

North Runnels County Hospital District

**Basic Financial Statements and
Independent Auditors' Report**

June 30, 2016 and 2015

**North Runnels County Hospital District
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DINGUS | ZARECOR & ASSOCIATES PLLC
Certified Public Accountants

INDEPENDENT AUDITORS' REPORT

Board of Directors
North Runnels County Hospital District
Winters, Texas

Report on the Financial Statements

We have audited the accompanying financial statements of North Runnels County Hospital District (the District) as of and for the year ended June 30, 2016, 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 auditors' 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 auditors consider 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 June 30, 2016, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 2 to the financial statements, the June 30, 2015, financial statements have been restated to correct deferred inflow of tax resource. Our opinion is not modified with respect to this restatement.

Prior Year (June 30, 2015) Auditors' Report

The 2015 financial statements were audited by other auditors and their report thereon, dated December 17, 2015, expressed an unmodified opinion.

Other Matters***Required Supplementary Information***

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Dingus, Zarecor & Associates PLLC

Spokane Valley, Washington
October 20, 2016

North Runnels County Hospital District
Statements of Net Position
June 30, 2016 and 2015

ASSETS	2016	2015
<i>Current assets</i>		
Cash and cash equivalents	\$ 3,912,715	\$ 4,275,645
Receivables:		
Patient accounts, net of estimated uncollectibles of \$203,000 and \$104,000, respectively	657,187	573,439
Estimated third-party payor settlements	577,000	695,061
Supplemental payments due from the State	187,209	31,649
Taxes	64,141	58,971
Inventories	93,529	92,523
Prepaid expenses	24,517	21,018
Total current assets	5,516,298	5,748,306
<i>Noncurrent assets</i>		
Capital assets, net	2,580,796	2,458,949
Total assets	\$ 8,097,094	\$ 8,207,255

See accompanying notes to basic financial statements.

**North Runnels County Hospital District
Statements of Net Position (Continued)
June 30, 2016 and 2015**

LIABILITIES AND NET POSITION	2016	2015
<i>Current liabilities</i>		
Accounts payable	\$ 77,220	\$ 157,158
Capital accounts payable	-	159,803
Accrued compensation and related liabilities	218,287	206,548
Current maturities of long-term debt	146,565	489,139
Total current liabilities	442,072	1,012,648
<i>Noncurrent liabilities</i>		
Long-term debt, less current maturities	567,143	380,368
Total liabilities	1,009,215	1,393,016
<i>Deferred inflow of resources, taxes</i>	220,000	266,250
<i>Net position</i>		
Net investment in capital assets	1,647,088	1,429,639
Unrestricted	5,220,791	5,118,350
Total net position	6,867,879	6,547,989
Total liabilities and net position	\$ 8,097,094	\$ 8,207,255

See accompanying notes to basic financial statements.

North Runnels County Hospital District
Statements of Revenues, Expenses, and Changes in Net Position
Years Ended June 30, 2016 and 2015

	2016	2015
<i>Operating revenues</i>		
Net patient service revenue, net of provision for bad debts of \$436,324 and \$398,893, respectively	\$ 4,358,364	\$ 4,036,817
Supplemental Medicaid funding	320,951	47,028
Grants	500	54,532
Other revenue	23,075	21,504
Total operating revenues	4,702,890	4,159,881
<i>Operating expenses</i>		
Salaries and wages	2,509,960	2,508,213
Employee benefits	641,336	561,728
Professional fees	1,018,131	1,028,902
Supplies	391,172	335,839
Depreciation	304,518	207,783
Repairs and maintenance	198,628	140,591
Utilities	85,799	80,191
Leases and rentals	28,147	46,189
Insurance	31,816	37,625
Other	121,881	105,949
Total operating expenses	5,331,388	5,053,010
Operating loss	(628,498)	(893,129)
<i>Nonoperating revenues (expenses)</i>		
Property taxes	956,338	1,142,874
Property tax collection expense	(40,095)	(38,288)
Tobacco settlement	18,467	26,221
Investment income	3,338	4,217
Interest expense	(24,769)	(7,236)
Total nonoperating revenues, net	913,279	1,127,788
Excess of revenues over expenses	284,781	234,659
Capital grants and contributions	-	23,320
Extraordinary item - gain on insurance settlement net of building impairment loss of \$6,927 and \$-0-, respectively	35,109	-
Change in net position	319,890	257,979
Net position, beginning of year, restated	6,547,989	6,290,010
Net position, end of year	\$ 6,867,879	\$ 6,547,989

See accompanying notes to basic financial statements.

