Management's Discussion and Analysis
And Financial Statements
March 31, 2015 and 2014

Sequoyah County-City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital

EideBailly

CPAs & BUSINESS ADVISORS

Independent Auditor's Report

To the Board of Trustees
Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Sequoyah Memorial Hospital
Sallisaw, OK

Report on the Financial Statements
We have audited the accompanying financial statements of Sequoyah County-City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital (Hospital) which comprises the statements of net position as of March 31, 2015 and 2014, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Hospital's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of Sequoyah County-City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital as of March 31, 2015 and 2014, and the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such 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. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquires, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated February 11, 2016 on our consideration of the Hospital's internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control over financial reporting and compliance.

Eide Bailly LLP

Oklahoma City, Oklahoma
February 11, 2016

Introduction

This discussion and analysis of the financial performance of Sequoyah County-City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital (Hospital) provides an overall review of the Hospital's financial activities and balances as of and for the years ended March 31, 2015, 2014, and 2013. The intent of this discussion and analysis is to provide further information on the Hospital's performance as a whole; readers should also review the basic financial statements and the notes thereto to enhance their understanding of the Hospital's financial status.

Financial Highlights

- Current assets decreased in 2015 by $811,669 or 20% and decreased in 2014 by $968,838 or 19%.
- Total liabilities increased in 2015 by $1,904,023 or 78% and increased in 2014 by $1,420,056 or 137%.
- The Hospital's net position decreased in 2015 by $2,979,717 or 48% and decreased in 2014 by $1,523,598 or 20%.
- The Hospital reported an operating loss in 2015 of $3,611,896 and an operating loss in 2014 of $2,211,212. During 2015, operating loss increased by $1,400,684 or 63% and increased by $323,435 or 17% in 2014.
- Other operating revenue decreased by $270,740 or 35% in 2015 and decreased by $1,022,180 or 57% in 2014.
- Operating expenses decreased in 2015 by $366,800 or 2% and increased $708,624 or 5% in 2014.

Using This Annual Report

The Hospital's financial statements consist of three statements – Statements of Net Position, Statements of Revenues, Expenses and Changes in Net Position, and Statements of Cash Flows. These financial statements and related notes provide information about activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by contributors, grantors, or enabling legislation. The Hospital is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

The Statements of Net Position and Statements of Revenues, Expenses and Changes in Net Position

One of the most important questions asked about the Hospital's finances is "Is the Hospital as a whole better or worse off as a result of the year's activities?" The Statements of Net Position and the Statements of Revenues, Expenses and Changes in Net Position report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net position and changes in it. You can think of the Hospital's net position - the difference between assets and liabilities - as one way to measure the Hospital's financial health, or financial position. Over time, increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the Hospital's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the Hospital.

The Statements of Cash Flows

The final required statement is the Statements of Cash Flows, which reports cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities. It provides answers to such questions as where did cash come from, what was cash used for and what was the change in cash balance during the reporting period.

The Hospital's Net Position

The Hospital's net position is the difference between its assets and liabilities reported in the Statements of Net Position. The Hospital's net position decreased by $2,979,717 or 48% in 2015 and decreased by $1,523,598 or 20% in 2014 as shown below.

Table 1: Assets, Liabilities, and Net Position

	2015	2014	2013
Assets			
Current assets	$ 3,343,499	$ 4,155,168	$ 5,124,006
Capital assets, net	3,211,625	3,481,927	2,623,427
Noncurrent assets	1,028,943	1,022,666	1,015,870
Total assets	$ 7,584,067	$ 8,659,761	$ 8,763,303
Liabilities			
Total current liabilities	$ 3,457,087	$ 1,553,064	$ 1,033,008
Long term debt	900,000	900,000	-
Total liabilities	4,357,087	2,453,064	1,033,008
Net Position			
Net investment in capital assets	3,211,625	3,481,927	2,670,227
Restricted, expendable for capital acquisitions	445,057	61,942	1,863,828
Unrestricted	(429,702)	2,662,828	3,196,240
Total net position	3,226,980	6,206,697	7,730,295
Total liabilities and net position	$ 7,584,067	$ 8,659,761	$ 8,763,303

<u>Assets, Liabilities, and Net Position</u>

The Hospital's total assets decreased $1,075,694 in 2015. Patient receivables decreased $884,963 and supplies decreased $89,868 as the Hospital is performing less procedures. The Hospital's total assets decreased $103,542 in 2014. Short term certificates of deposit decreased $463,258 as the Hospital used the funds for operations.

The Hospital's total liabilities increased $1,904,023 in 2015. This is a result of a line of credit withdraw for $1,225,337 which was used for operations. Accounts payable increased $728,068 due to cash management. The Hospital's total liabilities increased $1,420,056 in 2014. This is a result of a note payable for $900,000 which was used for operations. Accounts payable increased $578,007 due to cash management.

Table 2: Operating Results and Changes in Net Position

	2015	2014	2013
Operating Revenues			
Net patient service revenue	$ 11,530,879	$ 13,027,623	$ 11,620,254
Other operating revenue	507,450	778,190	1,800,370
Total operating revenues	12,038,329	13,805,813	13,420,624
Operating Expenses			
Salaries and wages	7,569,507	7,817,755	7,497,795
Employee benefits	1,466,838	1,499,458	1,232,506
Purchased services and professional fees	2,993,862	2,850,653	2,820,780
Supplies and other	3,034,911	3,284,721	3,308,381
Depreciation	585,107	564,438	448,939
Total operating expenses	15,650,225	16,017,025	15,308,401
Operating loss	(3,611,896)	(2,211,212)	(1,887,777)
Nonoperating Revenues (Expenses)			
Interest income	7,239	13,253	20,108
Interest expense	(53,783)	(4,839)	(13,501)
Noncapital gifts	3,494	1,400	8,905
Gain on disposal of capital assets	-	20,950	-
Capital Appropriations, City of Sallisaw, Oklahoma	675,229	656,850	646,465
Total nonoperating revenues	632,179	687,614	661,977
Decrease in net position	$ (2,979,717)	$ (1,523,598)	$ (1,225,800)

Operating Results

The first component of the overall change in the Hospital's net position is its operating results. Generally, the operating income or loss is the difference between net patient service and other operating revenues and the expenses incurred to perform those services. The past three years the Hospital has had operating losses.

