

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2021

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Transition Period From _____ to _____

Commission File Number **000-50009**

PACIFIC HEALTH CARE ORGANIZATION, INC.

(Exact name of registrant as specified in its charter)

Utah

(State or other jurisdiction of incorporation or organization)

87-0285238

(I.R.S. Employer I.D. No.)

1201 Dove Street, Suite 300
Newport Beach, California

(Address of principal executive offices)

92660

(Zip Code)

(949) 721-8272

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading symbol	Name of each exchange on which registered
None	N/A	N/A

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for any shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files.) Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Non-accelerated filer

Accelerated filer

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes No

As of November 12, 2021, the registrant had 12,800,000 shares of common stock, par value \$0.001, issued and outstanding.

PACIFIC HEALTH CARE ORGANIZATION, INC.
FORM 10-Q
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PART I. FINANCIAL INFORMATION

Item 1. Financial Information

Pacific Health Care Organization, Inc.
Condensed Consolidated Balance Sheets
(Unaudited)

	September 30, 2021	December 31, 2020
ASSETS		
Current Assets		
Cash	\$ 10,155,151	\$ 9,498,457
Accounts receivable, net of allowance of \$8,433 and \$19,404	786,112	1,063,090
Deferred rent assets	607	-
Receivable – other	3,000	4,000
Prepaid expenses	74,212	82,499
Total current assets	<u>11,019,082</u>	<u>10,648,046</u>
Property and Equipment, net		
Computer equipment	520,072	507,873
Furniture and fixtures	226,323	226,323
Office equipment	9,556	9,556
Total property and equipment	<u>755,951</u>	<u>743,752</u>
Less: accumulated depreciation and amortization	<u>(656,669)</u>	<u>(620,705)</u>
Net property and equipment	99,282	123,047
Operating lease right-of-use assets, net	138,600	309,282
Other assets	26,788	26,788
Total Assets	<u>\$ 11,283,752</u>	<u>\$ 11,107,163</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	\$ 59,005	\$ 80,134
Accrued expenses	255,509	275,152
Income tax payable	9,783	61,828
Deferred rent expense	-	2,725
Deferred tax liabilities	19,413	19,413
Dividend payable	37,000	37,000
Operating lease liabilities, current portion	138,600	243,049
Paycheck protection program loans, current portion	35,024	311,118
Unearned revenue	37,315	31,544
Total current liabilities	<u>591,649</u>	<u>1,061,963</u>
Long Term Liabilities		
Operating lease liabilities, long-term portion	-	66,233
Paycheck protection program loans, long-term portion	183,876	149,582
Total Liabilities	<u>775,525</u>	<u>1,277,778</u>
Commitments and Contingencies		
Stockholders' Equity		
Preferred stock; 5,000,000 shares authorized at \$0.001 par value of which 40,000 shares designated as Series A preferred and 16,000 shares issued and outstanding	\$ 16	\$ 16
Common stock, \$0.001 par value, 2,000,000,000 shares authorized, 12,800,000 shares issued and outstanding	12,800	12,800
Additional paid-in capital	416,057	416,057
Retained earnings	10,079,354	9,400,512
Total Stockholders' Equity	<u>10,508,227</u>	<u>9,829,385</u>
Total Liabilities and Stockholders' Equity	<u>\$ 11,283,752</u>	<u>\$ 11,107,163</u>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Pacific Health Care Organization, Inc.
 Condensed Consolidated Statements of Operations
 (Unaudited)

	For three months ended		For nine months ended	
	September 30,		September 30,	
	2021	2020	2021	2020
Revenues				
HCO	\$ 289,117	\$ 264,781	\$ 936,382	\$ 916,693
MPN	137,834	124,836	396,497	363,902
Utilization review	258,251	307,139	796,927	854,922
Medical bill review	117,685	77,075	292,445	242,237
Medical case management	439,073	590,784	1,381,929	1,855,314
Other	68,658	51,139	174,251	202,101
Total revenues	<u>1,310,618</u>	<u>1,415,754</u>	<u>3,978,431</u>	<u>4,435,169</u>
Expenses				
Depreciation	12,657	14,122	35,964	46,716
Bad debt provision	-	11,000	494	11,101
Consulting fees	58,275	58,621	173,796	195,978
Salaries and wages	679,530	694,352	2,073,133	2,238,079
Professional fees	76,014	68,979	221,970	223,747
Insurance	86,527	91,951	242,334	274,974
Outsource service fees	109,926	115,803	304,085	359,596
Data maintenance	11,917	6,603	75,293	59,415
General and administrative	168,939	163,863	492,264	515,738
Total expenses	<u>1,203,785</u>	<u>1,225,294</u>	<u>3,619,333</u>	<u>3,925,344</u>
Income from operations	106,833	190,460	359,098	509,825
Other income (expense)				
Paycheck protection program loan forgiveness income	-	-	464,386	-
Paycheck protection program loan interest expense	-	-	(3,686)	-
Total other income (expense)	<u>-</u>	<u>-</u>	<u>460,700</u>	<u>-</u>
Income before taxes	106,833	190,460	819,798	509,825
Income tax provision	29,987	53,463	140,956	143,111
Net income	<u>\$ 76,846</u>	<u>\$ 136,997</u>	<u>\$ 678,842</u>	<u>\$ 366,714</u>
Basic earnings per share:				
Earnings per share amount	\$ 0.01	\$ 0.01	\$ 0.05	\$ 0.03
Basic common shares outstanding	12,800,000	12,800,000	12,800,000	12,800,000
Fully diluted earnings per share:				
Earnings per share amount	\$ 0.01	\$ 0.01	\$ 0.05	\$ 0.03
Fully diluted common shares outstanding	12,816,000	12,816,000	12,816,000	12,816,000

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Pacific Health Care Organization, Inc.
Condensed Consolidated Statements of Stockholders' Equity
(Unaudited)

	Preferred Stock		Common Stock		Additional Paid-in Capital	Retained Earnings	Total Stockholders' Equity
	Shares	Amount	Shares	Amount			
Balances at December 31, 2019	16,000	\$ 16	12,800,000	\$ 12,800	\$ 416,057	\$ 8,850,942	\$ 9,279,815
Net Income	-	-	-	-	-	123,128	123,128
Balances at March 31, 2020	16,000	\$ 16	12,800,000	\$ 12,800	\$ 416,057	\$ 8,974,070	\$ 9,402,943
Net Income	-	-	-	-	-	106,589	106,589
Balances at June 30, 2020	16,000	\$ 16	12,800,000	\$ 12,800	\$ 416,057	\$ 9,080,659	\$ 9,509,532
Net Income	-	-	-	-	-	136,997	136,997
Balances at September 30, 2020	16,000	\$ 16	12,800,000	\$ 12,800	\$ 416,057	\$ 9,217,656	\$ 9,646,529
Balances at December 31, 2020	16,000	\$ 16	12,800,000	\$ 12,800	\$ 416,057	\$ 9,400,512	\$ 9,829,385
Net Income	-	-	-	-	-	507,285	507,285
Balances at March 31, 2021	16,000	\$ 16	12,800,000	\$ 12,800	\$ 416,057	\$ 9,907,797	\$ 10,336,670
Net Income	-	-	-	-	-	94,711	94,711
Balances at June 30, 2021	16,000	\$ 16	12,800,000	\$ 12,800	\$ 416,057	\$ 10,002,508	\$ 10,431,381
Net Income	-	-	-	-	-	76,846	76,846
Balances at September 30, 2021	16,000	\$ 16	12,800,000	\$ 12,800	\$ 416,057	\$ 10,079,354	\$ 10,508,227

