

# Windom Area Hospital

## 2018 Audit Results and Report to the Board of Directors

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# Section 1: Required Communications

# Required Communications

## Our Responsibility under Generally Accepted Auditing Standards

- **Express an opinion** on the fair presentation of the combined financial statements in conformity with GAAP
- Plan and perform the audit to obtain **reasonable, non absolute assurance** that the combined financial statements are free of material misstatement
- **Evaluate internal control** over financial reporting
- Utilize a **risk based** audit approach
- **Communicate significant matters** to appropriate parties

## Planned Scope and Timing of the Audit

- Performed the audit **according to the planned scope and timing** previously communicated

## Other Information in Documents Containing the Audited Financial Statements

- The combined financial statements may only be used **in their entirety**
- **Our approval** is required to use our audit report in a client prepared document
- We have **no responsibility to perform procedures** beyond those related to the combined financial statements



# Required Communications

## Significant Accounting Policies

- **Management is responsible** for the accounting policies of the organization
- Accounting policies are outlined in **Note 1** to the combined financial statements
- **No significant changes** to the accounting policies during the year
- Accounting policies **deemed appropriate**
- **No unusual transactions** occurred

## Significant Accounting Estimates

- **An area of focus** under a risk based audit approach
- Significant estimates include: **allowances for bad debts and contractual allowances and third-party settlements**
- **Estimates determined by management** based on their knowledge and experience
- **No management bias** indicated
- Estimates were deemed **reasonable**
- Estimate **uncertainty** is disclosed in the combined financial statements



# Required Communications

## Significant Financial Statement Disclosures

- Net Patient Service Revenue – **Note 2**
- Long-Term Debt – **Note 6**

## Significant Transactions

- No significant transactions

## Required Supplemental Information

- Schedule of Employer's Net Position Liability and Schedule of Employers' Contributions
- Engaged to report in relation to the combined financial statements as a whole
- Method of preparing has not changed from the prior year
- Supplemental information is appropriate and complete in relation to our audit

## Management Representation Letter

- Management has provided a signed representation letter dated August 17, 2018



# Required Communications

## Other

- **No difficulties** encountered in performing the audit
- **No issues** discussed prior to retention as independent auditors
- **No disagreements** with management regarding accounting, reporting, or other matters
- No Consultations with **other independent auditors** other than predecessor auditor communications
- No other findings or issues were discussed with, or communicated to, management

## Corrected and Uncorrected Adjustments

- **Audit adjustments were proposed and recorded that decreased net position approximately \$211,000**
- **Not advised by management of any uncorrected financial statement adjustments**





## Section 2: Internal Control Communication

# Internal Control Communication

## Purpose

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

## 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.

## Restricted Use

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

## Results:

- Material Weaknesses – Financial Statement Preparation, Material Audit Adjustments and Account Reconciliations
- Significant Deficiency – Segregation of Duties





## Section 3: Financial Ratios



# Industry Benchmark Data

## Windom Area Hospital (WAH)

- \$18.4 Million Net Patient Service Revenue
- 2014 –2018 Data, Based on Audited Financial Statements