**North Runnels County Hospital District
Statements of Cash Flows
Years Ended June 30, 2016 and 2015**

	2016	2015
<i>Increase (Decrease) in Cash and Cash Equivalents</i>		
<i>Cash flows from operating activities</i>		
Receipts from and on behalf of patients	\$ 4,392,677	\$ 3,768,121
Supplemental Medicaid funding receipts	165,391	15,379
Grants	500	54,532
Other receipts	23,075	21,504
Payments to and on behalf of employees	(3,139,557)	(3,036,795)
Payments to suppliers and contractors	(1,960,017)	(1,907,990)
Net cash used in operating activities	(517,931)	(1,085,249)
<i>Cash flows from noncapital financing activities</i>		
Property taxes	864,823	1,045,615
Property tax collection fee paid	18,467	26,221
Net cash provided by noncapital financing activities	883,290	1,071,836
<i>Cash flows from capital and related financing activities</i>		
Principal payments on long-term debt	(508,244)	(122,439)
Interest paid	(24,769)	(7,236)
Purchase of capital assets	(240,650)	(93,634)
Proceeds from insurance settlement	42,036	-
Capital grants and contributions	-	23,320
Net cash used in capital and related financing activities	(731,627)	(199,989)
<i>Cash flows from investing activities</i>		
Investment income	3,338	4,215
Net decrease in cash and cash equivalents	(362,930)	(209,187)
Cash and cash equivalents, beginning of year	4,275,645	4,484,832
Cash and cash equivalents, end of year	\$ 3,912,715	\$ 4,275,645

See accompanying notes to basic financial statements.

**North Runnels County Hospital District
Statements of Cash Flows (Continued)
Years Ended June 30, 2016 and 2015**

	2016	2015
<i>Reconciliation of Operating Loss to Net Cash Used in Operating Activities</i>		
Operating loss	\$ (628,498)	\$ (893,129)
<i>Adjustments to reconcile operating loss to net cash used in operating activities</i>		
Depreciation	304,518	207,783
Provision for bad debts	(436,324)	(398,893)
Decrease (increase) in assets:		
Receivables:		
Patient accounts	352,576	651,175
Estimated third-party payor settlements	118,061	(520,978)
Supplemental Medicaid payments due from State	(155,560)	(31,649)
Inventories	(1,006)	4,162
Prepaid expenses	(3,499)	60
Increase (decrease) in liabilities:		
Accounts payable	(79,938)	(136,926)
Accrued compensation and related liabilities	11,739	33,146
Net cash used in operating activities	\$ (517,931)	\$ (1,085,249)

Noncash Capital and Related Financial Activity

During the years ended June 30, 2016 and 2015, the District entered into capital lease obligations of \$735,455 and \$1,151,749, respectively.

See accompanying notes to basic financial statements.

**North Runnels County Hospital District
Notes to Basic Financial Statements
Years Ended June 30, 2016 and 2015**

1. Reporting Entity and Summary of Significant Accounting Policies:

a. Reporting Entity

North Runnels County Hospital District (the District), a critical access hospital located in Winters, Texas, is a hospital district created under the laws of the state of Texas. It is governed by a seven-member board of directors elected by the citizens of North Runnels County Hospital District, Texas. The District is responsible for indigent care of residents of the District as dictated by the law creating the District. The District provides inpatient, outpatient, and emergency care hospital services to patients in the District's jurisdiction. The District also operates a rural health clinic, home health agency, and ambulance services in the same geographic area.

b. Summary of Significant Accounting Policies

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 disclosures 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.

Enterprise fund accounting – The District's accounting policies conform to accounting principles generally accepted in the United States of America as applicable to proprietary funds of governments. The District uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus.

