# INTEGRIS MAYES COUNTY MEDICAL CENTER

(A Division of Baptist Healthcare of Oklahoma, Inc.)

Basic Financial Statements

March 31, 2012 and June 30, 2011

(With Independent Auditors' Report Thereon)

**INTEGRIS MAYES COUNTY MEDICAL CENTER**
(A Division of Baptist Healthcare of Oklahoma, Inc.)

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**KPMG LLP**
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# Independent Auditors' Report

Governing Board
INTEGRIS Mayes County Medical Center
(A Division of Baptist Healthcare of Oklahoma, Inc.):

We have audited the accompanying balance sheets of INTEGRIS Mayes County Medical Center, a division of Baptist Healthcare of Oklahoma, Inc., (the Medical Center) as of March 31, 2012 and June 30, 2011, and the related statements of revenues, expenses and changes in net assets and cash flows for the nine months ended March 31, 2012 and the year ended June 30, 2011. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Medical Center's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the Medical Center and do not purport to, and do not, present fairly the financial position of Baptist Healthcare of Oklahoma, Inc., as of March 31, 2012 and June 30, 2011, the changes in its financial position, or, where applicable, its cash flows for nine months ended March 31, 2012 and the year ended June 30, 2011 in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of INTEGRIS Mayes County Medical Center, a division of Baptist Healthcare of Oklahoma, Inc., as of March 31, 2012 and June 30, 2011, and the changes in its financial position and cash flows for the nine months ended March 31, 2012 and the year ended June 30, 2011 in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 2, 2012, on our consideration of the Medical Center's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial

reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

KPMG LLP

November 7, 2012

**INTEGRIS MAYES COUNTY MEDICAL CENTER**
(A Division of Baptist Healthcare of Oklahoma, Inc.)

Balance Sheets

March 31, 2012 and June 30, 2011

| Assets | | 2012 | 2011 |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | $ | 4,428,042 | 4,564,095 |
| Patient accounts and other receivables, net of allowance for contractuals and uncollectible accounts of $4,923,524 and $4,811,008 in 2012 and 2011, respectively | | 2,567,041 | 3,134,657 |
| Inventories | | 349,557 | 357,373 |
| Prepaid expenses and other current assets | | 473,218 | 2,854 |
| Total current assets | | 7,817,858 | 8,058,979 |
| Noncurrent cash and investments – restricted by management agreement | | 732,976 | 16,480 |
| Capital assets, net | | 9,524,374 | 10,362,660 |
| Other assets | | 20,583 | 92,839 |
| Board restricted assets | | 199,126 | 863,820 |
| Total assets | $ | 18,294,917 | 19,394,778 |
| **Liabilities and Net Assets** | | | |
| Current liabilities: | | | |
| Accounts payable and accrued expenses | $ | 1,465,730 | 738,584 |
| Due to related parties | | — | 1,127,110 |
| Employee compensation and related liabilities | | 1,014,106 | 739,881 |
| Total current liabilities | | 2,479,836 | 2,605,575 |
| Other long-term liabilities | | 254,326 | 246,685 |
| Total liabilities | | 2,734,162 | 2,852,260 |
| Commitments and contingencies | | | |
| Net assets: | | | |
| Invested in capital assets, net of related debt | | 9,524,374 | 10,362,660 |
| Restricted – expendable for capital acquisitions | | 732,976 | 16,480 |
| Unrestricted | | 5,303,405 | 6,163,378 |
| Total net assets | | 15,560,755 | 16,542,518 |
| Total liabilities and net assets | $ | 18,294,917 | 19,394,778 |

See accompanying notes to basic financial statements.