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Pacific Health Care Organization, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30,	
	2021	2020
<u>Cash flows from operating activities:</u>		
Net income	\$ 678,842	\$ 366,714
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	35,964	46,716
Bad debt provision	494	11,101
Paycheck protection program loan forgiveness	(460,700)	-
Changes in operating assets and liabilities:		
Decrease in accounts receivable	276,484	79,375
Decrease in receivable – other	1,000	4,454
Decrease in prepaid expenses	8,287	51,865
Decrease in accounts payable	(21,129)	(4,515)
Decrease in deferred rent expense	(2,725)	(20,039)
(Decrease) increase in accrued expenses	(19,643)	43,507
Decrease in income tax payable	(52,045)	-
Increase in deferred rent assets	(607)	-
Decrease in prepaid income tax	-	135,111
Increase (decrease) in unearned revenue	5,771	(13,751)
Net cash provided by operating activities	449,993	700,538
<u>Cash flows from investing activities:</u>		
Purchase of furniture and office equipment	(12,199)	(52,803)
Net cash used in investing activities	(12,199)	(52,803)
<u>Cash flows from financing activities:</u>		
Proceeds from paycheck protection program loans	218,900	460,700
Net cash provided by financing activities	218,900	460,700
Increase in cash	656,694	1,108,435
Cash at beginning of period	9,498,457	8,104,164
Cash at end of period	\$ 10,155,151	\$ 9,212,599
<u>Supplemental cash flow information</u>		
Cash paid for:		
Interest	\$ (3,686)	\$ -
Income taxes	\$ 69,000	\$ -

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

Pacific Health Care Organization, Inc.
Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2021
(Unaudited)

NOTE 1 - BASIS OF FINANCIAL STATEMENT PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (the “Commission”) and in accordance with accounting principles generally accepted in the United States (“GAAP”). Certain information and footnote disclosures normally included in consolidated financial statements have been condensed or omitted in accordance with GAAP rules and regulations. The information furnished in these interim condensed consolidated financial statements includes normal recurring adjustments and reflects all adjustments, which, in the opinion of management, are necessary for a fair presentation of such financial statements. The preparation of condensed consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect both the recorded values of assets and liabilities at the date of the condensed consolidated financial statements and the revenues recognized and expenses incurred during the reporting period. These estimates and assumptions affect the Company’s recognition of deferred expenses, bad debts, income taxes, the carrying value of its long-lived assets and its provision for certain contingencies. The reasonableness of these estimates and assumptions is evaluated continually based on a combination of historical and other information that comes to the Company’s attention that may vary its outlook for the future. While management believes the disclosures and information presented are adequate to make the information not misleading, the Company recommends these interim condensed consolidated financial statements be read in conjunction with its audited financial statements and notes thereto included in its annual report on Form 10-K for the year ended December 31, 2020. Operating results for the nine months ended September 30, 2021, are not necessarily indicative of the results to be expected for the year ending December 31, 2021.

Principles of Consolidation — The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated in consolidation.

Basis of Accounting — The Company uses the accrual method of accounting.

Revenue Recognition — The Company follows the guidance of Accounting Standards Codification (ASC) 606, “Revenue from Contracts with Customers (Topic 606).”

Topic 606 creates a five-step model to recognize revenue which includes (i) identifying the contract with the customer, (ii) identifying the performance obligations in the contract, (iii) determining the transaction price, including variable consideration to the extent that it is probable that a significant future reversal will not occur, (iv) allocating the transaction price to the respective performance obligations in the contract, and (v) recognizing revenue when (or as) the Company satisfies the performance obligation.

The Company derives its revenue from the sale of managed care, bill review, utilization review and medical case management services. These services are billed individually as separate components to the Company’s customers. These fees include monthly administration fees, claim network fees, legal support fees, Medicare set-aside fees, lien service fees, Workers’ Compensation carve-outs, flat rate fees or hourly fees depending on the agreement with the customer.

The Company enters arrangements for bundled managed care which includes various units of accounting such as network solutions and patient management, including managed care. Such elements are considered separate units of accounting due to each element having value to the customer on a stand-alone basis and are billed separately. The selling price for each unit of accounting is determined using the contract price. When the Company’s customers purchase several products the pricing of the products sold is generally the same as if the products were sold on an individual basis. Revenue is recognized as the work is performed in accordance with the Company’s customer contracts. Based upon the nature of the Company’s products, bundled managed care elements are generally delivered in the same accounting period. The Company recognizes revenue for patient management services ratably over the life of the customer contract. Based upon prior experience in managed care, the Company estimates the deferral amount from when the customer’s claim is received to when the customer contract expires. Advance payments from subscribers and billings made in advance are recorded on the balance sheet as unearned revenue.

Pacific Health Care Organization, Inc.
Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2021
(Unaudited)

Accounts Receivables and Bad Debt Allowance – In the normal course of business the Company extends credit to its customers on a short-term basis. Although the credit risk associated with these customers is minimal, the Company routinely reviews its accounts receivable balances and makes provisions for doubtful accounts. The Company ages its receivables by dates of invoices. Management reviews bad debt reserves quarterly and reserves specific accounts as warranted or sets up a general reserve based on amounts over 90 days past due. When an account is deemed uncollectible, the Company charges off the receivable against the bad debt reserve. A considerable amount of judgment is required in assessing the realization of these receivables including the current creditworthiness of each customer and related aging of the past-due balances, including any billing disputes. To assess the collectability of these receivables, the Company performs ongoing credit evaluations of its customers' financial condition. Through these evaluations, the Company may become aware of situations where a customer may not be able to meet its financial obligations due to deterioration of its financial viability, credit rating or bankruptcy. The allowance for doubtful accounts is based on the best information available to the Company and is reevaluated and adjusted as additional information is received. The Company evaluates the allowance based on historical write-off experience, the size of the individual customer balances, past-due amounts, and the overall national economy. At September 30, 2021 and December 31, 2020, bad debt reserves of \$8,433 and \$19,404, respectively, were maintained in a general reserve for certain balances over 90 days past due and for accounts that are potentially uncollectible.

The percentages of the amounts due from major customers to total accounts receivable as of September 30, 2021 and December 31, 2020, are as follows:

	9/30/2021	12/31/2020
Customer A	25%	21%
Customer B	10%	12%

Significant Customers - The Company provides services to insurers, third party administrators, self-administered employers, municipalities, and other industries. The Company is able to provide its full range of services to virtually any size employer in the state of California. Outside the state of California, the Company is able to provide utilization review, medical bill review and medical case management services.

During the period ended September 30, 2021 and 2020, the Company had two and three customers, respectively, that accounted for more than 10% of its total sales. The following table sets forth details regarding the percentages of total sales attributable to the Company's significant customers in the past two years:

	9/30/2021	9/30/2020
Customer A	25%	21%
Customer B	11%	12%
Customer C	8%	10%

Leases - The Company follows the guidance of ASC 842, Leases, which requires an entity to recognize a right-of-use asset and a lease liability for virtually all leases. The Company elected to exclude from its balance sheets recognition of leases having a term of 12 months or less ("short-term leases"). Lease expense is recognized on a straight-line basis over the lease term. See Note 2 for further information regarding the Company's leases.

NOTE 2 - OPERATING LEASES

In July 2015, the Company entered a 79-month lease for approximately 9,439 square feet of office space, which lease commenced in September 2015. This office space serves as the Company's principal executive offices, as well as the principal offices of its operating subsidiaries.

Operating lease right-of-use ("ROU") assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent its obligation to make lease payments arising from the lease. Generally, the implicit rate of interest in such arrangements is not readily determinable and the Company utilizes its incremental borrowing rate in determining the present value of lease payments. The Company's incremental borrowing rate is a hypothetical rate based on its understanding of what its credit rating would be. The operating lease ROU asset includes any lease payments made and excludes lease incentives.

