



Management's Discussion and Analysis
And Financial Statements
March 31, 2018 and 2017

**Sequoyah County-City of Sallisaw
Hospital Authority d/b/a
Northeastern Health System
Sequoyah**

Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Northeastern Health System Sequoyah

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March 31, 2018 and 2017

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Independent Auditor's Report

To the Board of Trustees
Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Northeastern Health System Sequoyah
Sallisaw, Oklahoma

Report on the Financial Statements

We have audited the accompanying statements of net position of Sequoyah County-City of Sallisaw Hospital Authority d/b/a Northeastern Health System Sequoyah (Hospital) as of March 31, 2018 and 2017, and the related statements of revenues, expenses, and changes in net position and statements of cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the Hospital's basic 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.

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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sequoyah County-City of Sallisaw Hospital Authority d/b/a Northeastern Health System Sequoyah as of March 31, 2018 and 2017, and the changes in its financial 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 a report dated August 16, 2019 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.


Eric Sully LLP
Oklahoma City, Oklahoma
August 16, 2019

Introduction

This discussion and analysis of the financial performance of Sequoyah County-City of Sallisaw Hospital Authority d/b/a Northeastern Health System Sequoyah (Hospital) provides an overall review of the Hospital's financial activities and balances as of and for the years ended March 31, 2018, 2017, and 2016. 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 increased in 2018 by \$593,789 or 30% and decreased in 2017 by \$1,203,129 or 38%.
- Total liabilities increased in 2018 by \$3,216,074 or 82% and decreased in 2017 by \$594,950 or 13%.
- The Hospital's net position decreased in 2018 by \$2,608,114 or 382% and decreased in 2017 by \$2,101,626 or 75%.
- The Hospital reported an operating loss in 2018 of \$3,308,853 and an operating loss in 2017 of \$2,670,559. During 2018, operating loss increased by \$638,294 or 24% and increased by \$1,462,898 or 121% in 2017.
- Net patient service revenue decreased by \$676,778 or 6% in 2018 and decreased by \$2,839,158 or 21% in 2017.
- Other operating revenue decreased by \$84,767 or 79% in 2018 and decreased by \$164,782 or 61% in 2017.
- Operating expenses decreased in 2018 by \$123,251 or 1% and decreased \$1,541,042 or 10% in 2017.

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 \$2,608,114 or 382% in 2018 and decreased by \$2,101,626 or 75% in 2017 as shown below.

Table 1: Assets, Liabilities, and Net Position

	2018	2017	2016
Assets			
Current assets	\$ 2,587,743	\$ 1,993,955	\$ 3,197,084
Capital assets, net	2,545,369	2,621,197	3,035,719
Noncurrent assets	97,330	7,330	1,086,255
Total assets	\$ 5,230,442	\$ 4,622,482	\$ 7,319,058
Liabilities			
Total current liabilities	\$ 2,725,554	\$ 2,156,395	\$ 3,493,737
Long term debt	4,429,702	1,782,787	1,040,395
Total liabilities	7,155,256	3,939,182	4,534,132
Net Position			
Net investment in capital assets	2,079,111	2,480,802	2,858,054
Unrestricted	(4,003,925)	(1,797,502)	(73,128)
Total net position (deficit)	(1,924,814)	683,300	2,784,926
Total liabilities and net position	\$ 5,230,442	\$ 4,622,482	\$ 7,319,058

Assets, Liabilities, and Net Position

The Hospital's total assets increased \$607,960 or 13% in 2018 and decreased \$2,696,576 or 37% in 2017. Cash and cash equivalents increased \$175,909 or 974% in 2018 compared to 2017 which decreased \$489,766 or 96%. Patient accounts receivable, net of allowances, increased \$401,295 or 27% in 2018 compared to 2017 which decreased \$660,132 or 31%. The Hospital liquidated all certificates of deposit during 2017.

Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Northeastern Health System Sequoyah
Management's Discussion and Analysis

The Hospital's total liabilities increased \$3,216,074 or 82% in 2018 and decreased \$594,950 or 13% in 2017. The Hospital refinanced their short-term notes payable of \$1,298,427 to a long-term note payable during 2017. Long-term debt increased \$2,675,992 or 140% in 2018 compared to 2017 which increased \$830,557 or 77%. The increase in 2018 is due to the Hospital obtaining a new long-term note payable for operations. Accrued expenses decreased \$359,795 or 94% in 2018 compared to 2017 which decreased \$400,494 or 51%.

Table 2: Operating Results and Changes in Net Position

	2018	2017	2016
Operating Revenues			
Net patient service revenue	\$ 9,840,187	\$ 10,516,965	\$ 13,356,123
Other operating revenue	22,730	107,497	272,279
Total operating revenues	<u>9,862,917</u>	<u>10,624,462</u>	<u>13,628,402</u>
Operating Expenses			
Salaries and wages	4,095,836	5,967,169	6,756,553
Employee benefits	893,905	891,205	1,485,385
Contract salary and benefits	2,002,190	-	-
Purchased services and professional fees	3,004,282	2,749,199	2,722,416
Supplies and other	2,690,717	3,150,822	3,297,005
Depreciation	484,840	536,626	574,704
Total operating expenses	<u>13,171,770</u>	<u>13,295,021</u>	<u>14,836,063</u>
Operating Loss	<u>(3,308,853)</u>	<u>(2,670,559)</u>	<u>(1,207,661)</u>
Nonoperating Revenues (Expenses)			
Interest income	15	3,728	7,994
Noncapital appropriations	736,695	673,549	618,431
Interest expense	(173,171)	(112,221)	(93,361)
Noncapital gifts	-	16,004	14,622
Gain (loss) on disposal of capital assets	12,200	(12,127)	147,648
Net nonoperating revenues	<u>575,739</u>	<u>568,933</u>	<u>695,334</u>
Expenses in Excess of Revenues Before Capital Contributions and Capital Appropriations	(2,733,114)	(2,101,626)	(512,327)
Capital Contributions	125,000	-	-
Capital Appropriations	<u>-</u>	<u>-</u>	<u>70,273</u>
Change in Net Position	<u>\$ (2,608,114)</u>	<u>\$ (2,101,626)</u>	<u>\$ (442,054)</u>