2015-2018

## CliftonLarsonAllen CAH Clients (CLA)

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

2015-2017

## Minnesota Critical Access Hospitals

- All Minnesota CAH facilities

2015-2017

## CliftonLarsonAllen Gold Standard(GS)

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

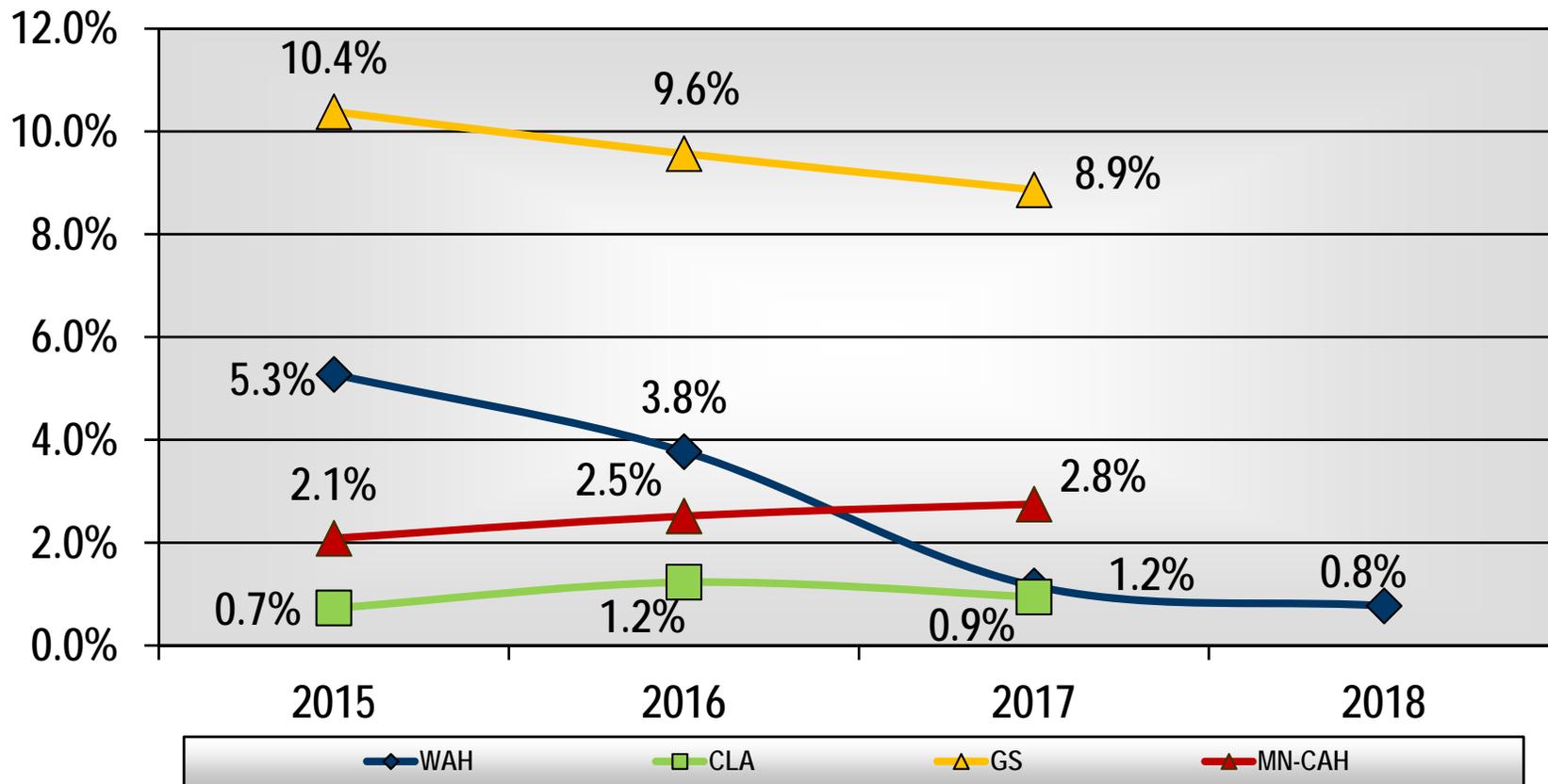
2015-2017



# Operating Margin

**Definition:**

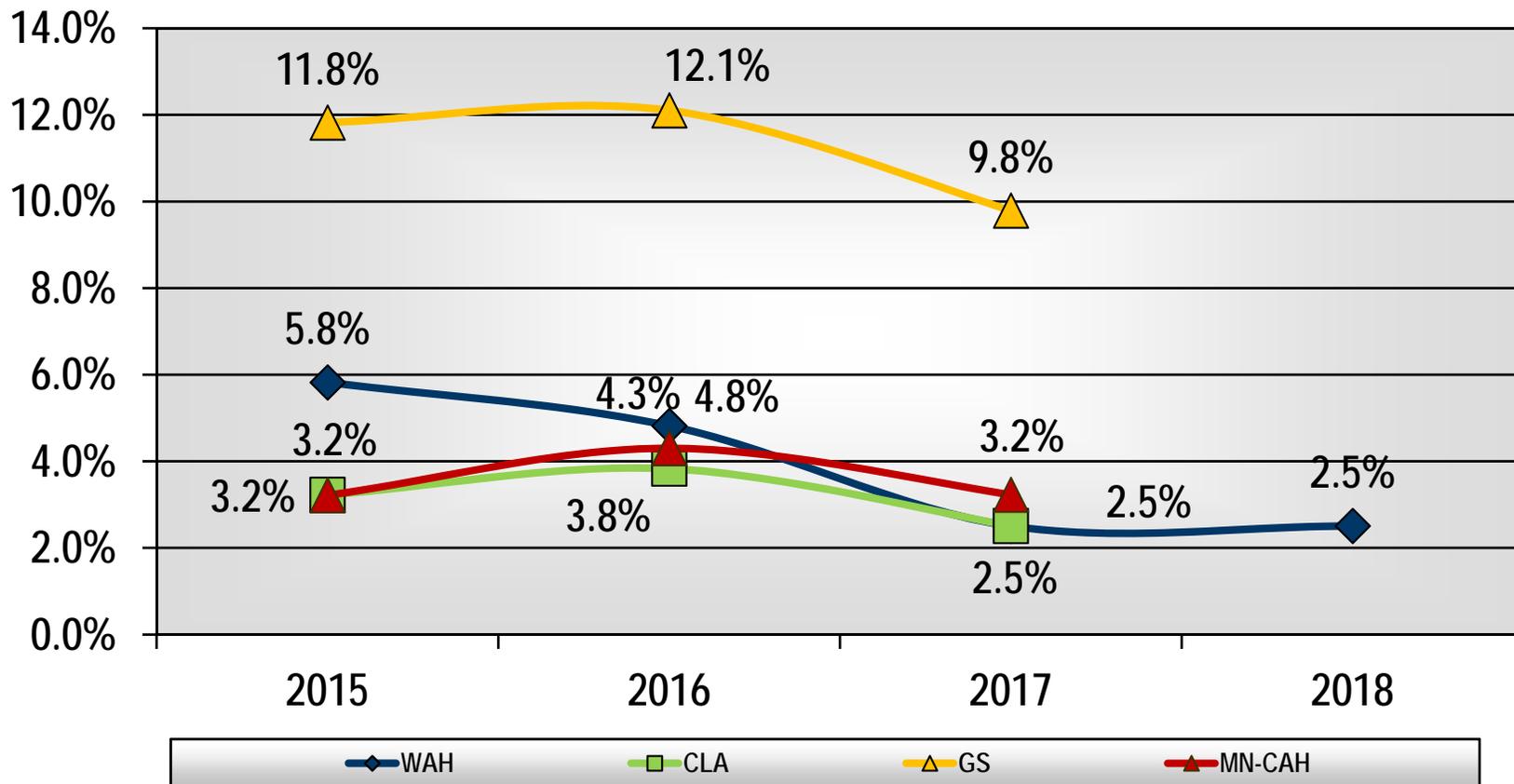
This ratio is operating income as a percentage of net patient service revenue plus other operating revenues. It is used to report the facility's return on revenues which relate to the main purpose of operations.



# Total Margin

**Definition:**

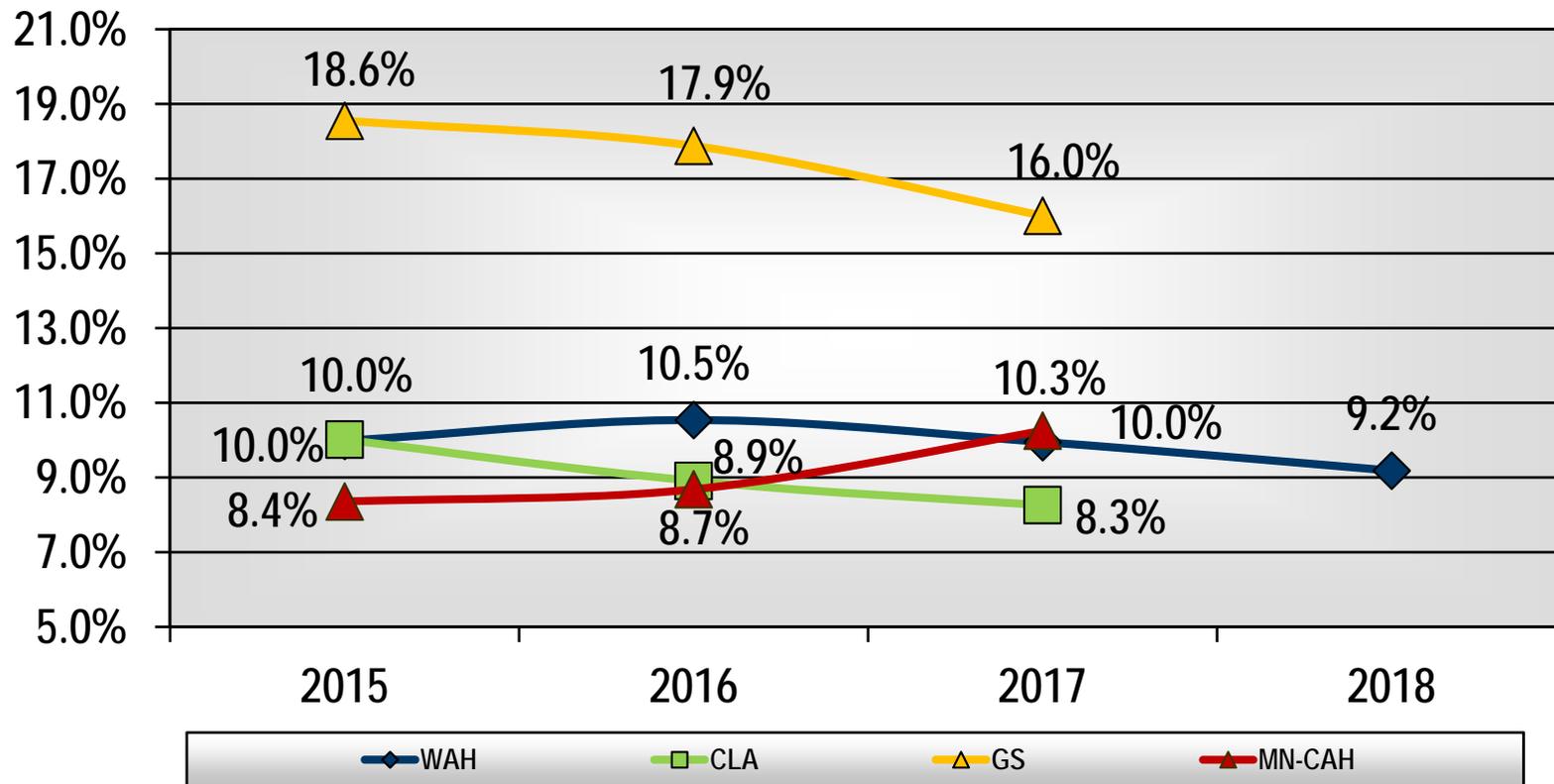
Total margin reflects excess of revenue over expenses as a percentage of total revenues, including nonoperating revenues.



