



# Windom Area Hospital

2016 Audit Results and  
Report to the Board of Directors

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# Section A

Governance Communication

# Governance Communication

Area	Comments
<b>Our responsibility under Generally Accepted Auditing Standards</b>	<ul style="list-style-type: none"> <li>• <b>Express an opinion</b> on the fair presentation of the combined financial statements in conformity with GAAP</li> <li>• Plan and perform the audit to <b>obtain reasonable, not absolute, assurance</b> that the combined financial statements are free of material misstatement</li> <li>• <b>Evaluate internal control</b> over financial reporting               <ul style="list-style-type: none"> <li>• Determine the nature, timing, and extent of audit procedures based on risk assessments and our evaluation of internal control</li> </ul> </li> <li>• Utilize a <b>risk based</b> audit approach</li> <li>• Communicate <b>significant matters</b> to appropriate parties</li> </ul>
<b>Planned scope and timing of the audit</b>	<ul style="list-style-type: none"> <li>• Performed the audit according to the <b>planned scope and timing</b> previously communicated</li> </ul>
<b>Other information in documents containing audited financial statements</b>	<ul style="list-style-type: none"> <li>• Financial statements may only be <b>used in their entirety</b></li> <li>• <b>Our approval</b> is required to use our audit report in a client prepared document</li> <li>• We have <b>no responsibility to perform procedures</b> beyond those related to the financial statements.</li> </ul>



# Governance Communication (Continued)

Area	Comments
<b>Significant accounting policies</b>	<ul style="list-style-type: none"> <li>• Management is <b>responsible for accounting policies</b></li> <li>• Outlined in Note 1 to the combined financial statements</li> <li>• <b>No changes</b> in accounting policies or new policies adopted</li> <li>• Appropriate accounting policies</li> <li>• No significant or unusual transactions occurred</li> </ul>
<b>Significant accounting estimates</b>	<ul style="list-style-type: none"> <li>• <b>Contractual allowances, allowance for bad debts, third-party payer settlement estimates</b></li> <li>• Determined based on management's knowledge and experience</li> <li>• No indicators of management bias</li> <li>• Estimates are reasonable</li> <li>• Estimate uncertainty disclosed in the financial statements</li> </ul>
<b>Significant disclosures</b>	<ul style="list-style-type: none"> <li>• <b>No</b> sensitive disclosures</li> <li>• <b>No</b> significant risks, exposures, or uncertainties</li> <li>• <b>No</b> unusual transactions</li> <li>• Disclosures are neutral, consistent, and clear</li> </ul>



# Governance Communication (Continued)

Area	Comments
Corrected and uncorrected misstatements	<ul style="list-style-type: none"> <li>• <b>Audit adjustments were proposed and recorded with a total increase in net position of approximately \$640,000</b></li> <li>• Not advised by management of any unrecorded financial statement adjustments.</li> </ul>
Management representation	<ul style="list-style-type: none"> <li>• Management provided a management representation letter dated July 13, 2016.</li> </ul>
Other	<ul style="list-style-type: none"> <li>• <b>No difficulties</b> encountered in performing the audit</li> <li>• <b>No issues</b> discussed prior to retention as independent auditors</li> <li>• <b>No disagreements</b> with management regarding accounting, reporting, or auditing matters</li> <li>• <b>No consultations</b> with other independent accountants</li> <li>• <b>No other findings</b> or issues were discussed with, or communicated to, management</li> </ul>





## Section B

Internal Control Communication

# Internal Control Communication

## Purpose

- Express an opinion on the financial statements, not on the effectiveness of internal controls.

## Material Weakness

- Reasonable possibility that a material misstatement would not be prevented, or detected and corrected on a timely basis.

## Significant Deficiencies

- Less significant than a material weakness, yet important enough to merit the attention of governance.



# Internal Control Communication (Continued)

Area	Comments
<b>Material Weaknesses</b> (Specific findings)	<ul style="list-style-type: none"><li>• Preparation of financial statements</li><li>• Material audit adjustments</li></ul>
<b>Significant Deficiency</b> (Specific finding)	<ul style="list-style-type: none"><li>• Journal entry review process</li></ul>





# Section C

Financial Ratios

# Industry Benchmark Data

## Windom Area Hospital (WAH)

2013-2016

- \$16 Million Net Patient Service Revenue
- 2013 –2016 Data, Based on Audited Financial Statements

## CliftonLarsonAllen Small CAH Clients (CLA)

2013-2015

- Critical Access Hospitals with Net Patient Service Revenue less than \$25 Million