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 2018 increased by \$638,294 or 24% as compared to the increase of \$1,462,898 or 121% in 2017. The primary components of the operating loss are:

- Net patient service revenue decreased \$676,778 or 6% in 2018 compared to a decrease of \$2,839,158 or 21% in 2017. The decrease in 2018 is attributed to a decrease in services provided by the Hospital. The decrease in 2017 is attributed to additional write-offs due to untimely billing.
- Salaries, wages and employee benefits expense decreased \$1,868,633 or 27% in 2018 and \$1,383,564 or 27% in 2017. The decrease in 2018 is attributed to the management agreement with Tahlequah Hospital Authority. The decrease in 2017 is primarily due to a reduction in employees.
- Contract salary and benefits expense increased \$2,002,190 or 100% in 2018. The increase is attributed to the management agreement with Tahlequah Hospital Authority.

Non-operating Revenues and Expenses

Non-operating revenues and expenses consist primarily of non-capital appropriations and interest expense. Non-capital appropriations increased \$63,146 or 9% in 2018 and increased \$55,118 or 9% in 2017. Interest expense increased \$60,950 or 54% in 2018 as compared to the increase of \$18,860 or 20% in 2017.

The Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with changes in operating income and nonoperating revenues and expenses, discussed earlier. The principal changes in the Hospital's nonoperating cash flows were:

- Net cash used for operating activities increased in 2018 by \$1,040,510 or 72% and increased in 2017 by \$868,316 or 1,500%.
- Net cash from noncapital financing activities increased in 2018 by \$2,583,456 or 1,670% and decreased in 2017 by \$401,627 or 72%.
- Net cash used for capital and capital related financing activities decreased in 2018 by \$101,781 or 58% and increased in 2017 by \$226,474 or 455%.
- Net cash provided by investing activities decreased in 2018 by \$979,052 or 100% and increased in 2017 by \$977,403 or 58,738%.

Capital Assets

The Hospital had \$2,545,369 invested in capital assets at the end of 2018 and \$2,621,197 at the end of 2017, net of accumulated depreciation, as detailed in Note 4 to the financial statements. The Hospital acquired new capital assets costing \$409,012 in 2018 and \$140,234 in 2017.

Debt

The Hospital had total debt of \$4,584,214 at the end of 2018. The Hospital incurred additional debt of \$4,484,361 for notes payable and a capital lease in 2018, as detailed in Note 6 to the financial statements. The Hospital had total debt of \$1,908,222 at the end of 2017. The Hospital refinanced the line of credit with a long-term debt and had a reduction in debt of \$467,871 during 2017, as detailed in 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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	<u>2018</u>	<u>2017</u>
Assets		
Current Assets		
Cash	\$ 193,965	\$ 18,056
Receivables		
Patient, net of estimated uncollectibles		
of \$8,749,000 in 2018 and \$4,412,000 in 2017	1,865,098	1,463,803
Capital appropriations	115,627	56,170
Other	-	32
Supplies	327,407	387,981
Prepaid expenses	85,646	67,913
Total current assets	<u>2,587,743</u>	<u>1,993,955</u>
Capital Assets		
Capital assets not being depreciated	193,633	193,633
Capital assets being depreciated, net	2,351,736	2,427,564
Total capital assets	<u>2,545,369</u>	<u>2,621,197</u>
Other Assets		
Cash value of life insurance	7,330	7,330
Prepaid expenses, net of current portion	90,000	-
Total other assets	<u>97,330</u>	<u>7,330</u>
Total assets	<u>\$ 5,230,442</u>	<u>\$ 4,622,482</u>

See Notes to Financial Statements

Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Northeastern Health System Sequoyah
Statements of Net Position
March 31, 2018 and 2017

	2018	2017
Liabilities and Net Position		
Current Liabilities		
Current maturities of long-term debt	\$ 154,512	\$ 125,435
Accounts payable	2,529,179	1,525,302
Estimated third-party payor settlements	19,000	123,000
Accrued expenses	22,863	382,658
Total current liabilities	2,725,554	2,156,395
Long-Term Debt, Less Current Maturities	4,429,702	1,782,787
Total liabilities	7,155,256	3,939,182
Net Position		
Net investment in capital assets	2,079,111	2,480,802
Unrestricted	(4,003,925)	(1,797,502)
Total net position (deficit)	(1,924,814)	683,300
Total liabilities and net position	\$ 5,230,442	\$ 4,622,482

Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Northeastern Health System Sequoyah
Statements of Revenues, Expenses and Changes in Net Position
Years Ended March 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Operating Revenue		
Net patient service revenue, net of provision for bad debts of \$5,770,517 in 2018 and \$5,750,390 in 2017	\$ 9,840,187	\$ 10,516,965
Other revenue	<u>22,730</u>	<u>107,497</u>
Total operating revenues	<u>9,862,917</u>	<u>10,624,462</u>
Operating Expenses		
Salaries and wages	4,095,836	5,967,169
Employee benefits	893,905	891,205
Contract salary and benefits	2,002,190	-
Purchased services and professional fees	3,004,282	2,749,199
Supplies and other	2,690,717	3,150,822
Depreciation	<u>484,840</u>	<u>536,626</u>
Total operating expenses	<u>13,171,770</u>	<u>13,295,021</u>
Operating Loss	<u>(3,308,853)</u>	<u>(2,670,559)</u>
Nonoperating Revenues (Expenses)		
Interest income	15	3,728
Noncapital appropriation	736,695	673,549
Interest expense	(173,171)	(112,221)
Noncapital gifts	-	16,004
Gain (loss) on disposal of capital assets	<u>12,200</u>	<u>(12,127)</u>
Net nonoperating revenues	<u>575,739</u>	<u>568,933</u>
Expenses in Excess of Revenues Before Capital Contributions	(2,733,114)	(2,101,626)
Capital Contributions	<u>125,000</u>	<u>-</u>
Change in Net Position	(2,608,114)	(2,101,626)
Net Position, Beginning of Year	<u>683,300</u>	<u>2,784,926</u>
Net Position (Deficit), End of Year	<u>\$ (1,924,814)</u>	<u>\$ 683,300</u>

Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Northeastern Health System Sequoyah
Statements of Cash Flows
Years Ended March 31, 2018 and 2017

	2018	2017
Operating Activities		
Receipts from and on behalf of patients	\$ 9,334,892	\$ 11,300,097
Payments to suppliers and contractors	(4,493,281)	(5,623,004)
Payments to employees	(7,351,726)	(7,259,944)
Other receipts	22,762	136,007
	(2,487,353)	(1,446,844)
Net Cash used for Operating Activities		
Noncapital Related Financing Activities		
Noncapital appropriations	677,238	676,329
Proceeds from long-term debt	4,000,000	749,203
Principal payments on long-term debt	(1,769,871)	(1,179,803)
Interest paid	(169,178)	(106,999)
Noncapital grants and contributions	-	16,004
	2,738,189	154,734
Net Cash from Noncapital Related Financing Activities		
Capital and Related Financing Activities		
Principal payments on long-term debt	(38,498)	(37,270)
Interest paid	(3,993)	(5,222)
Purchase of property and equipment	(44,651)	(140,234)
Proceeds from the sale of equipment	12,200	6,003
	(74,942)	(176,723)
Net Cash used for Capital and Related Financing Activities		
Investing Activities		
Interest income	15	3,728
Proceeds from redemption of certificates of deposit	-	975,339
	15	979,067
Net Cash from Investing Activities		
Net Change in Cash	175,909	(489,766)
Cash, Beginning of Year	18,056	507,822
Cash, End of Year	\$ 193,965	\$ 18,056

Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Northeastern Health System Sequoyah
Statements of Cash Flows
Years Ended March 31, 2018 and 2017

	2018	2017
Reconciliation of Operating Loss to Net Cash used for		
Operating Activities		
Operating Loss	\$ (3,308,853)	\$ (2,670,559)
Adjustments to reconcile operating loss to net cash		
used for operating activities		
Depreciation	484,840	536,626
Provision for bad debts	5,770,517	5,750,390
Changes in assets and liabilities		
Patient receivables	(6,171,812)	(5,090,258)
Other receivables	32	28,510
Supplies	60,574	(2,246)
Prepaid expenses and other	12,267	127,773
Accounts payable	1,128,877	150,414
Accrued expenses	(359,795)	(400,494)
Estimated third-party payor settlements	(104,000)	123,000
Net Cash used for Operating Activities	\$ (2,487,353)	\$ (1,446,844)
Supplemental Disclosure of Noncash Capital and Capital Related		
Financing Activities		
Equipment financed through capital lease arrangement	\$ 364,361	\$ -
Supplemental Disclosure of Noncash Noncapital Related		
Financing Activities		
Physician retention financed through debt agreement	\$ 120,000	\$ -

Note 1 - Reporting Entity and Summary of Significant Accounting Policies

The financial statements of Sequoyah County-City of Sallisaw Hospital Authority d/b/a Northeastern Health System Sequoyah (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 Hospital is a 35-bed acute care hospital located in the city of Sallisaw, Oklahoma (City). The Hospital is a public trust created under the laws of the State of Oklahoma and is exempt from income taxes under Section 115 of the Internal Revenue Code as a political subdivision of the State of Oklahoma. The Hospital is governed by the Board of Trustees, which is appointed by the City. During 2018, the Hospital changed their trade name from Sequoyah Memorial Hospital to Northeastern Health System Sequoyah. Effective June 1, 2017 the Hospital signed a management service agreement with Tahlequah Hospital Authority (THA). The terms of the management service agreement are discussed in Note 12.

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 unit of the Hospital. The financial statements include only the financial activity of the Hospital and Physician Group, collectively referred to as the Hospital. Financial statements of the Physician Group can be obtained by contacting the Hospital's Administration.

