

**Sid Peterson Memorial Hospital d/b/a
Peterson Health**

Independent Auditor's Report and
Consolidated Financial Statements

June 30, 2019 and 2018



**Sid Peterson Memorial Hospital d/b/a
Peterson Health
June 30, 2019 and 2018**

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Independent Auditor's Report

Board of Directors
Sid Peterson Memorial Hospital d/b/a
Peterson Health
Kerrville, Texas

We have audited the accompanying consolidated financial statements of Sid Peterson Memorial Hospital d/b/a Peterson Health, which comprise the consolidated balance sheets as of June 30, 2019 and 2018, and the related consolidated statements of operations, changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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 consolidated 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 consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sid Peterson Memorial Hospital d/b/a Peterson Health as of June 30, 2019 and 2018, and the results of its operations, the changes in net assets and cash flows for the years 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 consolidated financial statements, in 2019, the entity adopted Accounting Standards Update 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities* and Accounting Standards Update 2014-09, *Revenue from Contracts with Customers (Topic 606)*. Our opinion is not modified with respect to these matters.

Other Matter – Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information listed in the table of contents is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

BKD, LLP

Houston, Texas
November 21, 2019

Sid Peterson Memorial Hospital d/b/a Peterson Health

Consolidated Balance Sheets June 30, 2019 and 2018

	2019	2018
Assets		
Current Assets		
Cash and cash equivalents	\$ 18,064,123	\$ 26,113,180
Short-term investments	13,059,595	10,601,922
Patient accounts receivable, net of allowance; 2019 - (A); 2018 - \$14,501,000	18,373,970	14,357,871
Contributions receivable	530,528	1,317,166
Supplies	3,263,808	3,053,853
Prepaid expenses and other	13,434,856	9,915,318
Total current assets	66,726,880	65,359,310
Assets Limited As To Use		
Internally designated, self-insurance	1,690,914	1,597,155
Internally designated, capital acquisition and other	2,659,164	10,067,892
	4,350,078	11,665,047
Investments	95,350,716	87,487,310
Property and Equipment, At Cost		
Land	4,011,406	3,703,715
Buildings and leasehold improvements	109,704,076	96,384,994
Equipment	79,088,118	66,514,212
Construction in progress	612,221	9,184,081
	193,415,821	175,787,002
Less accumulated depreciation	98,531,650	91,567,684
	94,884,171	84,219,318
Other Assets		
Contributions receivable	290,676	526,781
Other	57,025	57,025
	347,701	583,806
Total assets	\$ 261,659,546	\$ 249,314,791

See Note 2: Change in Accounting Principle – Accounting Standards Update 2014-09

**Sid Peterson Memorial Hospital d/b/a
Peterson Health**

**Consolidated Balance Sheets (Continued)
June 30, 2019 and 2018**

	2019	2018
Liabilities and Net Assets		
Current Liabilities		
Current maturities of long-term debt	\$ 2,200,000	\$ 2,110,000
Accounts payable	4,829,451	3,534,641
Accrued expenses	13,780,603	12,711,527
Estimated amounts due to third-party payers	391,272	1,563,212
Estimated self-insured employee benefit costs	1,422,564	1,252,889
	22,623,890	21,172,269
Estimated Self-insured Professional Liability Costs	605,539	542,442
Deferred Compensation Obligation	150,461	165,156
Long-term Debt	49,750,351	52,127,219
	73,130,241	74,007,086
Net Assets		
Without donor restrictions	185,244,365	164,165,046
With donor restrictions	3,284,940	11,142,659
	188,529,305	175,307,705
Total liabilities and net assets	\$ 261,659,546	\$ 249,314,791

Sid Peterson Memorial Hospital d/b/a Peterson Health

Consolidated Statements of Operations Years Ended June 30, 2019 and 2018

	2019	2018
Revenues, Gains and Other Support Without Donor Restrictions		
Patient care service revenue	\$ 161,917,596	\$ 164,014,158
Provision for uncollectible accounts	-	22,652,562
Net patient service revenue less provision for uncollectible accounts	161,917,596	141,361,596
Other	7,041,669	7,795,143
Total revenues, gains and other support without donor restrictions	168,959,265	149,156,739
Expenses and Losses		
Salaries and wages	69,749,612	62,738,539
Employee benefits	18,593,544	15,666,930
Purchased services	14,719,662	14,275,579
Physician professional fees	5,342,657	5,353,917
Supplies and pharmaceuticals	23,464,741	21,550,848
Maintenance and repairs	4,199,295	4,024,359
Depreciation and amortization	8,588,967	7,890,689
Interest	2,368,430	2,452,424
Other	17,985,609	14,432,651
Loss on sale of property and equipment	-	101,606
Total expenses and losses	165,012,517	148,487,542
Operating Income	3,946,748	669,197
Other Income		
Investment return, net of expenses	8,162,516	6,309,548
Contributions	329,433	205,384
Total other income	8,491,949	6,514,932
Excess of Revenues Over Expenses	12,438,697	7,184,129
Net assets released from restriction used for purchase of property and equipment	8,640,622	99,985
Increase in Net Assets Without Donor Restrictions	\$ 21,079,319	\$ 7,284,114

**Sid Peterson Memorial Hospital d/b/a
Peterson Health**
Consolidated Statements of Changes in Net Assets
Years Ended June 30, 2019 and 2018

	<u>2019</u>	<u>2018</u>
Net Assets Without Donor Restrictions		
Excess of revenues over expenses	\$ 12,438,697	\$ 7,184,129
Net assets released from restriction used for purchase of property and equipment	<u>8,640,622</u>	<u>99,985</u>
Increase in net assets without donor restrictions	<u>21,079,319</u>	<u>7,284,114</u>
Net Assets With Donor Restrictions		
Contributions received	675,647	498,293
Investment return and change in unrealized gains and losses on other-than-trading securities	127,494	138,784
Net assets released from donor restrictions	<u>(8,660,860)</u>	<u>(151,983)</u>
Increase (decrease) in net assets with donor restrictions	<u>(7,857,719)</u>	<u>485,094</u>
Change in Net Assets	13,221,600	7,769,208
Net Assets, Beginning of Year	<u>175,307,705</u>	<u>167,538,497</u>
Net Assets, End of Year	<u>\$ 188,529,305</u>	<u>\$ 175,307,705</u>