## CliftonLarsonAllen MN CAH (MN-CAH)

2013-2015

- All MN CAH facilities from Gold Standard report

## CliftonLarsonAllen Gold Standard(GS)

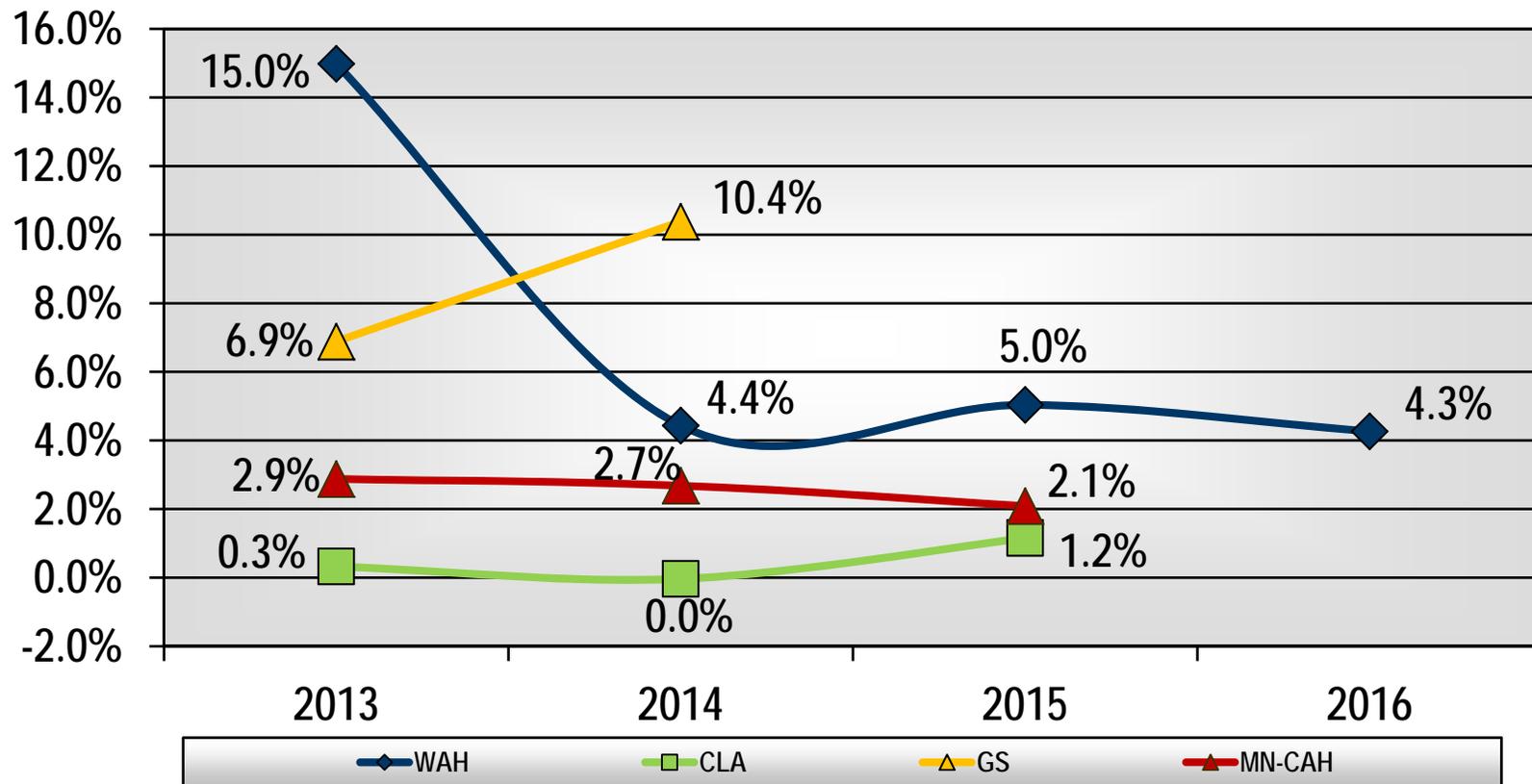
2013-2014

- Over 1300 fiscal year reports analyzed in preparation of ratios and benchmarks
- 22 Gold Standard Facilities

# Operating Margin

## Definition:

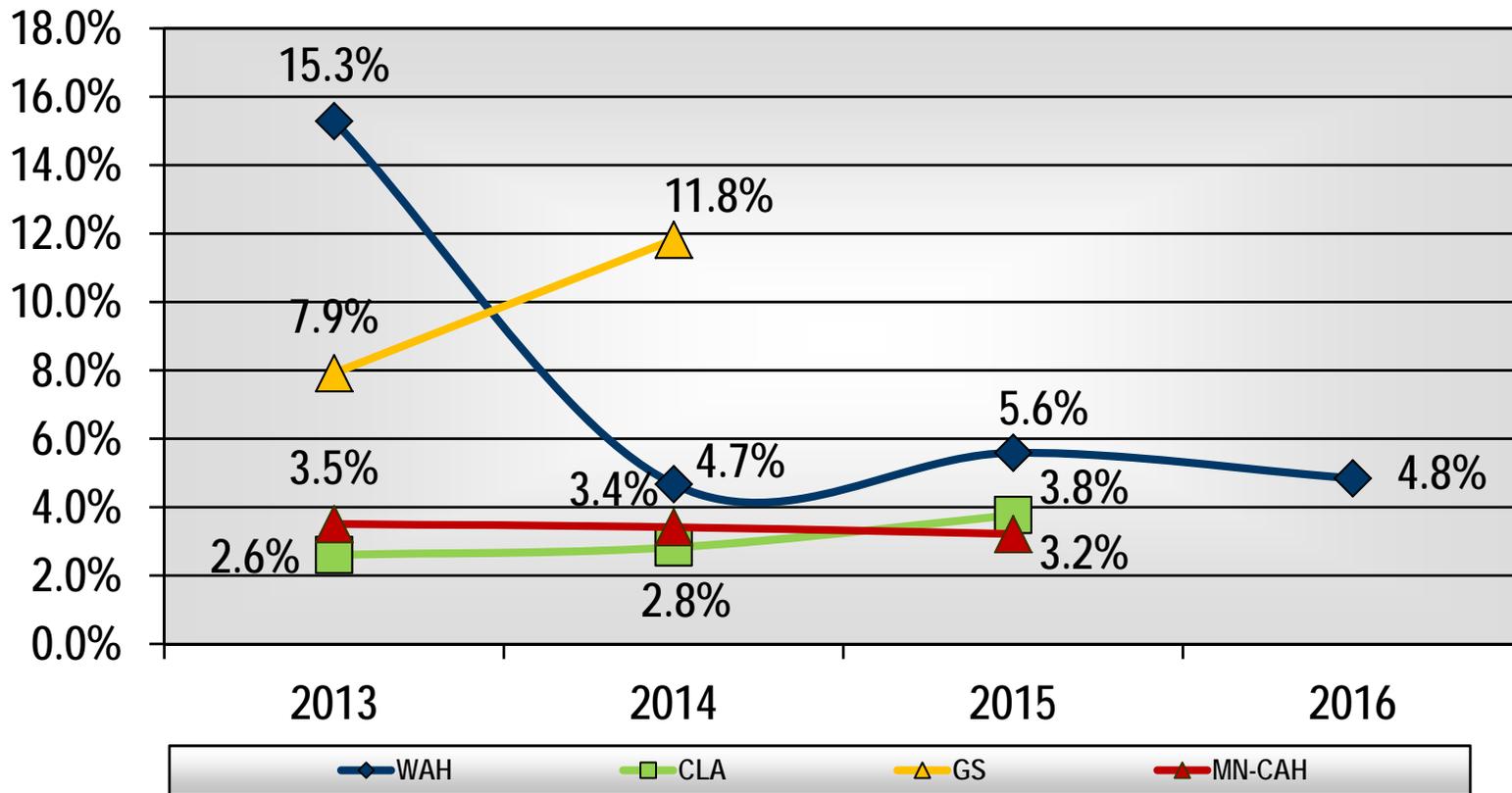
This ratio is operating income as a percentage of net patient service revenue plus other operating revenues. It is used to report the facility's return on revenues which relate to the main purpose of operations.