# Operating EBIDA

## Definition:

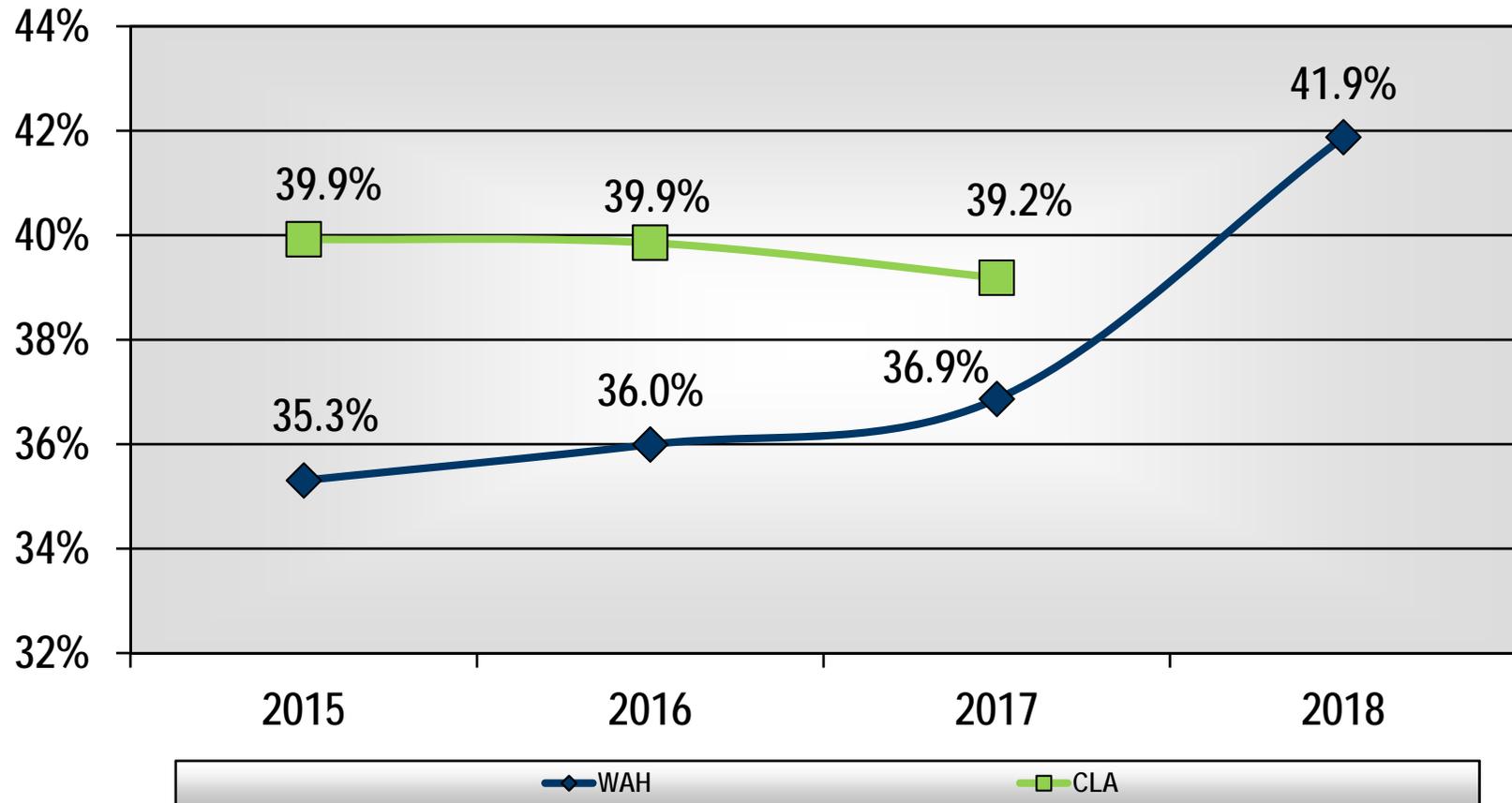
Operating EBIDA represents Earnings (operating income) Before Interest, Depreciation, and Amortization divided by total operating revenues. It is used as a rough measure of operating cash flow in a facility. This ratios is often used when evaluating debt capacity.



# Discount Percentage

**Definition:**

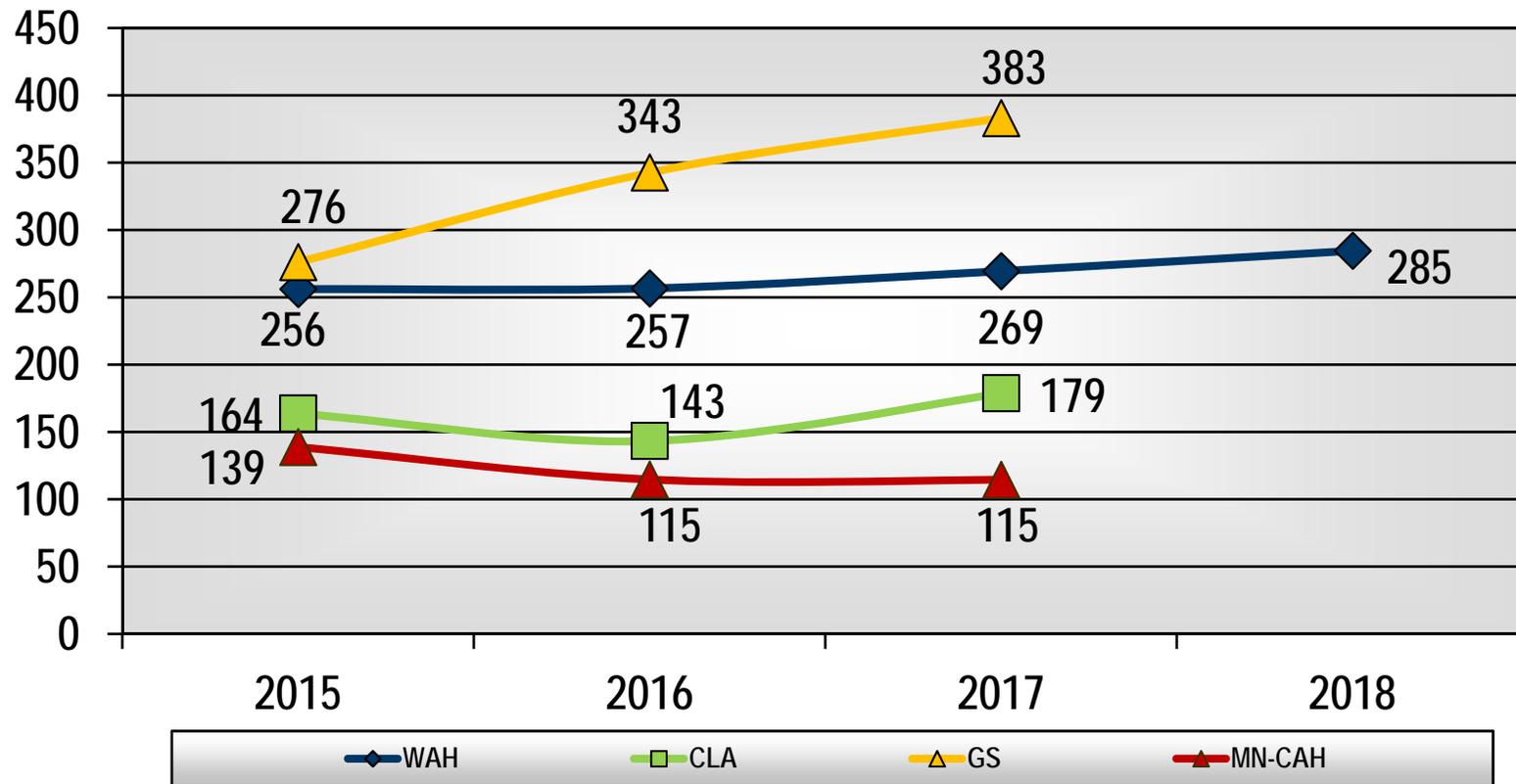
Discount percentage measures the amount of hospital charges that are not actually collected. Items such as charity care and discounts to government, HMOs, and other payors are examples of these amounts.



