

Board of Directors
Frio Hospital District
Pearsall, Texas

As part of our audit of the financial statements of Frio Hospital District (the District) as of and for the year ended September 30, 2020, we wish to communicate the following to you.

AUDIT SCOPE AND RESULTS

Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America

An audit performed in accordance with auditing standards generally accepted in the United States of America is designed to obtain reasonable, rather than absolute, assurance about the financial statements. In performing auditing procedures, we establish scopes of audit tests in relation to the financial statements taken as a whole. Our engagement does not include a detailed audit of every transaction. Our engagement letter more specifically describes our responsibilities.

These standards require communication of significant matters related to the financial statement audit that are relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. Such matters are communicated in the remainder of this letter or have previously been communicated during other phases of the audit. The standards do not require the auditor to design procedures for the purpose of identifying other matters to be communicated with those charged with governance.

An audit of the financial statements does not relieve management or those charged with governance of their responsibilities. Our engagement letter more specifically describes your responsibilities.

Qualitative Aspects of Significant Accounting Policies and Practices

Significant Accounting Policies

The District's significant accounting policies are described in *Note 1* of the audited financial statements.

Alternative Accounting Treatments

No matters are reportable.

Management Judgments and Accounting Estimates

- Provider Relief Fund revenue recognition – The District is a recipient of distributions from the Provider Relief Fund established by the CARES Act. The District attested to the terms and conditions upon receipt of the funding, including the requirement to demonstrate that funds received have been used for health care-related expenses or lost revenue attributable to coronavirus as defined in the CARES Act. Based on guidance issued by the U.S. Department of Health and Human Services as of September 30, 2020, no revenue was recognized in fiscal year 2020.

Financial Statement Disclosures

The following areas involve particularly sensitive financial statement disclosures for which we are prepared to discuss the issues involved and related judgments made in formulating those disclosures:

- Medicaid reimbursement program, including nursing home QIPP
- Intergovernmental transfer expense
- COVID-19 and CARES Act Funding

Audit Adjustments

During the course of any audit, an auditor may propose adjustments to financial statement amounts. Management evaluates our proposals and records those adjustments which, in its judgment, are required to prevent the financial statements from being materially misstated. A misstatement is a difference between the amount, classification, presentation or disclosure of a reported financial statement item and that which is required for the item to be presented fairly in accordance with the applicable financial reporting framework.

Areas in which adjustments were proposed include:

- Property tax allowance
- Construction in progress and accrued expenses

Auditor's Judgments About the Quality of the Entity's Accounting Principles

No matters are reportable.

Other Material Communications

Listed below are other material communications between management and us related to the audit:

- Management representation letter (*attached*)
- We observed matters that we consider to be deficiencies that we communicated to management verbally.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements of the District as of and for the year ended September 30, 2020, in accordance with auditing standards generally accepted in the United States of America, we considered the District's internal control over financial reporting (internal control) as a basis for designing our audit procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District'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.

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

A significant deficiency is a deficiency, or 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 observed the following matters that we consider to be a deficiency.

Segregation of Duties – Cash Disbursements

The District has outsourced all accounting functions to Frio Hospital Association d/b/a Frio Regional Hospital (Hospital). The chief financial officer, who is employed by the Hospital, has access to all aspects of the cash disbursements cycle including the ability to approve invoices for payment, initiating payment via electronic funds transfer, and can prepare entries to adjust the cash account. When employees have this combination of abilities, there is generally a risk of misappropriation. Management has implemented certain mitigating controls in this area, including dual board member signatures on checks issued and reconciliation of the cash account by another employee. However, it is important to understand this does not completely remove the risk. We recommend that management and the Board routinely review how duties are assigned and consider changes in controls around cash disbursements, including secondary approval of all electronic fund transfers by a person other than the chief financial officer.