The operating loss for 2015 increased by $1,400,684 or 63% as compared to the decrease of $323,435 or 17% in 2014. The primary component of the increase in operating loss is:

A decrease in net patient service revenue of $1,496,744 or 11% in 2015 compared to an increase of $1,407,369 or 12% in 2014. The Hospital is performing less procedures.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of capital appropriations, interest income, noncapital gifts and interest expense. Interest expense increased $48,944 or 1,011% in 2015 as compared to the decrease of $8,662 or 64% in 2014. Capital appropriations increased $18,379 or 3% in 2015 and increased $10,385 or 2% in 2014.

The Hospital's Cash Flows

The Hospital's overall liquidity increased during the year with a net increase to cash of $415,783 when compared with 2014. Cash flows used for operating activities decreased by $676,573 during 2015 when compared with 2014. This was due primarily to the decrease in payments to employees, suppliers and contractors. Cash from non-capital financing activities increased by $1,227,431 when compared with 2014. Cash from capital and capital related financing activities increased by $160,345 when compared with 2014. Cash from investing activities decreased by $404,236 when compared to 2014.

Capital Assets

The Hospital had $3,211,625 invested in capital assets at the end of 2015 and $3,481,927 at the end of 2014, net of accumulated depreciation, as detailed in Note 4 to the financial statements. The Hospital purchased new capital assets costing $314,805 in 2015 and $1,422,938 in 2014.

Debt

At March 31, 2015, the Hospital had $2,125,337 in outstanding debt, an increase of $1,225,337 from the prior year. For additional information regarding debt, please see Note 6 to the financial statements.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Hospital administration by calling 918-774-1100.

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	2015	2014
Assets		
Current Assets		
Cash	$ 89,009	$ 57,279
Cash restricted for capital improvements	389,565	5,512
Short term certificates of deposit	-	64,517
Patient, net of estimated uncollectibles of $9,583,000 in 2015 and $5,758,000 in 2014	1,801,978	2,686,941
Estimated third-party payor settlements	27,000	296,000
Capital appropriations receivable	55,492	56,430
Other	203,500	261,714
Supplies	505,297	595,165
Prepaid expenses	271,658	131,610
Total current assets	3,343,499	4,155,168
Noncurrent Cash and Investments		
Certificate of deposit	969,009	962,732
Capital Assets		
Capital assets not being depreciated	199,183	193,633
Capital assets being depreciation, net	3,012,442	3,288,294
Total capital assets	3,211,625	3,481,927
Other Assets		
Cash value of life insurance	59,934	59,934
Total assets	$ 7,584,067	$ 8,659,761

See Notes to Financial Statements

	2015	2014
Liabilities and Net Position		
Current Liabilities		
Notes payable	$ 1,225,337	$ -
Accounts payable	1,892,112	1,164,044
Accrued expenses	339,638	389,020
Total current liabilities	3,457,087	1,553,064
Long-term Liabilities		
Long-term debt	900,000	900,000
Total liabilities	4,357,087	2,453,064
Net Position		
Net investment in capital assets	3,211,625	3,481,927
Restricted, expendable for capital acquisitions	445,057	61,942
Unrestricted	(429,702)	2,662,828
Total net position	3,226,980	6,206,697
Total liabilities and net position	$ 7,584,067	$ 8,659,761

	2015	2014
Operating Revenue		
Net patient service revenue, net of provision for bad debts of $4,471,420 in 2015 and $4,159,612 in 2014	$ 11,530,879	$ 13,027,623
Other revenue	507,450	778,190
Total operating revenues	12,038,329	13,805,813
Operating Expenses		
Salaries and wages	7,569,507	7,817,755
Employee benefits	1,466,838	1,499,458
Purchased services and professional fees	2,993,862	2,850,653
Supplies and other	3,034,911	3,284,721
Depreciation	585,107	564,438
Total operating expenses	15,650,225	16,017,025
Operating Loss	(3,611,896)	(2,211,212)
Nonoperating Revenues (Expenses)		
Interest income	7,239	13,253
Interest expense	(53,783)	(4,839)
Noncapital gifts	3,494	1,400
Gain on disposal of capital assets	-	20,950
Total nonoperating revenues (expenses)	(43,050)	30,764
Expenses in Excess of Revenues Before Capital Appropriations	(3,654,946)	(2,180,448)
Capital Appropriations - City of Sallisaw, Oklahoma	675,229	656,850
Change in Net Position	(2,979,717)	(1,523,598)
Net Position, Beginning of Year	6,206,697	7,730,295
Net Position, End of Year	$ 3,226,980	$ 6,206,697