Sid Peterson Memorial Hospital d/b/a Peterson Health

Consolidated Statements of Cash Flows Years Ended June 30, 2019 and 2018

	2019	2018
Operating Activities		
Change in net assets	\$ 13,221,600	\$ 7,769,208
Items not requiring (providing) operating cash flow:		
Depreciation and amortization	8,588,967	7,890,689
Net gains on investments	(5,885,799)	(4,485,703)
(Gain) Loss on sale of property and equipment	(140,520)	101,606
Provision for uncollectible accounts	-	22,652,562
Restricted contributions	(675,647)	(498,293)
Changes in:		
Patient accounts receivable	(4,016,099)	(26,020,452)
Estimated amounts due from and to third-party payers	(1,171,940)	1,577,750
Accounts payable and accrued expenses	2,344,954	1,922,160
Deferred compensation obligation	(14,695)	23,215
Other current assets and liabilities	(3,496,721)	(4,786,672)
	<u>8,754,100</u>	<u>6,146,070</u>
Investing Activities		
Proceeds from the sale of property and equipment	450,111	-
Purchases of investments	(2,965,588)	(8,787,928)
Sales of investments	5,845,277	7,758,919
Purchase of property and equipment	(19,721,347)	(16,356,343)
	<u>(16,391,547)</u>	<u>(17,385,352)</u>
Financing Activities		
Proceeds from restricted contributions	1,698,390	2,886,249
Payments on long-term debt	(2,110,000)	(2,030,000)
	<u>(411,610)</u>	<u>856,249</u>
Decrease in Cash and Cash Equivalents	(8,049,057)	(10,383,033)
Cash and Cash Equivalents, Beginning of Year	<u>26,113,180</u>	<u>36,496,213</u>
Cash and Cash Equivalents, End of Year	<u>\$ 18,064,123</u>	<u>\$ 26,113,180</u>
Supplemental Cash Flows Information		
Interest paid	\$ 2,389,519	\$ 2,562,305
Fixed asset additions in accounts payable	251,719	232,787

Sid Peterson Memorial Hospital d/b/a Peterson Health

Notes to Consolidated Financial Statements June 30, 2019 and 2018

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

Nature of Operations

Sid Peterson Memorial Hospital d/b/a Peterson Health (the Medical Center) is a not-for-profit acute care hospital located in Kerrville, Texas. The Medical Center was incorporated on February 13, 1989. The Medical Center is governed by a Board of Directors (the Board) of not less than three or more than 15 members elected at an annual meeting of the Board. The Medical Center earns revenues by providing inpatient, outpatient and emergency services to residents in and around Kerr County, Texas.

Peterson Regional Health Care Center Foundation d/b/a Peterson Health Foundation (the Foundation) is a not-for-profit fund raising foundation organized to raise funds for the benefit of the Medical Center, its sole member.

Peterson Medical Associates (PMA) is a physician group practice organization. PMA's sole member is the Medical Center.

Healthcare Partnership of Greater San Antonio (HPGSA) is a service organization that facilitates affiliation agreements with hospitals to access Medicaid supplemental payments through the State of Texas. The Medical Center is the sole member of HPGSA. HPGSA was dissolved effective June 30, 2019.

Principles of Consolidation

The consolidated financial statements include the accounts of the Medical Center, the Foundation, PMA and HPGSA. All significant intercompany accounts and transactions have been eliminated in consolidation.

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

The Medical Center considers all liquid investments, other than those limited as to use, with original maturities of three months or less to be cash equivalents. At June 30, 2019 and 2018, cash equivalents consisted primarily of money market accounts with brokers and certificates of deposit.

Sid Peterson Memorial Hospital d/b/a Peterson Health

Notes to Consolidated Financial Statements June 30, 2019 and 2018

At June 30, 2019 and 2018, the Medical Center's cash accounts exceeded federally insured limits by approximately \$9,845,000 and \$15,387,000, respectively.

Investments and Investment Return

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

Investment return that is initially restricted by donor stipulation and for which the restriction will be satisfied in the same year is included in net assets without donor restrictions. Other investment return is reflected in the consolidated statements of operations and changes in net assets as with or without donor restrictions based upon the existence and nature of any donor or legally imposed restrictions.

Assets Limited As To Use

Assets limited as to use include (1) assets internally designated for self-insurance arrangements, (2) assets internally designated under the supplemental executive retirement plan agreement and (3) assets internally designated for future capital improvements over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Patient Accounts Receivable

Patient accounts receivable reflects the outstanding amount of consideration to which the Medical Center expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payers (including health insurers and government programs) and others. As a service to the patient, the Medical Center bills third-party payers directly and bills the patient when the patient's responsibility for co-pays, coinsurance and deductibles is determined. Patient accounts receivable are due in full when billed.

Contract Assets

Amounts related to health care services provided to patients which have not been billed and that do not meet the conditions of an unconditional right to payment at the end of the reporting period are contract assets. Contract asset balances consist primarily of health care services provided to patients who are still receiving inpatient care in the Medical Center at the end of the year. Contract asset balances at June 30, 2019 and 2018, were \$1,282,215 and \$1,497,478, respectively, and are included in patient accounts receivable on the consolidated balance sheets.

Sid Peterson Memorial Hospital d/b/a Peterson Health

Notes to Consolidated Financial Statements June 30, 2019 and 2018

Supplies

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

Property and Equipment

Property and equipment acquisitions are recorded at cost and are depreciated using the straight-line method over the estimated useful life of each asset. Leasehold improvements are depreciated over the shorter of the lease term, or their respective estimated useful lives.

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

Buildings and leasehold improvements	5-40 years
Equipment	3-10 years

Donations of property and equipment are reported at fair value as an increase in net assets without donor restrictions, unless use of the assets is restricted by the donor. Monetary gifts that must be used to acquire property and equipment are reported as net assets with donor restrictions. The expiration of such restrictions is reported as an increase in net assets without donor restrictions when the donated asset is placed in service.

Long-lived Asset Impairment

The Medical Center evaluates the recoverability of the carrying value of long-lived assets whenever events or circumstances indicate the carrying amount may not be recoverable. If a long-lived asset is tested for recoverability and the undiscounted estimated future cash flows expected to result from the use and eventual disposition of the asset is less than the carrying amount of the asset, the asset cost is adjusted to fair value, and an impairment loss is recognized as the amount by which the carrying amount of a long-lived asset exceeds its fair value.

No asset impairment was recognized during the years ended June 30, 2019 or 2018.

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. The Medical Center records these costs as direct deductions from the related debt. Such costs are being amortized over the term of the respective debt using the interest method.

Sid Peterson Memorial Hospital d/b/a Peterson Health

Notes to Consolidated Financial Statements June 30, 2019 and 2018

Physician Guarantees

In an effort to recruit new physicians to its service area, the Medical Center has entered into various physician income guarantee agreements. Under these agreements, the Medical Center guarantees minimum monthly income, revenues or collections, or guarantees reimbursement of expenses up to maximum limits to physicians during a specified period of time (typically, 12 to 24 months, the guarantee period). In return for the guarantee payments, the physicians are required to practice in the community for a stated period of time (typically, two to three years, the retention period) or else return the guarantee payments to the Medical Center. As of June 30, 2019, all physician income guarantee agreements were in the retention period; therefore, there are no significant potential future payments that the Medical Center could be required to make under the existing physician guarantee agreements.

Net Assets

Net assets, revenues, gains and losses are classified based on the existence or absence of donor restrictions.

Net assets without donor restrictions are available for use in general operations and not subject to donor restrictions.

Net assets with donor restrictions are subject to donor restrictions. Some restrictions are temporary in nature, such as those that will be met by the passage of time or other events specified by the donor. Other restrictions are perpetual in nature, where the donor stipulates that resources be maintained in perpetuity.

