Atoka County Healthcare Authority

Accountants' Reports and Financial Statements

December 31, 2011 and 2010

BKD LLP
CPAs & Advisors

Atoka County Healthcare Authority

December 31, 2011 and 2010

Contents

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Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Trustees
Atoka County Healthcare Authority
Atoka, Oklahoma

We have audited the accompanying balance sheets of Atoka County Healthcare Authority (the Hospital) as of December 31, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As more fully described in *Note 9* to the financial statements, the Hospital has classified its Series 2007 Revenue Bonds, which are subject to acceleration, as long-term debt in the accompanying 2011 balance sheet which practice, in our opinion, is not in accordance with accounting principles generally accepted in the United States of America. The effects on the 2011 balance of the aforementioned item are disclosed in *Note 9*.

In our opinion, except for the effect on the 2011 balance sheet of the matter described in the previous paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of Atoka County Healthcare Authority as of December 31, 2011 and 2010, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 11, 2012, on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis listed in the table of contents be presented to supplement the basic financial statements. Such information, although not 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 inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audits 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.

BKD, LLP

July 11, 2012

Atoka County Healthcare Authority

Management's Discussion and Analysis

Years Ended December 31, 2011 and 2010

Introduction

This management's discussion and analysis of the financial performance of Atoka County Healthcare Authority (the Hospital) provides an overview of the Hospital's financial activities for the years ended December 31, 2011 and 2010. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Cash, cash equivalents and short-term certificates of deposit decreased by $505,922 or 18% in 2011 compared to 2010.
- Long-term debt increased by $864,822 or 5% in 2011 compared to 2010.
- Other current liabilities increased by $328,248 or 36% in 2011 over 2010.
- Net patient service revenue decreased by $1,380,548 or 17% in 2011 over 2010.
- The Hospital's net assets decreased by $1,512,600 or 37%.
- The Hospital reported operating losses in both 2011 $(1,664,589) and 2010 $(709,818). The operating loss in 2011 increased by $954,771 or 135% over the operating loss reported in 2010.

Using This Annual Report

The Hospital's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, 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 Balance Sheet and Statement of Revenues, Expenses and Changes in Net Assets

One of the most important questions asked about any organization's finances is, "Is the organization as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement of revenues, expenses and changes in net assets 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 all liabilities using the accrual basis of accounting. Using the accrual basis of accounting means that 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 assets and changes in them. The Hospital's total net assets—the difference between assets and liabilities—is one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net assets are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

The Statement of Cash Flows

The statement of cash flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of 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 and cash equivalents during the reporting period.

The Hospital's Net Assets

The Hospital's net assets are the difference between its assets and liabilities reported in the accompanying balance sheets. The Hospital's net assets decreased by $1,512,600 (37%) in 2011 over 2010, as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets

	2011	2010
Assets		
Cash and cash equivalents	$ 1,684,884	$ 1,672,178
Patient accounts receivable, net	841,311	899,536
Other current assets	1,635,956	1,879,155
Capital assets, net	16,079,825	16,197,176
Other noncurrent assets	1,484,274	1,497,735
Total assets	$ 21,726,250	$ 22,145,780
Liabilities		
Long-term debt (including current portion)	$ 17,964,528	$ 17,099,706
Other current liabilities	1,147,380	919,132
Total liabilities	19,111,908	18,018,838
Net Assets		
Invested in capital assets, net of related debt	(875,726)	126,315
Restricted – expendable for debt service	815,915	808,312
Unrestricted	2,674,153	3,192,315
Total net assets	2,614,342	4,126,942
Total liabilities and net assets	$ 21,726,250	$ 22,145,780

Operating Results and Changes in the Hospital's Net Assets

In 2011, the Hospital's net assets decreased by $1,512,600 or 37%, as shown in Table 2. This decrease is made up of several different components and represents a decrease of $838,194 or 124% compared with the decrease in net assets for 2010 of $674,406. The table below represents the operating results of the Hospital for the years ended December 31, 2011 and 2010.