Cash and cash equivalents – Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less.

Inventories – Inventories are stated at cost on the first-in, first-out method. Inventories consist of pharmaceutical, medical-surgical, and other supplies used in the operation of the District.

Prepaid expenses – Prepaid expenses are expenses paid during the year relating to expenses incurred in future periods. Prepaid expenses are amortized over the expected benefit period of the related expense.

**North Runnels County Hospital District
Notes to Basic Financial Statements (Continued)
Years Ended June 30, 2016 and 2015**

1. Reporting Entity and Summary of Significant Accounting Policies (continued):

b. Summary of Significant Accounting Policies (continued)

Compensated absences – District policies permit most employees to accumulate vacation and sick leave benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the statement of net position date, plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

Net position – Net position of the District is classified into three components. *Net investment in capital assets* consists of capital assets net of accumulated depreciation and is reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted net position* is noncapital net position that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the District. The District had no restricted net position at June 30, 2016 or 2015. *Unrestricted net position* is remaining net position that does not meet the definition of *net investment in capital assets* or *restricted net position*.

Operating revenues and expenses – The District’s statements of revenues, expenses, and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions, including grants for specific operating activities associated with providing healthcare services — the District’s principal activity. Nonexchange revenues, including taxes and contributions received for purposes other than capital asset acquisitions, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide healthcare services other than financing costs.

Restricted resources – When the District has both restricted and unrestricted resources available to finance a particular program, it is the District’s policy to use restricted resources before unrestricted resources.

Tobacco settlement revenue – Tobacco settlement revenues are the result of a settlement between various counties and hospital districts in Texas and the tobacco industry for tobacco related healthcare costs. The funding from the tobacco industry is to offset indigent healthcare costs of local governments.

Grants and contributions – From time to time, the District receives federal, state, and county grants, as well as contributions from individuals and private organizations. 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. Grants that are unrestricted or that are restricted to a specific operating purpose are reported as operating revenues. Grants that are used to subsidize operating deficits are reported as nonoperating revenues. Contributions, except for capital contributions, are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

**North Runnels County Hospital District
Notes to Basic Financial Statements (Continued)
Years Ended June 30, 2016 and 2015**

1. Reporting Entity and Summary of Significant Accounting Policies (continued):

b. Summary of Significant Accounting Policies (continued)

Change in accounting policies – Governmental Accounting Standards Board Statement No. 72, *Fair Value Measurements and Application*, is effective for years beginning after June 15, 2015 (fiscal year ended June 30, 2016, for the District). The statement establishes new requirements on how fair value should be measured, which assets and liabilities should be measured at fair value, and what information about fair value should be disclosed in the notes to the financial statements. The adoption of this statement has no impact on change in net position.

Reclassifications – Certain reclassifications of the 2015 amounts have been made in the financial statements in order to conform to the 2016 presentation. These reclassifications had no effect on the previously reported change in net position.

Subsequent events – Subsequent events have been reviewed through October 20, 2016, the date on which the financial statements were available to be issued.

2. Prior Year Restatement:

The District has restated its 2015 financial statements to correct deferred inflow of resources, taxes. The District's change in net position for 2015 decreased by \$266,250 as a result of this restatement. The impact on net position balance is as follows:

	June 30, 2015	June 30, 2014
Net position, as previously reported	\$ 6,814,239	\$ 6,556,260
Correction of deferred inflow of resources, taxes	(266,250)	(266,250)
Net position, as restated	\$ 6,547,989	\$ 6,290,010

The restatement has no effect on previously reported 2015 change in net position.

3. Bank Deposits and Investments:

Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District's deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities of the state of Texas; bonds of any city, county, school district or special road district of the state of Texas; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

None of the District's were exposed to custodial credit risk because the investments pledged as collateral for the deposits in excess of Federal Deposit Insurance Corporation (FDIC) coverage were held in the name of the financial institution.