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 net position:

Expendable – Expendable net position results when constraints placed on net position are either externally imposed or imposed through enabling legislation. The Hospital does not have expendable restricted net position as of March 31, 2018 and 2017.

Nonexpendable – Nonexpendable net position is subject to externally imposed stipulations which require them to be maintained permanently by the Hospital. The Hospital does not have nonexpendable restricted net position as of March 31, 2018 and 2017.

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.

As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The net patient service revenue for the year ended March 31, 2018 increased approximately \$73,000 as a result of increased payments compared to originally estimated amounts. The net patient service revenue for the year ended March 31, 2017 decreased approximately \$529,000 due to removal of allowances previously estimated that are no longer necessary as a result of decreasing commercial insurance and patient payments compared to originally estimated amounts.

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.

Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Northeastern Health System Sequoyah

Notes to Financial Statements
March 31, 2018 and 2017

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 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 and Non-Capital Appropriations

The Hospital benefits from a 0.5% sales tax assessment to be used for operations of the Hospital. The tax, approved by the Board of Commissioners of the City of Sallisaw, has no expiration date. The Hospital received approximately 7% and 6% of its financial support from city appropriations during the years ended March 31, 2018 and 2017.

Supplies

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

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 expenses in excess of revenues. 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.

Physician Retention

The Hospital signed an agreement to pay a physician \$120,000 over four years as part of their retention process. The amount will be amortized over a four-year period. At March 31, 2018, the balance totaled \$120,000.

Compensated Absences

Effective January 2018, the Hospital transferred all employees to THA as part of the management service agreement. The Hospital has a payable recorded for compensated absences as they will reimburse THA when used. Prior to January 2018, 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, 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 care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Since the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The amount of charges foregone for services provided under the Hospital's charity care policy were approximately \$77,000 and \$0 for the years ended March 31, 2018 and 2017. Total direct and indirect costs related to these foregone charges were approximately \$25,000 and \$0 at March 31, 2018 and 2017, based on an average ratio of cost to gross charges.

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 expenses in excess of revenues.

Reclassifications

Reclassifications have been made to the March 31, 2017 financial information to make it conform to the current year presentation. The reclassifications had no effect on previously reported operating results or changes in net position.

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:

Medicare: 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, 2016.

Medicaid: 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.

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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, 2018 and 2017:

	2018	2017
Medicare	48%	49%
Medicaid	19%	19%
Blue Cross	8%	9%
Commercial insurance	12%	13%
Other third-party payors and patients	13%	10%
	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. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The net patient service revenue increased approximately \$77,000 for the year ended March 31, 2018 and decreased approximately \$110,000 for the year ended March 31, 2017 due to removal of allowances previously estimated that are no longer necessary as a result of final cost report settlements, adjustments to previously estimated settlements and cost report periods that are no longer likely subject to audits, reviews, and investigations.

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

The carrying amounts of deposits consisted of cash deposits in banks as of March 31, 2018 and 2017.

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 100% 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, 2018 and 2017 were entirely covered by federal depository insurance or by collateral held by the Hospital's custodial bank in the Hospital's name.

Sequoyah County-City of Sallisaw Hospital Authority
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Notes to Financial Statements
March 31, 2018 and 2017

Note 4 - Capital Assets

Capital assets additions, retirements, transfers and balances for the year ended March 31, 2018 are as follows:

	Balance March 31, 2017	Additions	Transfers and Retirements	Balance March 31, 2018
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	\$ 34,488	\$ -	\$ -	\$ 34,488
Building and improvements	3,317,883	44,651	-	3,362,534
Major moveable and fixed equipment	9,123,145	364,361	(18,950)	9,468,556
Total capital assets being depreciated	12,475,516	\$ 409,012	\$ (18,950)	12,865,578
Less accumulated depreciation for				
Land improvements	17,410	\$ 3,356	\$ -	20,766
Building and improvements	2,540,966	36,306	-	2,577,272
Major moveable and fixed equipment	7,489,576	445,178	(18,950)	7,915,804
Total accumulated depreciation	10,047,952	\$ 484,840	\$ (18,950)	10,513,842
Net capital assets being depreciated	\$ 2,427,564			\$ 2,351,736
Capital assets, net	\$ 2,621,197			\$ 2,545,369

Sequoyah County-City of Sallisaw Hospital Authority
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Notes to Financial Statements
March 31, 2018 and 2017

Capital assets additions, retirements, transfers and balances for the year ended March 31, 2017 are as follows:

	<u>Balance March 31, 2016</u>	<u>Additions</u>	<u>Transfers and Retirements</u>	<u>Balance March 31, 2017</u>
Capital assets not being depreciated				
Land	\$ 193,633	\$ -	\$ -	\$ 193,633
Construction in progress	<u>6,500</u>	<u>-</u>	<u>(6,500)</u>	<u>-</u>
Total capital assets not being depreciated	<u>\$ 200,133</u>	<u>\$ -</u>	<u>\$ (6,500)</u>	<u>\$ 193,633</u>
Capital assets being depreciated				
Land improvements	\$ 34,488	\$ -	\$ -	\$ 34,488
Building and improvements	3,374,383	-	(56,500)	3,317,883
Major moveable and fixed equipment	<u>8,976,411</u>	<u>140,234</u>	<u>6,500</u>	<u>9,123,145</u>
Total capital assets being depreciated	<u>12,385,282</u>	<u>\$ 140,234</u>	<u>\$ (50,000)</u>	<u>12,475,516</u>
Less accumulated depreciation for				
Land improvements	13,972	\$ 3,438	\$ -	17,410
Building and improvements	2,522,990	56,346	(38,370)	2,540,966
Major moveable and fixed equipment	<u>7,012,734</u>	<u>476,842</u>	<u>-</u>	<u>7,489,576</u>
Total accumulated depreciation	<u>9,549,696</u>	<u>\$ 536,626</u>	<u>\$ (38,370)</u>	<u>10,047,952</u>
Net capital assets being depreciated	<u>\$ 2,835,586</u>			<u>\$ 2,427,564</u>
Capital assets, net	<u>\$ 3,035,719</u>			<u>\$ 2,621,197</u>