Table 2: Operating Results and Changes in Net Assets

	2011	2010
Operating Revenues		
Net patient service revenue	$ 6,823,071	$ 8,103,619
Other operating revenue	330,663	12,448
Total operating revenues	7,153,734	8,116,067
Operating Expenses		
Salaries, wages and employee benefits	4,252,325	4,871,957
Purchased services and professional fees	1,151,392	875,650
Depreciation and amortization	1,512,216	1,413,140
Other operating expenses	1,902,390	1,665,138
Total operating expenses	8,818,323	8,825,885
Operating Income (Loss)	(1,664,589)	(709,818)
Nonoperating Revenues (Expenses)		
Noncapital appropriations – Atoka County	1,094,692	982,673
Investment income	19,732	8,899
Noncapital grants and gifts	24,285	15,308
Interest expense	(986,720)	(971,468)
Total nonoperating revenues (expenses)	151,989	35,412
Decrease in Net Assets	$ (1,512,600)	$ (674,406)

Operating Losses

The first component of the overall change in the Hospital's net assets is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In both 2011 and 2010, the Hospital has reported an operating loss. This is consistent with the Hospital's recent operating history, as the Hospital was formed and is operated primarily to serve residents of Atoka, Oklahoma, and the surrounding area. The Hospital receives appropriations from Atoka County, Oklahoma, based on sales taxes to provide sufficient resources to enable the facility to serve lower income and other residents.

The operating loss for 2011 increased by $954,771 or 135% as compared to 2010. The primary components of the improved operating loss are:

- A decrease in net patient service revenue of $1,280,548 or 16% primarily due to increased Medicare contractual adjustments.
- An increase in other operating revenue of $318,215 due to Medicaid incentive payments received for the Hospital's investment in electronic health records.
- A decrease in salaries, wages and employee benefits of $619,632 or 13% due to the Hospital's efforts to reduce costs and manage the number of hours worked by employees.
- An increase in purchased services and professional fees of $275,742 or 31% primarily due to increases in fees paid for physician coverage of the Hospital's emergency room and attorney's fees.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of appropriations from Atoka County based on sales taxes levied and investment income and interest expense. The Hospital recognized an increase in its County appropriations in 2011 compared to 2010, resulting primarily from an increase in County sales during the year.

The Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with changes in operating losses and nonoperating revenues and expenses for 2011 and 2010, discussed earlier, and with sales of certain investments.

Capital Assets and Debt Administration

Capital Assets

At the end of 2011, the Hospital had $16,079,825 invested in capital assets, net of accumulated depreciation, as detailed in *Note 6* to the accompanying financial statements. In 2011, the Hospital purchased new equipment costing $1,375,700. Of this amount, $94,628 was acquired through incursion of capital lease obligations.

At the end of 2010, the Hospital had $16,197,176 invested in capital assets, net of accumulated depreciation, as detailed in *Note 6* to the accompanying financial statements. In 2010, the Hospital purchased new equipment costing $91,919.

Debt

At December 31, 2011 and 2010, the Hospital had $17,964,528 and $17,099,706, respectively, in notes payable and capital lease obligations outstanding. In 2011, the Hospital issued debt of $1,400,454, of which $1,305,826 was a note payable to bank for purchase of an electronic health record, billing and accounting system and $94,628 related to a capital lease for diagnostic equipment. The Hospital issued no new debt in 2010.

As described in *Note 9*, for the year ended December 31, 2011, the Hospital had a debt service coverage ratio of .65 to 1.00, which is considered an Event of Default under the Bond Indenture. Management believes the additional revenues from the SHOPP program and Medicare electronic health records incentive program will be sufficient to raise the 2012 debt service coverage ratio to the required 1.25 to 1.00.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers 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's administrative office by telephoning 580.889.3333.

Atoka County Healthcare Authority
Balance Sheets
December 31, 2011 and 2010

Assets

	2011	2010
Current Assets		
Cash and cash equivalents	$ 1,684,884	$ 1,672,178
Restricted cash and investments – current	200,478	196,251
Patient accounts receivable, net of allowance; 2011 – $620,000, 2010 – $433,000	841,311	899,536
Short-term certificates of deposit	654,546	1,173,174
Other receivables	410,101	180,379
Supplies	260,321	185,830
Prepaid expenses and other	110,510	143,521
Total current assets	4,162,151	4,450,869
Noncurrent Cash and Investments		
Held by trustee for debt service	998,160	988,480
Externally restricted	170,028	169,074
	1,168,188	1,157,554
Less amount required to meet current obligations	200,478	196,251
	967,710	961,303
Capital Assets, Net	16,079,825	16,197,176
Deferred Financing Costs, Net	516,564	536,432
Total assets	$ 21,726,250	$ 22,145,780