Pacific Health Care Organization, Inc.
Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2021
(Unaudited)

The components of lease expense and supplemental cash flow information related to leases for the periods are as follows:

	Three Months Ended September 30, 2021	Nine Months Ended September 30, 2021
Lease Cost		
Operating lease cost (included in general and administrative in the Company's condensed consolidated statement of operations)	\$ 80,246	\$ 204,651
Other Information		
Cash paid for amounts included in the measurement of lease liabilities for the three and nine months ended September 30, 2021	\$ 80,246	\$ 204,651
Weighted average remaining lease term – operating leases (in years)	0.58 years	0.58 years
Average discount rate – operating leases	5.75%	5.75%

The supplemental balance sheet information related to leases for the period is as follows:

	At September 30, 2021	At December 31, 2020
Operating leases		
Operating lease right-of-use assets, net	\$ 138,600	\$ 309,282
Short-term operating lease liabilities	\$ 138,600	\$ 243,049
Long-term operating lease liabilities	-	66,233
Total operating lease liabilities	<u>\$ 138,600</u>	<u>\$ 309,282</u>

Maturities of the Company's lease liabilities are as follows:

Year Ending	Operating Leases
2021 (remaining 3 months)	\$ 70,509
2022	71,359
Total lease payments	<u>141,868</u>
Less: Imputed interest/present value discount	(3,268)
Present value of lease liabilities	<u>\$ 138,600</u>

Lease expenses were \$80,246 and \$72,687 during the three months ended September 30, 2021 and 2020, respectively, and \$204,651 and \$225,903 during the nine months ended September 30, 2021 and 2020, respectively.

NOTE 3 - PAYCHECK PROTECTION PROGRAM LOANS

In April and May 2020, Pacific Health Care Organization, Inc. ("PHCO"), Medex Managed Care, Inc. ("MMC") and Medex Medical Management, Inc. ("MMM") received loans pursuant to the Coronavirus Aid, Relief and Economic Security ("CARES") Act Paycheck Protection Program. PHCO received a loan in the amount of \$133,400 (the "PHCO PPP Loan"). The PHCO PPP Loan interest rate was 1.0% per annum. MMM and MMC received loans of \$267,700 and \$59,600, respectively (collectively the "Medex Companies PPP Loans"). The Medex Companies PPP Loans interest rate was also 1.0% per annum.

In February 2021, the principal and interest on the PHCO PPP Loan and the Medex Companies PPP Loans were forgiven in full. The total amount of the loan and interest forgiven for PHCO was \$133,400 and \$1,067, respectively. The total amount of the principal and interest forgiven for MMM was \$267,700 and \$2,142, respectively. The total amount of the principal and interest forgiven for MMC was \$59,600 and \$477, respectively. The funds were used for qualifying expenses as described in the CARES Act, namely payroll, rent, utilities and group health insurance benefits.

Pacific Health Care Organization, Inc.
Notes to Condensed Consolidated Financial Statements
For the Nine Months Ended September 30, 2021
(Unaudited)

Economic Aid Act

On April 1, 2021, MMM received a loan pursuant to section 311 of the Economic Aid Act Paycheck Protection Program Second Draw Loans in the amount of \$218,900 from First Citizens Bank (the “Second Draw PPP Loan”). The Second Draw PPP Loan bears interest at a rate of 1.0% per annum and is payable monthly commencing on February 28, 2022, if loan forgiveness is not requested by that date. The loan funds are eligible for full forgiveness if used for qualifying expenses, such as payroll, group health benefits, rent and utilities.

NOTE 4 - SUBSEQUENT EVENTS

In accordance with ASC 855-10 Company management reviewed all material events through the date of issuance and except as disclosed below, there are no material subsequent events to report.

On October 19, 2021, the Company completed short-form mergers with its wholly owned subsidiaries Medex Legal Support, Inc. (“MLS”), and Pacific Medical Holding Company (“PMHC”) and Industrial Resolutions Coalition (“IRC”). As a result of the short-form mergers the separate existence of MLS, PMHC and IRC terminated and the business, assets and liabilities of those entities have been transferred to PHCO and, as appropriate were transferred to the Company’s other subsidiaries. The Company continues to offer the services of IRC and MLS through its other subsidiaries. In addition to the services they currently offer, Medex Healthcare, Inc. (“Medex”) will now offer carve-out services and Medicare-set asides and Medex Managed Care, Inc. (“MMC”) will offer lien representation services.

Item 2. Management's Discussion and Analysis of Financial Statements and Results of Operations

Certain information included in this quarterly report on Form 10-Q ("quarterly report") and the documents incorporated by reference herein, if any, contain statements within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. All statements other than statements of historical fact are statements that could be forward-looking. You can recognize these statements through our use of words such as "anticipate," "believe," "continue," "could," "estimate," "expect," "forecast," "future," "intend," "likely," "may," "might," "objective," "plan," "potential," "predict," "project," "should," "strategy," "will," "would," other similar expressions and their negatives.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors, many of which may be beyond our control, that could cause actual results to differ materially from any future results, expressed or implied, in forward looking statements. Such factors include, but are not limited to:

- the impact on our business of COVID-19, as well as its impacts on the Workers' Compensation industry, the businesses of our customers and on the economy generally;
- cost reduction efforts by our existing and prospective customers;
- competition within our industry, including competition from much larger competitors;
- business combinations among our customers or competitors;
- legislative and regulatory requirements or changes which could render our services less competitive or obsolete;
- our failure to successfully develop new services and/or products either organically or through acquisition, or to anticipate current or prospective customers' needs;
- our ability to retain existing customers and to attract new customers;
- price increases;
- cybersecurity and software system failures and breaches;
- reductions in worker's compensation claims or the demand for our services, from whatever source; and
- delays, reductions, non-payment, or cancellations of contracts we have previously entered.

For more detailed information about particular risk factors related to us and our business, see Item 1A Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2020, filed the Securities and Exchange Commission (the "Commission") on March 31, 2021 (the "Annual Report").

We operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time, and it is not possible for our management to predict all risk factors, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

You should not place undue reliance on forward-looking statements. The forward-looking statements are based on the beliefs of management as well as assumptions made by and information currently available to management and apply only as of the date of this report or the respective dates of the documents from which they incorporate by reference. Neither we nor any other person assumes any responsibility for the accuracy or completeness of forward-looking statements. Further, except to the extent required by law, we undertake no obligations to update or revise any forward-looking statements, whether as a result of new information, future events, a change in events, conditions, circumstances or assumptions underlying such statements, or otherwise.

The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and the related notes contained elsewhere in this report and in our other filings with the Commission.

Throughout this quarterly report, unless the context indicates otherwise, the terms, "we," "us," "our" or "the Company" refer to Pacific Health Care Organization, Inc., ("PHCO") and our wholly-owned subsidiaries Medex Healthcare, Inc. ("Medex"), Industrial Resolutions Coalition, Inc. ("IRC"), Medex Managed Care, Inc. ("MMC"), Medex Medical Management, Inc. ("MMM"), Medex Legal Support, Inc. ("MLS") and Pacific Medical Holding Company, Inc. ("PMHC").