**North Runnels County Hospital District
Notes to Basic Financial Statements (Continued)
Years Ended June 30, 2016 and 2015**

3. Bank Deposits and Investments (continued):

The District may legally invest in direct obligations of and other obligations guaranteed as to principal by the U.S. Treasury and U.S. agencies and instrumentalities. The District has funds of \$25,215 and \$25,161 invested in TexPool as of June 30, 2016 and 2015, respectively, which do not require security, as shown below. These funds are immediately redeemable by the District. The State Comptroller of Public Accounts exercises oversight responsibility over TexPool, the Texas Local Government Investment Pool. Oversight includes the ability to significantly influence operations, designation of management, and accountability for fiscal matters. Additionally, the State Comptroller has established an advisory board composed of both participants in TexPool and other persons which do not have a business relationship with TexPool. The Advisory Board members review the investment policy and management fee structure. Weekly portfolio information must be submitted to Standard & Poor's, as well as the Office of the Comptroller of Public Accounts for review.

TexPool represents that they operate in a manner consistent with the SEC's rule 2a7 of the Investment Company Act of 1940. TexPool uses amortized cost rather than market value to report net position to compute share prices.

The District's investments may be exposed to the following types of risks:

- *Interest Rate Risk* – Interest rate risk is the risk that market values of investments will change based on changes in market interest rates. TexPool is presented as an investment with a maturity of less than one year because they are redeemable in full immediately.
- *Credit Risk* – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. It is the District's policy to limit its investments to certificates of deposit, indexed money market accounts which are FDIC insured or secured by obligations of a federal agency, treasury securities, or local government investment pools. TexPool is rated AAA by Standard and Poor's.
- *Custodial Credit Risk* – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party.
- *Concentration of Credit Risk* – The District places no limit on the amount that may be invested in any one issuer. The only investment held by the District at June 30, 2016 and 2015, was the investment in TexPool.

North Runnels County Hospital District
Notes to Basic Financial Statements (Continued)
Years Ended June 30, 2016 and 2015

4. Patient Accounts Receivable:

Patient accounts receivable are reduced by an allowance for uncollectible accounts. In evaluating the collectibility of patient accounts receivable, the District analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectible accounts and provision for bad debts. Management regularly reviews data about these major payor sources of revenue in evaluating the sufficiency of the allowance for uncollectible accounts. For receivables associated with services provided to patients who have third-party coverage, the District analyzes contractually due amounts and provides an allowance for uncollectible accounts and a provision for bad debts, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which include both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the District records a significant provision for bad debts 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) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectible accounts.

The District's allowance for uncollectible accounts for self-pay patients has not changed significantly from the prior year's. The District does not maintain a material allowance for uncollectible accounts from third-party payors, nor did it have significant writeoffs from third-party payors.

Patient accounts receivable reported as current assets were as follows:

	2016	2015
Receivable from patients and their insurance carriers	\$ 405,181	\$ 434,330
Receivable from Medicare	402,138	205,392
Receivable from Medicaid	52,582	37,784
Total patient accounts receivable	859,901	677,506
Less allowance for uncollectible accounts	(202,714)	(104,067)
Patient accounts receivable, net	\$ 657,187	\$ 573,439

**North Runnels County Hospital District
Notes to Basic Financial Statements (Continued)
Years Ended June 30, 2016 and 2015**

5. Extraordinary Item:

During the year ended June 30, 2016, the District determined that there was sufficient evidence of impairment due to hail damage to write down the reported value of a portion of the roof recorded by the District as part of the building. The recorded value was written down by \$6,927, the net book value of the damaged roof. The impairment loss has been presented net of the estimated insurance settlement of \$42,036.

6. Capital Assets:

The District capitalizes assets whose costs exceed \$5,000 and have an estimated useful life of at least two years. Major expenses for capital assets, including repairs that increase the useful lives, are capitalized. Maintenance, repairs, and minor renewals are accounted for as expenses as incurred. Capital assets are reported at historical cost or their estimated fair value at the date of donation. Depreciation is provided over the estimated useful life of each class of depreciable asset and computed using the straight-line method.