# Total Margin

**Definition:**

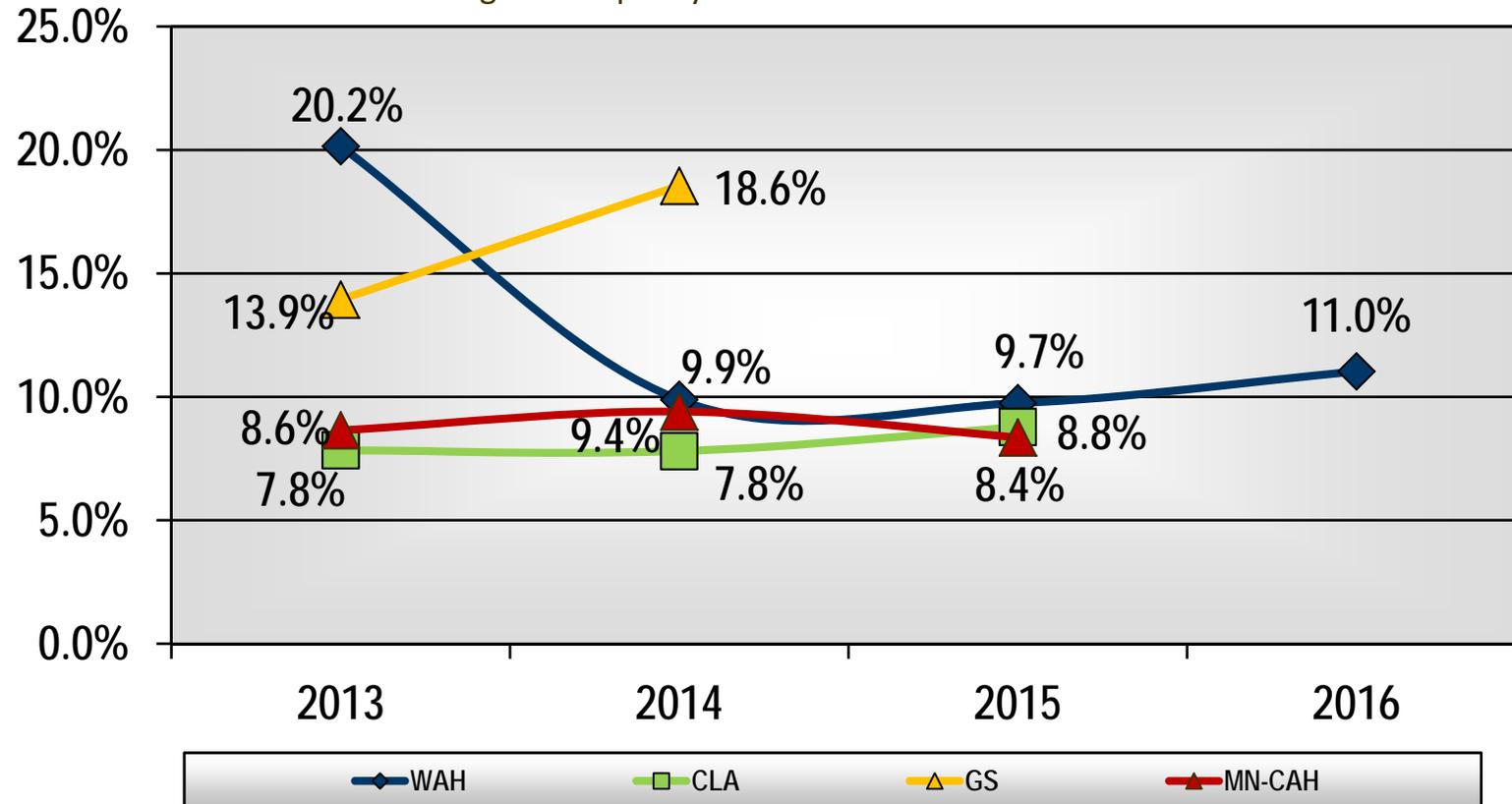
Total margin reflects excess of revenue over expenses as a percentage of total revenues, including non-operating revenues.



# Operating EBIDA

## Definition:

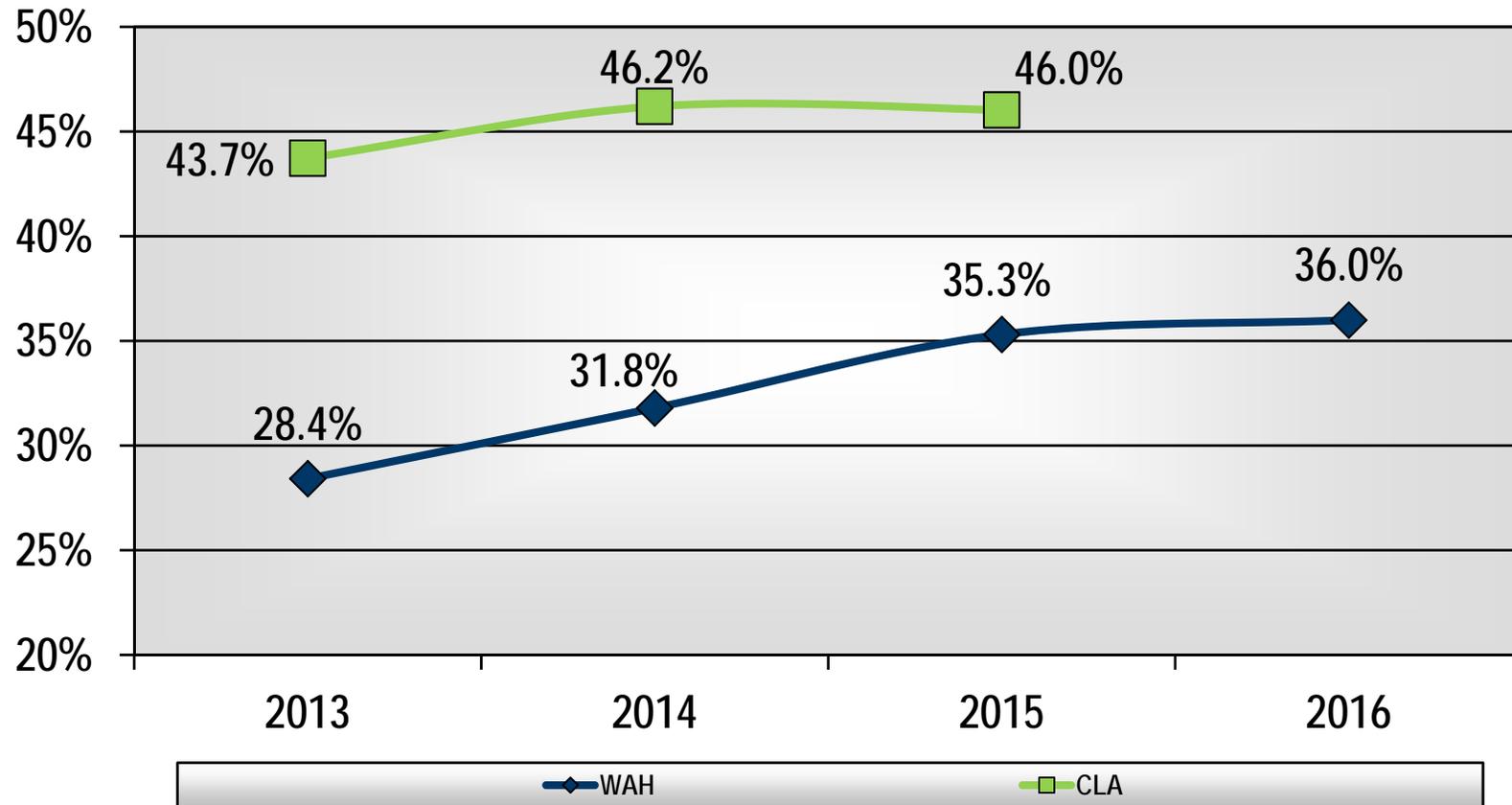
Operating EBIDA represents Earnings (operating income) Before Interest, Depreciation and Amortization divided by total operating revenues. It is used as a rough measure of operating cash flow in a facility. This ratio is often used when evaluating debt capacity.