**INTEGRIS MAYES COUNTY MEDICAL CENTER**
(A Division of Baptist Healthcare of Oklahoma, Inc.)

Statements of Revenues, Expenses and Changes in Net Assets

Nine months ended March 31, 2012 and year ended June 30, 2011

| | 2012 | 2011 |
|---|---|---|
| Operating revenues: | | |
| Net patient service revenue, net of contractual allowances and discounts | $ 19,575,843 | 26,017,523 |
| Patient bad debt expense | (1,953,358) | (4,667,892) |
| Net patient service revenue | 17,622,485 | 21,349,631 |
| Other operating revenue | — | 741,003 |
| Total operating revenues | 17,622,485 | 22,090,634 |
| Operating expenses: | | |
| Salaries and related expenses | 10,037,181 | 14,186,378 |
| Supplies and other | 7,257,482 | 7,951,798 |
| Professional services | 533,844 | 702,874 |
| Depreciation and amortization | 932,793 | 1,273,725 |
| Total operating expenses | 18,761,300 | 24,114,775 |
| Operating loss | (1,138,815) | (2,024,141) |
| Nonoperating revenues: | | |
| Investment income | 45,836 | 75,788 |
| Other | 111,216 | 212,313 |
| Total nonoperating revenues | 157,052 | 288,101 |
| Excess of expenses over revenues | (981,763) | (1,736,040) |
| Decrease in net assets | (981,763) | (1,736,040) |
| Capital grants and contributions | — | 21,273 |
| Net assets, beginning of year | 16,542,518 | 18,257,285 |
| Net assets, end of year | $ 15,560,755 | 16,542,518 |

See accompanying notes to basic financial statements.

**INTEGRIS MAYES COUNTY MEDICAL CENTER**
(A Division of Baptist Healthcare of Oklahoma, Inc.)

Statements of Cash Flows

Nine months ended March 31, 2012 and year ended June 30, 2011

| | 2012 | 2011 |
|---|---|---|
| Operating activities: | | |
| Receipts from and on behalf of patients | $ 18,190,101 | 21,227,306 |
| Payments to and on behalf of employees | (9,762,956) | (14,296,078) |
| Payments to suppliers and vendors | (8,646,196) | (7,864,583) |
| Other receipts and payments, net | 72,255 | 742,015 |
| Net cash used in operating activities | (146,796) | (191,340) |
| Investing activities: | | |
| (Sale) purchase of short-term investments | 664,694 | (2,992) |
| Income on investments | 45,836 | 75,788 |
| Net cash provided by investing activities | 710,530 | 72,796 |
| Noncapital financing activities: | | |
| Other nonoperating revenues | 111,216 | 284,715 |
| Net cash provided by noncapital financing activities | 111,216 | 284,715 |
| Capital and related financing activities: | | |
| Purchase of capital assets | (94,507) | (889,322) |
| Capital grants and contributions | — | 21,273 |
| Net cash used in capital and related financing activities | (94,507) | (868,049) |
| Increase (decrease) in cash and cash equivalents | 580,443 | (701,878) |
| Cash and cash equivalents, beginning of year | 4,580,575 | 5,282,453 |
| Cash and cash equivalents, end of year | $ 5,161,018 | 4,580,575 |
| Reconciliation of cash and cash equivalents to the balance sheets: | | |
| Cash and cash equivalents in current assets | $ 4,428,042 | 4,564,095 |
| Cash and cash equivalents in noncurrent cash and investments-restricted by management agreement | 732,976 | 16,480 |
| Total cash and cash equivalents | $ 5,161,018 | 4,580,575 |
| Reconciliation of operating loss to net cash used in operating activities: | | |
| Operating loss | $ (1,138,815) | (2,024,141) |
| Interest expense | — | — |
| Items not requiring cash: | | |
| Depreciation and amortization | 932,793 | 1,273,725 |
| Changes in: | | |
| Patient and other accounts receivable, net | 567,616 | (122,325) |
| Inventories, prepaid expenses and other assets | (390,292) | 113,964 |
| Current and other long-term liabilities | (118,098) | 567,437 |
| Net cash used in operating activities | $ (146,796) | (191,340) |

See accompanying notes to basic financial statements.