Useful lives are estimated as follows:

	<u>Years</u>
Building and improvements	5-40
Equipment	3-20

Capital asset activity follows:

	Balance June 30, 2015	Additions	Retirements	Transfers	Balance June 30, 2016
<i>Capital assets not being depreciated</i>					
Land	\$ 17,311	\$ -	\$ -	\$ -	\$ 17,311
Construction in progress	576,639	10,000	-	(447,770)	138,869
Total capital assets not being depreciated	593,950	10,000	-	(447,770)	156,180
<i>Capital assets being depreciated</i>					
Building and improvements	2,021,793	-	(69,269)	-	1,952,524
Equipment	2,553,276	829,148	(457,890)	447,770	3,372,304
Total capital assets being depreciated	4,575,069	829,148	(527,159)	447,770	5,324,828
<i>Less accumulated depreciation for</i>					
Building and improvements	(899,376)	(91,743)	62,342	-	(928,777)
Equipment	(1,810,694)	(212,775)	52,034	-	(1,971,435)
Total accumulated depreciation	(2,710,070)	(304,518)	114,376	-	(2,900,212)
Total capital assets being depreciated, net	1,864,999	524,630	(412,783)	447,770	2,424,616
Capital assets, net of accumulated depreciation	\$ 2,458,949	\$ 534,630	\$ (412,783)	\$ -	\$ 2,580,796

**North Runnels County Hospital District
Notes to Basic Financial Statements (Continued)
Years Ended June 30, 2016 and 2015**

6. Capital Assets (continued):

	Balance June 30, 2014	Additions	Retirements	Transfers	Balance June 30, 2015
<i>Capital assets not being depreciated</i>					
Land	\$ 17,311	\$ -	\$ -	\$ -	\$ 17,311
Construction in progress	-	576,639	-	-	576,639
Total capital assets not being depreciated	17,311	576,639	-	-	593,950
<i>Capital assets being depreciated</i>					
Building and improvements	1,976,144	45,649	-	-	2,021,793
Equipment	1,930,181	623,095	-	-	2,553,276
Total capital assets being depreciated	3,906,325	668,744	-	-	4,575,069
<i>Less accumulated depreciation for</i>					
Building and improvements	(855,516)	(43,860)	-	-	(899,376)
Equipment	(1,646,771)	(163,923)	-	-	(1,810,694)
Total accumulated depreciation	(2,502,287)	(207,783)	-	-	(2,710,070)
Total capital assets being depreciated, net	1,404,038	460,961	-	-	1,864,999
Capital assets, net of accumulated depreciation	\$ 1,421,349	\$ 1,037,600	\$ -	\$ -	\$ 2,458,949

Construction in progress as of June 30, 2016, consisted primarily of software costs for a new clinic software system. This project is expected to be put into service in late fiscal year 2017, and has no further costs of completion.

**North Runnels County Hospital District
Notes to Basic Financial Statements (Continued)
Years Ended June 30, 2016 and 2015**

7. Long-term Debt:

A schedule of changes in the District's noncurrent liabilities follows:

	Balance June 30, 2015	Additions	Reductions	Balance June 30, 2016	Amounts Due Within One Year
Note payable	\$ 315,307	\$ 62,126	\$ (377,433)	\$ -	\$ -
Capital lease obligations	554,200	673,329	(513,821)	713,708	146,565
Total noncurrent liabilities	\$ 869,507	\$ 735,455	\$ (891,254)	\$ 713,708	\$ 146,565

	Balance June 30, 2014	Additions	Reductions	Balance June 30, 2015	Amounts Due Within One Year
Note payable	\$ -	\$ 576,638	\$ (261,331)	\$ 315,307	\$ 315,307
Capital lease obligations	-	575,111	(20,911)	554,200	173,832
Total noncurrent liabilities	\$ -	\$ 1,151,749	\$ (282,242)	\$ 869,507	\$ 489,139

Scheduled principal and interest payments are as follows:

Years Ending June 30,	Long-term Debt		
	Principal	Interest	Total
2017	\$ 146,565	\$ 36,107	\$ 182,672
2018	154,517	28,155	182,672
2019	162,942	19,730	182,672
2020	146,813	10,987	157,800
2021	102,871	2,328	105,199
	\$ 713,708	\$ 97,307	\$ 811,015

Terms of the District's long-term debt follow:

- In April 2015, the District entered into a financing agreement for the installation of an electronic medical records system and the related hardware and software. The debt in the original amount of \$576,638, and secured by the system components, was paid in full in 2016.
- The District is obligated under leases for equipment that are accounted for as capital leases. The future minimum lease payments under the capital leases include interest at rates of 1.6% to 5.1% together with the present value of the future minimum lease. The capitalized basis and accumulated depreciation of the equipment under capital lease obligations were \$790,550 and \$122,936, respectively, at June 30, 2016 and 2015.