# Discount Percentage

## Definition:

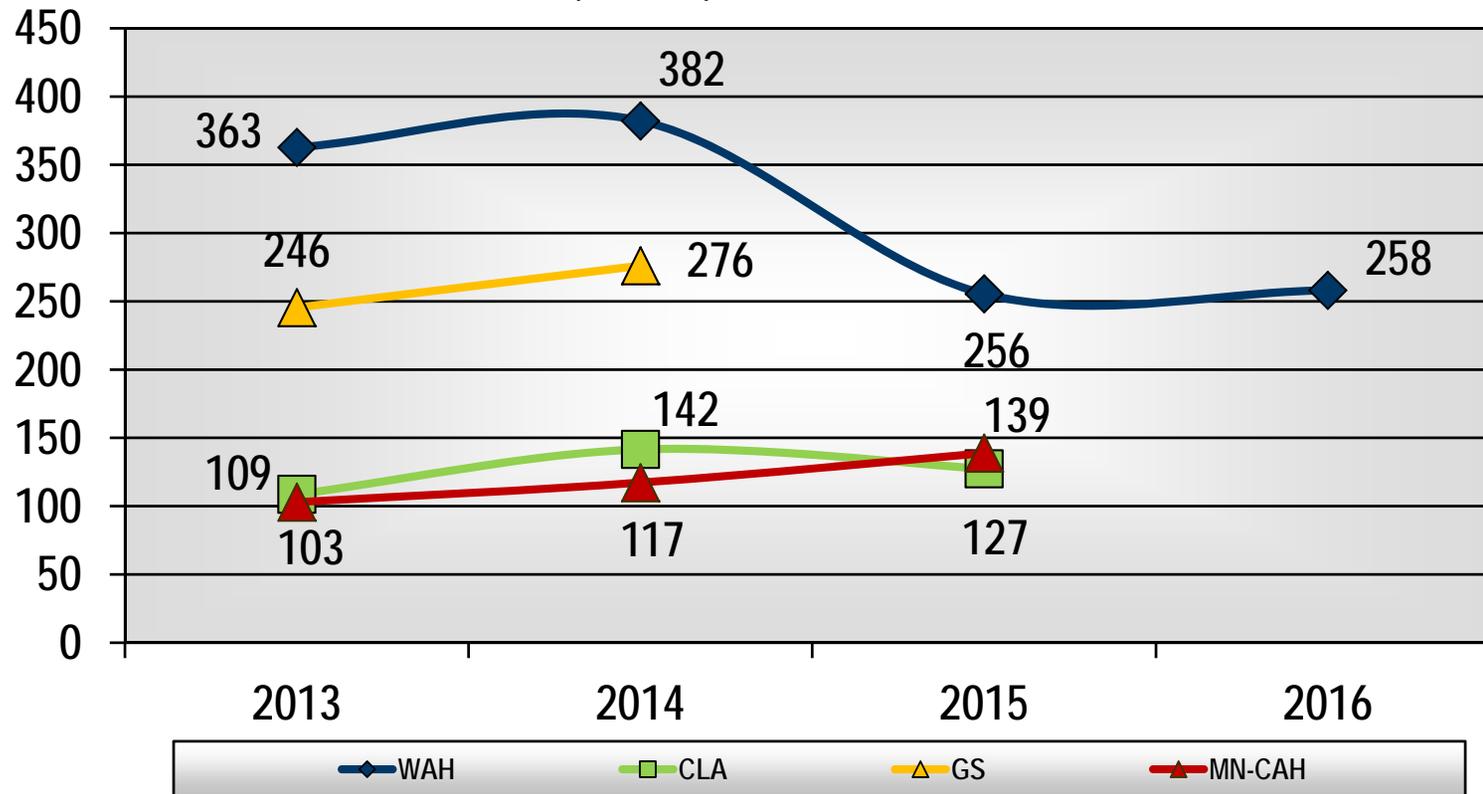
Discount percentage measures the amount of hospital charges that are not actually collected. Items such as charity care and discounts to government, HMOs and other payors are examples of these amounts.



# Days Cash on Hand (All Sources)

**Definition:**

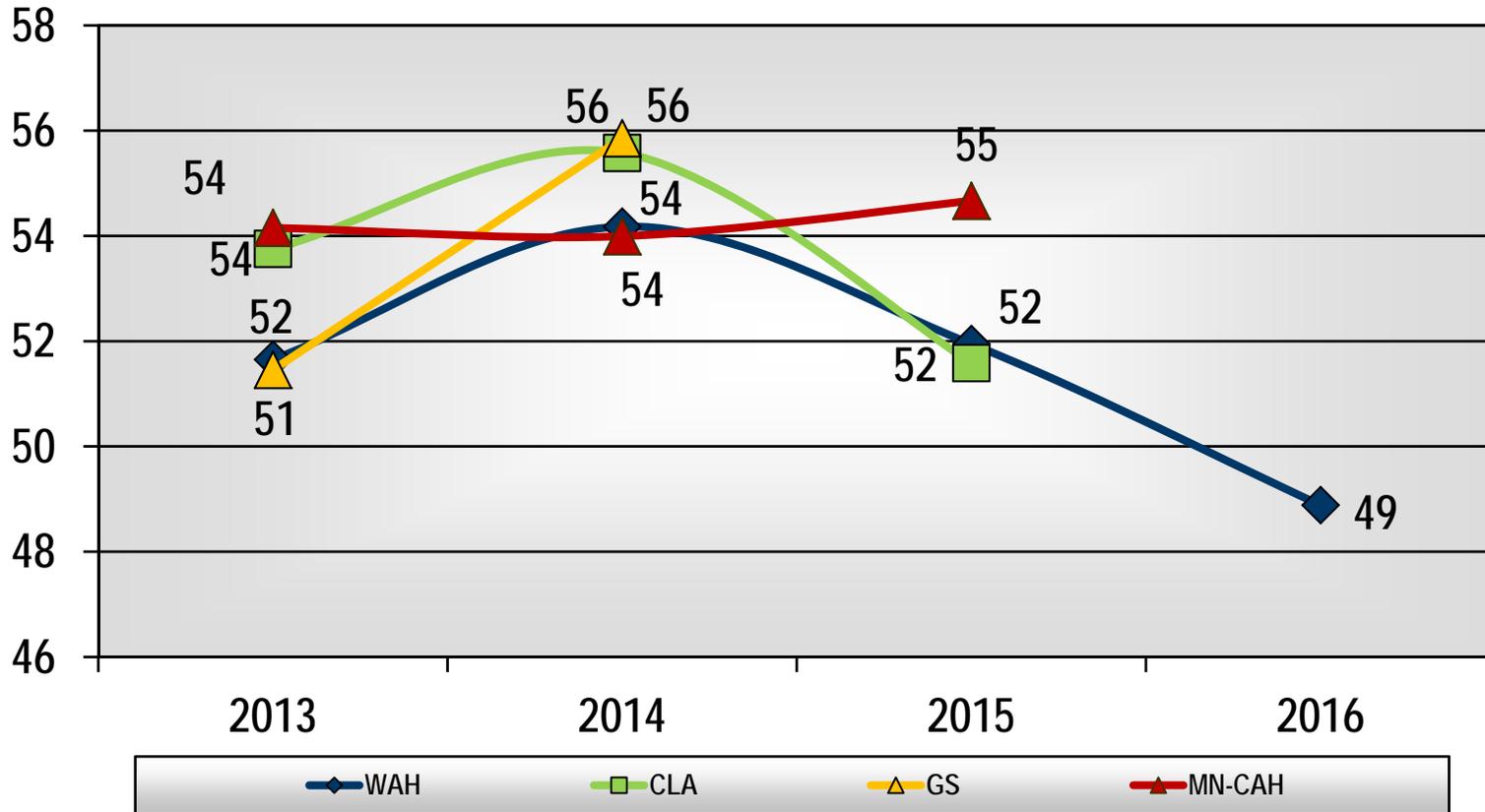
Days Cash on Hand measures the number of days of average cash expenses that the facility maintains in cash and amounts reserved for capital improvements. High values usually imply a greater ability to meet both short-term obligations and long-term capital replacement needs. For 2015 and 2016, the construction funds were excluded for comparability.