Overview

We incorporated under the laws of the state of Utah in April 1970, under the name Clear Air, Inc. We changed our name to Pacific Health Care Organization, Inc., in January 2001. In February 2001, we acquired Medex, a California corporation organized in March 1994, in a share for share exchange. Medex is in the business of managing and administering both Health Care Organizations (“HCOs”) and Medical Provider Networks (“MPNs”) in the state of California. In August 2001 we formed IRC, a California corporation, as a wholly owned subsidiary of PHCO. Prior to closing IRC, IRC oversaw and managed our Workers’ Compensation carve-outs services. In June 2010, we acquired MLS, a Nevada corporation incorporated in September 2009. Prior to closing MLS, MLS offered lien representation services and Medicare Set-aside services (“MSA”). In February 2012, we incorporated MMM, a Nevada corporation, as a wholly owned subsidiary of the Company. MMM is responsible for overseeing and managing medical case management services. In March 2011, we incorporated MMC, a Nevada corporation, as a wholly owned subsidiary of the Company. MMC oversees and manages the Company’s utilization review and bill review services. In October 2018, we incorporated PMHC, a Nevada corporation, as a wholly owned subsidiary of the Company to act as a holding company for future potential acquisitions.

In October 2021, to simplify business procedures, bookkeeping and administrative structure; and eliminate duplicative functions and reduce costs; we terminated the existence of IRC, MLS and PMHC and wound up those subsidiaries. The business, assets, liabilities, and services of those entities have been transferred to PHCO or its other subsidiaries. Medex will now offer our Workers’ Compensation carve-out services previously provided by IRC and Medicare-set asides previously managed by MLS and MMC will oversee the lien representation services previously offered by MLS.

Business of the Company

We offer an integrated and layered array of complimentary business solutions that enable our customers to better manage their employee Workers’ Compensation-related healthcare administration costs. We are constantly looking for ways to expand the suite of services we can provide our customers, either through strategic acquisitions or organic development.

Our business objective is to deliver value to our customers that reduces their Workers’ Compensation-related medical claims expense in a manner that will assure injured employees receive high quality healthcare that allows them to recover from injury and return to gainful employment without undue delay. According to studies conducted by auditing bodies on behalf of the California Division of Workers’ Compensation, (“DWC”) the two most significant cost drivers for Workers’ Compensation are claims frequency and medical treatment costs. Our services focus on containing medical treatment costs.

We offer our customers access to our health care organizations (“HCOs”) and our medical provider networks (“MPNs”). We also provide medical case management, field medical case management, network access, utilization review, medical bill review, Workers’ Compensation carve-outs and Medicare set-aside services. Additionally, we offer lien representation and expert witness testimony, ancillary to our services. We provide our services as a bundled solution, as standalone services, or as add-on services.

Our core services focus on reducing medical treatment costs by enabling our customers to share control over the medical treatment process. This control is primarily obtained by participation in one of our medical treatment networks. We hold several government-issued licenses to operate medical treatment networks. Through Medex we hold two of a total of seven licenses issued by the state of California to establish and manage HCOs within the state of California. We also hold approvals issued by the state of California to act as an MPN and currently administer 26 MPNs. Our HCO and MPN programs provide our customers with provider networks within which our customers have some ability to direct the administration of employee claims. This is designed to decrease the incidence of fraudulent claims and disability awards and ensure injured employees receive the necessary back-to-work rehabilitation and training they need. Our medical bill and utilization review services provide oversight of medical billing and treatment requests, along with medical case management, which keeps medical treatment claims progressing to a resolution and assures treatment plans are aligned from a medical perspective.

Our customers include self-administered employers, insurers, third party administrators, municipalities, and others. Our principal customers are companies with operations located in the state of California where the high cost of Workers’ Compensation insurance is a critical problem for employers, though we are able to process medical bills nationally. Our provider networks, which are located only in California, are composed of providers experienced in treating worker injuries.

Our business generally has a long sales cycle, typically eight months or more. Once we have established a customer relationship and enrolled employees of our customers, we anticipate our revenue to adjust with the growth or retraction of our customers’ employee headcount. Throughout the year, we expect new employees and customers to be added while others terminate for a variety of reasons.

Impact of COVID-19 on our Business

To date, we have been able to adapt our business operations to a primarily remote workforce, with no material interruptions in service, data breaches, technology failures, or inability to complete mission-critical functions. We have been able to effectively maintain contact with employees, partners, customers, and other related parties using technological solutions such as virtual meetings and enhanced collaboration programs and have developed policies and protocols to ensure department and employee performance quality is maintained despite the change in work setting. This has resulted in costs associated with maintaining a remote workforce, including reimbursing employees for internet, phone, and office supply expenses; costs of sanitizing and cleaning the office after potential COVID-19 exposure events; costs of cleaning and PPE supplies; additional computer hardware costs; and some administrative burdens in complying with California laws and regulations related to COVID-19.

Revenue for our services is derived from our customers' employee headcount and workers' workplace injuries. During the periods covered by this report, several of our customers, including some of our largest customers, have had to suspend or significantly modify their operations during much or all of the pandemic. While California has lifted many of its restrictions, it is still trying to slow the spread of COVID-19 and certain counties and businesses have continued or reinstated masking and now have vaccine requirements. Despite the lifting of COVID-19 restrictions for most businesses, some of our customers continue to experience lower than normal business volume and employee counts due to the pandemic. Until the impacts of COVID-19 on our customers' businesses lessen, employees return to more normal workloads and the occurrence of workplace injuries returns to more traditional levels, we anticipate our revenues will continue to be negatively affected.

California has passed legislation to address employer liability in Workers' Compensation for COVID-19 cases. The law creates two rebuttable presumptions that COVID-19 illnesses contracted by specific categories of employees are work related and therefore eligible for workers' compensation. The first presumption applies to COVID-19 workers' compensation claims filed by peace officers, firefighters, first responders, and health care workers, and does not apply to our employees, though it may apply to our customers' claims. The second presumption, for employers with five or more employees, applies to employees who test positive for COVID-19 during an outbreak at the employee's specific place of employment. An outbreak occurs when a set number of employees – depending on the number of employees at the workplace – test positive for COVID-19 during a continuous 14-day period. This presumption applies to the Company. However, no Workers' Compensation cases related to COVID-19 and/or via this California law have been filed against the Company to date.

In April 2020, the Department of Labor issued regulations to implement the Families First Coronavirus Response Act ("FFCRA") which provided employees paid leave for COVID-19 related illness for themselves and/or a family member and provided employers with tax credits. The FFCRA expired on December 31, 2020. In March 2021, the American Rescue Plan Act ("ARPA") was signed into law. The ARPA made tax credits available to employers with fewer than 500 employees who voluntarily chose to grant employees paid leave under the FFCRA through September 30, 2021 and updated certain FFCRA leave provisions. We voluntarily chose to extend the FFCRA paid leave to our employees through its expiration on September 30, 2021 and take the tax credits. Since its expiration, the company has ceased to offer COVID-19-specific paid leave benefits to its employees. Since its expiration, we have ceased to offer COVID-19-specific paid leave benefits to its employees. Family, medical, and other types of leave remain available to employees under existing company policy.

In March 2021, California passed its own COVID-19 Supplemental Paid Sick Leave law ("CA SPSL"). It provided employees paid leave for COVID-19 related reasons such as caring for themselves, family members, or for vaccine related appointments or illnesses caused by COVID-19 or the vaccine from January 1, 2021 through September 30, 2021. The CA SPSL allowed employees to retroactively request reimbursement for qualifying leave or to use it towards future requests through September 30, 2021. Employers whose employees utilized CA SPSL are eligible for federal tax credits to offset the costs of providing the CA SPSL. As of September 30, 2021, the CA SPSL paid leave expired. Therefore, we have ceased offering COVID-19-specific paid leave benefits to our employees. Family, medical, and other types of leave remain available to employees under existing Company policy.

In April and May 2020, PHCO, MMM and MMC were granted Paycheck Protection Program ("PPP") loans in the aggregate amount of \$460,700. In the spirit of the PPP loan program policy, which was to protect the continued economic stability of employees, most of the PPP loan amounts went towards payroll and employee benefit expenses. In February 2021, PHCO, MMC, and MMM received full forgiveness of their PPP loans including interest. MMM was eligible for and received a Second Draw PPP Loan in the amount of \$218,900 on April 1, 2021. This Second Draw PPP Loan can qualify for full loan forgiveness if the disbursements meet the required forgiveness criteria.