Patient Service Revenue

Patient service revenue is recognized as the Medical Center satisfies performance obligations under its contracts with patients. Patient care service revenue is reported at the estimated transaction price or amount that reflects the consideration to which the Medical Center expects to be entitled in exchange for providing patient care. The Medical Center determines the transaction price based on standard charges for goods and services provided, reduced by contractual adjustments provided to third-party payers, discounts provided to uninsured patients in accordance with the Medical Center's policies and implicit price concessions provided to uninsured patients.

The Medical Center determines its estimates of explicit price concessions which represent adjustments and discounts based on contractual agreements, its discount policies and historical experience by payer groups. The Medical Center determines its estimate of implicit price concessions based on its historical collection experience by classes of patients. The estimated amounts also include variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations by third-party payers.

Sid Peterson Memorial Hospital d/b/a Peterson Health

Notes to Consolidated Financial Statements June 30, 2019 and 2018

Charity Care

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

Contributions

Contributions are provided to the Medical Center either with or without restrictions placed on the gift by the donor. Revenues and net assets are separately reported to reflect the nature of those gifts – with or without donor restrictions. The value recorded for each contribution is recognized as follows:

Nature of the Gift	Value Recognized
<i>Conditional gifts, with or without restriction</i> Gifts that depend on the [Organization] overcoming a donor-imposed barrier to be entitled to the funds	Not recognized until the gift becomes unconditional, <i>i.e.</i> the donor imposed barrier is met
<i>Unconditional gifts, with or without restriction</i> Received at date of gift – cash and other assets	Fair value
Received at date of gift – property, equipment and long-lived assets	Estimated fair value
Expected to be collected within one year	Net realizable value
Collected in future years	Initially reported at fair value determined using the discounted present value of estimated future cash flows technique

When a donor stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified to net assets without donor restrictions and reported in the consolidated statements of activities as net assets released from restrictions. Absent explicit donor stipulations for the period of time that long-lived assets must be held, expirations of restrictions for gifts of land, buildings, equipment and other long-lived assets are reported when those assets are placed in service.

Gifts and investment income having donor stipulations which are satisfied in the period the gift is received are recorded as revenue and net assets without donor restrictions.

Sid Peterson Memorial Hospital d/b/a Peterson Health

Notes to Consolidated Financial Statements June 30, 2019 and 2018

Conditional contributions having donor stipulations which are satisfied in the period the gift is received are recorded as revenue and net assets without donor restrictions.

Professional Liability Claims

The Medical Center recognizes an accrual for claim liabilities based on estimated ultimate losses and costs associated with settling claims. Professional liability claims are described more fully in Note 7.

Income Taxes

The Medical Center, the Foundation and HPGSA have been recognized as exempt from income taxes under Section 501 of the Internal Revenue Code and a similar provision of state law. However, the Medical Center, the Foundation and HPGSA are subject to federal income tax on any unrelated business taxable income.

PMA is organized as a not-for-profit taxable 501(a) physician management organization. PMA's taxable income and deferred tax items as of and for the years ended June 30, 2019 and 2018, were not material.

The Medical Center, the Foundation, PMA and HPGSA file tax returns in the U.S. Federal jurisdiction.

The Affordable Care Act requires hospitals to conduct Community Health Needs Assessments (CHNAs) every three years. The Medical Center filed the initial CHNA in 2013. The Medical Center was required to have a new CHNA by June 30, 2019, and the CHNA was adopted by the Board June 25, 2019.

Excess of Revenues Over Expenses

The consolidated statements of operations include excess of revenues over expenses. Changes in net assets without donor restrictions, which are excluded from excess of revenues over expenses, consistent with industry practice, include contributions of long-lived assets (including assets acquired using contributions, which, by donor restriction, were to be used for the purpose of acquiring such assets).

Self-insurance

The Medical Center has elected to self-insure certain costs related to employee health and accident benefit programs. Costs resulting from noninsured losses are charged to income when incurred.

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Notes to Consolidated Financial Statements June 30, 2019 and 2018

Transfers Between Fair Value Hierarchy Levels

Transfers in and out of Level 1 (quoted market prices), Level 2 (other significant observable inputs) and Level 3 (significant unobservable inputs) are recognized on the period ending date.

Reclassifications

Certain reclassifications have been made to the 2018 consolidated financial statements to conform to the 2019 consolidated financial statement presentation. The reclassifications had no effect on the change in net assets.

Note 2: Changes in Accounting Principle

Accounting Standards Update (ASU) 2016-14, Not-for-Profit Entities (Topic 958)

On July 1, 2018, the Medical Center, adopted ASU 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*. A summary of the changes is as follows:

Balance Sheet

The balance sheet distinguishes between two new classes of net assets—those with donor-imposed restrictions and those without. This is a change from the previously required three classes of net assets—unrestricted, temporarily restricted and permanently restricted.

Statement of Operations

Investment income is shown net of external and direct internal investment expenses. Disclosure of the expenses netted against investment income is no longer required.

Notes to the Financial Statements

Enhanced quantitative and qualitative disclosures provide additional information useful in assessing liquidity and cash flows available to meet operating expenses for one-year from the date of the balance sheet.

Expenses are reported by both nature and function in one location. This change had no impact on previously reported total change in net assets and has been applied retrospectively to all periods presented.

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Notes to Consolidated Financial Statements June 30, 2019 and 2018

ASU 2014-09, Revenue from Contracts with Customers (Topic 606)

On July 1, 2018, the Medical Center adopted Accounting Standard Codification Topic 606, *Revenue from Contracts with Customers* (Topic 606), using a modified-retrospective method of adoption to all contracts with customers (patients) at July 1, 2018. The core guidance in Topic 606 is to recognize revenue to depict the transfer of promised goods or services to customers or patients in an amount that reflects the consideration to which the Medical Center expects to be entitled in exchange for those goods or services. The amount to which the Medical Center expects to be entitled is calculated as the transaction price and recorded as revenue in exchange for providing patient services to its patients. Adoption of Topic 606 resulted in changes in presentation of the consolidated financial statements and related disclosures in the notes to the consolidated financial statements.

Prior to the adoption of Topic 606, the majority of the provision for doubtful accounts related to patients without insurance, as well as patient responsibility balances for co-pays, co-insurance and deductibles for patients with insurance. Under Topic 606, the estimated amounts due from patients for which the Medical Center does not expect to be entitled or collect from the patients are considered implicit price concessions and excluded from the Medical Center's estimation of the transaction price or revenue recorded.

The adoption had no material impact on operating income, overall change in net assets, or net cash provided by (used in) operating activities.

Note 3: Patient Service Revenue

Patient service revenue is reported at the amount that reflects the consideration to which the Medical Center expects to be entitled in exchange for providing patient care. These amounts are due from patients, third-party payers (including health insurers and government programs) and others and includes variable consideration for retroactive revenue adjustments due to settlement of audits, reviews and investigations. Generally, the Medical Center bills the patients and third-party payers several days after the services are performed or the patient is discharged from the facility and patient accounts receivable are due in full when billed. Revenue is recognized as performance obligations are satisfied.

