representing interest under the capital lease obligation		<u>(58,703)</u>
Capital leases payable		<u>\$ 637,846</u>

Other: The District has other long-term debt obligations for various equipment which are payable in monthly installments of approximately \$1,600-\$6,500, including interest at an average rate of 5% to 20%. These obligations are secured by equipment.

Subsequent to year end, the District borrowed \$1,000,000, which is payable in monthly installments of \$10,396, including interest at 4.5% through October 2029.

The other long-term debt obligations, resulting from direct borrowings, contain provisions that, in the event of default, lenders may (a) declare the entire amount unpaid under the note, and any indebtedness to lenders, immediately due and payable, (b) assess late charge fees in accordance with the agreements, (c) take possession of and sell, operate or dispose of the equipment, and (d) enforce any and all other rights and remedies provided within the agreement or by present or future laws.

Scheduled principal and interest payments on the equipment loans, which were outstanding as of September 30, 2019, are as follows:

Years ending September 30:	Principal	Interest	Total
2020	\$ 289,864	\$ 57,843	\$ 347,707
2021	310,204	47,504	357,708
2022	320,681	26,401	347,082
2023	195,901	7,884	203,785
2024	34,284	566	34,850
	<u>\$ 1,150,934</u>	<u>\$ 140,198</u>	<u>\$ 1,291,132</u>

DeSoto County Hospital District

Notes to Financial Statements

Note 7. Line of Credit

In November 2015, the District established a \$1,000,000 line of credit with a local financial institution that is fully collateralized with District's certificates of deposit. The line of credit bears interest at a rate of 2.77% and was due on demand by, or at maturity on October 1, 2019. As of September 30, 2019 and 2018, there were no amounts outstanding on this line of credit. The line of credit was not renewed on October 1, 2019.

Note 8. Commitments and Contingencies

Pension cost: DMHI has a defined contribution plan administered by the Variable Annuity Life Insurance Company, Inc. The plan requires annual contributions equal to 4% of eligible salaries. Effective July 1, 2010, when the Hospital was transferred to the District, this plan was frozen, and the District adopted a 401(a) defined contribution plan with essentially the same provisions as the DMHI plan. Effective January 1, 2014, the contribution was changed whereby the District will match employee contributions up to 3%. Retirement costs under the plans for the years ended September 30, 2019 and 2018, were approximately \$231,000 and \$218,000, respectively.

Regulatory and compliance matters—general regulatory compliance: The health care industry is subject to voluminous and complex laws and regulations of federal, state and local governments. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement laws and regulations, anti-kickback and anti-referral laws and false claims prohibitions. In recent years, government activity has increased with respect to investigations and allegations concerning possible violations of reimbursement, false claims, anti-kickback and anti-referral statutes and other regulations by health care providers.

Recovery audit contractor program: Recovery audit contractors (RACs) search for potentially improper Medicare payments that may have been made to health care providers and that were not detected through existing CMS program integrity efforts. The Hospital deducts from revenue amounts assessed by RAC at the time a notice is received, until such time that estimates of net amounts due can be reasonably estimated. Future RAC assessments against the Hospital are anticipated; however, the outcome of such assessments is unknown and cannot be reasonably estimated. Amounts assessed to the Hospital by the RAC have been either recouped on a revised remittance advice, appealed or remain unadjusted. At both September 30, 2019 and 2018, \$493,000 was accrued for amounts assessed but not recouped by Medicare and are included in due to/from third-party payors in the accompanying statements of net position.

Operating leases: The District leases various equipment and facilities under operating leases expiring at various dates. Total rental expense for the years ended September 30, 2019 and 2018, was approximately \$843,000 and \$640,000, respectively.

The following is a schedule of approximate future minimum lease payments under operating leases as of September 30, 2019, that have initial or remaining lease terms in excess of one year:

Years ending September 30:	
2020	\$ 122,876
2021	21,097
2022	3,329
	<hr/>
	\$ 147,302
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DeSoto County Hospital District

Notes to Financial Statements

Note 9. New and Pending Accounting Guidance

GASB Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placement*, issued March 2018, was adopted for the District during the year ended September 30, 2019. Statement No. 88 clarifies which liabilities governments should include in their note disclosures related to debt. This Statement defines debt that must be disclosed in the notes to financial statements as a liability that arises from a contractual obligation to pay cash in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. Governments must also disclose amounts of unused lines of credit, assets pledged as collateral for debt and the terms specified in debt agreements related to significant events of default with finance-related consequences, termination events with finance-related consequences, and subjective acceleration clauses. Within the notes, governments should separate information regarding direct borrowings and direct placements of debt from other debt. See Note 6 to the financial statements.

GASB Statement No. 84, *Fiduciary Activities*, issued in January 2017, will be effective for the District beginning with its fiscal year ending September 30, 2020. This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. An activity meeting the criteria should be reported in a fiduciary fund on the basic financial statements.

GASB Statement No. 87, *Leases*, issued June 2017, will be effective for the District beginning with its fiscal year ending September 30, 2021, with earlier adoption encouraged. Statement No. 87 establishes a single approach to accounting for and reporting leases by state and local governments. Under this statement, a government entity that is a lessee must recognize (1) a lease liability and (2) an intangible asset representing the lessee's right to use the leased asset. In addition, the District must report the (1) amortization expense for using the lease asset over the shorter of the term of the lease or the useful life of the underlying asset, (2) interest expense on the lease liability and (3) note disclosures about the lease. The Statement provides exceptions from the single-approach for short-term leases, financial purchases, leases of assets that are investments, and certain regulated leases. This statement also addresses accounting for lease terminations and modifications, sale-leaseback transactions, non-lease components embedded in lease contracts (such as service agreements), and leases with related parties. Management is evaluating the impact that this standard will have on the financial statements.

Note 10. Management's Plans

The District's financial performance over the previous 10 years has resulted in an average annual net loss totaling approximately \$1,100,000. During the year ended September 30, 2019, the District experienced operating loss of approximately \$467,000, which is primarily due to a reduction of reimbursement. Management has implemented changes in operations that are intended to reduce expense levels and increase service volumes and net revenues. The District is estimating it will receive approximately \$1,731,000 annually from sales tax revenues for fiscal year 2020 and expects the revenues will increase 2% going forward, which are dedicated for the payment of the USDA mortgage. Sales tax revenue received for fiscal year 2019 was approximately \$1,574,000. In addition, the State of Florida receives matching funds from the Federal Government under Section 1115 Waivers, commonly referred to as the Low Income Pool Program (LIP) to assist health care facilities who experience high levels of uncompensated care. During the year ended September 30, 2019, the District received approximately \$1,990,000 related to this program. The Florida legislature has approved an allocation to the Hospital for the state fiscal year 2020 at a similar level and it is expected that this annual level of funding will continue through June 30, 2022. Management projects that fiscal year 2020 will also generate a slight increase in net position and that there will be no erosion in liquidity during 2020. The District is in the process of evaluating strategic relationships and partnerships that could be beneficial in improving the District's operations. However, no assurance can be provided that these events will occur.

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

Independent Auditor's Report

To the Board of Directors
DeSoto County Hospital District

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the DeSoto County Hospital District (the District), as of and for the year ended September 30, 2019, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated January 23, 2020.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of This Report

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

RSM US LLP

Davenport, Iowa
January 23, 2020