	2015	2014
Operating Activities		
Receipts from and on behalf of patients	$ 12,684,842	$ 12,616,912
Payments to suppliers and contractors	(5,350,885)	(5,620,901)
Payments to employees	(9,085,727)	(9,375,166)
Other receipts	565,664	516,476
Net Cash used for Operating Activities	(1,186,106)	(1,862,679)
Noncapital Related Financing Activities		
Proceeds from note payable	13,052,081	-
Principal payments on note payable	(11,826,744)	-
Noncapital grants and contributions	3,494	1,400
Net Cash from Noncapital Related Financing Activities	1,228,831	1,400
Capital and Related Financing Activities		
Sales tax revenue received	676,167	654,061
Proceeds from issuance of long term debt	-	900,000
Interest paid on long-term debt	(53,783)	(4,839)
Purchase of property and equipment	(314,805)	(1,422,938)
Proceeds from the sale of equipment	-	20,950
Net Cash from Capital and Related Financing Activities	307,579	147,234
Investing Activities		
Proceeds from redemption of certificates of deposit	64,517	456,462
Purchase of certificates of deposit	(6,277)	-
Interest income	7,239	13,253
Net Cash from Investing Activities	65,479	469,715
Net Change in Cash and Cash Equivalents	415,783	(1,244,330)
Cash, Beginning of Year	62,791	1,307,121
Cash, End of Year	$ 478,574	$ 62,791
Reconciliation of Cash to the Statements of Net Position		
Cash	$ 89,009	$ 57,279
Cash restricted for capital improvements	389,565	5,512
Total cash	$ 478,574	$ 62,791

	2015	2014
Reconciliation of Cash to the Statements of Net Position		
Operating Loss	$ (3,611,896)	$ (2,211,212)
Adjustments to reconcile operating loss to net cash used for operating activities		
Depreciation	585,107	564,438
Provision for bad debts	4,471,420	4,159,612
Changes in assets and liabilities		
Patient receivables	(3,586,457)	(4,547,092)
Other receivables	58,214	(261,714)
Supplies	89,868	(149,547)
Prepaid expenses	(9,389)	86,011
Accounts payable	597,409	578,007
Accrued expenses	(49,382)	(57,951)
Estimated third-party payor settlements	269,000	(23,231)
Net Cash used for Operating Activities	$ (1,186,106)	$ (1,862,679)
Supplemental Disclosures of Cash Flow Information		
Prepaid expenses financed through accounts payable	$ 130,659	$ -

Note 1 - Reporting Entity and Summary of Significant Accounting Policies

Sequoyah County-City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital (Hospital) have been prepared in accordance with generally accepted accounting principles in the United States of America. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The significant accounting and reporting policies and practices used by the Hospital are described below.

Reporting Entity

The Authority was created under a trust indenture dated September 1, 1978, as a public trust under the provisions of Title 60 of the Oklahoma statues for the benefit of Sequoyah County, Oklahoma, and the City of Sallisaw, Oklahoma. The Authority operates, as its sole activity, Sequoyah Memorial Hospital (Hospital), a 35 bed acute care facility.

For financial reporting purposes, the Hospital has included all funds, organizations, agencies, boards, commissions, and authorities. The Hospital has also considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Hospital are such that the exclusion would cause the Hospital's financial situation to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the Hospital to impose its will on that organization or (2) the potential for the organization to provide specific benefits to or impose specific financial burdens on the Hospital.

Blended Component Unit

On December 10, 2012, the SMH Physician Group, LLC (Physician Group), was established as a limited liability company in the state of Oklahoma for the purpose of providing physician services to patients in Sallisaw, Oklahoma and the surrounding communities. The Hospital is the sole member of the LLC. The Physician Group began operations on April 1, 2013. The Physician Group is included as a blended component unity of the Hospital. The financial statements included only the financial activity of the Hospital and Physician Group, collectivity referred to as the Hospital. Financial statements of the Physician Group can be obtained by contacting the Hospital Chief Financial Officer.

Measurement Focus and Basis of Accounting and Presentation

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The accompanying financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Revenues are recognized when earned, and expenses are recorded when the liability is incurred.

Basis of Presentation

The statement of net position displays the Hospital's assets and liabilities with the difference reported as net position. Net position is reported in the following categories/components:

Net investment in capital assets consists of net capital assets reduced by the outstanding balances of any related debt obligations attributable to the acquisition, construction or improvement of those assets or the related debt obligations related to those assets or debt obligations.

Restricted, expendable for capital acquisition consists of assets whose use is restricted for a specific purpose.

Unrestricted net position consists of net position not meeting the definition of the preceding categories. Unrestricted net position often has constraints on resources imposed by management which can be removed or modified.

When an expense is incurred that can be paid using either restricted or unrestricted resources (net position), the Hospital's policy is to first apply the expense toward the most restrictive resources and then toward unrestricted resources.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with an original maturity of three months or less, excluding internally designated or restricted cash and investments. For purposes of the statement of cash flows, the Hospital considers all cash and investments with an original maturity of three months or less as cash and cash equivalents.

Patient Receivables

Patient receivables are uncollateralized patient and third-party payor obligations. Patient receivables, excluding amounts due from third-party payors, are turned over to a collection agency if the receivables remain unpaid after the Hospital's collections procedures. The Hospital does not charge interest on the unpaid patient receivables. Payments of patient receivables are allocated to the specific claims identified on the remittance advice or, if unspecified, are applied to the earliest unpaid claim.

The carrying amount of patient receivables is reduced by a valuation allowance that reflects management's best estimate of amounts that will not be collected from patients and third-party payors. Management reviews patient receivables by payor class and applies percentages to determine estimated amounts that will not be collected from third parties under contractual agreements and amounts that will not be collected from patients due to bad debts. Management considers historical write off and recovery information in determining the estimated bad debt provision.

Capital Appropriations

The Hospital benefits from a 0.5% sales tax assessment. The tax, approved by the Board of Commissioners of the City of Sallisaw, has no expiration date. The Hospital received approximately 5% of its financial support from city appropriations during the years ended March 31, 2015 and 2014. These funds are restricted for capital improvements and debt service. In November 2015, Board of Commissioners of the City of Sallisaw, released the restriction on the sale tax funds to be used for operations of the Hospital.

Supplies

Supplies are stated at lower of cost (first-in, first-out) or market and are expenses when used.