# Net Days in Accounts Receivable

**Definition:**

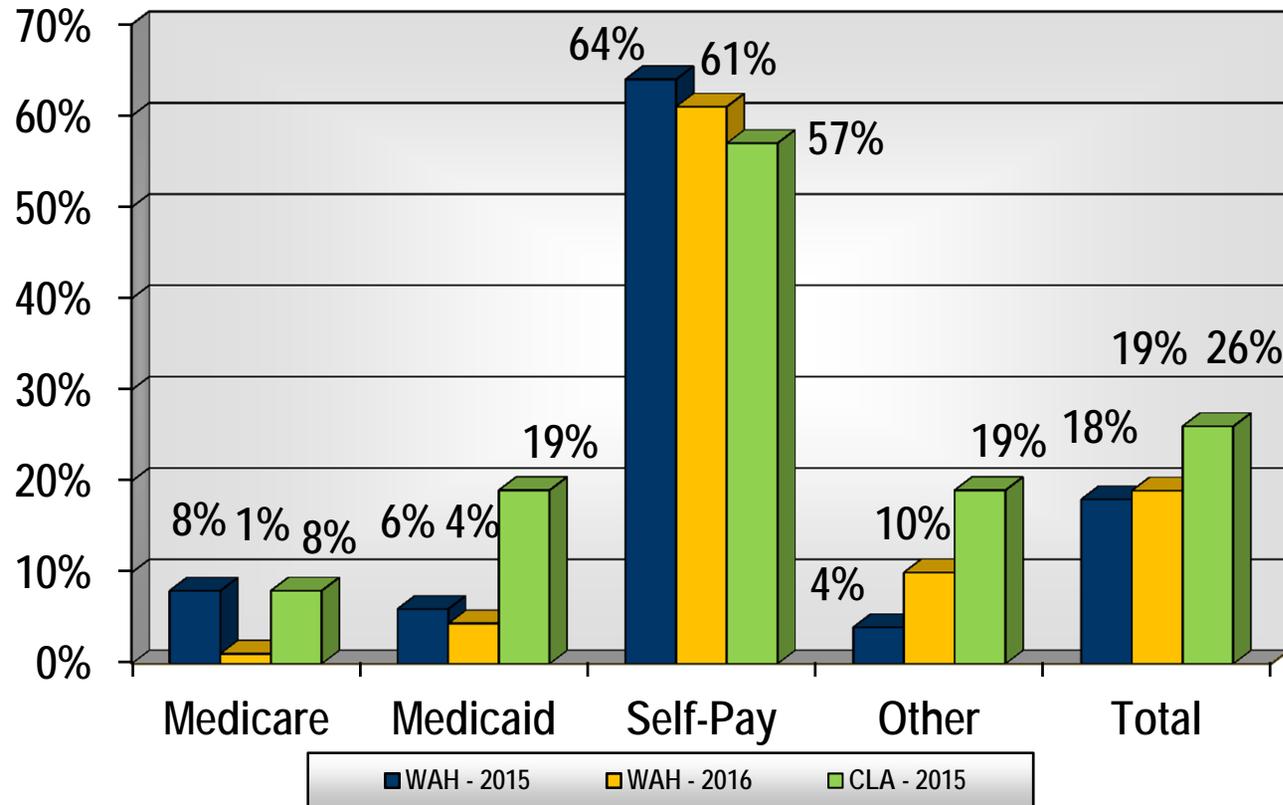
Days in patient accounts receivable is defined as the average time that receivables are outstanding, or the average collection period.



# Percentage of A/R over 90 Days Old

## Definition:

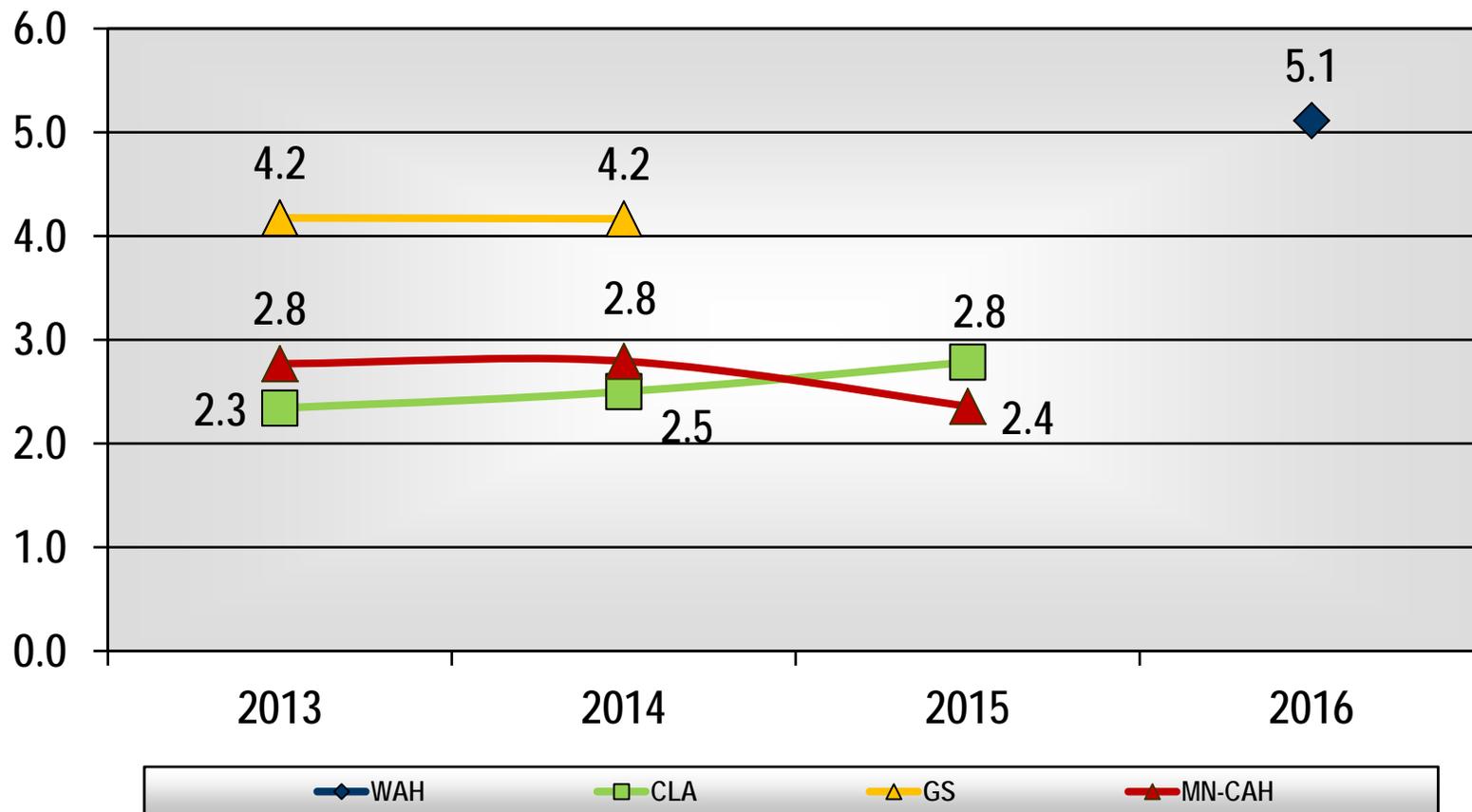
This is measured by dividing the amount of patient accounts receivable over 90 days by the total receivables in that payer category. Generally the lower this percentage is, the shorter turn around time the facility experiences for collecting receivables.