In June 2021, the Governor of California terminated the executive order that put into place the Stay Home Order and Blueprint for a Safer Economy. This removed restrictions on physical distancing, capacity limits on businesses, and the county tiers system. We have elected to allow employees to continue working remotely as a safety precaution, and currently anticipate maintaining a significant portion of our workforce fully remote after the pandemic.

We have taken measures to ensure data security in our transition to remote work during the pandemic, but there is no guarantee that they will be completely effective, that our productivity will not be adversely impacted, or that we will not encounter some of the common risks associated with a remote workforce, including employees accessing company data and systems remotely. As discussed in greater detail in Item 1A Risk Factors of our Annual Report, our business has been and could continue to be materially and adversely affected by the potential interruptions to our business operations arising from the COVID-19 outbreak.

Results of Operations**Comparison of the three months ended September 30, 2021 and 2020**

The following represents selected components of our consolidated results of operations for the three-month periods ended September 30, 2021 and 2020, respectively, together with changes from period-to-period:

	For three months ended September 30,		Amount Change	% Change
	2021	2020		
Revenues:				
HCO	\$ 289,117	\$ 264,781	\$ 24,336	9%
MPN	137,834	124,836	12,998	10%
Utilization review	258,251	307,139	(48,888)	(16%)
Medical bill review	117,685	77,075	40,610	53%
Medical case management	439,073	590,784	(151,711)	(26%)
Other	68,658	51,139	17,519	34%
Total revenues	<u>1,310,618</u>	<u>1,415,754</u>	<u>(105,136)</u>	<u>(7%)</u>
Expense:				
Depreciation	12,657	14,122	(1,465)	(10%)
Bad debt provision	-	11,000	(11,000)	(100%)
Consulting fees	58,275	58,621	(346)	(1%)
Salaries and wages	679,530	694,352	(14,822)	(2%)
Professional fees	76,014	68,979	7,035	10%
Insurance	86,527	91,951	(5,424)	(6%)
Outsource service fees	109,926	115,803	(5,877)	(5%)
Data maintenance	11,917	6,603	5,314	80%
General and administrative	168,939	163,863	5,076	3%
Total expenses	<u>1,203,785</u>	<u>1,225,294</u>	<u>(21,509)</u>	<u>(2%)</u>
Income from operations	106,833	190,460	(83,627)	(44%)
Income before taxes	106,833	190,460	(83,627)	(44%)
Income tax provision	29,987	53,463	(23,476)	(44%)
Net income	<u>\$ 76,846</u>	<u>\$ 136,997</u>	<u>\$ (60,151)</u>	<u>(44%)</u>

Revenue**HCO**

During the three-month periods ended September 30, 2021 and 2020, HCO revenue was \$289,117 and \$264,781, respectively. The 9% increase was due to an increase in claims activity and renegotiation of certain deliverables to an existing customer, partially offset by the loss of one customer in the third quarter of 2021. HCO revenue is generated largely from fees charged to our employer customers for access to our HCO networks, per claim fees, notification fees and fees for other ancillary services the employer customers using our HCO networks may select. HCO notifications are mailed out annually and handed out by the employer for all new hires.

MPN

MPN revenue for the three-month periods ended September 30, 2021 and 2020, was \$137,834 and \$124,836, respectively, an increase of 10%. The increase in MPN revenue was due to an increase in the number claims reported by existing customers which resulted in more claim network fees. Like HCO revenue, MPN revenue is generated largely from fees charged to our employer customers for access to our MPN networks, per claim fees and fees for other ancillary services the employer customers using our MPN networks may select. Unlike HCOs, MPNs do not require annual notifications. MPNs require a notice be given to an injured worker only at the time the employer is notified by the injured worker that an injury has occurred.

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Utilization Review

During the three-month periods ended September 30, 2021 and 2020, utilization review revenue was \$258,251 and \$307,139, respectively. The decrease of \$48,888 in the 2021 period was due to a decrease in utilization reviews from existing customers and the loss of two customers in 2021.

Utilization review is the review of medical treatment requests by providers to provide a safeguard for employers and injured workers against unnecessary and inappropriate medical treatment from the perspective of medical necessity, quality of care, appropriateness of decision-making, and timeliness of treatment. Its purpose is to reduce employer liability for medical costs that are not medically appropriate or approved by the relevant medical and legal authorities and the payor.

Medical Bill Review

During the three-month period ended September 30, 2021, medical bill review revenue increased by \$40,610, to \$117,685, compared to \$77,075 during the same period a year earlier. The increase was mainly due to processing more medical and hospital bills from existing customers, partially offset by the loss of a customer in the third quarter of 2021.

Medical bill review involves analyzing medical provider services and equipment billing to ascertain proper reimbursement. Such services include, but are not limited to, coding review and re-bundling, confirming that the services are customary and reasonable, fee schedule compliance, out-of-network bill review, pharmacy review, and preferred provider organization repricing arrangements. Our medical bill review services can result in significant savings for our customers.

Medical Case Management

During the three-month periods ended September 30, 2021 and 2020, medical case management revenue was \$439,073 and \$590,784, respectively. The decrease in medical case management revenue of \$151,711 was primarily due to a decrease in the number of claims managed with existing customers.

Medical case management keeps medical treatment claims progressing to a resolution and assures treatment plans are aligned from a medical perspective. Medical oversight is a collaborative process that assesses, evaluates, coordinates, implements and monitors medical treatment plans and the options and services required to meet an injured worker's health needs. A medical case manager acts as a liaison between the injured worker, claims adjuster, medical providers, and attorneys to achieve optimal results for injured workers and customers. We work to manage the number of nurses in our program to maintain our ratio of claims per nurse at a level that ensures timely and appropriate medical care is given to the injured worker and facilitates faster claims closures for our customers.

Other

Other revenue consists of revenue derived from network access fees charged to non-HCO, non-MPN customers to access our network of medical providers, lien representation, legal support services, Medicare set-aside and Workers' Compensation carve-out services. Other revenue for three-month periods ended September 30, 2021 and 2020, was \$68,658 and \$51,139, respectively. The increase in other revenue of 34% was the result of increases in network access and Medicare set-aside claims processed.

Expenses

Total expenses for the three months ended September 30, 2021 and 2020, were \$1,203,785 and \$1,225,294, respectively. The 2% decrease in expenses was the result of decreases in depreciation, bad debt provision, consulting fees, salaries and wages, insurance, and outsource service fees, partially offset by increases in professional fees, data maintenance, and general and administrative.

Depreciation

During the three-month period ended September 30, 2021, we recorded depreciation expense of \$12,657 compared to \$14,122 during the comparable 2020 period. The decrease in depreciation was primarily attributable to certain fixed assets being fully depreciated, partially offset by the purchasing of new fixed assets.

Bad Debt Provision

During the three-month period ended September 30, 2021, bad debt provision decreased by \$11,000 or 100% compared to the same period in 2020. The decrease was due to delinquent customers resolving outstanding past-due balances and staying current in their payment obligations.

Consulting Fees

During the three months ended September 30, 2021, consulting fees decreased to \$58,275 from \$58,621 compared to the three months ended September 30, 2020. The 1% decrease was the result of a reduction in the number of information systems consultants retained as compared to the third quarter of 2020.

Salaries and Wages

During the three-month period ended September 30, 2021, salaries and wages decreased by 2% when compared to the same period in 2020. This decrease was the result of the layoff of two employees in July 2021 because of the COVID-19 pandemic. As a result of the layoff, we expect salaries and wages to continue to be lower throughout the remainder of 2021 than they were in 2020.