Noncurrent Cash and Deposits

Noncurrent cash and deposits certificates of deposit and other deposits are recorded at historical cost. Other investments are measured at fair value.

Capital Assets

Capital assets acquisitions in excess of $500 are capitalized and recorded at cost. Depreciation is provided over the estimated useful life of each depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Amortization is included in depreciation and amortization in the financial statements. The estimated useful lives of property and equipment are as follows:

Land improvements	5-40 years
Buildings and improvements	5-40 years
Equipment	3-20 years

Gifts of long-lived assets such as land, buildings, or equipment are reported as additions to unrestricted net position, and are excluded from revenues in excess of (less than) expenses. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted net position.

Compensated Absences

The Hospital's employees earn vacation days at varying rates depending on years of service. Employees may accumulate vacation days up to a specified maximum. Compensated absence liabilities are computed using the regular pay in effect at the statements of net position date plus an additional amount for compensation related payments such as Social Security and Medicare taxes computed using rates in effect at that date.

Operating Revenues and Expenses

The Hospital's statement of revenues, expenses, and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues and expenses of the Hospital result from exchange\ transactions associated with providing health care services - the Hospital's principal activity, and the costs of providing those services, including depreciation and excluding interest cost. All other revenues and expenses are reported as nonoperating.

Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Charity Care

The Hospital provides health care services to patients who meet certain criteria under its charity care policy without charge or at amounts less that established rates. Since the Hospital does not pursue collection of these amounts, they are not reported as patient service revenue. The estimated cost of providing these services was $88,000 and $19,000 for the years ended March 31, 2015 and 2014, calculated by multiplying the ratio of cost to gross charges for the Hospital by the gross uncompensated charges associated with providing charity care to its patients.

Grants and Contributions

The Hospital may receive grants as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as non-operating revenues. Amounts restricted to capital acquisitions are reported after revenues in excess of (less than) expenses.

Electronic Health Record Incentive Payments

The American Recovery and Reinvestment Act of 2009 (ARRA) amended the Social Security Act to establish incentive payments under the Medicare and Medicaid programs for certain hospitals and professionals that demonstrate meaningful use of certified Electronic Health Records (EHR) technology.

To qualify for the EHR incentive payments, hospitals and physicians must meet designated EHR meaningful use criteria. In addition, hospitals must attest that they have used certified EHR technology, satisfied the meaningful use objectives, and specify the EHR reporting period. This attestation is subject to audit by the federal government or its designee. The EHR incentive payment to hospitals for each payment year is calculated as a product of (1) an initial amount; (2) the Medicare share; and (3) a transition factor applicable to that payment year.

The Hospital recognizes EHR incentive payments as revenue when there is reasonable assurance that the Hospital will comply with the conditions attached to the incentive payments. EHR incentive payments are included in other operating revenue in the accompanying financial statements. The amount of EHR incentive payments recognized are based on management's best estimate and those amounts are subject to change with such changes impacting the period in which they occur.

The Hospital recognized revenue of $466,679 and $712,949 for the years March 31, 2015 and 2014 related to EHR incentive payments. These incentive payments are included in other revenue in the accompanying financial statements.

Supplemental Hospital Offset Payment Program Act

The Supplemental Hospital Offset Payment Program Act (SHOPP), designated as House Bill 1381 (HB 1381), was passed during 2011 implementing a fee on hospitals to generate matching funds to the state of Oklahoma from federal sources. The program is designed to assess Oklahoma hospitals, unless exempt, a supplemental hospital offset payment program fee. The collected fees will be placed in pools and then allocated to hospitals as directed by legislation. The Oklahoma Health Care Authority (OHCA) does not guarantee that allocations will or equal or exceed the amount of the supplemental hospital offset payment program fee paid by the hospital.

The Hospital records payments to other expenses and receipts as net patient service revenue. Future changes in law or regulation at the federal or state level can adversely affect or eliminate SHOPP.

The Hospital made SHOPP payments totaling $352,823, for the year ended March 31, 2015. In return, the Hospital received $889,915. The Hospital made SHOPP payments totaling $290,888, for the year ended March 31, 2014. In return, the Hospital received $614,583.

Note 2 - Net Patient Service Revenue

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

<u>Medicare</u>: Inpatient acute care and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per visit. These rates vary according to a patient classification system based on clinical, diagnostic, and other factors. Outpatient services are paid based on a prospectively determined amount per procedure. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare Administrative Contractor (MAC). The Hospital's Medicare cost reports have been audited by the MAC through March 31, 2011.

<u>Medicaid:</u> The Hospital is reimbursed for services rendered to patients covered by the State Medicaid Program on a prospective basis at predetermined rates with no retroactive adjustment.

The Hospital has also entered into payment agreements with certain commercial insurance carriers and other organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Concentration of gross charges by major payor accounted for the following percentages of the Hospital's patient service revenues for the years ended March 31, 2015 and 2014:

	2015	2014
Medicare	47%	48%
Medicaid	22%	21%
Commercial insurance	23%	20%
Other third-party payors and patients	8%	11%
	100%	100%

Laws and regulations governing the Medicare, Medicaid, and other programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

The Centers for Medicare and Medicaid Services (CMS) has implemented a Recovery Audit Contractor (RAC) program under which claims are reviewed by contractors for validity, accuracy, and proper documentation. A demonstration project completed in several other states resulted in the identification of potential overpayments, some being significant. If selected for audit, the potential exists that the Hospital may incur a liability for a claims overpayment at a future date. The Hospital is unable to determine if it will be audited and, if so, the extent of the liability of overpayments, if any. As the outcome of such potential reviews is unknown and cannot be reasonably estimated, it is the Hospital's policy to adjust revenue for deductions from overpayment amounts or additions from underpayment amounts determined under the RAC audits at the time a change in reimbursement is agreed upon between the Hospital and CMS.