Sequoyah County-City of Sallisaw Hospital Authority
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Notes to Financial Statements
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Note 5 - Lease Obligations

The Hospital leases certain equipment under noncancelable long-term lease agreements. Certain leases have been recorded as capital leases and others as operating leases. Total lease expense for the years ended March 31, 2018 and 2017 for all operating leases was approximately \$71,000 and \$79,000. The capitalized leased assets consist of:

	2018	2017
Major movable equipment	\$ 560,743	\$ 196,382
Less accumulated amortization	(111,204)	(58,915)
	\$ 449,539	\$ 137,467

Minimum future lease payments for capital and operating leases are as follows:

Year Ending March 31,	Capital Leases	Operating Leases
2019	\$ 111,597	\$ 3,853
2020	98,748	1,956
2021	78,503	-
2022	57,256	-
2023	57,239	-
2024-2025	101,200	-
Total minimum lease payments	504,543	\$ 5,809
Less interest	(38,285)	
Present value of minimum lease payments - Note 6	\$ 466,258	

Note 6 - Notes Payable and Long-Term Debt

During 2017, the Hospital's line of credit was refinanced with note payable (2) listed below. There was no activity during the year ended March 31, 2018.

A schedule of changes in the Hospital's notes payable for March 31, 2017 is as follows:

	Balance March 31, 2016	Additions	Payments	Balance March 31, 2017
Notes payable:				
Line of credit	\$1,298,427	\$247,629	\$ (1,546,056)	\$ -

Sequoyah County-City of Sallisaw Hospital Authority
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Notes to Financial Statements
March 31, 2018 and 2017

A schedule of changes in the Hospital's long-term debt for March 31, 2018 and 2017 is as follows:

	Balance March 31, 2017	Additions	Payments	Balance March 31, 2018	Due Within One Year
Note payable (2)	\$ 1,767,827	\$ -	\$ (1,767,827)	\$ -	\$ -
Note payable (5)	-	4,000,000	-	4,000,000	28,793
Note payable (6)	-	120,000	(2,044)	117,956	25,892
Capital lease (3)	140,395	-	(38,498)	101,897	39,770
Capital lease (4)	-	364,361	-	364,361	60,057
	<u>\$ 1,908,222</u>	<u>\$ 4,484,361</u>	<u>\$ (1,808,369)</u>	<u>\$ 4,584,214</u>	<u>\$ 154,512</u>
	Balance March 31, 2016	Additions	Payments	Balance March 31, 2017	Due Within One Year
Note payable (1)	\$900,000	\$ -	\$ (900,000)	\$ -	\$ -
Note payable (2)	-	1,800,000	(32,173)	1,767,827	86,936
Capital lease (3)	177,665	-	(37,270)	140,395	38,499
	<u>\$1,077,665</u>	<u>\$ 1,800,000</u>	<u>\$ (969,443)</u>	<u>\$ 1,908,222</u>	<u>\$ 125,435</u>

The terms and due dates of the Hospital's long-term debt at March 31, 2018 and 2017 are as follows:

- Note payable to bank with an interest rate of 1.65%, due annually with the principal balance to be paid in a single payment on July 29, 2017. The note was paid in full during 2017.
- Note payable to bank with a variable interest rate, due in monthly installments of \$14,085 including interest, due October 2031, secured by assets of the Authority. The note was refinanced during 2018 with the 6.0% interest rate note payable.
- Capital lease with imputed interest rate of 3.25%, due in monthly installments of \$3,541, collateralized by associated equipment, due September 2020.
- Capital lease with imputed interest rate of 2.74%, due in monthly installments of \$4,771, collateralized by associated equipment, due December 2024.
- Note payable to bank with a variable interest rate (6.00% as of March 31, 2018), due in monthly installments of \$29,550 including interest, due November 2037, secured by assets of the Authority.
- Promissory note to a physician with an interest rate of 10.00%, due in monthly installments of \$3,044, unsecured, due February 2022.

Sequoyah County-City of Sallisaw Hospital Authority
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Notes to Financial Statements
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Future payments of principal and interest on the long-term debt obligations are as follows:

<u>Year Ending March 31,</u>	<u>Notes Payable</u>		<u>Capital Lease Obligations</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2019	\$ 54,685	\$ 252,418	\$ 99,827	\$ 11,770
2020	148,184	243,509	89,626	9,122
2021	158,554	232,568	71,965	6,538
2022	166,650	221,429	52,330	4,926
2023	143,100	211,500	53,781	3,458
2024-2028	859,293	913,707	98,729	2,471
2029-2033	1,159,058	613,942	-	-
2034-2038	1,428,432	210,730	-	-
Total	<u>\$ 4,117,956</u>	<u>\$ 2,899,803</u>	<u>\$ 466,258</u>	<u>\$ 38,285</u>

Note 7 - Pension Plan

The Hospital had a defined contribution pension plan covering substantially all employees that was terminated during 2017. The plan was administered by the Board of Trustees. The plan provided retirement and death benefits to plan members and their beneficiaries. Contributions by the Hospital to the plan were subject to the Board of Trustees approval annually. The Hospital did not make any contributions to the plan in 2017.