# Days Cash on Hand (All Sources)

## Definition:

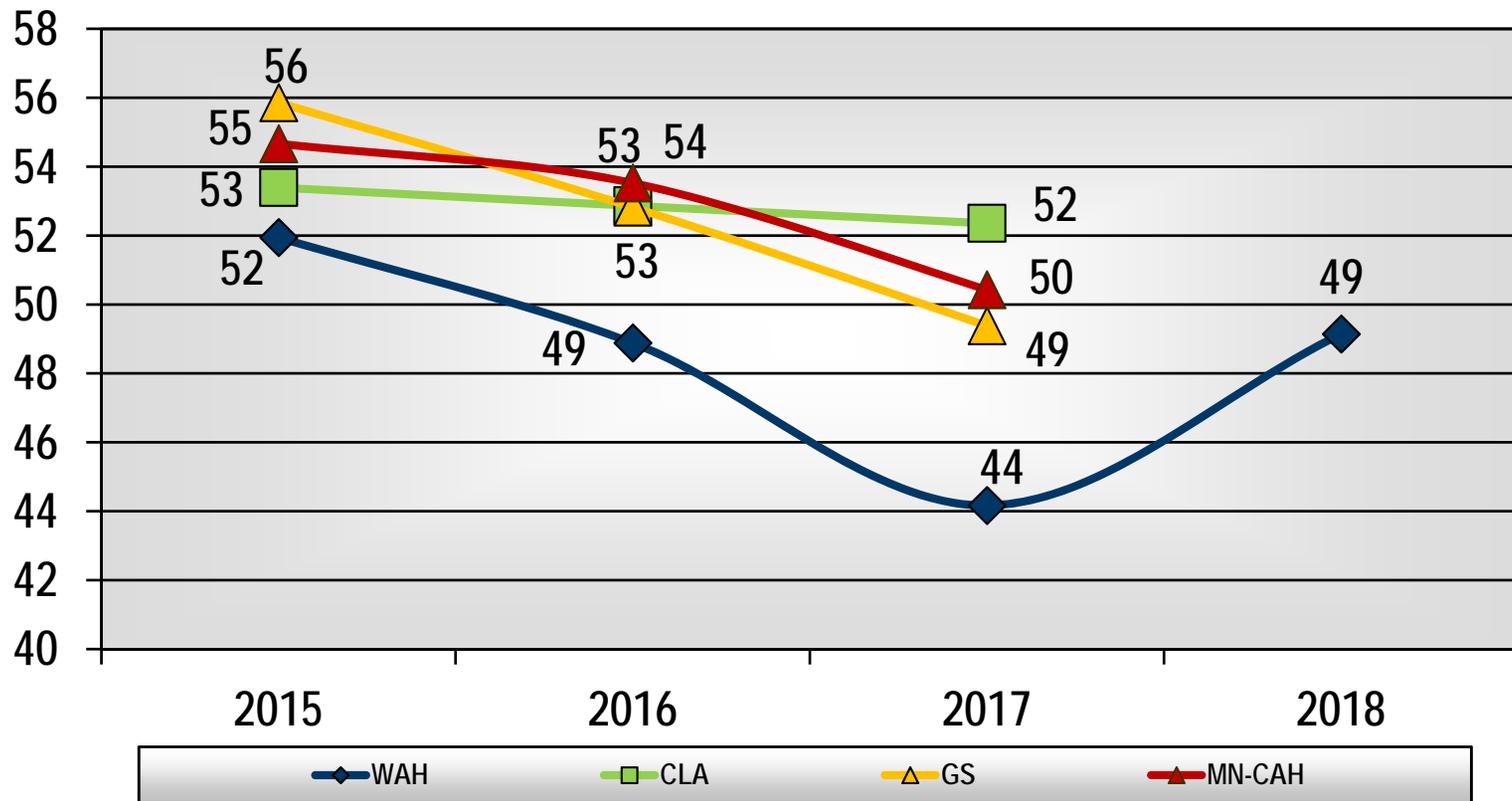
Days cash on hand measures the number of days of average cash expenses that the facility maintains in cash and amounts reserved for capital improvements. High values usually imply a greater ability to meet both short-term obligations and long-term capital replacement needs.