See Notes to Financial Statements

Liabilities and Net Assets

	2011	2010
Current Liabilities		
Current maturities of long-term debt	$ 710,806	$ 387,595
Accounts payable	290,562	156,530
Accrued expenses	274,573	207,434
Accrued interest payable	182,245	180,168
Estimated amounts due to third-party payers	400,000	375,000
Total current liabilities	1,858,186	1,306,727
Long-Term Debt	17,253,722	16,712,111
Total liabilities	19,111,908	18,018,838
Net Assets		
Invested in capital assets, net of related debt	(875,726)	126,315
Restricted – expendable for debt service	815,915	808,312
Unrestricted	2,674,153	3,192,315
Total net assets	2,614,342	4,126,942
Total liabilities and net assets	$ 21,726,250	$ 22,145,780

Atoka County Healthcare Authority

Statements of Revenues, Expenses and Changes in Net Assets

Years Ended December 31, 2011 and 2010

	2011	2010
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2011 – $2,303,619, 2010 – $1,181,863	$ 6,823,071	$ 8,103,619
Other	330,663	12,448
Total operating revenues	7,153,734	8,116,067
Operating Expenses		
Salaries and wages	3,717,652	4,208,076
Employee benefits	534,673	663,881
Purchased services and professional fees	1,151,392	875,650
Supplies and other	1,292,041	1,082,134
Medical supplies and drugs	610,349	583,004
Depreciation and amortization	1,512,216	1,413,140
Total operating expenses	8,818,323	8,825,885
Operating Loss	(1,664,589)	(709,818)
Nonoperating Revenues (Expenses)		
Noncapital appropriations – Atoka County	1,094,692	982,673
Investment income	19,732	8,899
Interest expense	(986,720)	(971,468)
Noncapital grants and gifts	24,285	15,308
Total nonoperating revenues (expenses)	151,989	35,412
Deficiency of Revenues over Expenses and Change in Net Assets	(1,512,600)	(674,406)
Net Assets, Beginning of Year	4,126,942	4,801,348
Net Assets, End of Year	$ 2,614,342	$ 4,126,942

Atoka County Healthcare Authority

Statements of Cash Flows

Years Ended December 31, 2011 and 2010

	2011	2010
Operating Activities		
Receipts from and on behalf of patients	$ 6,906,296	$ 9,881,841
Payments to suppliers and contractors	(3,011,027)	(2,645,164)
Payments to and on behalf of employees	(4,185,186)	(4,906,069)
Other receipts and payments, net	330,663	12,448
Net cash provided by operating activities	40,746	2,343,056
Noncapital Financing Activities		
Noncapital grants and gifts	24,285	15,308
County appropriations supporting operations	864,970	1,085,600
Net cash provided by noncapital financing activities	889,255	1,100,908
Capital and Related Financing Activities		
Proceeds from issuance of long-term debt	1,305,826	-
Principal paid on long-term debt	(535,632)	(338,557)
Interest paid on long-term debt	(984,643)	(1,044,963)
Purchase of capital assets	(1,230,572)	(91,919)
Net cash used in capital and related financing activities	(1,445,021)	(1,475,439)
Investing Activities		
Purchase of investments	(997,746)	(1,170,172)
Proceeds from disposition of investments	1,511,489	504,243
Investment income received	19,732	8,899
Net cash provided by (used in) investing activities	533,475	(657,030)
Increase in Cash and Cash Equivalents	18,455	1,311,495
Cash and Cash Equivalents, Beginning of Year	2,040,216	728,721
Cash and Cash Equivalents, End of Year	$ 2,058,671	$ 2,040,216
Reconciliation of Cash and Cash Equivalents to the Balance Sheet		
Cash and cash equivalents in current assets	$ 1,684,884	$ 1,672,178
Cash equivalents in noncurrent cash and investments		
Held by trustee for debt service	203,759	198,964
Externally restricted	170,028	169,074
	$ 2,058,671	$ 2,040,216