Professional Fees

For the three months ended September 30, 2021, professional fees increased by 10% from \$68,979 to \$76,014 when compared to the three months ended September 30, 2020. The increase in professional fees was the result of increases in accounting, legal, and medical management fees, partially offset by decreases in other professional fees.

Insurance

During the three-month period ended September 30, 2021, we incurred insurance expenses of \$86,527, a 6% decrease over the same three-month period of 2020. The decrease in insurance expenses was primarily attributed to lower medical insurance premiums and Workers' Compensation coverage as a result of our reduced workforce, partially offset by increases in insurance expenses for business, and directors' and officers' liability for the three-month period of 2021 compared to the same period of 2020.

Outsource Service Fees

Outsource service fees consist of costs incurred by our subsidiaries in outsourcing some functions of utilization review, medical bill review, Medicare set-aside services and field medical case management and typically fluctuates with the demand for those services. We incurred \$109,926 and \$115,803 in outsource service fees during the three-month periods ended September 2021 and 2020, respectively. The decrease of 5% was due to a decrease in volume from our customers which resulted in fewer outsource services fees for Medicare-set-asides, utilization review, and field medical case management assignments, partially offset by incurring more outsource service fees for medical bill review due to an increase in the number of bills reviewed and a \$15,000 penalty paid to State of California Department of Industrial Relations for errors found during our regularly scheduled utilization review audit. We have since made the required corrections to our system and process.

Data Maintenance

During the three-month periods ended September 30, 2021 and 2020, data maintenance fees were \$11,917 and \$6,603, respectively. The increase of \$5,314 was the result of an increase in volume of HCO, MPN, and new hire notifications for existing customers during the three-month period ended September 30, 2021, when compared to the same period in 2020. Data maintenance fees tend to fluctuate monthly depending on when new customers are enrolled, annual renewals for existing customers, and the number of new employees our customers enroll in our HCO or MPN programs.

General and Administrative

During the three-month period ended September 30, 2021, general and administrative expenses increased 3% to \$168,939 when compared to the three-month period ended September 30, 2020. This increase of \$5,076 was primarily attributable to increases in charity – cash contribution, dues and subscriptions, education, IT enhancement, licenses and permits, parking, printing and reproduction, office rent, shareholders' expense, and travel and entertainment, partially offset by decreases in auto expenses, bank charges, equipment/repairs, office supplies, postage, rent expense for equipment, telephone, miscellaneous expenses, and vacation expenses.

Income from Operations

As a result of the \$105,136 decrease in total revenue during the three-month period ended September 30, 2021, and the \$21,509 decrease in total expenses during the same period, our income from operations decreased \$83,627, or 44%, during the three-month period ended September 30, 2021, when compared to the same period in 2020.

Income Tax Provision

We realized a \$23,476, or 44%, decrease in our income tax provision during the three-month period ended September 30, 2021, compared to the three-month period ended September 30, 2020, because of the decrease in income before taxes realized in the 2021 period.

Net Income

During the three-month period ended September 30, 2021, we realized a 7% decrease in total revenues, a 2% decrease in total expenses, and a 44% decrease in our provision for income tax when compared to the same period in 2020. As a result, we realized a net decrease of \$60,151, or 44%, in net income during the three-month period ended September 30, 2021, compared to the three-month period ended September 30, 2020.

Comparison of nine months ended September 30, 2021 and 2020

The following represents selected components of our consolidated results of operations, for the nine-month periods ended September 30, 2021 and 2020, respectively, together with changes from period-to-period:

	<u>For nine months ended September 30,</u>		<u>Amount Change</u>	<u>% Change</u>
	<u>2021</u>	<u>2020</u>		
Revenues:				
HCO	\$ 936,382	\$ 916,693	\$ 19,689	2%
MPN	396,497	363,902	32,595	9%
Utilization review	796,927	854,922	(57,995)	(7%)
Medical bill review	292,445	242,237	50,208	21%
Medical case management	1,381,929	1,855,314	(473,385)	(26%)
Other	174,251	202,101	(27,850)	(14%)
Total revenues	<u>3,978,431</u>	<u>4,435,169</u>	<u>(456,738)</u>	<u>(10%)</u>
Expense:				
Depreciation	35,964	46,716	(10,752)	(23%)
Bad debt provision	494	11,101	(10,607)	(96%)
Consulting fees	173,796	195,978	(22,182)	(11%)
Salaries and wages	2,073,133	2,238,079	(164,946)	(7%)
Professional fees	221,970	223,747	(1,777)	(1%)
Insurance	242,334	274,974	(32,640)	(12%)
Outsource service fees	304,085	359,596	(55,511)	(15%)
Data maintenance	75,293	59,415	15,878	27%
General and administrative	492,264	515,738	(23,474)	(5%)
Total expenses	<u>3,619,333</u>	<u>3,925,344</u>	<u>(306,011)</u>	<u>(8%)</u>
Income from operations	359,098	509,825	(150,727)	(30%)
Other income (expense)				
Paycheck protection program loan forgiveness income	464,386	-	464,386	-
Paycheck protection program loan interest expense	(3,686)	-	(3,686)	-
Total other income (expense)	<u>460,700</u>	<u>-</u>	<u>460,700</u>	<u>-</u>
Income before taxes	819,798	509,825	309,973	61%
Income tax provision	<u>140,956</u>	<u>143,111</u>	<u>(2,155)</u>	<u>(2%)</u>
Net income	<u>\$ 678,842</u>	<u>\$ 366,714</u>	<u>\$ 312,128</u>	<u>85%</u>

Revenue

HCO

During the nine-month periods ended September 30, 2021 and 2020, HCO revenue was \$936,382 and \$916,693, respectively. The 2% increase in HCO revenue was primarily attributable to an increase in claims from existing customers and renegotiation of certain deliverables to an existing customer, partially offset by the loss of three HCO customers and fewer custom network fees paid by customers to maintain custom provider lists.

MPN

MPN revenue for the nine-month periods ended September 30, 2021 and 2020, was \$396,497 and \$363,902, respectively, an increase of 9%, due to an increase in the number of claims reported by two customers. Like HCO revenue, MPN revenue is generated largely from fees charged to our employer customers for access to our MPN networks, per claim fees and fees for other ancillary services.

Utilization Review

During the nine-month periods ended September 30, 2021 and 2020, utilization review revenue was \$796,927 and \$854,922, respectively. The decrease of 7% in the 2021 period was primarily attributable to decreased utilization reviews from the loss of two customers and fewer utilization reviews submitted by other customers.

Medical Bill Review

During the nine-month period ended September 30, 2021, medical bill review revenue increased by 21% to \$292,445 from \$242,237 when compared to the same period a year earlier. This increase was due to an increase in hospital and non-hospital bills reviewed, partially offset by the loss of two customers in 2021.

Medical Case Management

During the nine months ended September 30, 2021 and 2020, medical case management revenue was \$1,381,929 and \$1,855,314, respectively. The 26% decrease in medical case management revenue was primarily due to the loss of two customers and a decrease in the number of claims and amount of time spent on claims managed with existing customers. The decrease was partially offset by the addition of a new customer during the first quarter of 2021.

Other

Other revenue for the nine-month periods ended September 30, 2021 and 2020, was \$174,251 and \$202,101, respectively. The decrease of \$27,850 was primarily the result of fewer Medicare set-aside claims, partially offset by an increase in network access fee revenue from an existing customer increasing its utilization of our provider network.