# Debt Service Coverage

**Definition:**

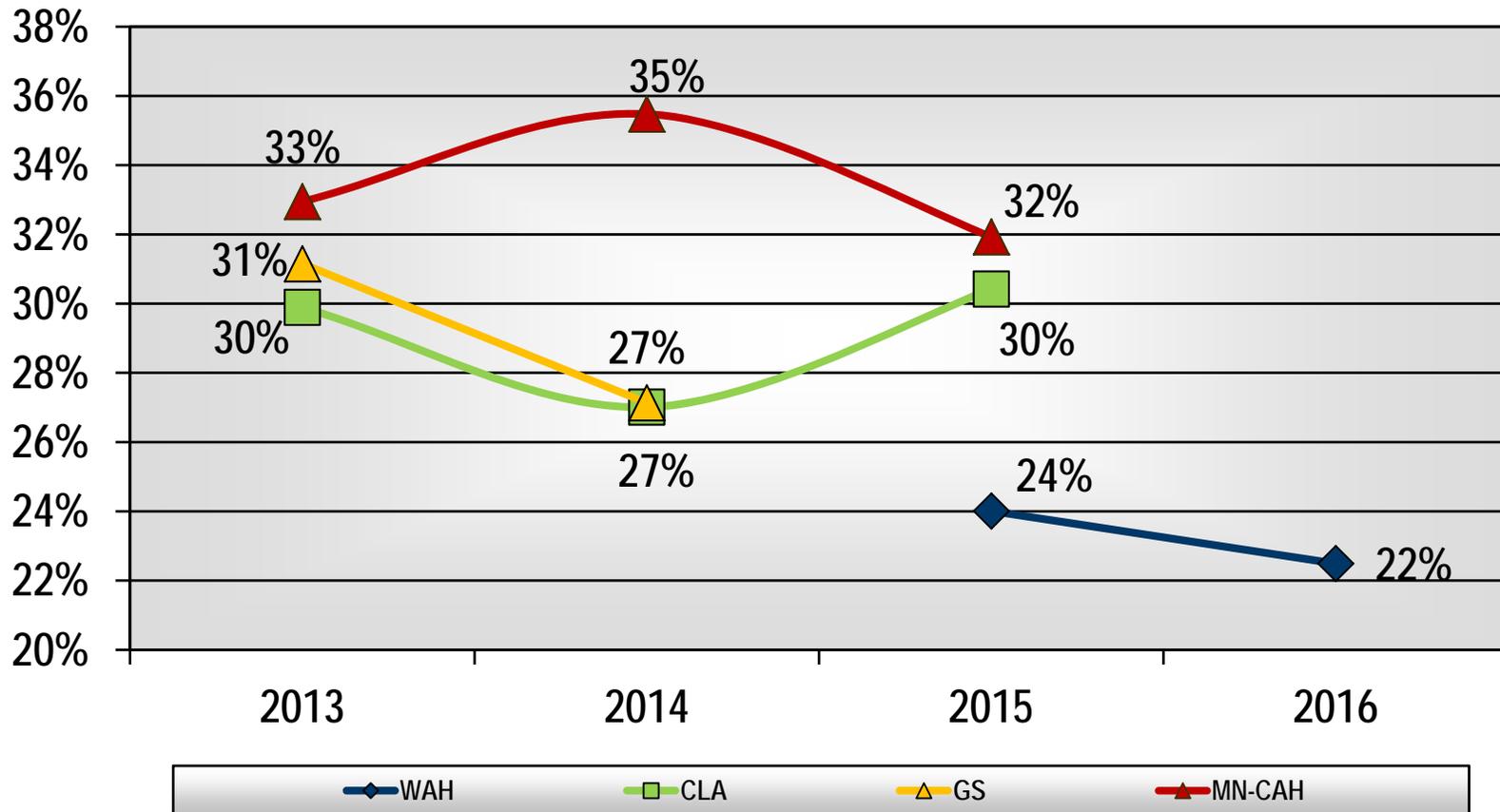
Debt service coverage is calculated as income available for debt service (net income + depreciation and amortization + interest expense) divided by the annual debt service requirements (principal payments made + interest expense). Debt Service Coverage was not applicable prior to FY 2016 as no principal payments on debt.



# Debt to Capitalization

## Definition:

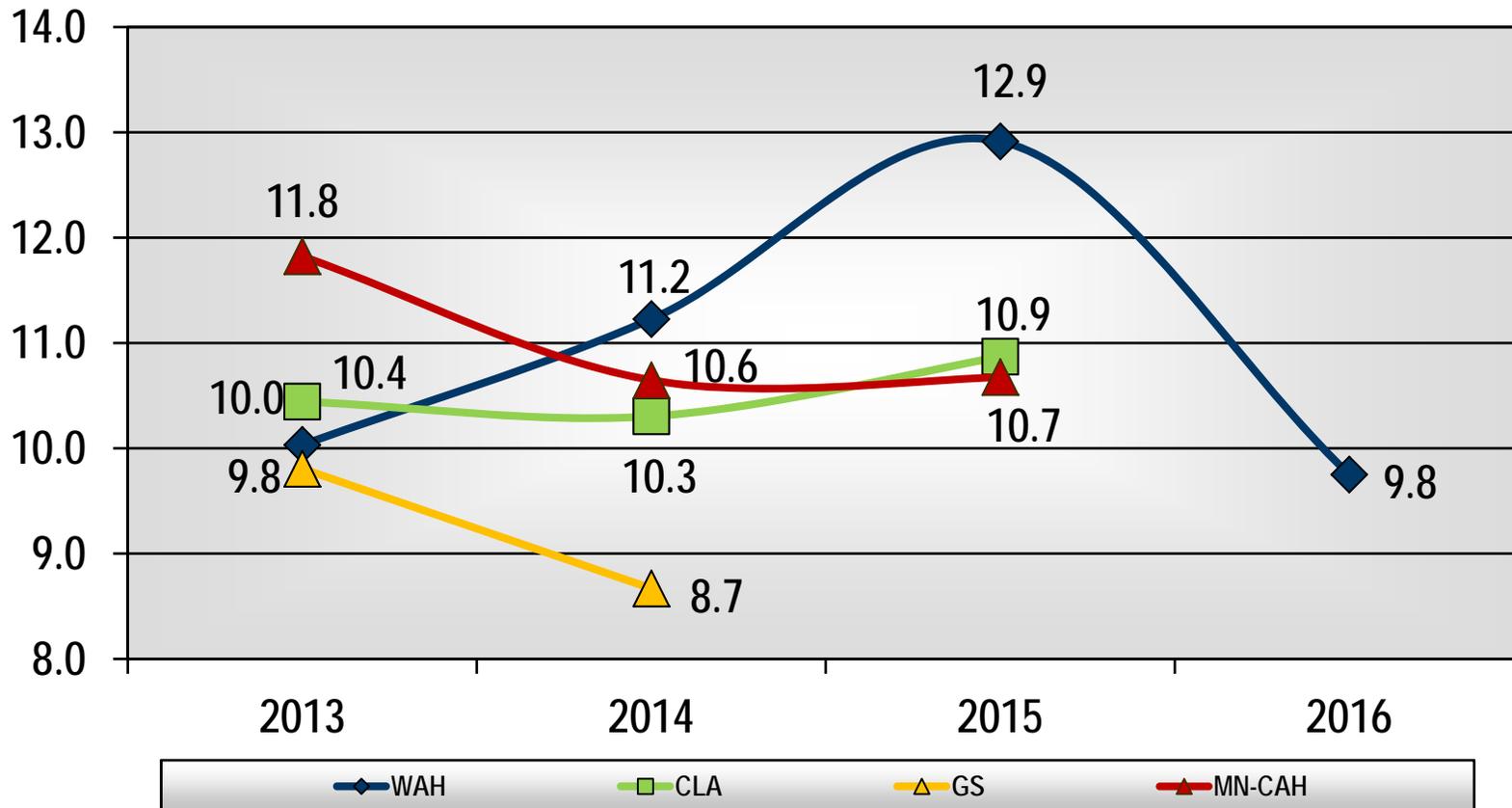
Debt to capitalization is defined as the portion of long-term debt divided by long-term debt plus total net assets. Higher values imply a greater reliance on debt financing. Debt to Capitalization was zero prior to FY 2015 as no debt.