See Notes to Financial Statements

	2011	2010
Reconciliation of Operating Loss to Net Cash Provided by Operating Activities		
Operating loss	$ (1,664,589)	$ (709,818)
Loss on sale of capital assets	-	3,775
Item not requiring cash		
Depreciation and amortization	1,512,216	1,413,140
Changes in operating assets and liabilities		
Patient accounts receivable, net	58,225	648,590
Supplies, prepaid expenses and other	(40,776)	(34,023)
Estimated amounts due to third-party payers	25,000	1,129,632
Accounts payable and accrued expenses	150,670	(108,240)
Net cash provided by operating activities	$ 40,746	$ 2,343,056
Supplemental Cash Flows Information		
Capital lease obligations incurred for capital assets	$ 94,628	$ -
Capital asset additions in accounts payable	$ 50,500	$ -

Atoka County Healthcare Authority
Notes to Financial Statements
December 31, 2011 and 2010

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations and Reporting Entity

Atoka County Healthcare Authority (the Hospital) was established January 1, 1992, as a public trust to develop and deliver health care and health care-related services to the citizens of Atoka County, Oklahoma (the County), the trust's beneficiary. The Hospital's trustees are appointed by a majority vote of the Atoka County Commissioners.

The Hospital operates the Atoka County Medical Center under a bargain lease agreement with the County. The lease commenced January 1, 1992, and is in effect for 99 years and until all indebtedness incurred by the Hospital has been paid, or provisions for such payment have been made.

The Hospital, located in Atoka, Oklahoma, operates a 25-bed critical access hospital and primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Atoka, Oklahoma, area.

The Atoka Memorial Hospital Foundation (the Foundation) is a not-for-profit organization organized to support certain charitable health care activities of the Hospital and, accordingly, is included as a component unit in the Hospital's financial statements using the blended method. All significant intercompany accounts and transactions between the Hospital and the Foundation have been eliminated in the accompanying financial statements.

Basis of Accounting and Presentation

The accompanying financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally, County appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific, such as County appropriations, investment income and interest on capital assets-related debt, are included in nonoperating revenues and expenses. The Hospital first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989, and do not conflict with or contradict GASB pronouncements.

Use of Estimates

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

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2011 and 2010, cash equivalents consisted primarily of certificates of deposit held at a bank and money market mutual funds held by a broker.

Risk Management

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

Investments and Investment Income

Investments in nonnegotiable certificates of deposit are carried at amortized cost. All other investments are carried at fair value. Fair value is determined using quoted market prices. Investment income includes interest and dividend income and the net change for the year in the fair value of investments carried at fair value.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Supplies

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

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

Buildings, improvements and fixed equipment	5–40 years
Major movable equipment	2–20 years

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method.

Compensated Absences

Hospital policies permit most employees to accumulate vacation benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments, such as Social Security and Medicare taxes, computed using rates in effect at that date.

Net Assets

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

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue.

Income Taxes

As an essential government function, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law. However, the Hospital is subject to federal income tax on any unrelated business taxable income.

Foundation

Atoka Memorial Hospital Foundation (the Foundation) is a legally separate, tax-exempt component unit of the Hospital. The Foundation's primary function is to raise and hold funds to support the Hospital and its programs. The Foundation's bylaws require the Foundation's board of trustees to always include a majority of members elected by the Hospital's trustees.

Although the Hospital does not control the timing or amount of receipts from the Foundation, the majority of the Foundation's resources and related income are restricted by donors for the benefit of the Hospital. Because the majority of the Foundation's board of trustees are elected by the Hospital's trustees, the Foundation is considered a component unit of the Hospital and is presented in the Hospital's financial statements using the blended method.

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). Critical access hospitals are eligible to receive incentive payments for up to four years under the Medicare program for its reasonable costs of the purchase of certified EHR technology multiplied by the Hospital's Medicare utilization plus 20%, limited to 100% of the costs incurred. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the Hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period.

The Hospital recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

In 2011, the Hospital completed the first-year requirements under the Medicaid program and has recorded revenue of approximately $200,000, which is included in other revenue within operating revenues in the statement of revenues, expenses and changes in net assets.

In 2012, the Hospital completed the first-year requirements under the Medicare program and received an initial payment of approximately $772,000.

The final amount for any payment year under both programs is determined based upon an audit by the administrative contractor. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

Reclassifications

Certain reclassifications have been made to the 2010 financial statements to conform to the 2011 presentation. The reclassifications had no effect on the changes in net assets.