Expenses

Total expenses for the nine months ended September 30, 2021 and 2020, were \$3,619,333 and \$3,925,344, respectively. The decrease of \$306,011 was the result of decreases in depreciation, bad debt provision, consulting fees, salaries and wages, professional fees, insurance, outsource service fees, and general and administrative expenses, which was partially offset by an increase in data maintenance fees.

Depreciation

During the nine-month period ended September 30, 2021, we recorded depreciation expense of \$35,964 compared to \$46,716 during the comparable 2020 period. The decrease in depreciation was primarily attributable to certain fixed assets being fully depreciated prior to the quarter ended September 30, 2021, partially offset by the purchasing of new fixed assets.

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Bad Debt Provision

During the nine-month period ended September 30, 2021, bad debt provision decreased by \$10,607 or 96% compared to the same period in 2020. The decrease was due to delinquent customers resolving outstanding past-due balances and staying current on their payment obligations.

Consulting Fees

During the nine months ended September 30, 2021, consulting fees decreased 11% to \$173,796 from \$195,978 during the nine months ended September 30, 2020. This decrease of \$22,182 was because we had fewer information systems consulting and consultant fees related to our insurance company acquisition search.

Salaries and Wages

During the nine-month period ended September 30, 2021, salaries and wages decreased 7% to \$2,073,133 compared to \$2,238,079 during the same period in 2020. The decrease was primarily the result of the layoff of two employees in the third quarter of 2021. As noted above, we expect salaries and wages to continue to be lower throughout the remainder of 2021 than they were in 2020.

Professional Fees

For the nine months ended September 30, 2021, we incurred professional fees of \$221,970 compared to \$223,747 during the nine months ended September 30, 2020. The \$1,777 decrease in professional fees was primarily the result of fewer fees incurred for other professional and medical management services as a result of decreased medical case management activity, partially offset by increases in accounting and legal professional fees.

Insurance

During the nine-month period ended September 30, 2021, we incurred insurance expenses of \$242,334, a 12% decrease over the same period in 2020. The decrease in insurance expenses was primarily attributed to a decrease in medical insurance premiums as a result of our lower employee count and lower insurance expense for business, directors' and officers' liability, and Workers' Compensation coverage.

Outsource Service Fees

We incurred \$304,085 and \$359,596 in outsource service fees during the nine-month periods ended September 2021 and 2020, respectively. The decrease of \$55,511 was primarily the result of fewer Medicare set-aside claims, medical bills reviewed, and utilization reviews processed partially offset by an increase in outsource service fees for field medical case management and a \$15,000 penalty paid to State of California Department of Industrial Relations for errors found during our regularly scheduled utilization review audit. As noted above, we have since made the required corrections to our system and process.

Data Maintenance

During the nine-month periods ended September 30, 2021 and 2020, data maintenance fees were \$75,293 and \$59,415, respectively. The increase of \$15,878 was primarily the result of an increase in the number of employees enrolled in our HCO and MPN programs with our existing customers and an increase in customers' new hire notifications.

General and Administrative

During the nine-month period ended September 30, 2021, general and administrative expenses decreased 5% to \$492,264 when compared to the nine-month period ended September 30, 2020. This decrease of \$23,474 was primarily attributable to decreases in advertising, dues and subscriptions, equipment/repairs, IT enhancement, licenses and permits, office supplies, parking, postage, printing and reproduction, rent expense for equipment, miscellaneous expenses, and shareholders' expense, partially offset by increases in charity – cash contribution, auto expenses, bank charge, education, telephone, office rent, travel and entertainment, and vacation expense.

Income from Operations

Total revenue during the nine-month period ended September 30, 2021, decreased by \$456,738 to \$3,978,431 compared to \$4,435,169 in the same period in 2020. Our total expenses decreased by \$306,011 during the nine months ended September 30, 2021, compared to the same period in 2020. This led to a decrease in income from operations of \$150,727, or 30%, during the nine months ended September 30, 2021, compared to the nine months ended September 30, 2020.

Other Income (Expense)

In February 2021, the principal and interest on the PPP loans issued to PHCO, MMC and MMM in April and May 2020, was forgiven in full. As a result, we realized income from paycheck protection loan forgiveness of \$464,386 and loan interest expense from paycheck protection loans of \$3,686 during the nine months ended September 30, 2021, resulting in total other income during the period of \$460,700. During the corresponding period ended September 30, 2020, we realized no other income (expense).

Income Tax Provision

We realized a decrease of \$2,155 or 2%, in our income tax provision during the nine-month period ended September 30, 2021, compared to the nine months ended September 30, 2020. The income realized from the PPP loan forgiveness is exempt from federal income taxation, but not state income taxation.

Net Income

During the nine-month period ended September 30, 2021, total revenues was \$3,978,431, a decrease of 10%, our provision for income tax decreased 2% and our total expenses decreased 8% compared to the same period of 2020. These decreases were offset by the recognition of \$460,700 in total other income as a result of PPP loan forgiveness by PHCO, MMM and MMC. As a result, we realized a \$312,128, or 85%, increase in net income during the nine months ended September 30, 2021, when compared to the nine months ended September 30, 2020.

Liquidity and Capital Resources

As of September 30, 2021, we had cash on hand of \$10,155,151 compared to \$9,498,457 as of December 31, 2020. The \$656,694 increase was the result of net cash provided by our operating activities and financing activities, partially offset by cash used in investing activities.

As of the date of this report, we have laid off six employees, including four in July 2020, and two in July 2021, as a result of the COVID-19 pandemic and loss of customers. As noted above, we have taken advantage of and may in the future further avail ourselves of federal, state, or local government programs to protect our workforce as management and our board of directors determine to be in the best interest of the Company and our shareholders. We have focused on using our Second Draw PPP Loan for qualifying expenses, such as payroll, and currently plan to apply for forgiveness of the Second Draw PPP Loan when appropriate.

We currently have planned certain capital expenditures during the remainder of 2021 to decommission certain IT systems and move to another platform. We believe we have adequate capital on hand to cover these expenses and do not anticipate this will require us to seek outside sources of funding.

Historically, we have generally realized positive cash flows from operating activities, which coupled with positive reserves of cash on hand, have been used to fund our operating expenses and obligations. Management currently believes that absent any unanticipated COVID-19 impact, including, but not limited to a significant longer-term downturn in the economy or the loss of several major customers within a condensed period, cash on hand and anticipated revenues from operations will be sufficient to cover our operating expenses over the foreseeable future.

As the impact of the COVID-19 pandemic continues to play out throughout our industry and the broader economy, we believe our strong cash position, could allow us to identify and capitalize on potential opportunities to expand our business either through the acquisition of existing businesses that may have insufficient resources to overcome the impacts of the pandemic, including, expansion into the insurance industry or through the creation of new lines of business. Depending upon the nature of the opportunities we identify, such acquisitions or expansion could require greater capital resources than we currently possess. Should we need additional capital resources, we could seek to obtain such through debt and/or equity financing. We do not currently possess an institutional source of financing and there is no assurance that we could be successful in obtaining equity or debt financing when needed on favorable terms, or at all. We could also use shares of our capital stock as consideration for a business acquisition transaction, but there is also no assurance that there would be significant market interest in our capital stock.

Cash Flow

During the nine months ended September 30, 2021, cash was primarily used to fund operations. We had a net increase in cash of \$656,694 during the nine months ended September 30, 2021. See below for additional information.

	For the nine months ended September 30,	
	2021	2020
	(unaudited)	(unaudited)
Net cash provided by operating activities	\$ 449,993	\$ 700,538
Net cash used in investing activities	(12,199)	(52,803)
Net cash provided by financing activities	218,900	460,700
Net increase in cash	<u>\$ 656,694</u>	<u>\$ 1,108,435</u>

During the nine months ended September 30, 2021 and 2020, net cash provided by operating activities was \$449,993 and \$700,538, respectively, a decrease of \$250,545. This decrease was primarily the result of decreases in total revenue, allowance for bad debt, prepaid expenses, accounts receivable, receivable – other, accounts payable, accrued expenses, income tax payable, and deferred rent expense, partially offset by increases in deferred rent assets and unearned revenue. As a result of applying the PPP loan forgiveness we realized an increase in net income.