Performance Obligations

Performance obligations are determined based on the nature of the services provided by the Medical Center. Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected charges. The Medical Center believes that this method provides a faithful depiction of the transfer of services over the term of the performance obligation based on the inputs needed to satisfy the obligation. Generally, performance obligations satisfied over time relate to patients in the Medical Center receiving inpatient acute care services, patients receiving services in its outpatient centers, home health and

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hospice services or physician services. The Medical Center measures the performance obligation from inpatient admission, or the commencement of an outpatient service, to the point when it is no longer required to provide services to that patient, which is generally at the time of discharge or completion of the outpatient services. Revenue for performance obligations satisfied at a point in time is generally recognized when goods are provided to its patients and customers in a retail setting (for example, pharmaceuticals and medical equipment) and the Medical Center does not believe it is required to provide additional goods related to the patient.

Because practically all of its performance obligations relate to contracts with a duration of less than one year, the Medical Center has elected to apply the optional exemption provided in Financial Accounting Standards Board (FASB) ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

Transaction Price

The Medical Center determines the transaction price based on standard charges for goods and services provided, reduced by explicit price concessions which consist of contractual adjustments provided to third-party payers, discounts provided to uninsured patients in accordance with the Medical Center's policy and implicit price concessions provided to uninsured patients. The Medical Center determines its estimates of contractual adjustments and discounts based on contractual agreements, its discount policies and historical experience. The Medical Center determines its estimate of implicit price concessions based on its historical collection experience with this class of patients.

Third-party Payers

Agreements with third-party payers typically provide for payments at amounts less than established charges. A summary of the payment arrangements with major third-party payers follows:

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

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June 30, 2019 and 2018

Medicaid. Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology for certain services and at prospectively determined rates for all other services. The Medical Center is reimbursed for cost reimbursable services at tentative rates, with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicaid administrative contractor.

Other. Payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations provide for payment using prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Laws and regulations concerning government programs, including Medicare and Medicaid, are complex and subject to varying interpretation. As a result of investigations by governmental agencies, various health care organizations have received requests for information and notices regarding alleged noncompliance with those laws and regulations, which, in some instances, have resulted in organizations entering into significant settlement agreements. Compliance with such laws and regulations may also be subject to future government review and interpretation, as well as significant regulatory action, including fines, penalties and potential exclusion from the related programs. There can be no assurance that regulatory authorities will not challenge the Medical Center's compliance with these laws and regulations, and it is not possible to determine the impact (if any) such claims or penalties would have upon the Medical Center. In addition, the contracts the Medical Center has with commercial payers also provide for retroactive audit and review of claims.

Settlements with third-party payers for retroactive adjustments due to cost report or other audits, reviews or investigations are considered variable consideration and are included in the determination of the estimated transaction price for providing patient care. These settlements are estimated based on the terms of the payment agreement with the payer, correspondence from the payer and the Medical Center's historical settlement activity, including an assessment to ensure that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the retroactive adjustment is subsequently resolved. Estimated settlements are adjusted in future periods as adjustments become known based on newly available information or as years are settled or are no longer subject to such audits, reviews and investigations. Adjustments arising from a change in the transaction price were not significant in fiscal years 2019 or 2018.

From time to time the Medical Center will receive overpayments of patient balances from third-party payers or patients resulting in amounts owed back to either the patients or third-party payers. These amounts are excluded from revenues and are recorded as liabilities until they are refunded. As of June 30, 2019 and 2018, the Medical Center has a liability for refunds to third-party payers and patients recorded in the accounts payable on the consolidated balance sheets of approximately \$391,000 and \$1,537,000, respectively.

Sid Peterson Memorial Hospital d/b/a Peterson Health

Notes to Consolidated Financial Statements June 30, 2019 and 2018

Patient and Uninsured Payers

Generally, patients who are covered by third-party payers are responsible for related deductibles and coinsurance, which vary in amount. The Medical Center also provides services to uninsured patients and offers those uninsured patients a discount, either by policy or law, from standard charges. The Medical Center's estimates the transaction price for patients with deductibles and coinsurance and from those who are uninsured based on historical experience and current market conditions. The initial estimate of the transaction price is determined by reducing the standard charge by any contractual adjustments, discounts and implicit price concessions based on historical collection experience. Subsequent changes to the estimate of the transaction price are generally recorded as adjustments to patient care service revenue in the period of the change.

Consistent with the Medical Center's mission, care is provided to patients regardless of their ability to pay. Therefore, the Medical Center has determined it has provided implicit price concessions to uninsured patients and patients with other uninsured balances, such as copays and deductibles. The implicit price concessions included in estimating the transaction price represent the difference between amounts billed to patients and the amounts the Medical Center expects to collect based on its collection history with those patients.

Patients who meet the Medical Center's criteria for charity care are provided care without charge or at amounts less than established rates. Such amounts determined to qualify as charity care are not reported as revenue.

Revenue Composition

The Medical Center determined that the nature, amount, timing and uncertainty of revenue and cash flows are primarily affected by factors including payers and service lines. Tables providing details of these factors are presented below.

The composition of patient care service revenue by primary payer for the years ended June 30, 2019 and 2018, is as follows:

	2019	2018
Medicare	\$ 58,088,508	\$ 52,412,210
Medicaid	18,200,334	11,492,253
Other third-party payers	64,745,651	60,994,675
Self-Pay	20,883,103	16,462,458
Total	\$ 161,917,596	\$ 141,361,596

Revenue from patients' deductibles and coinsurance are included in the categories presented above based on the primary payer.

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Notes to Consolidated Financial Statements June 30, 2019 and 2018

The composition of patient care service revenue based on service lines for the years ended June 30, 2019 and 2018, is as follows:

	2019	2018
Hospital inpatient	\$ 41,432,646	\$ 38,654,644
Hospital outpatient	99,924,658	86,320,896
Hospice Care	5,910,362	5,526,843
Home Health Care	3,416,134	2,629,434
PMA - Physician Services	11,233,796	8,229,779
Total	\$ 161,917,596	\$ 141,361,596
Health care services transferred over time	\$ 157,521,297	\$ 138,807,347
Outpatient pharmacy at point in time	4,396,299	2,554,249
Total	\$ 161,917,596	\$ 141,361,596

Supplemental Medicaid Funding Programs

In response to the growing number of uninsured patients and the rising cost of health care, the Texas Legislature established a Texas Medicaid Disproportionate Share Program (DSH Program) that was designed to assist those facilities serving the majority of the indigent patients by providing funds supporting increased access to health care within the community. This program allows the Texas Department of Human Services to levy assessments from certain hospitals, use the assessed funds to obtain federal matching funds, and then redistribute the total funds to those facilities serving a disproportionate share of indigent patients in the state of Texas.

On December 12, 2011, the United States Department of Health and Human Services (HHSC) approved a Medicaid Section 1115(a) demonstration entitled "Texas Health Transformation and Quality Improvement Program" (Waiver). The Waiver expanded existing Medicaid managed care programs and established two funding pools that assist providers with uncompensated care costs (UC Pool) and promote health system transformation (DSRIP Pool). The revenue from the two funding pools is recognized as earned throughout the related demonstration year. The funding the Medical Center has received is subject to audit and is not representative of funding to be received in future years. The Waiver was originally effective from December 12, 2011 to September 30, 2016, and has now been extended through September 30, 2022. Among other changes, the approved plan requires a change in the methodology used to allocate UC funds and a phase out of the DSRIP program over the five year period. The impact of these changes has not yet been determined, but could have an adverse impact on the Medical Center's operating results.