## (1) Nature of Operations and Summary of Significant Accounting Policies

### *(a) Nature of Operations*

INTEGRIS Mayes County Medical Center, a division of Baptist Healthcare of Oklahoma, Inc., (the Medical Center) operates a 52-bed licensed acute care hospital located in Pryor, Oklahoma. The Medical Center's primary source of revenue consists of providing inpatient, outpatient and emergency care services to patients in Mayes County, Oklahoma, and the surrounding area. The Medical Center also operates a home health agency and outpatient clinics in the same geographic area.

The hospital facilities were managed and operated by the Medical Center, pursuant to a management agreement dated May 1, 1990, between Mayes County Hospital Authority (the Authority), the owner of the hospital facilities, and Baptist Healthcare of Oklahoma, Inc. (BHO), an Oklahoma not-for-profit corporation. The management agreement was for an initial term of five years that ended May 1, 1995, with BHO having the option to renew the agreement for seven additional consecutive terms of five years each. The management agreement was renewed May 1, 2010, for a fifth five-year term. The agreement may be terminated by either party under certain circumstances, but under no event shall it be terminated so long as any indebtedness issued or incurred by or on behalf of BHO for the purpose of refinancing the Authority's indebtedness or financing or refinancing BHO's indebtedness incurred for the benefit of the Medical Center remains outstanding. Upon termination, certain rights and property are afforded to BHO and the Authority. The management agreement provides BHO to have all rights, titles and interest in the hospital facilities while the agreement is in effect. BHO controls the Medical Center and the sole member of BHO is The Medical Center (INTEGRIS). BHO created a separate division, INTEGRIS Mayes County Medical Center, to operate the Medical Center and execute its responsibilities under the management agreement. This separate division is the subject of the accompanying financial statements and it does not purport to and does not present the financial position of BHO.

The management agreement was in place the first nine months of fiscal year 2012. As of April 1, 2012, INTEGRIS entered into an agreement whereby all of the assets, operations, lease rights and licenses of the INTEGRIS Mayes County Medical Center were sold through the BHO subsidiary company to INTEGRIS HMA, LLC, which is owned 20% by INTEGRIS.

### *(b) Basis of Accounting and Presentation*

The financial statements of the Medical Center have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transactions takes place, while those from government-mandated nonexchange transactions (principally federal and state grants and county appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific (such as county appropriations), property taxes, investment income and interest on capital assets-related debt are included in nonoperating

revenues and expenses. The Medical Center first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

The Medical Center prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the Medical Center has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that do not conflict with or contradict GASB pronouncements.

### *(c) Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### *(d) Charity Care*

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

### *(e) Net Patient Service Revenue and Patient Accounts Receivable*

Net patient service revenue is recorded in the period services are provided to patients at the Medical Center's established rates net of contractual adjustments, charity care, and administrative adjustments. Retroactively calculated contractual adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered. Adjustments to estimates in future periods are recorded as final settlements are determined or as additional information becomes available.

Net patient service revenue in the accompanying statements of revenues, expenses and changes in net assets has been reduced by amounts resulting from contractual allowances related to the participation in Medicare, discount arrangements, and other prospective reimbursement programs as follows:

| | | 2012 | 2011 |
|---|---|---|---|
| Patient service revenue (net of contractual allowances and discounts, before provision for bad debt): | | | |
| Medicare | $ | 4,272,065 | 4,560,355 |
| Medicaid | | 1,527,790 | 1,411,174 |
| Managed Care | | 11,904,949 | 11,754,767 |
| Commercial and Other | | 208,837 | 85,330 |
| Private Pay | | 1,662,202 | 8,205,897 |
| | $ | 19,575,843 | 26,017,523 |

Accounts receivable are recorded net of an allowance for uncollectible accounts and contractual adjustments of approximately $4,924,000 and $4,811,000 at March 31, 2012 and June 30, 2011, respectively. Although the Medical Center estimates uncollectible accounts on a reasonable basis, the net patient accounts receivable balance is subject to an accounting loss if patients and third-party payors are unable to meet their contractual obligations.