**North Runnels County Hospital District
Notes to Basic Financial Statements (Continued)
Years Ended June 30, 2016 and 2015**

7. Long-term Debt (continued):

Borrowing restrictions – Texas governmental hospitals have significant limitations on their ability to borrow funds. Generally, they are limited in the length of term for obligations to purchase equipment and severely restricted in their ability to borrow for working capital needs. Additionally, there are restrictions on their ability to pledge tax revenues to meet obligations more than one year in the future.

8. Net Patient Service Revenue:

The District recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients that do not qualify for charity care, the District recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated, or provided by policy). On the basis of historical experience, a significant portion of the District's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the District records a significant provision for bad debts related to uninsured patients in the period the services are provided. The District's provisions for bad debts and writeoffs have not changed significantly from the prior year. The District has not changed its charity care or uninsured discount policies during fiscal years 2016 or 2015. Patient service revenue, net of contractual adjustments and discounts (but before the provision for bad debts), recognized in the period from these major payor sources, is as follows:

	2016	2015
Patient service revenue (net of contractual adjustments and discounts):		
Medicare	\$ 3,893,125	\$ 3,651,208
Medicaid and other third-party payors	538,228	382,766
Patients	415,498	424,352
	4,846,851	4,458,326
Less:		
Charity care	52,163	22,616
Provision for bad debts	436,324	398,893
Net patient service revenue	\$ 4,358,364	\$ 4,036,817

**North Runnels County Hospital District
Notes to Basic Financial Statements (Continued)
Years Ended June 30, 2016 and 2015**

8. Net Patient Service Revenue (continued):

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

- *Medicare* – The District has been designated a critical access hospital and rural health clinic by Medicare and is reimbursed for inpatient, outpatient, and clinic services on a cost basis as defined and limited by the Medicare program. The District is reimbursed for cost-reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicare administrative contractor. Home health services are reimbursed on a prospective rate per episode of care.
- *Medicaid* – Inpatient acute care services rendered to Medicaid program beneficiaries are 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. Most outpatient services are paid a blending of prospectively set amounts and on a cost basis, although some services such as laboratory and surgeries are paid based on a fee schedule. The District is reimbursed for cost-reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the District and audits thereof by Medicaid. There is no settlement if there is an amount due to the District, but payback is required by the District to Medicaid if an amount is due to Medicaid. Medicaid also pays a managed care amount to rural hospitals with less than 100 beds. The District is reimbursed at a tentative rate for managed care claims with a settlement determined after submission of the annual Medicare cost report. There is no payback required by the District to Medicaid for managed care services, but the District could receive an additional payment based on the settlement.
- The District also has entered into payment agreements with certain commercial insurance carriers and preferred provider organizations. The basis for payment to the District under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Laws and regulations governing Medicare, Medicaid, and other programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near-term. Net patient service revenue decreased by approximately \$99,000 for the year ended June 30, 2016, due to the differences between the original estimates and final settlements.

The District provides charity care to patients who are financially unable to pay for the healthcare services they receive. The District's policy is not to pursue collection of amounts determined to qualify as charity care. Accordingly, the District does not report these amounts in net operating revenues or in the allowance for uncollectible accounts. The District determines the costs associated with providing charity care by aggregating the applicable direct and indirect costs, including salaries and wages, benefits, supplies, and other operating expenses, based on data from its costing system. The costs of caring for charity care patients for the years ended June 30, 2016 and 2015, were approximately \$46,000 and \$21,000, respectively. The District receives Medicaid supplemental funding for uncompensated care as disclosed in Note 9.