OTHER MATTERS

Provider Relief Funds

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), as part of the government's response to the spread of the SARS-CoV-2 virus and the incidence of COVID-19. The CARES Act contained provisions expanding the Medicare Accelerated and Advanced Payment Program and providing support to health care providers through Provider Relief Funds.

The District received approximately \$2.8 million of distributions from the Provider Relief Fund. These distributions are not subject to repayment, provided the District is able to attest to and comply with the terms and conditions of the funding, including demonstrating that the distributions received have been used for qualifying expenses or lost revenue attributable to COVID-19, as defined by the Department of Health and Human Services (HHS). Based on an analysis of the compliance and reporting requirements and the effect of the pandemic on the District's operating revenues and expenses through September 30, 2020, the District did not recognize any revenue from this program. Subsequent to year-end, HHS issued guidance on the use of payments from the Provider Relief Fund. The District considers the guidance issued subsequent to year-end to be substantive changes in guidance rather than clarifications of guidance existing at September 30, 2020. As a result, the amounts recorded in the financial statements compared to the District's Provider Relief Fund reporting could differ.

The District should continue to monitor compliance with the terms and conditions of the Provider Relief Fund and the effect of the pandemic on the District's revenues and expenses. The terms and conditions governing the Provider Relief Funds are complex and subject to interpretation and change. If the District is unable to attest to or comply with current or future terms and conditions the District's ability to retain some or all of the distributions received may be affected.

Future Change in Accounting Standard

GASB Statement No. 87, *Leases* (GASB 87), provides a new framework for accounting for leases under the principle that leases are financings. No longer will leases be classified between capital and operating. Lessees will recognize an intangible asset and a corresponding liability. The liability will be based on the payments expected to be paid over the lease term, which includes an evaluation of the likelihood of exercising renewal or termination options in the lease. Lessors will recognize a lease receivable and related deferred inflow of resources. Lessors will not derecognize the underlying asset. An exception to the general model is provided for short-term leases that cannot last more than 12 months. Contracts that contain lease and nonlease components will need to be separated so each component is accounted for accordingly.

GASB 87 is effective for financial statements for the District's fiscal year ending September 30, 2022. Earlier application is encouraged. Governments will be allowed to transition using the facts and circumstances in place at the time of adoption, rather than retroactive to the time each lease was begun.

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

BKD, LLP

January 21, 2021

FRIO HOSPITAL DISTRICT

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January 21, 2021

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14241 Dallas Parkway, Suite 1100
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We, Frio Hospital District (the District) are providing this letter in connection with your audits of our financial statements as of and for the years ended September 30, 2020 and 2019. We confirm that we are responsible for the fair presentation of the financial statements in conformity with accounting principles generally accepted in the United States of America. We are also responsible for adopting sound accounting policies, establishing and maintaining effective internal control over financial reporting, operations and compliance, and preventing and detecting fraud.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following:

1. We have fulfilled our responsibilities, as set out in the terms of our engagement letter dated July 15, 2020, for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America.
2. We acknowledge our responsibility for the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
3. We acknowledge our responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.
4. We have reviewed and approved a draft of the financial statements and related notes referred to above, which you prepared in connection with your audit of our

financial statements. We acknowledge that we are responsible for the fair presentation of the financial statements and related notes.

5. We have provided you with:
 - (a) Access to all information of which we are aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation and other matters.
 - (b) Additional information that you have requested from us for the purpose of the audit.
 - (c) Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
 - (d) All minutes of directors' meetings held through the date of this letter.
 - (e) All significant contracts and grants.
 - (f) All peer review organizations, fiscal intermediary and third-party payer reports and information.
6. All transactions have been recorded in the accounting records and are reflected in the financial statements.
7. We have informed you of all current risks of a material amount that are not adequately prevented or detected by District procedures with respect to:
 - (a) Misappropriation of assets.
 - (b) Misrepresented or misstated assets or liabilities.
8. We have no knowledge of any known or suspected:
 - (a) Fraudulent financial reporting or misappropriation of assets involving management or employees who have significant roles in internal control.
 - (b) Fraudulent financial reporting or misappropriation of assets involving others that could have a material effect on the financial statements.
 - (c) Communications from regulatory agencies, governmental representatives, employees or others concerning investigations or allegations of noncompliance with laws and regulations, deficiencies in financial reporting practices or other matters that could have a material adverse effect on the financial statements.