The allowance and resulting provision for bad debts is based upon a combination of the aging of receivables and management's assessment of historical and expected net collections considering business and economic conditions, trends in healthcare coverage, and other collection indicators. Management assesses the adequacy of the allowance for doubtful accounts based upon historical write-off experience and payment trends by payor category. Patient accounts are also monitored, and, if necessary, past due accounts are placed with collection agencies in accordance with guidelines established by the Medical Center. All patient balances regardless of payor source are collected in accordance with a predefined time limited process designed to give the patient an opportunity to pay the balance before writing off the balance to bad debt expense and turning the account over to a collection agency.

For receivables associated with services provided to patients who have third-party coverage, the Medical Center analyzes contractually due amounts and provides an allowance for doubtful accounts and a provision for bad debt, if necessary (for example, for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely). For receivables associated with self-pay patients (which include both patients without insurance and patients with deductible and copayment balance due for which third-party coverage exists for part of the bill), the Medical Center records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the billed rates (which are discounted from gross charges for all uninsured self-pay patients by 55% in 2012 as

discussed below) and the amounts actually collected after all reasonable collection efforts have been exhausted is written off against the allowance for doubtful accounts.

The IRS issued new 501(r) guidance for nonprofit hospitals recently. Section 501(r) was enacted by the Patient Protection and Affordable Care Act. Hospital organizations covered by Section 501(r) may not charge an individual eligible for a financial assistance policy more than the amount generally billed to individuals with insurance covering their health care. As a result of this guidance, the Medical Center implemented a policy effective July 1, 2011 that discounts all private pay patient charges by 55%. This adjustment is considered a contractual adjustment rather than a bad debt adjustment; therefore the 55% adjustment is recorded as a direct reduction to net patient service revenue instead of bad debt. This change resulted in less charges being written off to the provision for uncollectible accounts.

The Medical Center's allowance for doubtful accounts for self-pay patients increased from 96% of self-pay accounts receivable at June 30, 2011 to 97% of self-pay accounts receivable at March 31, 2012. The Medical Center does not maintain a material allowance for doubtful accounts from third-party payors, nor did it have significant write-offs from third-party payors other than for contractual allowances.

### *(f) Cash Equivalents*

The Medical Center considers all liquid investments with original maturities of three months or less at date of purchase to be cash equivalents. At March 31, 2012 and June 30, 2011, cash equivalents consisted primarily of money market accounts for which the cost approximates fair value.

### *(g) Reclassifications*

Certain prior year amounts have been reclassified to conform to the current year presentation.

### *(h) Investments*

Investments are stated at fair value and consist primarily of investments in cash and cash equivalents, certificates of deposit, and fixed income funds.

Noncurrent cash and investments include assets consisting of a money market fund restricted under the terms of the management agreement discussed previously. The management agreement requires the Medical Center to maintain a repair and replacement fund, which is an asset of Mayes County Hospital Authority. The repair and replacement fund is to be used exclusively for capital improvements and repairs at Mayes County Medical Center.

### *(i) Supplies*

Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

### *(j) Capital Assets*

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation, if acquired by contribution. The Medical Center capitalizes assets with a cost or fair value at date of donation in excess of $1,000. Depreciation is computed using the straight-line method over the estimated useful life of each asset. The following estimated useful lives are being used by the Medical Center:

| | |
|---|---|
| Land and land improvements | 15 to 20 years |
| Building, improvements and fixed equipment | 10 to 40 years |
| Major moveable equipment | 3 to 7 years |

### *(k) Risk Management*

The Medical Center is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets, business interruption, errors and omissions, and natural disasters. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the two preceding years.

### *(l) Medical Malpractice Coverage and Claims*

The Medical Center is covered for medical malpractice risks under a medical malpractice insurance plan established by INTEGRIS for all of its owned, leased and managed facilities (see note 11). The costs of the insurance plan are allocated to controlled entities and affiliates through intercompany accounts. The Medical Center has no liability beyond those costs allocated to it by INTEGRIS.