Net cash used in investing activities was \$12,199 and \$52,803 during the nine-month periods ended September 30, 2021 and 2020, respectively. During the nine-month periods ended September 30, 2021 and 2020, net cash was used in investing activities to purchase computers and equipment.

Net cash provided by financing activities during the nine months ended September 30, 2021 and 2020, was \$218,900 and \$460,700, respectively. During 2020 we received three PPP loans for PHCO, MMC and MMM in the amounts of \$133,400, \$59,600, and \$267,700, respectively. These loans were forgiven in February 2021. In April 2021, MMM received a Second Draw PPP loan in the amount of \$218,900. We have focused on using these funds for qualifying expenses and plan to apply for loan forgiveness in the future.

Off-Balance Sheet Financing Arrangements

As of September 30, 2021, we had no off-balance sheet financing arrangements.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with GAAP. Application of these principles requires us to make estimates, assumptions, and judgments that affect the amounts reported in our consolidated financial statements and accompanying notes. We continually evaluate our accounting policies, estimates, and judgments and base our estimates and judgments on historical experience and various other factors that we believe to be reasonable under the circumstances. Because of the inherent uncertainty in making estimates and judgments, actual results could differ from our estimates and judgments. We consider (i) revenue recognition, (ii) leases, (iii) allowance for uncollectible accounts, and (iv) income taxes to be the most critical accounting policies because they relate to accounting areas that require the most subjective or complex judgments by us, and, as such, could be most subject to revision as new information becomes available.

Revenue Recognition: We recognize revenue when control of the promised services is transferred to our customers in an amount that reflects the consideration we expect to be entitled to in exchange for those services. As we complete our performance obligations which are identified below, we have an unconditional right to consideration as outlined in our contracts with our customers. Generally, our accounts receivables are expected to be collected in 30 days in accordance with the underlying payment terms.

We offer multiple services under our managed care and network solutions service lines, which the customer may choose to purchase. These services are billed individually as separate components to our customers. Revenue is recognized as the work is performed in accordance with our customer contracts. Based upon the nature of our products, bundled managed care elements are generally delivered in the same accounting period. Advance payments from subscribers and billings made in advance are recorded on the balance sheet as unearned revenue.

Leases: We determine if an arrangement includes a lease at inception. Right-of-use assets represent our right to use an underlying asset for the lease term; and lease liabilities represent our obligation to make lease payments arising from the lease. Right-of-use assets and lease liabilities are recognized at the commencement date of the lease, renewal date of the lease or significant remodeling of the lease space based on the present value of the remaining future minimum lease payments. Leases with a term greater than one year are recognized on the balance sheet as right-of-use assets and short-term and long-term lease liabilities, as applicable.

Operating lease liabilities and their corresponding right-of-use assets are initially recorded based on the present value of lease payments over the expected remaining lease term. The interest rate implicit in lease contracts is typically not readily determinable. As a result, we utilize our incremental borrowing rate to discount lease payments, which reflects the fixed rate at which we could borrow on a collateralized basis the amount of the lease payments in the same currency, for a similar term, in a similar economic environment. Our leases may include options to extend or terminate the lease which are included in the lease term when it is reasonably certain that we will exercise any such options. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

Allowance for Uncollectible Accounts: We determine our allowance for uncollectible accounts by considering several factors, including the length of time trade accounts receivables are past due, our previous loss history, the customers' current ability to pay their obligations to us, and the condition of the general economy and the industry as a whole. We write off accounts receivables when they become uncollectible.

We must make significant judgments and estimates in determining contractual and bad debt allowances in any accounting period. One significant uncertainty inherent in our analysis is whether our experience will be indicative of future periods. Although we consider future projections when estimating contractual and bad debt allowances, we ultimately make our decisions based on the best information available to us at the time the decision is made. Adverse changes in general economic conditions or trends in reimbursement amounts for our services could affect our contractual and bad debt allowance estimates, collection of accounts receivables, cash flows, and results of operations. Two customers accounted for 10% or more of accounts receivable at September 30, 2021 and 2020, respectively.

Accounting for Income Taxes: We record a tax provision for the anticipated tax consequences of our reported results of operations. The provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. We record a valuation allowance, if necessary, to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

We recognize tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement.

Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with future reversals of existing taxable temporary differences, will be sufficient to fully recover the deferred tax assets. In the event we determine all, or part of the net deferred tax assets are not realizable in the future, we will make an adjustment to the valuation allowance that would be charged to earnings in the period such determination is made. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of GAAP and complex tax laws. Resolution of these uncertainties in a manner inconsistent with management's expectations could have a material impact on our financial condition and operating results. The significant assumptions and estimates described above are important contributors to our ultimate effective tax rate in each year.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

Smaller reporting companies are not required to provide this information.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, which are controls and other procedures that are designed to provide reasonable assurance that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Our management, under the supervision and with the participation of our principal executive officer and principal financial officer, conducted an evaluation the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report on Form 10-Q. Based on the evaluation of our disclosure controls and procedures as of September 30, 2021, the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at a reasonable assurance level.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2021, that materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

Management does not believe there have been any material changes to the risk factors listed in Part I, Item 1A, Risk Factors in our Annual Report. These risk factors should be carefully considered with the information provided elsewhere in this report, which could materially adversely affect our business, financial condition, or results of operations.

Item 6. Exhibits

Exhibits. The following exhibits are filed or furnished, as applicable, as part of this report:

Exhibit Number	Title of Document
Exhibit 31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 101	The following materials from Pacific Health Care Organization, Inc.'s Quarterly Report on Form 10-Q for the period ended September 30, 2021, formatted in XBRL (eXtensible Business Reporting Language): (i) the Unaudited Condensed Consolidated Balance Sheets, (ii) the Unaudited Condensed Consolidated Statements of Operations, (iii) the Unaudited Condensed Consolidated Statements of Cash Flows, and (iv) Notes to the Unaudited Condensed Consolidated Financial Statements.
Exhibit 104	Cover Page Interactive Data File (formatted as Inline XBRL and contained in Exhibit 101)

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PACIFIC HEALTH CARE ORGANIZATION, INC.

Date: November 12, 2021 /s/ Tom Kubota
Tom Kubota
Chief Executive Officer

Date: November 12, 2021 /s/ Kristina Kubota
Kristina Kubota
Chief Financial Officer

EXHIBIT 31.1

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Tom Kubota, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Pacific Health Care Organization, Inc.
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - (a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal controls over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2021

By: /s/ Tom Kubota
Tom Kubota
Chief Executive Officer

EXHIBIT 31.2

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Kristina Kubota, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Pacific Health Care Organization, Inc.
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - (a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal controls over financial reporting; and
- 5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 12, 2021

By: /s/ Kristina Kubota
Kristina Kubota
Chief Financial Officer

EXHIBIT 32.1

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT BY
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the quarterly report on Form 10-Q of Pacific Health Care Organization, Inc. (the "Company") for the period ended September 30, 2021, as filed with the Securities and Exchange Commission (the "Report"), the undersigned hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of their knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: November 12, 2021

By: /s/ Tom Kubota
Tom Kubota
Chief Executive Officer

Date: November 12, 2021

By: /s/ Kristina Kubota
Kristina Kubota
Chief Financial Officer

This certification is not deemed filed with the Securities and Exchange Commission and is not incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of this Report), irrespective of any general incorporation language contained in such filing.