The funding from the UC Pool has historically been limited by a federally determined Hospital Specific Limit (HSL) calculation and is subject to recoupment based on subsequent audit results. There has been significant litigation in U.S. district and circuit appellate courts regarding the legislative intent of certain aspects of the HSL calculation. On August 13, 2019, the D.C. Circuit

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Notes to Consolidated Financial Statements June 30, 2019 and 2018

Court of Appeals issued an opinion in the case of Children's Hospital Association of Texas vs. HHS that held that the HSL could be reduced by payments received from other third-party payers related to Medicaid eligible patients. This would result in a recoupment of uncompensated care pool funds the Medical Center has received for 2019 and 2018. There are similar cases being considered in other appellate courts and there has been no clarification on the effective date of the application of this rule. The Medical Center has estimated a potential liability of approximately \$1,250,000 should the final resolution result in the HSL reduction described above with retroactive application, however, as a result of this uncertainty, the Medical Center has not recorded a liability for potential funding recoupment.

The Medical Center recognized as a component of net patient service revenue approximately \$11,067,000 and \$5,933,602 under the UC Pool for the years ended June 30, 2019 and 2018, respectively. The Medical Center recognized as a component of other revenue approximately \$3,048,000 and \$3,953,000 for the years ended June 30, 2019 and 2018, respectively, for the DSRIP Pool as the barriers were met for the conditional contribution.

Financing Component

The Medical Center has elected the practical expedient allowed under FASB ASC 606-10-32-18 and does not adjust the promised amount of consideration from patients and third-party payers for the effects of a significant financing component due to the Medical Center's expectation that the period between the time the service is provided to a patient and the time that the patient or a third-party payer pays for that service will be one year or less. However, the Medical Center does, in certain instances, enter into payment agreements with patients that allow payments in excess of one year. For those cases, the financing component is not deemed to be significant to the contract.

Contract Costs

The Medical Center has applied the practical expedient provided by FASB ASC 340-40-25-4 and all incremental customer contract acquisition costs are expensed as they are incurred, as the amortization period of the asset that the Medical Center otherwise would have recognized is one year or less in duration.

Note 4: Concentration of Credit Risk

Accounts Receivable

The Medical Center grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. The mix of net receivables from patients and third-party payers at June 30, 2019 and 2018, is as follows.

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Notes to Consolidated Financial Statements June 30, 2019 and 2018

	2019	2018
Medicare	51%	41%
Medicaid	4%	2%
Other third-party payers	39%	47%
Patients	6%	10%
	100%	100%

Note 5: Investments and Investment Return

Assets Limited As To Use

Assets limited as to use as of June 30, 2019 and 2018, include the following items:

	2019	2018
Internally designated for self-insurance:		
Cash and cash equivalents	\$ 85,063	\$ 22,648
Certificates of deposit	175,434	148,078
U.S. Treasury and agency obligations	111,029	35,190
Mutual funds principally invested in corporate and government bonds	1,319,388	1,391,239
	\$ 1,690,914	\$ 1,597,155
Internally designated for capital acquisition and other:		
Cash and cash equivalents	\$ 273,299	\$ 7,184,542
Certificates of deposit	326,951	1,281,070
Municipal bonds and notes	105,287	6,620
Mutual funds principally invested in corporate and government bonds	185,442	206,197
Corporate fixed income instruments	15,666	10,304
Domestic mutual funds	93,495	102,123
Domestic equity securities	1,659,024	1,277,036
	\$ 2,659,164	\$ 10,067,892

Other Investments

Other investments at June 30, 2019 and 2018, include.

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Notes to Consolidated Financial Statements June 30, 2019 and 2018

	2019	2018
Certificates of deposit	\$ 2,035,573	\$ 758,123
Mutual funds principally invested in corporate and government bonds	42,906,509	42,344,033
Domestic mutual funds	4,781,604	1,979,585
Foreign mutual funds	9,343,476	9,323,115
Domestic equity securities	49,343,149	43,684,376
	108,410,311	98,089,232
Less long-term investments	95,350,716	87,487,310
Short-term investments	\$ 13,059,595	\$ 10,601,922

Total investment return is comprised of the following:

	2019	2018
Interest and dividend income	\$ 2,811,113	\$ 2,354,144
Net realized gains	1,824,676	951,588
Net unrealized gains	4,061,123	3,534,115
Investment expenses	(406,902)	(391,515)
	\$ 8,290,010	\$ 6,448,332

Total investment return is reflected in the consolidated statements of operations and changes in net assets as follows:

	2019	2018
Net assets without donor restrictions:		
Other income - investment return	\$ 8,162,516	\$ 6,309,548
Net assets with donor restrictions:		
Change in unrealized gains on other-than-trading securities	127,494	138,784
	\$ 8,290,010	\$ 6,448,332

Note 6: Contributions Receivable

Contributions receivable consisted of the following items at June 30, 2019 and 2018.

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Notes to Consolidated Financial Statements June 30, 2019 and 2018

	2019	2018
Due within one year	\$ 530,528	\$ 1,317,166
Due in one to five years	514,761	750,629
	1,045,289	2,067,795
Less		
Allowance for doubtful contributions	75,378	113,018
Unamortized discount	148,707	110,830
	224,085	223,848
	\$ 821,204	\$ 1,843,947

Contributions receivable are primarily for capital contributions and have been discounted using an adjusted risk free rate at the time of the contribution.

Note 7: Risk Management

Professional and General Liability

The Medical Center is self-insured for medical malpractice risks. Losses from asserted and unasserted claims identified under the Medical Center's incident reporting system are accrued based on estimates that incorporate the Medical Center's past experience, as well as other considerations, including the nature of each claim or incident and relevant trend factors. It is reasonably possible the Medical Center's estimate of losses will change by a material amount in the near term.

The Medical Center has engaged professional actuarial consultants to assist in computing its accrual for malpractice exposure. Amounts accrued by the Medical Center as of June 30, 2019 and 2018, were approximately \$606,000 and \$542,000, respectively, which are shown as estimated self-insured professional liability costs in the accompanying consolidated balance sheets.

Employee Health and Workers' Compensation

The Medical Center is self-insured for employee health care and workers' compensation claims. The Medical Center has purchased excess insurance coverage for employee health care, which limits their annual individual exposure to \$370,000 for each of the years ended June 30, 2019 and 2018. A reserve has been established for unpaid claims and claims incurred, but not received, and are shown as estimated self-insured employee benefit costs in the accompanying consolidated balance sheets. Amounts accrued by the Medical Center for employee health and workers' compensation claims were approximately \$1,423,000 and \$1,253,000 for the years ended June 30, 2019 and 2018, respectively.