### *(m) Workers' Compensation and Health Care Coverages*

Medical Center employees are covered for workers' compensation and health care benefits under self-insured plans established by INTEGRIS for all of its owned, leased and managed facilities. These plans are self-insured by INTEGRIS to the extent of the deductible amounts under the excess risk insurance policies INTEGRIS has purchased. The Medical Center has no liability beyond those costs allocated to it by INTEGRIS.

### *(n) Income Taxes*

The activities of the Medical Center reflected on the accompanying basic financial statements are reported by BHO for federal and state tax purposes. The Internal Revenue Service has recognized BHO as exempt from income taxes under Section 501(a) of the Internal Revenue Code as an organization described in Code Section 501(c)(3) and a similar provision of state law. However, these organizations are subject to federal income tax on any unrelated business income. The activities of the Medical Center do not include any unrelated business activities.

***(o) Compensated Absences***

Medical Center policies permit most employees to accumulate vacation benefits that may be realized as paid personal leave. As vacation benefits are earned, expense and the related liability are recognized. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

***(p) Net Assets***

Net assets of the Medical Center are classified in three components. Net assets invested in capital assets, net of related debt, consist of capital assets, net of accumulated depreciation, and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital assets that must be used for a particular purpose, as specified by creditors, grantors or donors external to the Medical Center. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt or restricted expendable.

***(q) Asset Retirement Obligations***

The Medical Center recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which the obligation is incurred, if a reasonable estimate of the fair value of the obligation can be made. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation is factored into the measurement of the liability when sufficient information exists. When the liability is initially recorded, the cost of the asset retirement obligation is capitalized by increasing the carrying amount of the related long-lived asset. The liability is accreted to its present value each period, and the capitalized cost associated with the retirement obligation is depreciated over the useful life of the related asset. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the accompanying consolidated statements of operations and changes in net assets.

The liability for the asset retirement obligation is approximately $254,000 and $247,000 as of March 31, 2012 and June 30, 2011, respectively. Substantially all of the obligation relates to estimated costs to remove asbestos. Changes from June 30, 2011 are primarily due to remediation activities, changes in inflation rates, and revisions to estimates of the amount of asbestos at specific facilities.

**(2) Net Patient Service Revenue**

The Medical Center has agreements with third-party payers that provide for payments to the Medical Center at amounts different from its established rates. A summary of the payment arrangements with major third-party payers follows:

- *Medicare* – Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other

factors. The Medical Center is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medical fiscal intermediary. The Medical Center's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2007.

- *Medicaid* – Prior to October 1, 2005, inpatient and outpatient services were rendered to patients covered by the state Medicaid program on a prospective basis at set per diem rates and fee schedules with no retroactive adjustment. Effective October 1, 2005, the state's Medicaid program changed its basis of reimbursement for inpatient services from a prospective per diem method to a prospective per discharge method with no retroactive adjustments. These payment rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

Approximately 54% and 60% of the Medical Center's gross patient service revenues are from participation in the Medicare and state-sponsored Medicaid programs for the nine months ended March 31, 2012 and year ended June 30, 2011, respectively. Laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Medical Center has also entered into payment agreements with certain commercial insurance carriers, health maintenance organization and preferred provider organizations. The basis for payment to the Medical Center under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

The Supplemental Hospital Offset Payment Program (SHOPP) program was created and implemented by the State of Oklahoma in fiscal year 2012 for the purpose of assuring access to quality care for Oklahoma Medicaid members. The program is designed to assess Oklahoma hospitals, unless exempt, a supplemental hospital offset payment program fee. The collected fees are placed in pools and then allocated to hospitals as directed by legislation. The Oklahoma Health Care Authority (OHCA) does not guarantee that allocations will equal or exceed the amount of the supplemental hospital offset payment program fee paid by the hospital. The SHOPP program assessment rate in effect during fiscal year 2012 is 2.5% of net patient service revenue. The total fee incurred in 2012 was $424,000 and is included in supplies and other expenses in the consolidated statements of operations. The allocation from the pool in 2012 was $546,000 for all INTEGRIS Health facilities and is included in net patient service revenue in the consolidated statements of operations. The SHOPP program is expected to remain in effect through fiscal year 2014.