# Net Days Revenue in Accounts Receivable

**Definition:**

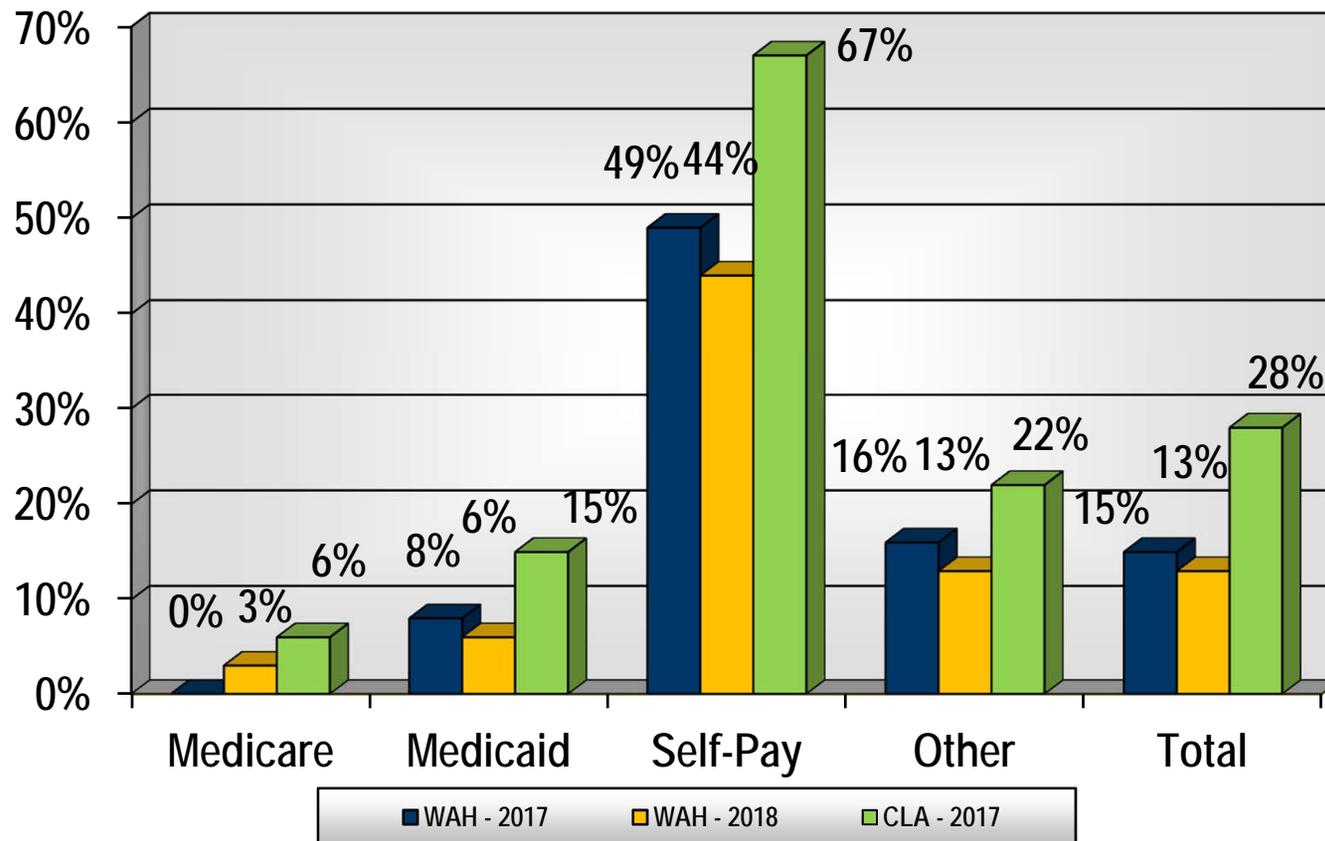
Days in patient accounts receivable is defined as the average time that receivables are outstanding, or the average collection period.



# Percentage of A/R over 90 Days Old

**Comments:**

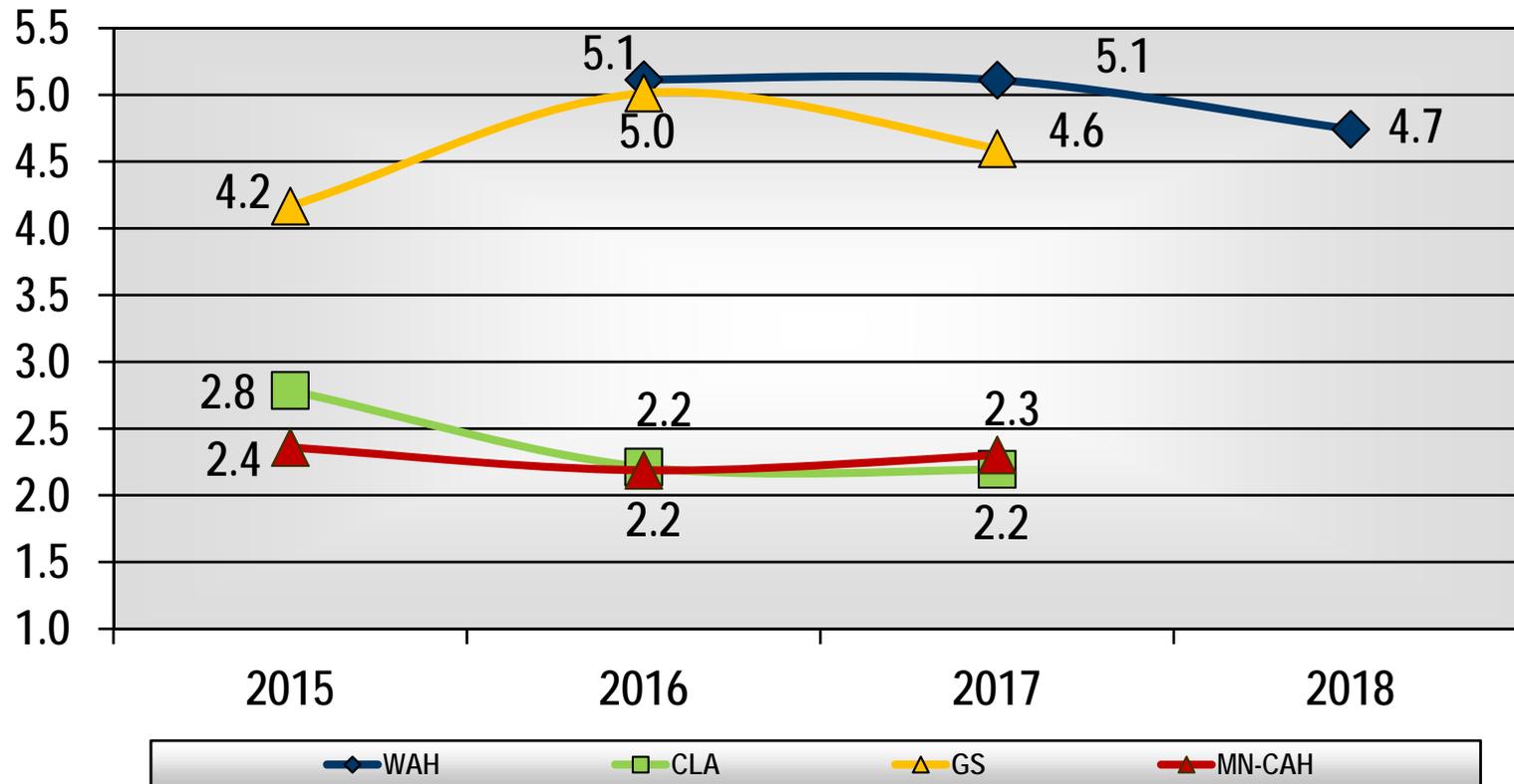
This is measured by dividing the amount of patient accounts receivable over 90 days by the total receivables in that payer category. Generally, the lower this percentage is the shorter turn around time the facility has for collecting receivables.