Note 3 - Deposits and Investments

The carry amounts of deposits as of March 31, 2015 and 2014 are as follows:

	2015	2014
Carry amount		
Cash deposits in banks	$ 478,574	$ 62,791
Certificates of deposit	969,009	1,027,249
	$ 1,447,583	$ 1,090,040

Deposits and investments are reported in the following statement of net position captions:

	2015	2014
Cash	$ 89,009	$ 57,279
Restricted cash	389,565	5,512
Certificates of deposit	969,009	1,027,249
	$ 1,447,583	$ 1,090,040

Deposits – Custodial Credit Risk

Custodial credit risk is the risk that in the event of a bank or investment company failure, the Hospital's deposits may not be returned to it. State statute requires that any deposits in excess of federal depository or other insured amounts be collateralized by U.S. Government securities in the name of the Hospital. Statutes also require that the market value of the collateral be at least 110% of the excess deposits. The Hospital's deposit policy does not further restrict bank deposits or limit investment deposits.

The Hospital's deposits in banks at March 31, 2015 and 2014 were entirely covered by federal depository insurance or by collateral held by the Hospital's custodial bank in the Hospital's name.

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. The Hospital's investment policy does not provide specific maturity limits in certificates of deposits to manage exposure to fair value losses arising from changing interest rates.

Concentration of Credit Risk

The Hospital does not have a formally adopted investment policy for managing concentration of credit risk.

Investment Income

Investment income, primarily interest income, for the years ended March 31, 2015 and 2014, consisted of interest income in the amounts of $7,239 and $13,253.

Note 4 - Capital Assets

Capital assets additions, retirements, transfers and balances for the year ended March 31, 2015 are as follows:

	Balance March 31, 2014	Additions	Transfers and Retirements	Balance March 31, 2015
Capital assets not being depreciated				
Land	$ 193,633	$ -	$ -	$ 193,633
Construction in progress	-	5,550	-	5,550
Total capital assets not being depreciated	$ 193,633	$ 5,550	$ -	$ 199,183
Capital assets being depreciated				
Land improvements	$ 12,443	$ -	$ -	$ 12,443
Building and improvements	3,638,924	25,989	-	3,664,913
Major moveable and fixed equipment	8,202,997	283,266	-	8,486,263
Total capital assets being depreciated	11,854,364	$ 309,255	$ -	12,163,619
Less accumulated depreciation for				
Land improvements	9,628	$ 3,438	$ -	13,066
Building and improvements	2,532,810	52,408	-	2,585,218
Major moveable and fixed equipment	6,023,632	529,261	-	6,552,893
Total accumulated depreciation	8,566,070	$ 585,107	$ -	9,151,177
Net capital assets being depreciated	$ 3,288,294			$ 3,012,442
Capital assets, net	$ 3,481,927			$ 3,211,625

Construction in progress at March 31, 2015, represents replacing the bulk oxygen storage system pad. The cost to complete this project was approximately $95,000, which was financed with Hospital funds. The project was completed in December 2015.

Capital assets additions, retirements, transfers and balances for the year ended March 31, 2014 are as follows:

	Balance March 31, 2013	Additions	Transfers and Retirements	Balance March 31, 2014
Capital assets not being depreciated				
Land	$ 193,633	$ -	$ -	$ 193,633
Total capital assets not being depreciated	$ 193,633	$ -	$ -	$ 193,633
Capital assets being depreciated				
Land improvements	$ 12,443	$ -	$ -	$ 12,443
Building and improvements	3,040,744	598,180	-	3,638,924
Major moveable and fixed equipment	7,378,239	824,758	-	8,202,997
Total capital assets being depreciated	10,431,426	$ 1,422,938	$ -	11,854,364
Less accumulated depreciation for				
Land improvements	7,625	$ 2,003	$ -	9,628
Building and improvements	2,469,458	63,352	-	2,532,810
Major moveable and fixed equipment	5,524,549	499,083	-	6,023,632
Total accumulated depreciation	8,001,632	$ 564,438	$ -	8,566,070
Net capital assets being depreciated	$ 2,429,794			$ 3,288,294
Capital assets, net	$ 2,623,427			$ 3,481,927

Note 5 - Leases

The Hospital leases certain equipment under noncancelable long-term lease agreements. Total lease expense for the years ended March 31, 2015 and 2014 for all operating leases was $84,687 and $70,327. Minimum future lease payments for operating leases are as follows:

Year Ending March 31,	Operating Leases
2016	$ 13,042
2017	8,024
2018	5,788
2019	1,956
Total minimum lease payments	$ 28,810

Note 6 - Notes Payable and Long-Term Debt

A schedule of changes in the Hospital's notes payable for 2015 is as follows:

	Balance March 31, 2014	Additions	Payments	Balance March 31, 2015
Notes payable:				
Line of credit	$ -	$ 13,052,081	$ (11,826,744)	$ 1,225,337

The terms and due date of the Hospital's notes payable at March 31, 2015 is as follows:

- Revolving line of credit, unpaid principal and accrued interest due June 1, 2015; variable interest rate; interest at March 31, 2015 4.75%; collateralized by the assets of the Hospital. Subsequent to year end, the Hospital extended the line of credit with a new maturity date of May 2, 2016.

A schedule of changes in the Hospital's long-term debt for March 31, 2015 and 2014 is as follows:

	Balance March 31, 2014	Additions	Payments	Balance March 31, 2015	Due Within One Year
Long-term debt	$ 900,000	$ -	$ -	$ 900,000	$ -

	Balance March 31, 2013	Additions	Payments	Balance March 31, 2014	Due Within One Year
Long-term debt	$ -	$ 900,000	$ -	$ 900,000	$ -

The terms and due dates of the Hospital's long-term debt at March 31, 2015 and 2014 are as follows:

- Promissory note with an interest rate of 1.65%, due annually with the principal balance to be paid in a single payment on July 29, 2017, collateralized by certificate of deposit.