9. We have no knowledge of any allegations of fraud or suspected fraud affecting the District received in communications from employees, customers, regulators, suppliers or others.
10. We have disclosed to you the identity of the District's related parties and all the related party relationships and transactions of which we are aware. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with accounting principles generally accepted in the United States of America. We understand that the term related party refers to an affiliate; principal owners, management, and members of their immediate families, subsidiaries accounted for by the equity method; and any other party with which the District may deal if the District can significantly influence, or be influenced by, the management or operating policies of the other. The term affiliate refers to a party that directly or indirectly controls, is controlled by, or is under common control with, the District.
11. Except as reflected in the financial statements, there are no:
 - (a) Plans or intentions that may materially affect carrying values or classifications of assets and liabilities.
 - (b) Material transactions omitted or improperly recorded in the financial records.
 - (c) Material gain/loss contingencies requiring accrual or disclosure, including those arising from environmental remediation obligations.
 - (d) Events occurring subsequent to the balance sheet date through the date of this letter requiring adjustment or disclosure in the financial statements.
 - (e) Agreements to purchase assets previously sold.
 - (f) Restrictions on cash balances or compensating balance agreements.
 - (g) Guarantees, whether written or oral, under which the District is contingently liable.
12. We have disclosed to you all known instances of noncompliance or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements.
13. We have no reason to believe the District owes any penalties or payments under the Employer Shared Responsibility Provisions of the Patient Protection and Affordable Care Act nor have we received any correspondence from the IRS or other agencies indicating such payments may be due.

14. We have disclosed to you all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements. The effects of all known actual or possible litigation and claims have been accounted for and disclosed in accordance with accounting principles generally accepted in the United States of America.
15. We have informed you of all pending or completed investigations by regulatory authorities of which we are aware. There are no known circumstances that could jeopardize the District's participation in the Medicare or other governmental health care programs.
16. Adequate provisions and allowances have been accrued for any material losses from:
 - (a) Uncollectible receivables.
 - (b) Medicare/Medicaid and other third-party payer contractual, audit or other adjustments.
Purchase commitments in excess of normal requirements or above prevailing market prices.
17. Except as disclosed in the financial statements, the District has:
 - (a) Satisfactory title to all recorded assets, and they are not subject to any liens, pledges or other encumbrances.
 - (b) Complied with all aspects of contractual agreements, for which noncompliance would materially affect the financial statements.
18. With regard to deposit and investment activities:
 - (a) All deposit, repurchase and reverse repurchase agreements and investment transactions have been made in accordance with legal and contractual requirements.
 - (b) Disclosures of deposit and investment balances and risks in the financial statements are consistent with our understanding of the applicable laws regarding enforceability of any pledges of collateral.
 - (c) We understand that your audit does not represent an opinion regarding the enforceability of collateral pledges.