## (3) Long-Term Obligations

The following is a summary of long-term obligation transactions related to the asset retirement obligation (see note 1) for the nine months period ended March 31, 2012 and year ended June 30, 2011:

| | 2012 | | | | |
|---|---|---|---|---|---|
| | Beginning balance | Additions | Deductions | Ending balance | Current portion |
| Other long-term liabilities | $ 246,685 | 7,641 | — | 254,326 | — |
| Total long-term obligations | $ 246,685 | 7,641 | — | 254,326 | — |

| | 2011 | | | | |
|---|---|---|---|---|---|
| | Beginning balance | Additions | Deductions | Ending balance | Current portion |
| Other long-term liabilities | $ 243,508 | 9,612 | 6,435 | 246,685 | — |
| Total long-term obligations | $ 243,508 | 9,612 | 6,435 | 246,685 | — |

## (4) Capital Assets

Capital assets activity for the nine months period ended March 31, 2012 and year ended June 30, 2011 was as follows:

| | 2012 | | | |
|---|---|---|---|---|
| | **Beginning balance** | **Additions** | **Disposals and transfers** | **Ending balance** |
| Land | $ 572,903 | — | — | 572,903 |
| Land improvements | 222,229 | — | — | 222,229 |
| Building, improvements and fixed equipment | 12,964,652 | 231,224 | (386,067) | 12,809,809 |
| Major moveable equipment | 10,761,544 | — | — | 10,761,544 |
| Construction in progress | 83,363 | 4,680 | (88,043) | — |
| | 24,604,691 | 235,904 | (474,110) | 24,366,485 |
| Less accumulated depreciation: | | | | |
| Land improvements | 120,667 | 10,123 | — | 130,790 |
| Building, improvements and fixed equipment | 6,211,462 | 367,726 | (332,713) | 6,246,475 |
| Major moveable equipment | 7,909,902 | 554,944 | — | 8,464,846 |
| | 14,242,031 | 932,793 | (332,713) | 14,842,111 |
| Capital assets, net | $ 10,362,660 | (696,889) | (141,397) | 9,524,374 |


(Continued)

| | 2011 | | | |
|---|---|---|---|---|
| | **Beginning balance** | **Additions** | **Disposals and transfers** | **Ending balance** |
| Land | $ 572,903 | — | — | 572,903 |
| Land improvements | 222,229 | — | — | 222,229 |
| Building, improvements and fixed equipment | 12,883,507 | 81,145 | — | 12,964,652 |
| Major moveable equipment | 9,999,032 | 791,249 | (28,737) | 10,761,544 |
| Construction in progress | 134,147 | 78,377 | (129,161) | 83,363 |
| | 23,811,818 | 950,771 | (157,898) | 24,604,691 |
| Less accumulated depreciation: | | | | |
| Land improvements | 107,169 | 13,498 | — | 120,667 |
| Building, improvements and fixed equipment | 5,719,677 | 491,785 | — | 6,211,462 |
| Major moveable equipment | 7,165,507 | 768,442 | (24,047) | 7,909,902 |
| | 12,992,353 | 1,273,725 | (24,047) | 14,242,031 |
| Capital assets, net | $ 10,819,465 | (322,954) | (133,851) | 10,362,660 |

## (5) Patient Accounts Receivable

The Medical Center grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at March 31, 2012 and June 30, 2011 consisted of the following:

| | **2012** | **2011** |
|---|---|---|
| Receivable from patients and their insurance carriers | $ 4,011,482 | 5,718,773 |
| Receivable from Medicare | 2,715,377 | 1,549,052 |
| Receivable from Medicaid | 763,706 | 677,840 |
| Total patient accounts receivable | 7,490,565 | 7,945,665 |
| Less allowance for contractuals and uncollectible amounts | 4,923,524 | 4,811,008 |
| Patient accounts receivable, net | $ 2,567,041 | 3,134,657 |

## (6) Deposits and Investment Income

### *(a) Deposits*

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. As discussed in note 1, the repair and replacement fund for Mayes County Hospital Authority has been included in the accompanying financial statements. The hospital has not experienced any past history of lost deposits.