# Debt Service Coverage Ratio

**Definition:**

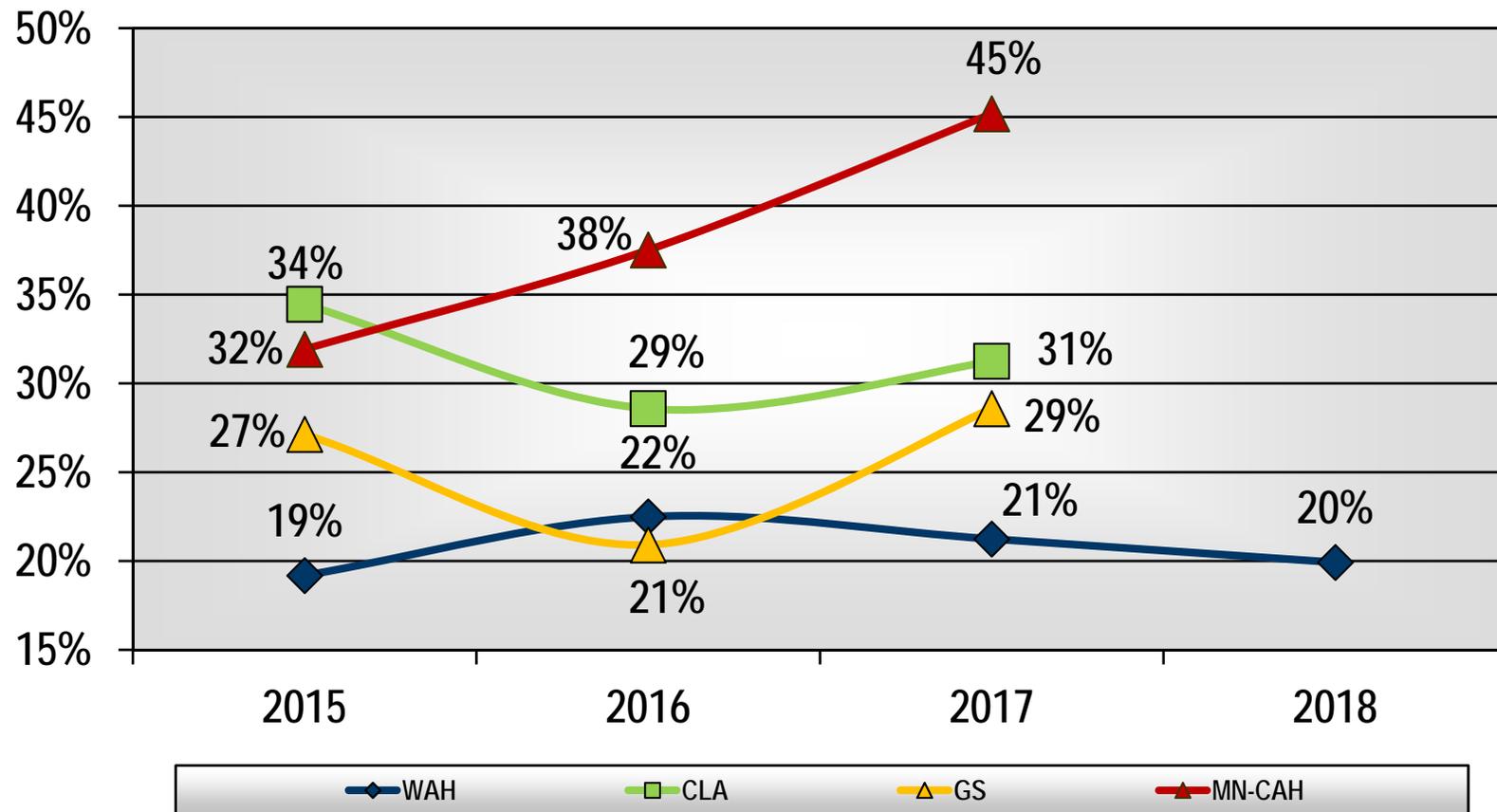
The debt service coverage is calculated as income available for debt services (net income + depreciation and amortization + interest expense) divided by the debt service requirements on the outstanding bonds. Debt Service Coverage was not applicable prior to FY 2016 as no principal payments on debt.



# Debt to Capitalization

**Definition:**

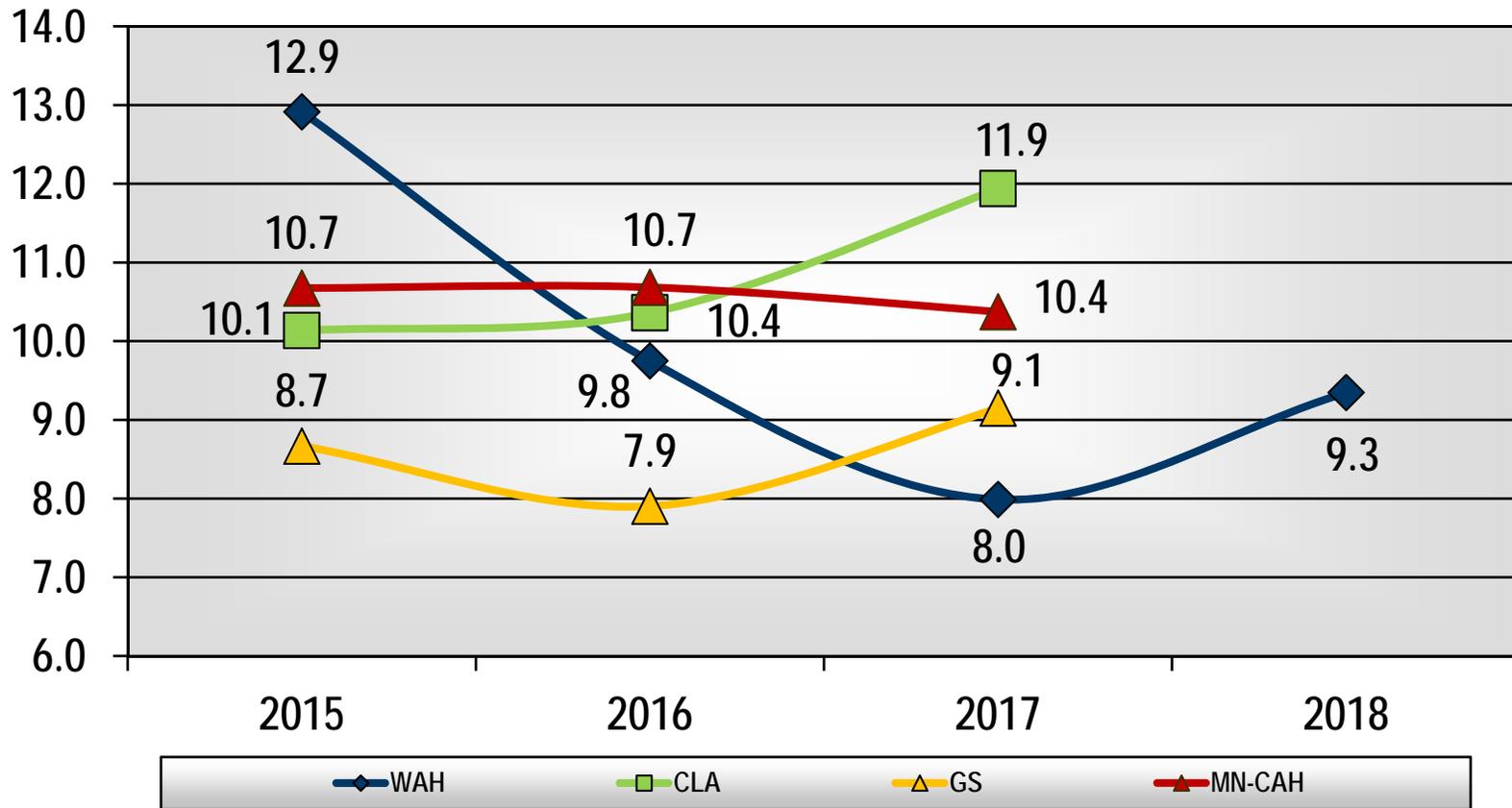
Debt to capitalization is defined as the portion of long-term debt divided by long-term debt plus total net assets. Higher values imply a greater reliance on debt financing.