# Average Age of Plant

## Definition:

Average age of plant attempts to approximate the average age of an organization's fixed assets. A low value is considered to be desirable as it indicates a newer facility.

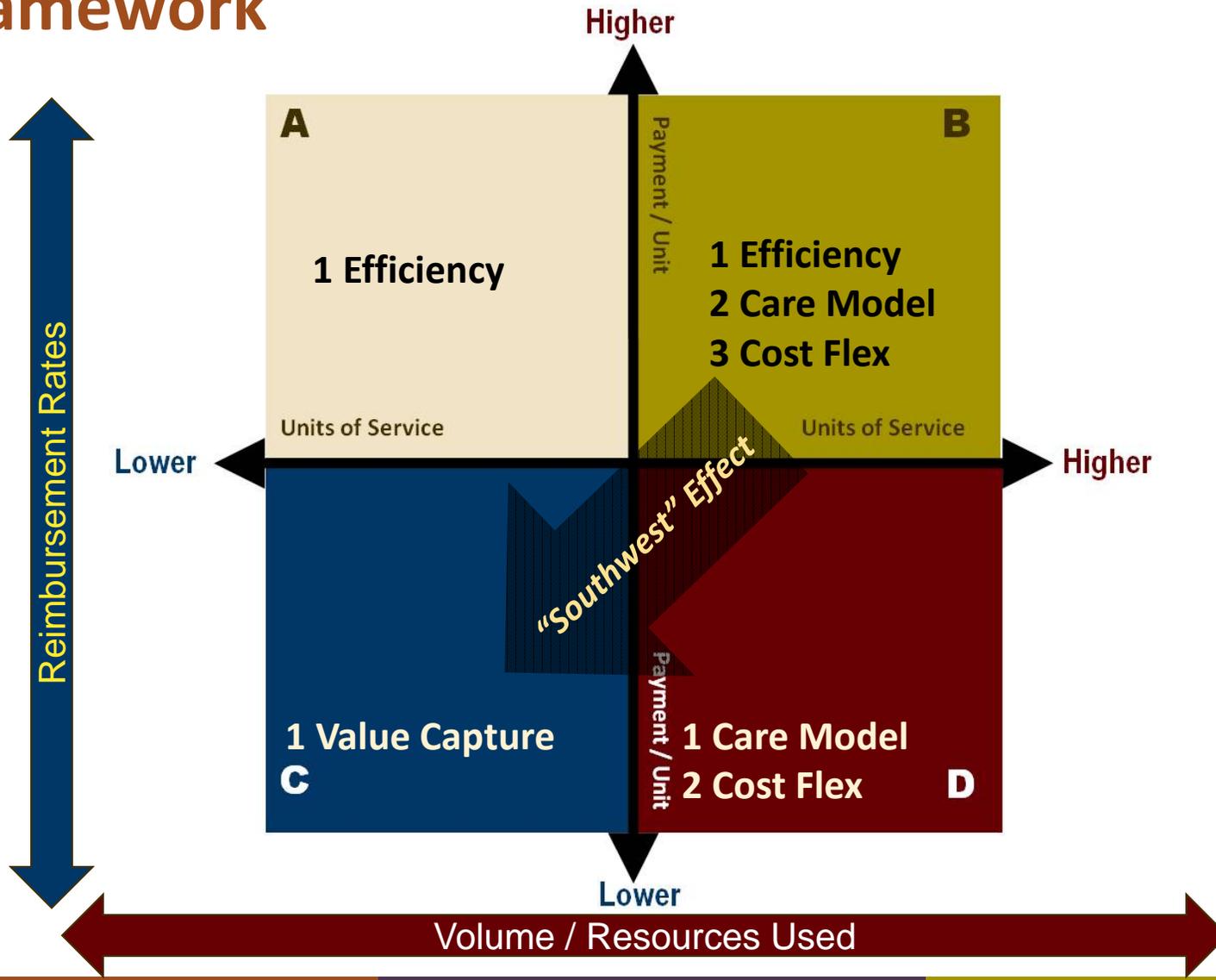




## Section D

Industry Trends

# New Strategic Standard: Creating an Operating Framework



# Transitioning Reimbursement: HHS Framework

Payment Taxonomy Framework				
	Category One Fee-for-Service No Link to Quality	Category Two Fee-for-Service With Link to Quality	Category Three Alternative Payment Models Built on Fee- for-Service Architecture	Category Four Population-Based Payment
Description	Payments are based on volume of services and not linked to quality or efficiency.	At least a portion of payments vary based on the quality or efficiency of health care delivery.	Some payment is linked to effective management of a population or an episode of care. Payments still triggered by delivery of services, but opportunities for shared savings or two-sided risk.	Payment is not directly triggered by service delivery so volume is not linked to payment. Clinicians and organizations are paid and responsible for the care of a beneficiary for a long period.
Medicare FFS	<ul style="list-style-type: none"> <li>- Limited in Medicare fee-for-service</li> <li>- Majority of Medicare payments now are linked to quality.</li> </ul>	<ul style="list-style-type: none"> <li>- Hospital value-based purchasing</li> <li>- Physician value-based modifier</li> <li>- Readmissions/Hospital Acquired Condition Reduction Program</li> </ul>	<ul style="list-style-type: none"> <li>- Accountable care organizations (ACOs)</li> <li>- Medical homes</li> <li>- Bundled payments</li> <li>- Comprehensive primary care initiative</li> <li>- Comprehensive End-Stage Renal Disease Initiative</li> <li>- Medicare-Medicaid Financial Alignment Initiative</li> <li>- Fee-for-Service (FFS) Model</li> </ul>	<ul style="list-style-type: none"> <li>- Eligible Pioneer ACOs in years 3 – 5</li> </ul>