Note 8 - Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, many of whom are insured under third-party payor agreements. The mix of receivables from third-party payors and patients at March 31, 2018 and 2017 was as follows:

	<u>2018</u>	<u>2017</u>
Medicare	21%	33%
Medicaid	7%	5%
Blue Cross	5%	6%
Other commercial insurance	14%	14%
Other third-party payors and patients	53%	42%
	<u>100%</u>	<u>100%</u>

Note 9 - Contingencies

Risk Management

The Hospital is exposed to various risks of loss from torts; theft of or 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 an occurrence-based coverage subject to a limit of \$1,000,000 per claim and an annual aggregate limit of \$3,000,000.

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 services.

Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Northeastern Health System Sequoyah
Notes to Financial Statements
March 31, 2018 and 2017

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, 2018.

Statement of net position as of March 31, 2018:

	Northeastern Health System Sequoyah	SMH Physician Group, LLC	Eliminations	Total
Assets				
Current assets	\$ 2,916,612	\$ 39,201	\$ (368,070)	\$ 2,587,743
Capital assets	2,434,576	110,793	-	2,545,369
Other non current assets	97,330	-	-	97,330
Total assets	\$ 5,448,518	\$ 149,994	\$ (368,070)	\$ 5,230,442
Liabilities and Net Position				
Current liabilities	\$ 2,701,488	\$ 392,136	\$ (368,070)	\$ 2,725,554
Long term liabilities	4,429,702	-	-	4,429,702
Total liabilities	7,131,190	392,136	(368,070)	7,155,256
Net Position				
Net investment in capital assets	1,968,318	110,793	-	2,079,111
Unrestricted net position	(3,650,990)	(352,935)	-	(4,003,925)
Total net position	(1,682,672)	(242,142)	-	(1,924,814)
Total liabilities and net position	\$ 5,448,518	\$ 149,994	\$ (368,070)	\$ 5,230,442

Sequoiah County-City of Sallisaw Hospital Authority
d/b/a Northeastern Health System Sequoiah

Notes to Financial Statements
March 31, 2018 and 2017

Operating results and changes in net position for the year ended March 31, 2018:

	Northeastern Health System Sequoiah	SMH Physician Group, LLC	Eliminations	Total
Operating Revenues				
Net patient service revenue	\$ 9,403,429	\$ 436,758	\$ -	\$ 9,840,187
Other operating revenue	44,330	-	(21,600)	22,730
Total operating revenue	9,447,759	436,758	(21,600)	9,862,917
Operating Expenses				
Depreciation	473,938	10,902	-	484,840
Other operating expenses	12,312,076	396,454	(21,600)	12,686,930
Total operating expenses	12,786,014	407,356	(21,600)	13,171,770
Operating Loss	(3,338,255)	29,402	-	(3,308,853)
Nonoperating Revenue (Expense)				
Interest income	15	-	-	15
Noncapital appropriation	736,695	-	-	736,695
Interest expense	(173,171)	-	-	(173,171)
Loss on disposal of equipment	12,200	-	-	12,200
Total non operating revenue (expense)	575,739	-	-	575,739
Expenses in Excess of Revenues Before Capital Contributions	(2,762,516)	29,402	-	(2,733,114)
Capital Contributions	125,000	-	-	125,000
Change in Net Position	(2,637,516)	29,402	-	(2,608,114)
Net Position Beginning of Year	954,844	(271,544)	-	683,300
Net Deficit End of Year	\$ (1,682,672)	\$ (242,142)	\$ -	\$ (1,924,814)

Sequoyah County-City of Sallisaw Hospital Authority
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Notes to Financial Statements
March 31, 2018 and 2017

Cash flows for the year ended March 31, 2018:

	Northeastern Health System Sequoyah	SMH Physician Group, LLC	Total
Net Cash used for Operating Activities	\$ (2,493,481)	\$ 6,128	\$ (2,487,353)
Net Cash from Noncapital Financing Activities	2,738,189	-	2,738,189
Net Cash used for Capital and related Financing Activities	(74,942)	-	(74,942)
Net Cash from Investing Activities	15	-	15
Net Change in Cash	169,781	6,128	175,909
Cash, Beginning of Year	18,026	30	18,056
Cash, End of Year	<u>\$ 187,807</u>	<u>\$ 6,158</u>	<u>\$ 193,965</u>

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, 2017.