# Average Age of Plant

## Definition:

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





## Section 4: Industry Trends



# 2018 A New Era: New Secretary of Health & Human Services

- Alex Azar, Secretary HHS
  - Confirmed by Senate 1/24/18
  - Previously held significant roles in HHS
    - ◇ 2001 General Counsel
    - ◇ 2005 Deputy Secretary
  - Played key roles during President George W. Bush Administration
    - ◇ Implementation of Medicare Part D
    - ◇ Managed and oversight over various epidemic and chemical outbreaks/concerns
  - 2007 to 2017 President of Eli Lilly U.S. Operations
- Azar's Top Priorities as Leader of HHS
  - Sky rocketing drug prices
  - Health care affordability and availability
  - Shifting Medicare to paying for health and outcomes
  - Tackling the opioid epidemic

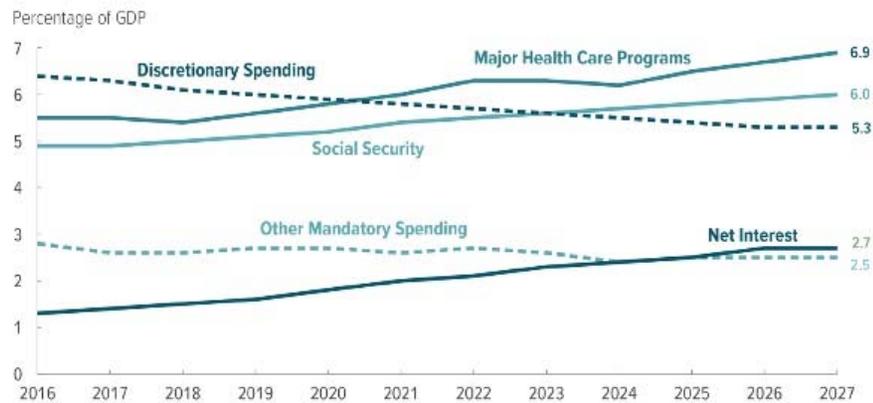


# 2018 A New Era: Health Care Spending Drives Unsustainable Trend

- Major Health Care Programs are projected to continue to escalate to 6.9% of GDP
- This is the fastest and largest of any spending category.
- Under this scenario, the total deficit would grow from 77% to 89% of GDP.
- This would be the highest level of debt since WWII in 1947 and more than double the average over the past five decades.

CBO

### Projected Outlays for Major Budget Categories

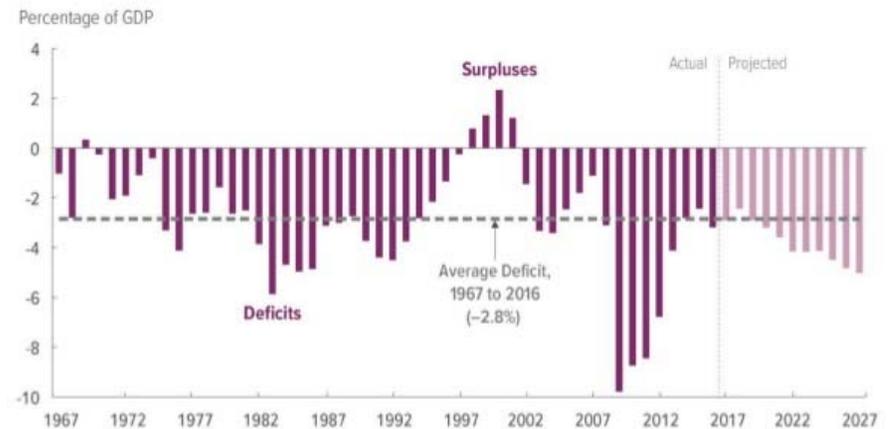


By 2027, discretionary spending is projected to drop to its lowest share of GDP in any year to date since 1962 (the earliest year for which such data have been reported). That reduction occurs because most discretionary funding is capped through 2021 at amounts that increase more slowly than the projected growth of the economy.

12

CBO

### Total Deficits or Surpluses



By 2027, if current laws remained generally unchanged, the deficit would reach 5.0 percent of GDP, far exceeding its 50-year average.

2



# 2018 A New Era:

## Key Take Away for Health Care Providers

- Azar's priorities are signaling a return to advancing the speed of payment transformation, along with other potential changes that could impact providers of all types.
- Key comments he made during his various Senate hearings included the following signals:
  - Stressed his belief in market competition and opening up markets to allow competition
  - On record as agreeing with the “able bodied work” initiative to receive Medicaid benefits
  - Emphasized the need to move the current payment to paying for health and outcomes
  - Believes in leveraging technologies that have been implemented
  - Believes in capitalizing on best elements in one program, and translating them to others
- Themes we hear from Azar are in direct alignment with the Administration



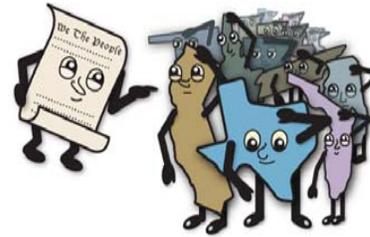
*\* Source: 2016 letter to CMS from 178 congressional law makers*



# 2018 A New Era: HHS in Alignment with Administration Principles



**Reductions in federal health care spending**



**Greater state management and control with less federal intervention**



**Increased market competition and incentives to drive consumerism**



**Continue to drive policies that promote increasing the value of health care**



# Future Outlook

- Key health care provisions funded/extended, but some may necessitate additional CMS rulemaking
- BBA 2018 funded government *but only through 3/23*
- Congress currently working on a large budget package (now that BBA 2018 increased domestic/military spending caps) to fund government longer term
  - Congress could target health care spending in Medicare, Medicaid or other health care programs as “pay-fors”
- 2018 an election year with *less legislative* activity as elections get closer; expect *more regulatory activity*

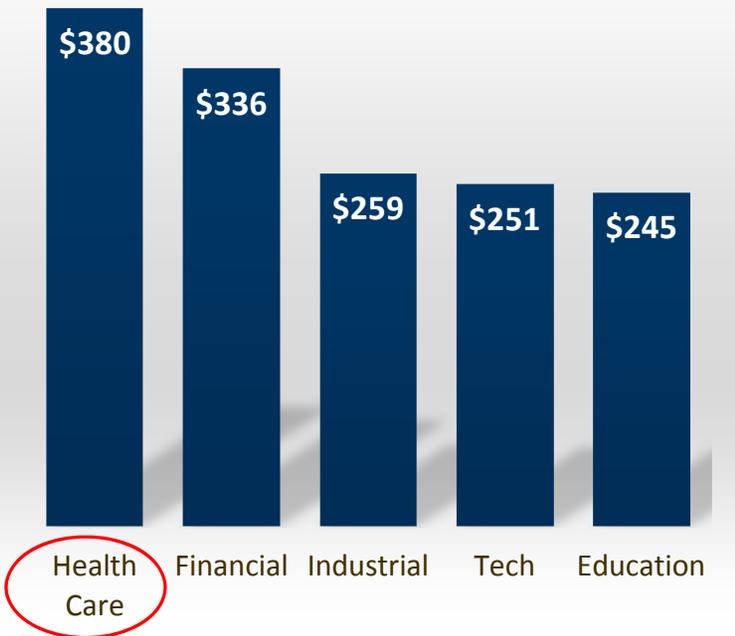
Stay tuned to CLA for future policy insights!