***(b) Investment Income***

Investment income for the nine months period ended March 31, 2012 and year ended June 30, 2011 consisted primarily of interest income.

## (7) Retirement Plans

The Medical Center participates in a cost sharing defined benefit pension plan sponsored by INTEGRIS for all of its owned, leased and managed facilities. The plan covers certain eligible employees upon their retirement and provides monthly retirement benefits. The benefits are based on the employee's years of service and compensation. Beginning July 1, 2009 the Pension Plan was closed to new participants. The Medical Center will contribute 3% of the participant's quarterly pay for eligible employees with fewer than 10 years of vesting service and 4% for those participants with greater than 10 years of vesting service. Total contributions to the plan by the Medical Center for the nine months ended March 31, 2012 and year ended June 30, 2011 were approximately $733,000 and $914,000, respectively, which were equal to the amounts billed.

For employees hired or rehired after July 1, 2009, the Medical Center participates in a basic contribution plan sponsored by INTEGRIS for all of its owned, leased and managed facilities. The plan provides disability and survivor benefits in addition to retirement benefits. All full-time employees who have completed one year of service are eligible to participate in the plan. Eligible employees may contribute pretax wages in accordance with the retirement savings plan. The Medical Center will match 50% of each participant's contributions limited to a maximum participant's contribution of 5%. Employee contributions vest immediately and participants' rights in employer contributions vest over a period of five years. Total matching contributions to the plan by the Medical Center for the nine months ended March 31, 2012 and year ended June 30, 2011 were approximately $122,000 and $166,000, respectively.

## (8) Related-Party Transactions

As described in note 1, the Medical Center has a management agreement with BHO whose sole member is INTEGRIS. The Medical Center makes payments to INTEGRIS for various services provided by and secured through INTEGRIS. The following is a summary of the approximate expenses for those services for the following nine months ended March 31, 2012 and year ended June 30, 2011:

| | | 2012 | 2011 |
|---|---|---|---|
| Administrative services | $ | 338,000 | 450,000 |
| Workers' compensation coverage | | 119,000 | 159,000 |
| Healthcare benefits and life insurance | | 913,000 | 1,392,000 |
| Malpractice and general liability coverage | | 331,000 | 247,000 |
| | $ | 1,701,000 | 2,248,000 |

At March 31, 2012 INTEGRIS owed approximately $2,000 to the Medical Center. At June 30, 2011 the Medical Center owed INTEGRIS approximately $1,127,000.

## (9) Restricted and Designated Net Assets

At March 31, 2012 and June 30, 2011, restricted expendable net assets were available for capital acquisitions in the amount of $732,976 and $16,480, respectively.

The Management Agreement between INTEGRIS and the Medical Center stipulates that deposits were to be made to the above account equal to one-twelfth of the budgeted depreciation of the Medical Center for that fiscal year. If revenue was insufficient, the deposit was to be made up at the earliest date, as determined by INTEGRIS. The First Amendment to the Management Agreement states that when the Master Facility Renovation Plan began incurring expenses, the previous obligation would end and the required annual deposit would be $100,000, for a period of fifteen years. If revenues are insufficient to make the annual deposit, it is to be deferred to the next year in which there are sufficient revenues derived from the operation of the Medical Center. As of March 31, 2012 the account was fully funded.

At March 31, 2012 and June 30, 2011, approximately $199,000 and $864,000, respectively, of unrestricted net assets have been designated by the Medical Center's Board of Directors for capital acquisitions. Designated net assets remain under the control of the Board of Directors, which may at its discretion later use these net assets for other purposes.