19. With respect to any nonattest services you have provided us during the year, including assistance with drafting the financial statements and related note disclosures:
 - (a) We have designated a qualified management-level individual to be responsible and accountable for overseeing the nonattest services.
 - (b) We have established and monitored the performance of the nonattest services to ensure that they meet our objectives.
 - (c) We have made any and all decisions involving management functions with respect to the nonattest services and accept full responsibility for such decisions.
 - (d) We have evaluated the adequacy of the services performed and any findings that resulted.
20. The financial statements disclose all significant estimates and material concentrations known to us. Significant estimates are estimates at the balance sheet date, which could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets for which events could occur which would significantly disrupt normal finances within the next year. Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
21. We have not been designated as a potentially responsible party (PRP or equivalent status) by the Environmental Protection Agency (EPA) or other cognizant regulatory agency with authority to enforce environmental laws and regulations.
22. Billings to third-party payers comply in all material respects with applicable coding guidelines, laws and regulations. Billings reflect only charges for goods and services that were medically necessary; properly approved by regulatory bodies, if required; and properly rendered.
23. With regard to cost reports filed with Medicare, Medicaid or other third parties:
 - (a) All required reports have been properly filed.
 - (b) Management is responsible for the accuracy and propriety of those reports.
 - (c) All costs reflected on such reports are appropriate and allowable under applicable reimbursement rules and regulations and are patient-related and properly allocated to applicable payers.
 - (d) The reimbursement methodologies and principles employed are in accordance with applicable rules and regulations.

- (e) All items required to be disclosed, including disputed costs that are being claimed to establish a basis for a subsequent appeal, have been fully disclosed in the cost report.
 - (f) Recorded third-party settlements include differences between filed (and to be filed) cost reports and calculated settlements, which are necessary based upon historical experience or new or ambiguous regulations that may be subject to differing interpretations. While management believes the Company is entitled to all the amounts claimed on the cost reports, management also believes the amounts of these differences are appropriate.
24. We acknowledge the current protracted economic decline continues to present difficult circumstances and challenges for the health care industry. Hospitals are facing declines in the fair values of investments and other assets, declines in contributions, constraints on liquidity and difficulty obtaining financing. We understand the values of the assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments to asset values, allowances for accounts and contributions receivable, etc. that could negatively impact the District's ability to maintain sufficient liquidity. We acknowledge that you have no responsibility for future changes caused by the current economic environment and the resulting impact on the District's financial statements. Further, management and the Board are solely responsible for all aspects of managing the District, including questioning the quality and valuation of assets, reviewing allowances for uncollectible amounts and evaluating capital needs and liquidity plans.
25. With regards to the payments received from the Provider Relief Fund established by the CARES Act, we represent the following:
- (a) We have not recognized revenue associated with the Provider Relief Fund as we do not believe we have met the eligibility requirements as outlined in the U.S. Department of Health and Human Services' (HHS) terms and conditions for the Provider Relief Fund as of September 30, 2020.
 - (b) We believe the method we have utilized to conclude that no revenue should be recognized as of September 30, 2020 associated with the Provider Relief Fund is consistent with acceptable methods outlined in HHS' terms and conditions and other guidance available as of September 30, 2020.
 - (c) Consistent with the terms and conditions established by HHS and other guidance available as of September 30, 2020, Provider Relief Fund payments were not used to reimburse expenses or losses that have been reimbursed or are obligated to be reimbursed by other sources, including payments from insurance and/or patients and amounts received from federal, state, or local governments.

- (d) We believe the “Post-Payment Notice of Reporting Requirements” (Notice) guidance HHS amended on October 22, 2020, and November 2, 2020, and the Frequently Asked Questions (FAQs) issued by HHS on October 28, 2020, are substantive changes in guidance rather than clarifications of guidance existing at September 30, 2020. Therefore, we consider the amendments of the Notice and release of FAQs, nonrecognized subsequent events in accordance with GASB codification Section 2250. However, we have reviewed this guidance and believe it will have a material impact on the amount of Provider Relief Fund the District has recognized through September 30, 2020 and have disclosed this impact in the notes to the financial statements. In addition, we acknowledge that HHS may issue new guidance that could have a material impact of the amount of revenue recognized from the Provider Relief Fund as of September 30, 2020.
- (e) We understand that amounts recognized on the Schedule of Expenditures of Federal Awards may differ from amounts recognized on the financial statements.



John Hughson
Frio Hospital District
Chief Executive Officer



Thomas A. Grimert
Frio Hospital District
Chief Financial Officer