# Information Security and Compliance Issues

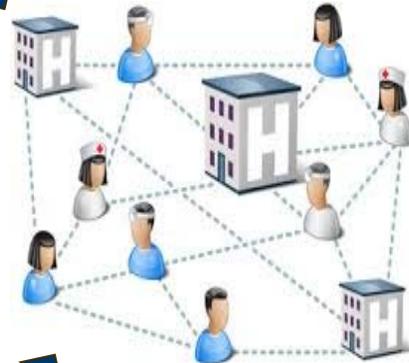
- Regulatory Pressure is increasing
- \$22,855,300 in fines (2017)

Cost of a breach (per record) by industry



## External Threats

- Ransomware
- E-mail Phishing
- Hackers



- Noncompliance
- Accidental Disclosure of e-Phi
- Malicious Insider

## Internal Threats

## Things to consider

- Have your staff been trained?
- Are your systems secure?
- Would you know if an insider was stealing info?
- Do you know the risks?
- Are you compliant?
- Can you recover?



# Individual Tax Rates

## 2017 Individual Tax Rates (Pre-TCJA)

Tax Bracket	Single	MFJ	H of H
10%	9,325	18,650	13,350
15%	37,950	75,900	50,800
25%	91,900	153,100	131,200
28%	191,650	233,350	212,500
33%	416,700	416,700	416,700
35%	418,400	470,700	444,550
<b>39.6%</b>	<b>EXCESS</b>		

## 2018 – 2025\* Individual Tax Rates (Under TCJA)

Tax Bracket	Single	MFJ	H of H
10%	9,325	19,050	13,600
12%	38,700	77,400	51,800
22%	82,500	165,000	82,500
24%	157,500	315,000	157,500
32%	200,000	400,000	200,000
35%	500,000	600,000	500,000
<b>37%</b>	<b>EXCESS</b>		

\* Barring further legislation, the TCJA individual rate changes will expire (sunset) after 2025.



# Individual Tax Deductions

Tax Bracket	Pre-TCJA	Under TCJA
Standard Deduction	Single: 6,350 MFJ: 12,700 HoH: 9,350	Single: 12,000 MFJ: 24,000 HoH: 18,000
Personal Exemption	\$4,050 per Individual <i>*Subject to AGI Phase-out</i>	<i>Repealed</i>
Mortgage Interest	Debt Limit: \$1.1M 2 <sup>nd</sup> Home Allowed: Yes Home Equity Interest Allowed: Yes	Debt Limit: \$750,000 2 <sup>nd</sup> Home Allowed: Yes Home Equity Interest Allowed: No
Taxes	<u>Itemized Deduction Allowed for:</u> <ul style="list-style-type: none"> <li>Real Estate Tax (U.S. Property Only)</li> <li>Personal Property Tax</li> <li>State/Local Income Tax (or sales tax)</li> </ul> <i>*Subject to AGI Phase-out</i>	<b>Itemized Deduction Limited to \$10,000</b> for the <i>Aggregate</i> of State & Local Property and Income Taxes
Charitable Deductions	Limited to 50% AGI	Limited to 60% AGI <i>*80% Deduction for Athletic Tickets Repealed</i>
Miscellaneous Deductions	Itemized Deduction Subject to 2% AGI Floor (includes employee business expense, investment expenses, tax prep fees, professional dues, etc.)	<i>Repealed</i>
Medical Expenses	Subject to 10% AGI Floor	Subject to 7.5% AGI Floor <i>*Retroactive to 2017</i>
AGI Phase-out	Phase-out begins at \$313,800 (MFJ)	<i>Repealed</i>





## Section 5: Accounting Standards Update

# Accounting Standards Update

## Blending Requirements for Certain Component Units – GASBS 80

- This Statement establishes a blending requirement for financial statement presentation of component units organized as not-for-profit corporations if the primary government is the sole corporate member.
- Not applicable to component units included in the financial reporting entity under GASBS 39.
- Effective for years **beginning after** June 15, 2016, and should be applied retrospectively. Earlier application is encouraged.

## Irrevocable Split Interest Agreements – GASB 81

- This Statement establishes guidance for governments that receive resources pursuant to an irrevocable split interest agreement.
- Applicable when a donor transfers resources to an intermediary to hold for the unconditional benefit of a government and at least one beneficiary. Usually in the form of a trust.
- The government may be both the intermediary and the interest beneficiary
- Examples include a charitable remainder trust, life interest trust, charitable gift annuity.
- Effective for years **beginning after** December 15, 2016, and should be applied retrospectively.



# Accounting Standards Update

## Certain Debt Extinguishment Issues – GASB 86

- Provides guidance for governments to report in-substance defeasance transactions in which cash and other monetary assets acquired with only existing resources are placed in an irrevocable trust for the purpose of extinguishing debt
- Liability, cash and other monetary assets are removed from the government's statement of net position
- Effective for years **beginning after** June 15, 2018

## Leases - GASB 87

- Addresses accounting and financial reporting for leases by state and local governments.
- The Statement establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset
- Requires the recognition of certain right to use lease assets and related liabilities for leases that were previously classified as operating leases.
- Effective for years **beginning after** December 15, 2019, with earlier application permitted



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# Appendix: Internal Control Letter



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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, 2018, 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 and a deficiency we consider to be a significant deficiency.

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 (U.S. GAAP) and knowledge of the Hospital's activities and operations.

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 U.S. 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 a decrease of approximately \$211,000.

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

***Account Reconciliation Process***

During the performance of our audit engagement procedures there were a number of unreconciled balance sheet accounts identified as of year-end, including cash and accounts payable. In some cases these balances were adjusted as part of the audit, as discussed above, but in the case of cash there remains an immaterial unreconciled variance between the supporting documents and the general ledger balance.

The adjustments required above illustrate the importance of timely, regular reconciliations of balances, and we recommend the Hospital devote time and effort to resolve the unreconciled variances in these accounts, and implement processes to ensure all accounts are reconciled monthly, and in a timely manner. Without these processes in place, there are greater risks for improper activity, or misstated financial statements.

### **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***

Due to the size of the Hospital and turnover of a member of the finance team near year end, there was a significant amount of reliance placed on the Chief Financial Officer. As a result of this, there were instances where there was not proper segregation of duties. As such, there is an increased risk of misappropriation or inappropriate financial reporting that may not be detected on a timely basis. Management replaced the employee that left and is committed to transitioning the additional roles and responsibilities placed on the Chief Financial Officer in 2019.

\* \* \*

This communication is intended solely for the information and use of management, the board of directors, 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  
August 17, 2018