## (10) Charity Care and Other Community Benefits

The Medical Center provides care to patients who lack financial resources and are deemed medically or financially indigent. Because the healthcare related entities do not pursue collection of amounts determined to qualify as charity care, these amounts are removed from net patient service revenue. The charges related to this care, along with estimates for possible future charity care write-offs related to current accounts receivable, totaled approximately $1,442,000 and $1,737,000 in 2012 and 2011 respectively. The estimated direct and indirect cost of providing these services, calculated using the ratio of patient care cost to charges, was approximately $565,000 and $702,000 in 2012 and 2011 respectively. In addition, the healthcare related controlled entities provide services through government-sponsored indigent health care programs (such as Medicaid) to other indigent patients.

In addition to uncompensated charges, the Medical Center also commits significant time and resources to endeavors and critical services that meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable.

## (11) Contingencies

### *Litigation*

The Medical Center may become involved in litigation arising in the ordinary course of business. Claims alleging malpractice may be asserted against the Medical Center. The Medical Center was insured on a claims-made basis for medical malpractice and other liability risks with individual and aggregate limits of coverage through March 31, 2012, through a captive insurance company of INTEGRIS.

The captive insurance company was formed for the purpose of providing coverage to INTEGRIS and its affiliates for medical malpractice and other liability risks. The captive insurance company charges a premium to the respective entities for coverage, and accrues losses for the coverage based on estimates that

incorporate past experience as well as other considerations. The premiums are retrospectively rated based primarily on loss experience. The captive insurance company also maintains reinsurance coverage to reduce exposure for significant individual and aggregate losses. All amounts billed for coverage through March 31, 2012 have been paid by the Medical Center.

The Medical Center evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based on the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. No provision has been made in the financial statements for any adverse outcome that might ultimately result from these matters, as the amount of any such loss is not reasonably estimable. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

The U.S. Department of Justice and other federal agencies are increasing resources dedicated to regulatory investigations and compliance audits of healthcare providers. The Medical Center is subject to these regulatory efforts. In consultation with legal counsel, management is aware of no significant pending regulatory issues. Resolution of such matters (if any) is not expected to have a material adverse effect on the Medical Center's financial position or results of operations.

***Future Construction***

The Medical Center has completed two-thirds of a master facility plan which includes an addition to the hospital facility and remodeling the existing facility. The total cost of the project is expected to be approximately $10,000,000 of which approximately $7,190,000 was expended as of March 31, 2012. The final phase is projected to begin in the 2013 fiscal year. The project is to be funded with then-current cash balances and cash flows generated from future operations.

## (12) Significant Estimates and Concentrations

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

### *(a) Significant Estimates*

Estimates of allowances for adjustments included in net patient service revenue are described in notes 1 and 2. Estimates related to the accrual for medical malpractice claims are described in notes 1 and 11.

### *(b) Physician Concentration*

For the nine months ended March 31, 2012 and year ended June 30, 2011, several physicians who are employed by a large, urban hospital outside Mayes County were responsible for approximately 65% and 47%, respectively, of the Medical Center's admissions.

## (13) Subsequent Event

The Medical Center has evaluated subsequent events through November 7, 2012, the date on which the financial statements were issued.

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# Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Governing Board
INTEGRIS Mayes County Medical Center
(A Division of Baptist Healthcare of Oklahoma, Inc.):

We have audited the financial statements of INTEGRIS Mayes County Medical Center, a division of Baptist Healthcare of Oklahoma, Inc., (the Medical Center) as of and for the nine months ended March 31, 2012 and year ended June 30, 2011, and have issued our report thereon dated November 7, 2012. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

## Internal Control over Financial Reporting

In planning and performing our audits, we considered the Medical Center's internal control over financial reporting as a basis for designing auditing 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 Medical Center's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Medical Center's internal control over financial reporting.

A deficiency in internal control over financial reporting 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 combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Medical Center's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the board of directors and management and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 7, 2012