Sid Peterson Memorial Hospital d/b/a Peterson Health

Notes to Consolidated Financial Statements June 30, 2019 and 2018

Note 8: Long-term Debt

	2019	2018
Revenue bonds payable (A)	\$ 49,105,000	\$ 51,215,000
Bond premium	3,706,930	3,937,354
	52,811,930	55,152,354
Less unamortized deferred financing costs	861,579	915,135
	\$ 51,950,351	\$ 54,237,219

City of Kerrville, Texas, Health Facilities Development Corporation Hospital Revenue Bonds (Sid Peterson Memorial Hospital Project, Series 2015) (Series 2015 bonds) in the original amount of \$55,195,000, plus a net original issue premium of \$4,531,042 dated November 24, 2015, bearing interest at rates ranging from 2.20 percent to 5.00 percent. The bond indenture requires the Medical Center to make annual principal payments each August 15 beginning in 2016 through 2035, with interest due each August 15 and February 15. Unamortized debt issuance costs were \$861,579 and \$915,135 at June 30, 2019 and 2018, respectively. The effective interest rate was 4.55 percent and 4.51 percent for the years ended June 30, 2019 and 2018, respectively.

The bond issue includes \$23,635,000 of term bonds due August 15, 2025. Bonds maturing after August 15, 2026, are subject to general redemption prior to maturity, in whole or in part, on August 15, 2025.

The City of Kerrville, Texas, Health Facilities Development Corporation (the Corporation) issued the bonds on behalf of the Medical Center. The bonds are secured by a pledge of the Medical Center's revenues, the reserve funds established with the bond trustee pursuant to the loan agreement and bond indenture, and a mortgage lien on substantially all land and buildings of the Medical Center. The bonds have not been guaranteed by the Corporation.

The agreements requires the Medical Center to comply with certain restrictive covenants including rate covenant, a liquidity covenant that requires a minimum of 60 days of cash and unrestricted investments on hand, and debt service average ratio.

Aggregate annual maturities of long-term debt at June 30, 2019, are:

2020	\$ 2,200,000
2021	2,270,000
2022	2,365,000
2023	2,485,000
2024	2,605,000
Thereafter	37,180,000
	\$ 49,105,000

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Notes to Consolidated Financial Statements June 30, 2019 and 2018

Note 9: Line of Credit

At June 30, 2019 and 2018, the Medical Center had an unsecured \$3,000,000 line of credit with a prime rate (5.00 percent at June 30, 2019 and 2018), with a local financial institution, which expires February 1, 2020. No amounts were drawn on the line of credit during the years ended June 30, 2019 or 2018.

Note 10: Net Assets With Donor Restrictions

Net Assets With Donor Restrictions

During the years ended June 30, 2019 and 2018, investments to be held in perpetuity were \$220,000 for both years. Net assets that are restricted by the donor for specific purposes was \$3,064,940 and \$10,922,659 for the years ended June 30, 2019 and 2018, respectively.

Note 11: Charity Care

In support of its mission, the Medical Center voluntarily provides free care to patients who lack financial resources and are deemed to be medically indigent. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported in net patient service revenue. In addition, the Medical Center provides services to other medically indigent patients under certain government-reimbursed public aid programs. Such programs pay providers amounts which are less than established charges for the services provided to the recipients, and many times the payments are less than the cost of rendering the services provided.

The costs of charity care provided under the Medical Center's charity care policy were approximately \$3,385,000 and \$2,711,000 for the years ended June 30, 2019 and 2018, respectively. The cost of providing charity care is estimated by applying the ratio of cost to gross charges to gross uncompensated charges.

Note 12: Functional Expenses

The Medical Center provides health care services primarily to residents within its geographic area. Certain costs attributable to more than one function have been allocated among the health care services, general and administrative and fundraising functional expense classifications based on the estimates of time and effort and other methods. The following schedule presents the natural classification of expenses by function as follows.

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	Health Care Services					Support Services			
	Inpatient	Outpatient	Home Health and Hospice	Physician Group	Total	General and Administrative	Fundraising	HPGSA	Total
Salaries and wages	\$ 15,758,301	\$ 27,951,036	\$ 6,078,187	\$ 12,501,579	\$ 62,289,103	\$ 7,135,484	\$ 325,025	\$ -	\$ 69,749,612
Employee benefits	3,223,997	5,480,166	1,320,720	3,901,632	13,926,515	4,576,435	90,594	-	18,593,544
Purchased services	820,768	2,299,386	654,405	2,081,975	5,856,534	6,612,452	122,405	926,655	14,719,662
Physician professional fees	3,062,551	1,164,168	222,968	96,472	4,546,159	796,498	-	-	5,342,657
Supplies and pharmaceuticals	1,408,708	20,358,590	689,678	911,742	23,368,718	44,095	51,773	155	23,464,741
Maintenance and supplies	378,643	2,011,429	44,701	201,133	2,635,906	1,558,464	4,925	-	4,199,295
Depreciation and amortization	1,807,945	3,426,657	203,083	624,655	6,062,340	2,500,541	26,086	-	8,588,967
Interest	676,052	805,722	-	-	1,481,774	876,902	9,754	-	2,368,430
Other	3,268,251	7,191,367	903,113	1,613,902	12,976,633	4,867,269	141,707	-	17,985,609
Total expenses	\$ 30,405,216	\$ 70,688,521	\$ 10,116,855	\$ 21,933,090	\$ 133,143,682	\$ 28,968,140	\$ 772,269	\$ 926,810	\$ 165,012,517

For 2018, the Medical Center had \$134,788,857 in health care services expenses and \$13,698,685 in support services expenses.

Sid Peterson Memorial Hospital d/b/a Peterson Health

Notes to Consolidated Financial Statements June 30, 2019 and 2018

Note 13: Liquidity and Availability

The Medical Center's financial assets available within one year of the balance sheet date for general expenditure are:

	2019	2018
Financial assets at year-end:		
Cash and cash equivalents	\$ 18,064,123	\$ 26,113,180
Accounts receivable, net	18,904,498	15,675,037
Investments available for use	108,410,311	98,089,232
Investments limited to use:		
Internally designated, self-insurance	1,690,914	1,597,155
Internally designated, capital acquisition and other	2,659,164	10,067,892
Total financial assets	149,729,010	151,542,496
Less amounts not available to be used within one year:		
Internally designated, self-insurance	(1,690,914)	(1,597,155)
Internally designated, capital acquisition and other	(2,659,164)	(10,067,892)
Financial assets available to meet general expenditures within one year	145,378,932	139,877,449
Current liabilities:		
Current maturities of long-term debt	2,200,000	2,110,000
Accounts payable and accrued expenses	20,423,890	19,062,269
Total current liabilities	22,623,890	21,172,269
Excess of financial assets available to meet general expenditures within one year	\$ 122,755,042	\$ 118,705,180

The Medical Center has certain Board-designated assets that are designated for self-insurance and future capital expenditures. These assets limited to use, which are more fully described in Notes 1 and 5, are not available for general expenditure within the next year. However, the Board-designated amounts could be made available, if necessary.

As part of the Medical Center's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities and other obligations come due. In addition, the Medical Center invests cash in excess of daily requirements in short-term investments. To help manage unanticipated liquidity needs, the Medical Center has a committed line of credit of \$3,000,000, which it could draw upon.

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Notes to Consolidated Financial Statements June 30, 2019 and 2018

Note 14: Pension Plan

The Medical Center has a defined contribution pension plan covering substantially all employees. The Board annually determines the amount, if any, of the Medical Center's contributions to the pension plan. Pension expense was approximately \$556,000 and \$550,000 for the years ended June 30, 2019 and 2018, respectively.