Future payments of principal and interest on the long-term debt obligations are as follows:

	Long-Term Debt		
Year Ending March 31,	Principal	Interest	Total
2016	$ -	$ 14,850	$ 14,850
2017	-	14,850	14,850
2018	900,000	4,950	904,950
Total	$ 900,000	$ 34,650	$ 934,650

Note 7 - Pension Plan

The Hospital has a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital's required contributions, determined in accordance with the terms of the plan. The plan is administered by the Board of Trustees. The plan provides retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's Board of Trustees. As of April 1, 2010, the Hospital is no longer required by the plan to make contributions as a result of amendments to the plan by the Board of Trustees. The Hospital did not make any contributions to the plan in 2015, 2014 or 2013.

Note 8 - Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, many of who are residents and are insured under third-party payor agreements. The mix of receivables from third-party payors and patients March 31, 2015 and 2014 was as follows:

	2015	2014
Medicare	16%	17%
Medicaid	5%	7%
Commercial insurance	8%	11%
Other third-party payors and patients	71%	65%
	100%	100%

Note 9 - Contingencies

Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage, of assets; business interruptions; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than employee health claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Malpractice Insurance

The Hospital has malpractice insurance coverage to provide protection for professional liability losses on a claims-made basis subject to a limit of $1 million per claim and an annual aggregate limit of $3 million. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, would be uninsured.

Litigations, Claims, and Disputes

The Hospital is subject to the usual contingencies in the normal course of operations relating to the performance of its tasks under its various programs. In the opinion of management, the ultimate settlement of any litigation, claims, and disputes in process will not be material to the financial position, operations, or cash flows of the Hospital.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Federal government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenues from patient and resident services.

Note 10 - Condensed Combining Information

The following summarizes combining information for the Hospital and Physician Group, which has been presented as a blended component unit, as of and for the year ended March 31, 2015.

Statement of net position as of March 31, 2015:

	Sequoyah Memorial Hospital	SMH Physician Group, LLC	Eliminations	Total
Assets				
Current assets	$ 3,433,554	$ 87,673	$ (177,728)	$ 3,343,499
Capital assets	3,211,625	-	-	3,211,625
Limited to use	969,009	-	-	969,009
Other non current assets	59,934	-	-	59,934
Total assets	$ 7,674,122	$ 87,673	$ (177,728)	$ 7,584,067
Liabilities				
Current liabilities	$ 3,438,487	$ 196,328	$ (177,728)	$ 3,457,087
Long term liabilities	900,000	-	-	900,000
	$ 4,338,487	$ 196,328	$ (177,728)	$ 4,357,087
Net Position				
Net investment in capital assets	$ 3,211,625	$ -	$ -	$ 3,211,625
Restricted, expendable for capital acquisitions	445,057	-	-	445,057
Unrestricted net position	(321,047)	(108,655)	-	(429,702)
Total net position	$ 3,335,635	$ (108,655)	$ -	$ 3,226,980
Total liabilities and net position	$ 7,674,122	$ 87,673	$ (177,728)	$ 7,584,067

Operating results and changes in net position for the year ended March 31, 2015:

	Sequoyah Memorial Hospital	SMH Physician Group, LLC	Eliminations	Total
Operating Revenues				
Net patient service revenue	$ 10,511,355	$ 1,019,524	$ -	$ 11,530,879
Other operating revenue	529,050	-	(21,600)	507,450
Total operating revenue	11,040,405	1,019,524	(21,600)	12,038,329
Operating Expenses				
Depreciation	573,924	11,183	-	585,107
Other operating expenses	14,081,091	1,005,627	(21,600)	15,065,118
Total operating expense	14,655,015	1,016,810	(21,600)	15,650,225
Operating Income (Loss)	(3,614,610)	2,714	-	(3,611,896)
Nonoperating Revenue (Expense)				
Interest income	7,239	-	-	7,239
Interest expense	(53,783)	-	-	(53,783)
Noncapital gifts	3,494	-	-	3,494
Gain on disposal of equipment	-	-	-	-
Total non operating revenue (expense)	(43,050)	-	-	(43,050)
Capital appropriations	675,229	-	-	675,229
Change in Net Position	(2,982,431)	2,714	-	(2,979,717)
Net Position Beginning of Year	6,318,066	(111,369)	-	6,206,697
Net Position End of Year	$ 3,335,635	$ (108,655)	$ -	$ 3,226,980

Cash flows for the year ended March 31, 2015:

	Sequoyah Memorial Hospital	SMH Physician Group, LLC	Total
Net Cash from (used for) Operating Activities	$ (1,187,786)	$ 1,680	$ (1,186,106)
Net Cash from Noncapital Financing Activities	3,494	-	3,494
Net Cash from Capital and related Financing Activities	1,532,916	(1,225,337)	307,579
Net Cash from Investing Activities	65,479	-	65,479
Net Increase in Cash and Cash Equivalents	414,103	(1,223,657)	(809,554)
Cash and Cash Equivalents, Beginning of Year	62,956	(165)	62,791
Cash and Cash Equivalents, End of Year	$ 477,059	$ (1,223,822)	$ (746,763)

Statement of net position as of March 31, 2014:

	Sequoyah Memorial Hospital	SMH Physician Group, LLC	Eliminations	Total
Assets				
Current assets	$ 4,266,537	$ 115,778	$ (227,147)	$ 4,155,168
Capital assets	3,481,927	-	-	3,481,927
Limited to use	962,732	-	-	962,732
Other non current assets	59,934	-	-	59,934
Total assets	$ 8,771,130	$ 115,778	$ (227,147)	$ 8,659,761
Liabilities				
Current liabilities	$ 1,553,064	$ 227,147	$ (227,147)	$ 1,553,064
Long term liabilities	900,000	-	-	900,000
Total liabilities	$ 2,453,064	$ 227,147	$ (227,147)	$ 2,453,064
Net Position				
Net investment in capital assets	$ 3,481,927	$ -	$ -	$ 3,481,927
Restricted, expendable for capital acquisitions	61,942	-	-	61,942
Unrestricted net position	2,774,197	(111,369)	-	2,662,828
Total net position	$ 6,318,066	$ (111,369)	$ -	$ 6,206,697
Total liabilities and net position	$ 8,771,130	$ 115,778	$ (227,147)	$ 8,659,761

Operating results and changes in net position for the year ended March 31, 2014:

	Sequoyah Memorial Hospital	SMH Physician Group, LLC	Total
Operating Revenues			
Net patient service revenue	$ 12,006,906	$ 1,020,717	$ 13,027,623
Other operating revenue	778,190	-	778,190
Total operating revenue	12,785,096	1,020,717	13,805,813
Operating Expenses			
Depreciation	540,954	23,484	564,438
Other operating expenses	14,343,985	1,108,602	15,452,587
Total operating expense	14,884,939	1,132,086	16,017,025
Operating Loss	(2,099,843)	(111,369)	(2,211,212)
Nonoperating Revenue (Expense)			
Interest income	13,253	-	13,253
Interest expense	(4,839)	-	(4,839)
Noncapital gifts	1,400	-	1,400
Gain on disposal of equipment	20,950	-	20,950
Total non operating revenue (expense)	30,764	-	30,764
Capital appropriations	656,850	-	656,850
Change in Net Position	(1,412,229)	(111,369)	(1,523,598)
Net Position Beginning of Year	7,730,295	-	7,730,295
Net Position End of Year	$ 6,318,066	$ (111,369)	$ 6,206,697

Cash flows for the year ended March 31, 2014:

	Sequoyah Memorial Hospital	SMH Physician Group, LLC	Total
Net Cash from (used for) Operating Activities	$ (1,862,514)	$ (165)	$ (1,862,679)
Net Cash from Noncapital Financing Activities	1,400	-	1,400
Net Cash from (used for) Capital and related Financing Activities	147,234	-	147,234
Net Cash from (used for) Investing Activities	469,715	-	469,715
Net Increase in Cash and Cash Equivalents	(1,244,165)	(165)	(1,244,330)
Cash and Cash Equivalents, Beginning of Year	1,307,121	-	1,307,121
Cash and Cash Equivalents, End of Year	$ 62,956	$ (165)	$ 62,791

Note 11 - Decrease in Net Position and Management Plans

For the year ended March 31, 2015, the Hospital experienced a decrease in net position of $2,898,717. The Hospital has approved and implemented plans to mitigate this issue. The plans implemented included a reduction in expense through a reduction in payroll and contracted services, and improved revenue through revising billing and collection procedures. The efforts have already begun and management projects that cash needs will be met throughout the 2016 fiscal year.

Note 12 - Subsequent Events

The Hospital has evaluated subsequent events through February 11, 2016 the date which the financial statements were available to be issued.

In November 2015, Board of Commissioners of the City of Sallisaw, released the restriction on the sale tax funds totaling approximately $600,000 to be used for operations of the Hospital.

In December 2015, the Hospital sold the clinic building for approximately $270,000.

CPAs & BUSINESS ADVISORS

Independent Auditor's 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*

The Board of Trustees
Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Sequoyah Memorial Hospital
Sallisaw, Oklahoma

We have audited, 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, the financial statements of Sequoyah Memorial Hospital d/b/a Sequoyah Memorial Hospital (Hospital) as of and for the year ended March 31, 2015, and the related notes to the financial statements, which collectively comprise the Hospital's basic financial statements, and have issued our report thereon dated February 11, 2016.

Internal Control over Financial Reporting
In planning and performing our audit of the financial statements, we considered the Hospital's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, we identified certain deficiencies in internal control that we consider to be material weaknesses, and other deficiencies we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Hospital's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings to be material weaknesses: 2015-A through 2015-E.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the accompanying Schedule of Findings to be significant deficiencies: 2015-F through 2015-H.

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Compliance and Other Matters
As part of obtaining reasonable assurance about whether the Hospital's financial statements are free from 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*.

Hospital's Response to Findings
The Hospital's responses to the findings identified in our audit are described in the accompanying Schedule of Findings. The Hospital's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report
The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Hospital's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Eide Bailly LLP

Oklahoma City, Oklahoma
February 11, 2016

Material Weaknesses Internal Control Over Financial Reporting:

2015-A Preparation of Financial Statements

Criteria: A properly designed system of internal control over financial reporting includes the preparation of an entity's financial statements and accompanying notes to the financial statements by internal personnel of the entity. Management is responsible for establishing and maintaining internal control over financial reporting and procedures related to the fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles (GAAP).

Condition: The Hospital does not have the internal control system over financial reporting designed to provide for the preparation of the financial statements, including the accompanying footnotes as required by generally accepted accounting standards, on a periodic or annual basis. This circumstance is not unusual in an organization of your size. It is the responsibility of management and those charged with governance to make the decisions whether to accept the degree of risk associated with this condition because of the cost or other considerations.

Cause: Misstatements to the internal financial statements were not prevented or detected on a timely basis in the normal course of business. Therefore, there were several significant adjusting journal entries at year end proposed during the audit process.

Effect: Failure to periodically review account balances can result in errors on the interim financial statements and represents a weakness in internal control over financial reporting. Improper oversight of the accounting function allowed misstatements to occur. Also, the year-end financial report is prepared by the auditors, a party outside of the Hospital. The outside party does not have constant contact with ongoing financial transactions that the internal staff has. Furthermore, it is possible that new standards may not be adopted and applied timely to the interim financial reporting. It is the responsibility of Hospital management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations.