**North Runnels County Hospital District
Notes to Basic Financial Statements (Continued)
Years Ended June 30, 2016 and 2015**

9. Supplemental Medicaid Funding:

In 2012, the United States Department of Health & Human Services approved a Medicaid Section 1115(a) demonstration entitled "Texas Health Transformation and Quality Improvement Program". This demonstration expands existing Medicaid managed care programs and establishes two funding pools that will assist providers with uncompensated care costs and promote health system transformation. The demonstration is effective from December 12, 2011 to September 30, 2016.

A summary of funds received through this program is as follows:

	2016	2015
Delivery System Reform Incentive Payment Pool	\$ 206,112	\$ -
Uncompensated Care Pools	114,839	47,028
Supplemental Medicaid Funding	\$ 320,951	\$ 47,028

10. Property Taxes:

Property taxes are levied by October 1 of each year in conformity with Subtitle E of the Texas Property Tax Code. Taxes are due on receipt of the tax statement and are delinquent if not paid before February 1 of the year following the year of assessment. On January 1 of each year, a tax lien attaches to property to secure the payment of all taxes, penalties, and interest ultimately imposed.

The District is authorized to levy a tax on property not to exceed \$.75 per \$100 valuation for the purpose of paying operating expenses and for debt service. The District's property tax rates were \$.4203 and \$.3794 per \$100 valuation and property tax revenue totaled \$956,338 and \$1,142,874 for 2016 and 2015, respectively. Taxes for fiscal years 2016 and 2015 were levied on property within the District having an assessed valuation of approximately \$206,000,000 and \$230,000,000, respectively.

11. Defined Contribution Pension Plan:

The District sponsors a defined contribution pension plan covering substantially all employees classified by the employer as full-time employees who have completed one year of eligible service. The plan name is North Runnels County Hospital District 457 Deferred Compensation Plan (the Plan). The Plan is administered by the District. The District's board of directors has the authority to amend the Plan. It is funded by voluntary monthly employee contributions in an amount up to 33 1/3% of the employees' compensation, not to exceed \$7,500. In addition, the District makes discretionary contributions equal to 1% of the compensation of the participant on a one dollar for two dollar basis with a 50% match of employee contributions of less than 2%. Pension expense is recorded for the amount of the District's contributions. District contributions to the Plan in future periods will be determined by board resolution. Defined contribution pension plan expense for the years ended June 30, 2016 and 2015, was approximately \$16,000 and \$12,000, respectively. Employee contributions to the Plan were approximately \$49,000 for each of the years ended June 30, 2016 and 2015.

**North Runnels County Hospital District
Notes to Basic Financial Statements (Continued)
Years Ended June 30, 2016 and 2015**

12. Contingencies:

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

Medical malpractice claims – The District is a unit of government covered by the Texas Tort Claims Acts which, by statute, limits its liability to \$100,000 per person/\$300,000 per occurrence. These limits coincide with the malpractice insurance coverage maintained by the District. The District, from time to time, may be subject to claims and suits for other damages as well. In the opinion of management, the ultimate resolution of the above types of legal proceedings will not have a material effect on the District’s financial position or results of operations.

No liability has been accrued for future coverage of acts, if any, occurring in this or prior years. Also, it is possible that claims may exceed coverage available in any given year.

Industry regulations – The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of various statutes and regulations by healthcare providers. 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. Management believes the District is in compliance with fraud and abuse as well as other applicable government laws and regulations. If the District is found in violation of these laws, the District could be subject to substantial monetary fines, civil and criminal penalties, and exclusion from participation in the Medicare and Medicaid programs.

13. Concentrations of Credit Risk:

Patient accounts receivable – The District grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The majority of these patients are geographically concentrated in Winters, Texas, and North Runnels County, Texas.

	2016	2015
Medicare	48 %	34 %
Medicaid	8	8
Other third-party payors	20	37
Patients	24	21
	100 %	100 %

Physicians – The District is dependent on local physicians practicing in its service area to provide admissions and utilize hospital services on an outpatient basis. A decrease in the number of physicians providing these services or change in their utilization patterns may have an adverse effect on hospital operations.