Note 2: Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

Medicare – Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid based on a cost reimbursement methodology. Certain outpatient services related to Medicare beneficiaries are paid based on a combination of fee schedules and a cost reimbursement methodology. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare administrative contractor. The Hospital's Medicare cost reports have been audited by the Medicare administrative contractor through December 31, 2009.

Medicaid – The Hospital is reimbursed for services rendered to patients covered by the state Medicaid program on a prospective per discharge or fee schedule method with no retroactive adjustments. These payment rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

Approximately 81% and 79% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2011 and 2010, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider 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.

Note 3: Unrestricted County Appropriations

In 1985, the citizens of Atoka County, Oklahoma, approved a 1% sales tax to be appropriated to the Hospital to support its operations. The tax is to remain in effect as long as the Hospital is in operation or until the sales tax is repealed. The Hospital received approximately 13% and 11% of its financial support from County appropriations related to the sales tax during 2011 and 2010, respectively. Revenue from County appropriations is recognized in the year in which the sales tax is earned.

Note 4: Deposits, Investments and Investment Income

Deposits

Custodial credit risk is the risk that in the event of a bank failure a government's deposits may not be returned to it. The Hospital's deposit policy for custodial credit risk requires collateralization of all deposits with federal depository insurance and other acceptable collateral in specific amounts.

At December 31, 2011 and 2010, respectively, none of the Hospital's bank balance of $3,304,894 and $3,807,802 was exposed to custodial credit risk.

Investments

At December 31, 2011 and 2010, respectively, the Hospital had $203,759 and $198,964 of money market mutual funds that have maturities of less than one year. At December 31, 2011 and 2010, all of the Hospital's investments were held by a trustee for debt service. The Hospital does not have an investment policy.

Interest Rate Risk – Interest rate risk is the exposure to fair value losses arising from rising interest rates. The money market mutual funds are considered as an investment with a maturity of less than one year because they are redeemable in full immediately.

Credit Risk – Credit risk is the risk that the issuer or other counterparty to an investment will not fulfill its obligations. At December 31, 2011 and 2010, none of the Hospital's investments were rated by credit agencies.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party.

Concentration of Credit Risk – The Hospital places no limit on the amount that may be invested in any one issuer. At December 31, 2011 and 2010, all of the Hospital's investments were held in the money market mutual fund of Federated Prime Obligation Funds.

Summary of Carrying Values

The carrying values of deposits and investments are included in the balance sheets as follows:

	2011	2010
Carrying value		
Deposits	$ 3,303,859	$ 3,803,942
Investments	203,759	198,964
	$ 3,507,618	$ 4,002,906
Included in the following balance sheet captions		
Cash and cash equivalents	$ 1,684,884	$ 1,672,178
Restricted cash and investments – current	200,478	196,251
Short-term certificates of deposit	654,546	1,173,174
Noncurrent cash and investments	967,710	961,303
	$ 3,507,618	$ 4,002,906

Investment Income

Investment income for the years ended December 31, 2011 and 2010, consisted of interest income.

Note 5: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at December 31 consisted of:

	2011	2010
Patients	$ 655,849	$ 647,352
Insurance carriers	274,468	110,887
Medicare	482,524	528,304
Medicaid	48,470	45,993
	1,461,311	1,332,536
Less allowance for uncollectible accounts	620,000	433,000
	$ 841,311	$ 899,536

Note 6: Capital Assets

Capital assets activity for the years ended December 31 was:

	2011				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 158,508	$ -	$ -	$ -	$ 158,508
Buildings, improvements and fixed equipment	17,068,450	171,973	-	-	17,240,423
Major moveable equipment	3,047,233	1,203,727	(94,234)	-	4,156,726
	20,274,191	1,375,700	(94,234)	-	21,555,657
Less accumulated depreciation					
Buildings, improvements and fixed equipment	2,871,925	972,182	-	(78,357)	3,765,750
Major moveable equipment	1,205,090	520,869	(94,234)	78,357	1,710,082
	4,077,015	1,493,051	(94,234)	-	5,475,832
Capital assets, net	$ 16,197,176	$ (117,351)	$ -	$ -	$ 16,079,825