Effective July 1, 2010, the Medical Center implemented a supplemental executive retirement plan covering certain members of management. The Medical Center's funding policy is to contribute the minimum annual contribution that is required by applicable regulations, plus such amounts as the Medical Center may determine to be appropriate from time to time. The Medical Center contributed approximately \$40,000 for the year ended June 30, 2018. The Plan was terminated effective June 30, 2019.

Note 15: Disclosures About Fair Value of Financial Instruments

Fair value is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

- Level 1** Quoted prices in active markets for identical assets or liabilities.
- Level 2** Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3** Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities.

Recurring Measurements

The following table presents the fair value measurements of assets recognized in the accompanying consolidated balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at June 30, 2019 and 2018.

Sid Peterson Memorial Hospital d/b/a Peterson Health

Notes to Consolidated Financial Statements June 30, 2019 and 2018

	<u>Fair Value Measurement Using</u>			
	<u>Fair Value</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
June 30, 2019:				
Mutual funds principally invested in corporate and government bonds	109,864,069	109,743,116	120,953	< I provided these totals
U.S. Treasury and agency obligations	\$ 44,411,339	\$ 44,411,339	\$ -	\$ -
Domestic mutual funds	111,029	111,029	-	-
Foreign mutual funds	4,875,099	4,875,099	-	-
Domestic equity securities	9,343,476	9,343,476	-	-
Municipal bonds and notes	51,002,173	51,002,173	-	-
Corporate fixed income instruments	105,287	-	105,287	-
	15,666	-	15,666	-
June 30, 2018:				
Mutual funds principally invested in corporate and government bonds	\$ 43,941,469	\$ 43,941,469	\$ -	\$ -
U.S. Treasury and agency obligations	35,190	35,190	-	-
Domestic mutual funds	2,081,708	2,081,708	-	-
Foreign mutual funds	9,323,115	9,323,115	-	-
Domestic equity securities	44,961,412	44,961,412	-	-
Municipal bonds and notes	6,620	-	6,620	-
Corporate fixed income instruments	10,304	-	10,304	-

Following is a description of the valuation methodologies and inputs used for assets measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the years ended June 30, 2019 or 2018.

Investments

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include domestic and foreign mutual funds and equity securities and mutual funds principally invested in corporate and government bonds.

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Notes to Consolidated Financial Statements June 30, 2019 and 2018

If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include corporate and municipal fixed income securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy. The Medical Center had no Level 3 investments at June 30, 2019 or 2018.

Quoted market prices were used to determine the fair value of Level 1 items listed previously. For Level 2 investments, inputs include maturity and coupon rates and/or closing prices of similar securities from comparable industry financial data.

Note 16: Related-party Transactions

The Medical Center was party to an indigent care affiliation agreement with the City of Seguin and Guadalupe County, Texas d/b/a Guadalupe Regional Medical Center to collaborate with HPGSA, to access Medicaid supplemental payments through the State of Texas as of June 30, 2018. The affiliation agreement with HPGSA was dissolved as of June 30, 2019 and Intergovernmental Transfers (IGTs) are now made through a third party. The Medical Center contributed approximately \$9,994,000 and \$6,591,000 to access Medicare Supplemental payments during the years ended June 30, 2019 and 2018, respectively. These contributions, which were used to fund indigent care in west Texas, are reflected as a component of supplies and other expense in the consolidated statements of operations.

Note 17: Significant Estimates and Concentrations

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

Allowance for Net Patient Service Revenue Adjustments

Estimates of allowances for adjustments included in net patient service revenue are described in Notes 1 and 3.

Professional Liability Claims

Estimates related to the accrual for medical malpractice claims are described in Notes 1 and 7.

Litigation

In the normal course of business, the Medical Center is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by the Medical Center's self-insurance programs (discussed elsewhere in these notes) or by commercial

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Notes to Consolidated Financial Statements

June 30, 2019 and 2018

insurance (*e.g.*, allegations regarding employment practices or performance of contracts). The Medical Center evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of counsel, management records an estimate of the amount of ultimate expected loss, if any, for each of these matters. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Self-insured Employee Health Care and Workers' Compensation

Estimates related to the accrual for self-insured employee health care and workers' compensation claims are discussed in Note 7.

Investments

The Medical Center invests in various investment securities. Investment securities are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term, and that such change could materially affect the amounts reported in the accompanying consolidated balance sheets.

Note 18: Future Change in Accounting Principles

Accounting for Leases

The Financial Accounting Standards Board (FASB) amended its standard related to the accounting for leases. Under the new standard, lessees will now be required to recognize substantially all leases on the balance sheet as both a right-of-use asset and a liability. The standard has two types of leases for income statement recognition purposes: operating leases and finance leases. Operating leases will result in the recognition of a single lease expense on a straight-line basis over the lease term similar to the treatment for operating leases under existing standards. Finance leases will result in an accelerated expense similar to the accounting for capital leases under existing standards. The determination of lease classification as operating or finance will be done in a manner similar to existing standards. The new standard also contains amended guidance regarding the identification of embedded leases in service contracts and the identification of lease and nonlease components in an arrangement. The new standard is effective for annual periods beginning after December 15, 2019 (2018 for not-for-profits that are conduit debt obligors), and any interim periods within annual reporting periods that begin after December 15, 2020 (2018 for not-for-profits that are conduit debt obligors). As the Medical Center is a conduit debt obligor, the effective date of adoption is for the year ending June 30, 2020. The Medical Center is evaluating the impact the standard will have on the consolidated financial statements; however, the standard is expected to have a material impact on the consolidated financial statements due to the recognition of additional assets and liabilities for operating leases.

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**Notes to Consolidated Financial Statements
June 30, 2019 and 2018**

Note 19: Subsequent Events

Subsequent events have been evaluated through November 21, 2019, which is the date the consolidated financial statements were issued.

Supplementary Information

**Sid Peterson Memorial Hospital d/b/a
Peterson Health**
Balance Sheet Information – Consolidating Schedule
June 30, 2019

	The Medical Center	The Foundation	PMA	HPGSA	Eliminations	Consolidated
Assets						
Current Assets						
Cash and cash equivalents	\$ 17,602,882	\$ 460,249	\$ 1,009	\$ (17)	\$ -	\$ 18,064,123
Short-term investments	13,059,595	-	-	-	-	13,059,595
Patient accounts receivable, net of allowance	16,715,676	-	1,658,294	-	-	18,373,970
Contributions receivable	-	530,528	-	-	-	530,528
Supplies	3,252,240	-	11,568	-	-	3,263,808
Prepaid expenses and other	13,337,302	-	97,554	-	-	13,434,856
Total current assets	<u>63,967,695</u>	<u>990,777</u>	<u>1,768,425</u>	<u>(17)</u>	<u>0</u>	<u>66,726,880</u>
Assets Limited As To Use						
Internally designated, self-insurance	1,690,914	-	-	-	-	1,690,914
Internally designated, capital acquisition and other	879,057	1,780,107	-	-	-	2,659,164
	<u>2,569,971</u>	<u>1,780,107</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>4,350,078</u>
Investments	<u>94,335,756</u>	<u>1,014,960</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>95,350,716</u>