Statement of net position as of March 31, 2017:

	Northeastern Health System Sequoyah	SMH Physician Group, LLC	Eliminations	Total
Assets				
Current assets	\$ 2,387,191	\$ 49,727	\$ (442,963)	\$ 1,993,955
Capital assets	2,499,505	121,692	-	2,621,197
Other non current assets	7,330	-	-	7,330
Total assets	<u>\$ 4,894,026</u>	<u>\$ 171,419</u>	<u>\$ (442,963)</u>	<u>\$ 4,622,482</u>
Liabilities and Net Position				
Current liabilities	\$ 2,156,395	\$ 442,963	\$ (442,963)	\$ 2,156,395
Long term liabilities	1,782,787	-	-	1,782,787
Total liabilities	<u>3,939,182</u>	<u>442,963</u>	<u>(442,963)</u>	<u>3,939,182</u>
Net Position				
Net investment in capital assets	2,359,110	121,692	-	2,480,802
Unrestricted net position	<u>(1,404,266)</u>	<u>(393,236)</u>	<u>-</u>	<u>(1,797,502)</u>
Total net position	<u>954,844</u>	<u>(271,544)</u>	<u>-</u>	<u>683,300</u>
Total liabilities and net position	<u>\$ 4,894,026</u>	<u>\$ 171,419</u>	<u>\$ (442,963)</u>	<u>\$ 4,622,482</u>

Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Northeastern Health System Sequoyah
Notes to Financial Statements
March 31, 2018 and 2017

Operating results and changes in net position for the year ended March 31, 2017:

	Northeastern Health System Sequoyah	SMH Physician Group, LLC	Eliminations	Total
Operating Revenues				
Net patient service revenue	\$ 10,034,628	\$ 482,337	\$ -	\$ 10,516,965
Other operating revenue	129,097	-	(21,600)	107,497
Total operating revenue	<u>10,163,725</u>	<u>482,337</u>	<u>(21,600)</u>	<u>10,624,462</u>
Operating Expenses				
Depreciation	525,621	11,005	-	536,626
Other operating expenses	12,226,344	553,651	(21,600)	12,758,395
Total operating expenses	<u>12,751,965</u>	<u>564,656</u>	<u>(21,600)</u>	<u>13,295,021</u>
Operating Loss	<u>(2,588,240)</u>	<u>(82,319)</u>	<u>-</u>	<u>(2,670,559)</u>
Nonoperating Revenue (Expense)				
Interest income	3,728	-	-	3,728
Noncapital appropriation	673,549	-	-	673,549
Interest expense	(112,221)	-	-	(112,221)
Noncapital gifts	16,004	-	-	16,004
Gain on disposal of equipment	(12,127)	-	-	(12,127)
Total non operating revenue (expense)	<u>568,933</u>	<u>-</u>	<u>-</u>	<u>568,933</u>
Change in Net Position	(2,019,307)	(82,319)	-	(2,101,626)
Net Position Beginning of Year	<u>2,974,151</u>	<u>(189,225)</u>	<u>-</u>	<u>2,784,926</u>
Net Position End of Year	<u>\$ 954,844</u>	<u>\$ (271,544)</u>	<u>\$ -</u>	<u>\$ 683,300</u>

Sequoyah County-City of Sallisaw Hospital Authority
d/b/a Northeastern Health System Sequoyah
Notes to Financial Statements
March 31, 2018 and 2017

Cash flows for the year ended March 31, 2017:

	Northeastern Health System Sequoyah	SMH Physician Group, LLC	Total
Net Cash from Operating Activities	\$ (1,445,270)	\$ (1,574)	\$ (1,446,844)
Net Cash from Noncapital Financing Activities	154,734	-	154,734
Net Cash from Capital and related Financing Activities	(176,723)	-	(176,723)
Net Cash from Investing Activities	979,067	-	979,067
Net Change in Cash	(488,192)	(1,574)	(489,766)
Cash, Beginning of Year	506,218	1,604	507,822
Cash, End of Year	\$ 18,026	\$ 30	\$ 18,056

Note 11 - 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 \$401,664, for the year ended March 31, 2018. In return, the Hospital received \$837,749. The Hospital made SHOPP payments totaling \$364,875, for the year ended March 31, 2017. In return, the Hospital received \$906,334. Future changes in law or regulation at the federal or state level can adversely affect or eliminate SHOPP.

Note 12 - Management Agreement

Effective June 1, 2017, the Hospital entered into a management service agreement with THA. The contract is for a five-year term with automatic renewal term of five years. The Hospital is to pay \$15,000 per month for the management services and 5% of receipts from patient billing for billing and collection services. Effective January 2018, the Hospital transferred all employees to THA. The Hospital will reimburse THA all salaries plus 30% for benefits. In addition, the Hospital will pay THA an incentive based on net profits above \$250,000. The Hospital paid THA \$1,516,610 for management fee, other professional services, contract salary and benefits in the year ended March 31, 2018. As of March 31, 2018, the Hospital owes THA \$848,405 for management fee, other professional services, contract salary and benefits. As of March 31, 2018, the Hospital owes \$364,361 for equipment leased from THA.

Note 13 - Recurring Losses and Management Plans

The Hospital has incurred operating losses during the years ended March 31, 2018 and 2017. For the years ended March 31, 2018 and 2017, the Hospital experienced a decrease in net position of \$2,608,114 and \$2,101,626. During the year, the Hospital's board signed a management agreement with a health system to manage the operations of the Hospital. The Hospital is currently working on cost cutting measures without impacting the quality of patient care. In addition, the Hospital has obtained additional financing as discussed in Note 6. Management believes these plans alleviate substantial doubt about the Hospital's ability to continue as a going concern for one year from the report date.

Note 14 - Subsequent Events

The Hospital has evaluated subsequent events through August 16, 2019 the date which the financial statements were available to be issued.



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 Northeastern Health System Sequoyah
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 Authority d/b/a Northeastern Health System Sequoyah (Hospital) as of and for the year ended March 31, 2018, and the related notes to the financial statements, which collectively comprise the Hospital’s basic financial statements, and have issued our report thereon dated August 16, 2019.