	2010				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 158,508	$ -	$ -	$ -	$ 158,508
Buildings, improvements and fixed equipment	17,013,806	54,644	-	-	17,068,450
Major moveable equipment	4,625,646	37,275	(1,615,688)	-	3,047,233
	21,797,960	91,919	(1,615,688)	-	20,274,191
Less accumulated depreciation					
Buildings, improvements and fixed equipment	1,905,945	965,980	-	-	2,871,925
Major moveable equipment	2,399,542	418,671	(1,613,123)	-	1,205,090
	4,305,487	1,384,651	(1,613,123)	-	4,077,015
Capital assets, net	$ 17,492,473	$ (1,292,732)	$ (2,565)	$ -	$ 16,197,176

Note 7: Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses included in current liabilities at December 31 consisted of:

	2011	2010
Payable to suppliers and contractors	$ 290,562	$ 156,530
Payable to employees (including payroll taxes and benefits)	274,573	207,434
	$ 565,135	$ 363,964

Note 8: Medical Malpractice Claims

The Hospital purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

Note 9: Long-Term Debt

The following is a summary of long-term debt transactions for the Hospital for the years ended December 31:

	2011				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Revenue bonds	$ 9,860,000	$ -	$ (150,000)	$ 9,710,000	$ 155,000
Bond discount	(21,118)	-	2,816	(18,302)	(704)
	9,838,882	-	(147,184)	9,691,698	154,296
USDA mortgage	6,729,905	-	(80,256)	6,649,649	84,202
Note payable – bank	-	1,305,826	(149,904)	1,155,922	310,905
Capital lease obligations	530,919	94,628	(158,288)	467,259	161,403
Total long-term debt	$ 17,099,706	$ 1,400,454	$ (535,632)	$ 17,964,528	$ 710,806

	2010				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Revenue bonds	$ 10,000,000	$ -	$ (140,000)	$ 9,860,000	$ 150,000
Bond discount	(21,118)	-	-	(21,118)	(704)
	9,978,882	-	(140,000)	9,838,882	149,296
USDA mortgage	6,750,000	-	(20,095)	6,729,905	80,704
Capital lease obligations	709,381	-	(178,462)	530,919	157,595
Total long-term debt	$ 17,438,263	$ -	$ (338,557)	$ 17,099,706	$ 387,595

Revenue Bonds

Atoka County Healthcare Authority Hospital Revenue Bonds, Series 2007 (the Bonds) in the original amount of $10,000,000 and sold at a discount of $28,118 are dated September 6, 2007. The Bonds are payable with principal payments due annually and interest payments at interest rates of 5.875% to 6.625% due semiannually. The Hospital is required to make monthly payments to the debt service fund held by the trustee in the amount of 1/6 the next semiannual interest payment due and 1/12 the amount of the next annual principal payment due. All of the Bonds outstanding may be redeemed at the Hospital's option no earlier than October 1, 2017, at par value. The Bonds are secured by the revenues, including County appropriations, and certain assets of the Hospital as described in the mortgage and security agreement.

The bond indenture (the Indenture) requires that certain funds be established with the trustee. Accordingly, these funds are included as assets held by trustee for debt service in the accompanying balance sheets. The bond indenture also requires the Hospital to comply with certain restrictive covenants, including minimum insurance coverage, maintaining a debt service coverage ratio of at least 1.25 to 1.00, restrictions on incurrence of additional debt, maintaining minimum days cash on hand of 45 days and maintaining a minimum current ratio of 2.0 to 1.0.

At December 31, 2011, the Hospital had a debt service coverage ratio of less than 1.00 to 1.00, which is considered an Event of Default as defined by the Indenture. The Indenture stipulates that as a result of the Event of Default the bond trustee may declare that the principal and accrued interest on the Bonds become due and payable immediately. The bond trustee has not formally waived this Event of Default. Under accounting principles generally accepted in the United States of America, debt subject to acceleration should be classified on the balance sheet as a current liability. Instead, Hospital management has elected to classify the portion of the Bonds not originally scheduled to mature in the next year as long-term debt in the accompanying 2011 balance sheet. The effect of this treatment is to understate current liabilities and overstate long-term debt by $9,555,000 in the accompanying 2011 balance sheet.

The discount on the Bonds is being amortized over the term of the Bonds using the straight-line method.