Auditor's Recommendation: It is recommended the Hospital implement a system that allows the preparation of financial statements in accordance with GAAP.

Management Response: The Board of Trustees has taken into consideration the expense of hiring additional accounting personnel for the accurate reporting of the financial statements and feels that the cost does not justify the benefit.

2015-B Material Audit Entries

Criteria: A properly designed system of internal control over financial reporting allows entities to initiate, authorize, record, process, and report financial data reliably in accordance with generally accepted accounting principles.

Condition: During the course of our engagement, we proposed a material audit adjustment to patient accounts receivables, accounts payable, and accrued expenses that would not have been identified as a result of the Hospital's existing internal controls, and therefore, could have resulted in a material misstatement of the Hospital's financial statements.

Cause: Material misstatements was not identified and corrected in a timely manner.

Effect: Material misstatements could occur in the financial statements and not be detected by management in a timely manner.

Auditor's Recommendation: It is recommended the Hospital implement a system that provides adequate controls over recording transactions and identifying misstatements.

Management Response: Management agrees with the finding and recommendation and will evaluate the controls in place.

2015-C Calculation of Bad Debt and Contractual Allowances

Criteria: Accountings standards require an entity to estimate an allowance on the collectability of receivables. The allowance should be based on historical data and current reimbursement rates.

Condition: The allowance calculations were not properly estimated during the year.

Effect: Interim financial statements may not be properly stated. A material audit adjustment was made to the allowance accounts.

Cause: Historical collections are not reviewed and considered in determining the potential impact on contractual adjustments or bad debt write-offs.

Recommendation: We recommend that management develop an estimate based on historical collections and adjustments. The allowance accounts should be reviewed each month as well for reasonableness in relation to the accounts receivable and revenue.

Auditor's Recommendation: We recommend the Hospital develop an allowance on actual self-pay collection and separate the major commercial payors. The Hospital should also review the contractual adjustments regularly for unusual fluctuations.

Management Response: Management agrees with the finding and recommendation and will evaluate the controls in place.

2015-D Cost Report Estimate

Criteria: Accountings standards require an entity to estimate the Medicare cost report settlement in order to fairly state the financial position as of year-end.

Condition: During the current year, the Hospital did not record an estimate for the Medicare cost report settlement for the current year.

Cause: The current year cost report settlement was not estimated at year-end which resulted in a material journal entry to the financial statements.

Effect: This resulted in a material adjusting journal entry to properly state the current year settlement.

Auditor's Recommendation: It is recommended that the Hospital implement a system to estimate the Hospital's cost report settlement.

Management Response: Management agrees with the finding and recommendation and will evaluate the controls in place.

2015-E Cash Reconciliation

Criteria: Reviewing and reconciling the cash accounts to the general ledger is a necessary step in ensuring proper controls over cash management.

Condition: During the course of our engagement, we noted that the Hospital was not properly reconciling bank accounts.

Cause: Bank accounts were not properly reconciled or reviewed.

Effect: Material misstatements could occur in the financial statements and not be detected by management in a timely manner as well as an increased risk of fraud due to misappropriation of cash

Auditor's Recommendation: It is recommended the Hospital establish procedures to ensure reconcile all cash accounts are properly reconciled on a timely basis.

Management Response: Management agrees with the finding and recommendation and will evaluate the controls in place.

Significant Deficiencies Internal Control Over Financial Reporting:

2015-F Segregation of Duties

Criteria: A properly designed system of internal control segregates the initiation, record keeping, and authorization of transactions.

Condition: During the course of our engagement, we noted that the Hospital has limited staff completing incompatible accounting functions due to the size of the entity. There were no review of the journal entries or monthly reconciliations.

Cause: The Hospital's size and budget constraints limit the number of personnel and does not facilitate the segregation of duties necessary to adequately separate procedures.

Effect: Inadequate segregation of duties could adversely affect the organizations ability to detect and correct unintentional or intentional misstatements in a timely manner by employees in the normal course of performing their assigned functions.

Auditor's Recommendation: It is the responsibility of management and those charged with governance to make the decisions whether to accept the degree of risk associated with this condition because of cost or other considerations. In addition, we recommend that the functions be reviewed to determine if additional segregation is feasible to improve efficiency and effectiveness of the financial management of the organization.

Management Response: Management accepts the risk associated with this condition.

2015-G Journal Entry Support

Criteria: Journal entries should be supported by appropriate documentation where possible.

Condition: During the course of our engagement, we noted that the Hospital was unable to locate journal entry documentation and support.

Cause: The Hospital did not maintain proper documentation supporting journal entries.

Effect: Good documentation serves as an accounting record and facilitates future follow-up as well as additional insight for other users.

Auditor's Recommendation: It is recommended that the Hospital review policies and procedures to ensure supporting documentation for manual journal entries is properly maintained.

Management Response: Management agrees with the finding and recommendation and will evaluate the controls in place.

2015-H Accounts Payable

Criteria: Proper cutoffs are critical for the accuracy of the accrual basis of accounting.

Condition: During the course of our engagement, we noted exceptions in which invoices relating to goods received or services performed prior to the year-end date were not recorded as payables in the proper period.

Effect: Interim financial statements may not be properly stated. A material audit adjustment was made to accounts payable.

Cause: Invoices were not properly recorded in the proper period.

Recommendation: We suggest that management prepare written instructions to be included as a part of the Hospital accounting policies and procedures manual which indicates basic concepts of proper cutoffs and the individuals responsible for accruing payables at the accounting period end.

Management Response: Management agrees with the finding and recommendation and will evaluate the controls in place.