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 have not been identified. However, as described in the accompanying Schedule of Findings and Responses, we identified certain deficiencies in internal control that we consider to be material weaknesses and 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 entity’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 and Responses to be material weaknesses: 2018-001 through 2018-004.

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 deficiencies described in the accompanying Schedule of Findings and Responses to be significant deficiencies: 2018-005 through 2018-007.

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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* which is described in the accompanying Schedule of Findings and Responses as item 2018-008.

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.

The image shows a handwritten signature in cursive script that reads "Eide Bailly LLP".

Oklahoma City, Oklahoma
August 16, 2019

Material Weaknesses In Internal Control Over Financial Reporting:

2018-001 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 proposed during the audit process.

Effect: Failure to timely prepare interim financial statements represents a weakness in internal control over financial reporting. 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.

Views of Responsible Officials: Management agrees with the finding.

2018-002 Account Reconciliation

Criteria: Reviewing and reconciling accounts to the general ledger is a necessary step in the Hospital's internal control process.

Condition: During the course of our engagement, it was identified that certain accounts are not reconciled from a sub-ledger or other detail or support to the general ledger on a timely basis.

Effect: Misstatements are not identified and corrected in a timely manner.

Cause: Areas with differences that resulted in significant adjustments to the financial statements included capital assets, accounts payables and accrued liabilities.

Auditor's Recommendation: We recommend management prepare account reconciliations on a timely basis as well as a review of these reconciliations, in order to identify potential misstatements and reconciling items. Significant accounts should be reconciled from a sub-ledger or other detail or support to the general ledger at least on a monthly basis. Any variances should also be reconciled on a periodic basis to ensure that these balances also remain applicable.

Views of Responsible Officials: Management agrees with the finding.

2018-003 Calculation of Bad Debt and Contractual Allowances

Criteria: Accountings standards require an entity to report receivables at net realizable value. This requires management to estimate an allowance for contractual adjustments and doubtful accounts. The allowance should be based on historical data and current reimbursement rates.

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

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

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

Auditor's Recommendation: We recommend that management fully implement the developed methodology for estimating collections and adjustments. The allowance accounts should be reviewed each month as well for reasonableness in relation to the accounts receivable and revenue.

Views of Responsible Officials: Management agrees with the finding.

2018-004 Capital Lease

Criteria: There are two types of leases, capital and operating. A capital lease is identified by meeting one of four criteria. If the lease does not meet any of the criteria for a capital lease, it is considered an operating lease. Each type of lease is accounted for differently within an organization.

Condition: During the course of the engagement, we identified a lease that should have been recorded as a capital lease.

Cause: The Hospital does not have proper policies and procedures in place to distinguish between capital and operating leases.

Effect: Capital assets and long-term debt were not properly stated in the interim financial statements.

Auditor's Recommendation: It is recommended that the Hospital develop policies and procedures to identify capital and operating leases.

Views of Responsible Officials: Management agrees with the finding.

Significant Deficiencies In Internal Control Over Financial Reporting:

2018-005 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 Hospital. There were no review of the journal entries or monthly reconciliations for a portion of the year.

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.

Views of Responsible Officials: Management agrees with the finding.

2018-006 Estimated Third-Party Payor Settlements

Criteria: Accountings standards require an entity to estimate the amount due or receivable from Medicare in order to fairly state the financial position monthly and as of year-end.

Condition: During the current year, the Hospital did not estimate the financial effect of the Medicare cost report settlement for the current year correctly. The Hospital should record adjustments for current year activity to the estimated third-party payor settlement account.

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

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

Auditor's Recommendation: It is recommended the Hospital implement a system that provides adequate controls over estimating cost report settlements.

Views of Responsible Officials: Management agrees with the finding.

2018-007 Compensated Absences

Criteria: The Hospital implemented policies to ensure proper treatment of employees' paid time off. The policy does not allow employees to use more than what the employee has earned.

Condition: During the course of our engagement, we noted that several employees had negative paid time off balances.

Cause: The Hospital allowed employees to have negative paid time off balances which is not allowed per the Hospital's policy.

Effect: The Hospital was not in compliance with their own policies.

Auditor's Recommendation: We recommend that employees' paid time off balance be reviewed each pay period to adhere to the Hospital's policies.

Views of Responsible Officials: Management agrees with the finding.

Material Weaknesses In Internal Control Over Compliance:

2018-008 Payroll Taxes

Criteria: An employer is required to withhold federal and state income and payroll taxes from its employees' wages and pay them to the taxing authority. Withheld taxes are called trust fund taxes because the employer holds the employee's money (federal and state income taxes and the employee portion Federal Insurance Contributions Act taxes) in trust until federal and state deposits of the amounts are made.

Condition: The Hospital had delinquent federal payroll taxes for the quarter ending June 30, 2015, from the quarter ending December 31, 2015 to quarter ending December 31, 2016 and the quarter ending June 30, 2017.

Cause: The Hospital was delinquent in paying payroll taxes.

Effect: This resulted in penalties and interest being assessed against the Hospital. In addition, the Hospital was in violation of federal laws.

Auditor's Recommendation: It is recommended that the Hospital establish policies and procedures to ensure trust tax deposits are made in a timely manner.

Views of Responsible Officials: Management agrees with the finding.