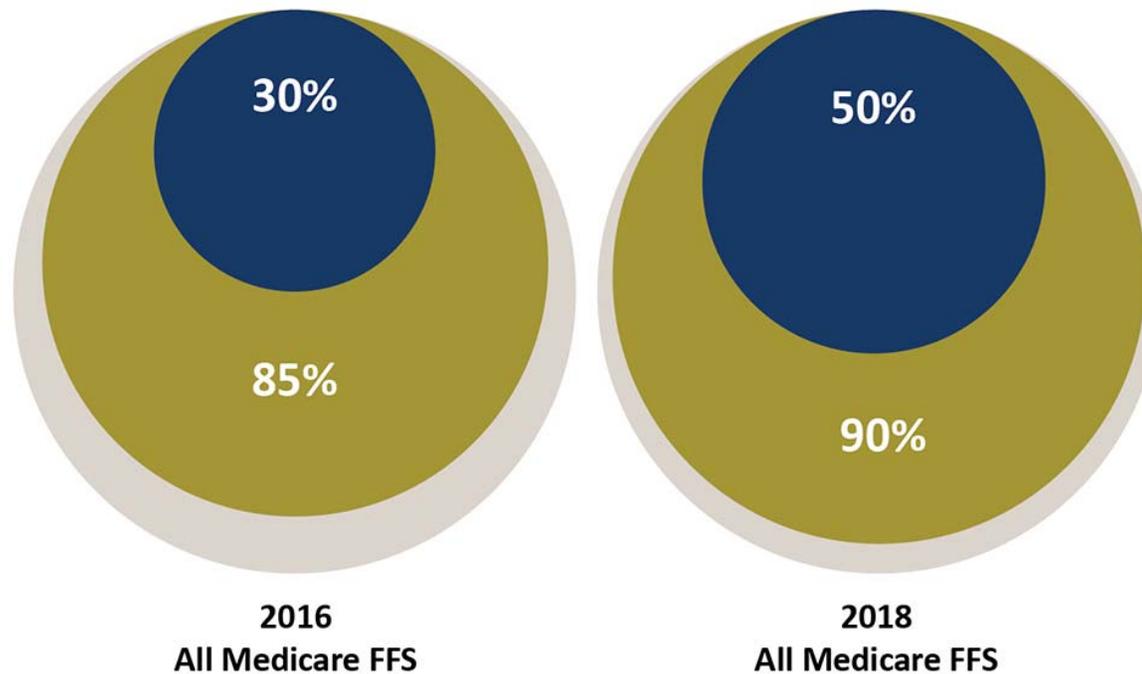
Source: U.S. Department of Health and Human Services



# Transitioning Reimbursement: A Glimpse At The Future

## Target Percentages for Medicare FFS Payments Linked to Quality and Alternative Payment Models in 2016 and 2018

- All Medicare FFS (Categories 1 – 4)
- FFS linked to quality (Categories 2 – 4)
- Alternative payment models (Categories 3 – 4)



Source: U.S. Department of Health and Human Services



# Contact Information



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# Section E Appendix

Internal Control Communication Letter



CliftonLarsonAllen

CliftonLarsonAllen LLP  
CLAconnect.com

Board of Directors and Management  
Windom Area Hospital  
Windom, Minnesota

In planning and performing our audit of the combined financial statements of the business-type activities of Windom Area Hospital (the Hospital) as of and for the year ended April 30, 2016, in accordance with auditing standards generally accepted in the United States of America, we considered the Hospital's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinions on the combined financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to fraud or error may occur and not be detected by such controls. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

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 Hospital's financial statements will not be prevented, or detected and corrected on a timely basis.

### **Material Weaknesses**

We consider the following deficiencies in the Hospital's internal control to be material weaknesses:

#### ***Control over the Financial Reporting Process***

The board of directors and management share the ultimate responsibility for the Hospital's internal control system. While it is acceptable to outsource various accounting functions, the responsibility for internal control cannot be outsourced.

The Hospital engages us to assist in preparing its combined financial statements and accompanying disclosures. However, as independent auditors, we cannot be considered part of the Hospital's internal control system. As part of its internal control over the preparation of its combined financial statements, including disclosures, the Hospital has implemented a comprehensive review procedure to ensure that the combined financial statements, including disclosures, are complete and accurate. Such review procedures should be performed by an individual possessing a thorough understanding of accounting principles generally accepted in the United States of America (GAAP) and knowledge of the Hospital's activities and operations.



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***Control over the Financial Reporting Process (Continued)***

The Hospital's personnel have not monitored recent accounting developments to the extent necessary to enable them to prepare the Hospital's financial statements and related disclosures, to provide a high level of assurance that potential omissions or other errors that are material would be identified and corrected on a timely basis.

***Misstatements Detected by the Audit***

Management is responsible for establishing and maintaining internal controls, including monitoring, and for the fair presentation in the combined financial statements of financial position, results of operations, and cash flows, including the notes to combined financial statements, in conformity with GAAP.

Management is responsible for the accuracy and completeness of all financial records and related information. Their responsibilities include adjusting the combined financial statements to correct misstatements.

Management is responsible for controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals into the general ledger, initiate, authorize, record, and process journal entries into the general ledger; and record recurring and nonrecurring adjustments to the combined financial statements.

During the course of our audit, adjustments were proposed and recorded by management. These changes were material to the financial statements taken as a whole. Without these adjustments, the financial statements would be materially misstated. Overall impact of the adjustments on net income was an increase of approximately \$640,000.

Without these adjustments, the combined financial statements would be materially misstated.

**Significant Deficiency**

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. We consider the following deficiency in the Hospital's internal control to be a significant deficiency:

***Segregation of Duties***

In any system of internal accounting control, one primary goal is adequate segregation of duties. Because of the way certain duties are assigned and carried out within the various accounting cycles, an adequate segregation of duties and responsibilities is not always present. This condition increases the possibility of errors or irregularities may occur and not be detected on a timely basis.

The size of the Hospital and its staff sometimes limits the application of adequate segregation of duties. Although mitigating controls exist within the Hospital's operations, the accounting controls should be reviewed periodically and consideration should be given to improving the segregation of duties and developing procedures which additionally mitigate potential risks. In making this review, it is most important to consider the benefit derived versus the cost of proposed changes.

***Journal entry review process***

Due to changes in management during the year, there was not a formal review and approval process in place related to manual journal entries made by the CFO. This increases the possibility that errors or irregularities may occur and not be detected on a timely basis. We recommend implementing a formal review and approval process for all manual journal entries.

\* \* \* \* \*

This communication is intended solely for the information and use of management, members of the board, and others within the Hospital, and is not intended to be, and should not be, used by anyone other than these specified parties.



**CliftonLarsonAllen LLP**

Minneapolis, Minnesota  
July 13, 2016