**Sid Peterson Memorial Hospital d/b/a
Peterson Health**
Balance Sheet Information – Consolidating Schedule (Continued)
June 30, 2019

	The Medical Center	The Foundation	PMA	HPGSA	Eliminations	Consolidated
Property and Equipment, At Cost						
Land	\$ 4,011,406	\$ -	\$ -	\$ -	\$ -	\$ 4,011,406
Buildings and leasehold improvements	109,704,076	-	-	-	-	109,704,076
Equipment	79,088,118	-	-	-	-	79,088,118
Construction in progress	612,221	-	-	-	-	612,221
	<u>193,415,821</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>193,415,821</u>
Less accumulated depreciation	98,531,650	-	-	-	-	98,531,650
	<u>94,884,171</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>94,884,171</u>
Other Assets						
Contributions receivable	-	290,676	-	-	-	290,676
Other	-	-	-	57,025	-	57,025
	<u>0</u>	<u>290,676</u>	<u>0</u>	<u>57,025</u>	<u>0</u>	<u>347,701</u>
Total assets	<u>\$ 255,757,593</u>	<u>\$ 4,076,520</u>	<u>\$ 1,768,425</u>	<u>\$ 57,008</u>	<u>\$ 0</u>	<u>\$ 261,659,546</u>

**Sid Peterson Memorial Hospital d/b/a
Peterson Health**
Balance Sheet Information – Consolidating Schedule (Continued)
June 30, 2019

	The Medical Center	The Foundation	PMA	HPGSA	Eliminations	Consolidated
Liabilities and Net Assets						
Current Liabilities						
Current maturities of long-term debt	\$ 2,200,000	\$ -	\$ -	\$ -	\$ -	\$ 2,200,000
Accounts payable	4,825,506	-	2,945	1,000	-	4,829,451
Accrued expenses	13,101,280	91	679,232	-	-	13,780,603
Estimated amounts due to third-party payers	391,272	-	-	-	-	391,272
Estimated self-insured employee benefit costs	1,422,564	-	-	-	-	1,422,564
Total current liabilities	21,940,622	91	682,177	1,000	0	22,623,890
Estimated Self-insured Professional Liability Costs	605,539	-	-	-	-	605,539
Deferred Compensation Obligation	150,461	-	-	-	-	150,461
Long-term Debt	49,750,351	-	-	-	-	49,750,351
Total liabilities	72,446,973	91	682,177	1,000	0	73,130,241
Net Assets						
Net assets without donor restrictions	183,006,151	1,095,958	1,086,248	56,008	-	185,244,365
Net assets with donor restrictions	304,469	2,980,471	-	-	-	3,284,940
Total net assets	183,310,620	4,076,429	1,086,248	56,008	0	188,529,305
Total liabilities and net assets	\$ 255,757,593	\$ 4,076,520	\$ 1,768,425	\$ 57,008	\$ 0	\$ 261,659,546

**Sid Peterson Memorial Hospital d/b/a
Peterson Health**

**Statement of Operations and Changes in Net Assets Information – Consolidating Schedule
Year Ended June 30, 2019**

	The Medical Center	The Foundation	PMA	HPGSA	Eliminations	Consolidated
Revenues, Gains, and Other Support Without Donor Restrictions						
Patient care service revenue (net of explicit and implicit concessions)	\$ 150,683,800	\$ -	\$ 11,233,796	\$ -	\$ -	\$ 161,917,596
Other	5,068,403	-	303,905	626,481	1,042,880	7,041,669
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total revenues, gains, and other support without donor restrictions	155,752,203	0	11,537,701	626,481	1,042,880	168,959,265
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Expenses and Losses						
Salaries and wages	57,049,787	198,246	12,501,579	-	-	69,749,612
Employee benefits	16,480,105	33,278	2,080,161	-	-	18,593,544
Purchased services	10,773,099	43,858	1,933,170	926,655	1,042,880	14,719,662
Physician professional fees	5,246,185	-	96,472	-	-	5,342,657
Supplies and pharmaceuticals	22,501,071	51,773	911,742	155	-	23,464,741
Maintenance and repairs	4,152,472	-	46,823	-	-	4,199,295
Depreciation and amortization	8,588,967	-	-	-	-	8,588,967
Interest	2,368,430	-	-	-	-	2,368,430
Other	16,371,707	-	1,613,902	-	-	17,985,609
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total expenses and losses	143,531,823	327,155	19,183,849	926,810	1,042,880	165,012,517
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Operating (Loss) Income	12,220,380	(327,155)	(7,646,148)	(300,329)	0	3,946,748
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>

**Sid Peterson Memorial Hospital d/b/a
Peterson Health**

**Statement of Operations and Changes in Net Assets Information – Consolidating Schedule (Continued)
Year Ended June 30, 2019**

	The Medical Center	The Foundation	PMA	HPGSA	Eliminations	Consolidated
Other Income						
Investment return	\$ 8,124,208	\$ 38,308	\$ -	\$ -	\$ -	\$ 8,162,516
Contributions	-	329,433	-	-	-	329,433
Total other income	<u>8,124,208</u>	<u>367,741</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>8,491,949</u>
Excess (Deficiency) of Revenues Over Expenses	20,344,588	40,586	(7,646,148)	(300,329)	-	12,438,697
Net assets released from restriction used for purchase of property and equipment	8,640,622	-	-	-	-	8,640,622
Transfer (to) from affiliates	<u>(8,617,432)</u>	<u>319,871</u>	<u>8,297,561</u>	<u>-</u>	<u>-</u>	<u>-</u>
Increase (Decrease) in Net Assets Without Donor Restrictions	<u>20,367,778</u>	<u>360,457</u>	<u>651,413</u>	<u>(300,329)</u>	<u>0</u>	<u>21,079,319</u>

**Sid Peterson Memorial Hospital d/b/a
Peterson Health**

**Statement of Operations and Changes in Net Assets Information – Consolidating Schedule (Continued)
Year Ended June 30, 2019**

	The Medical Center	The Foundation	PMA	HPGSA	Eliminations	Consolidated
Net Assets With Donor Restrictions						
Contributions received	\$ 47,258	\$ 628,389	\$ -	\$ -	\$ -	\$ 675,647
Investment return, change in unrealized gains and losses on other-than-trading securities	8,078	119,416	-	-	-	127,494
Net assets released from donor restrictions	(166,128)	(8,494,732)	-	-	-	(8,660,860)
	<u>(110,792)</u>	<u>(7,746,927)</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>(7,857,719)</u>
Change in Net Assets	20,256,986	(7,386,470)	651,413	(300,329)	-	13,221,600
Net Assets, Beginning of Year	<u>163,053,634</u>	<u>11,462,899</u>	<u>434,835</u>	<u>356,337</u>	<u>-</u>	<u>175,307,705</u>
Net Assets, End of Year	<u>\$ 183,310,620</u>	<u>\$ 4,076,429</u>	<u>\$ 1,086,248</u>	<u>\$ 56,008</u>	<u>\$ 0</u>	<u>\$ 188,529,305</u>