The debt service requirements as of December 31, 2011, are as follows:

Year Ending December 31,	Total to be Paid	Principal	Interest
2012	$ 788,500	$ 155,000	$ 633,500
2013	789,394	165,000	624,394
2014	789,700	175,000	614,700
2015	789,419	185,000	604,419
2016	788,550	195,000	593,550
2017-2021	3,954,644	1,180,000	2,774,644
2022-2026	3,950,313	1,615,000	2,335,313
2027-2031	3,954,488	2,230,000	1,724,488
2032-2036	3,950,794	3,070,000	880,794
2037-2041	789,025	740,000	49,025
	$ 20,544,827	$ 9,710,000	$ 10,834,827

USDA Mortgage

Obligations issued by Atoka County Healthcare Authority and secured by first mortgage on the Hospital's property and pledge of the Hospital's gross revenues; principal and interest of $30,432 payable monthly through September 2047; interest at 4.25%.

The debt service requirements as of December 31, 2011, are as follows:

Year Ending December 31,	Total to be Paid	Principal	Interest
2012	$ 365,184	$ 84,202	$ 280,982
2013	365,184	87,851	277,333
2014	365,184	91,658	273,526
2015	365,184	95,630	269,554
2016	365,184	99,775	265,409
2017-2021	1,825,920	567,604	1,258,316
2022-2026	1,825,920	701,730	1,124,190
2027-2031	1,825,920	867,550	958,370
2032-2036	1,825,920	1,072,554	753,366
2037-2041	1,825,920	1,326,001	499,919
2042-2046	1,825,920	1,639,337	186,583
2047	15,813	15,757	56
	$ 12,797,253	$ 6,649,649	$ 6,147,604

Note Payable to Bank

The note payable to bank is due June 23, 2015, with principal and interest at 4.75% payable monthly. The note is secured by certain capital assets. The debt service requirements as of December 31, 2011, are as follows:

Year Ending December 31,	Total to be Paid	Principal	Interest
2012	$ 359,095	$ 310,905	$ 48,190
2013	359,095	325,998	33,097
2014	359,095	341,825	17,270
2015	179,655	177,194	2,461
	$ 1,256,940	$ 1,155,922	$ 101,018

Capital Lease Obligations

The Hospital is obligated under various leases for equipment that are accounted for as capital leases. Assets under capital leases at December 31, 2011 and 2010, totaled $955,794 and $955,400, respectively, net of accumulated depreciation of $489,822 and $466,565, respectively. The following is a schedule by year of future minimum lease payments under capital leases, including interest at rates ranging from 2.30% to 9.87% together with the present value of the future minimum lease payments as of December 31, 2011:

Year Ending December 31,	
2012	$ 184,955
2013	178,375
2014	112,643
2015	22,008
2016	14,671
Total minimum lease payments	512,652
Less amount representing interest	45,393
Present value of future minimum lease payments	$ 467,259

Note 10: Charity Care

In support of its mission, the Hospital voluntarily provides free care to patients who lack financial resources and are deemed to be medically indigent. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported in net patient service revenue. In addition, the Hospital provides services to other medically indigent patients under certain government-reimbursed public aid programs. Such programs pay providers amounts which are less than established charges for the services provided to the recipients and many times the payments are less than the cost of rendering the services provided.

Uncompensated charges relating to these services are approximately as follows:

	2011	2010
Charity allowances	$ 66,000	$ 105,000
Medicaid welfare	2,049,000	1,958,000
	$ 2,115,000	$ 2,063,000

In addition to uncompensated charges, the Hospital also commits significant time and resources to endeavors and critical services which meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. Such programs include health screening and assessments, community educational services and various support groups.

Note 11: Risks and Uncertainties

Current Economic Conditions

The current protracted economic decline continues to present hospitals with difficult circumstances and challenges, which in some cases have resulted in large declines in the fair values of investments and other assets, large declines in contributions, constraints on liquidity and difficulty obtaining financing. The financial statements have been prepared using values and information currently available to the Hospital.

Current economic conditions, including the rising unemployment rate, have made it difficult for certain of the Hospital's patients to pay for services rendered. As employers make adjustments to health insurance plans or more patients become unemployed, services provided to self-pay and other payers may significantly impact net patient service revenue, which could have an adverse impact on the Hospital's future operating results. Further, the effect of economic conditions on the state may have an adverse effect on cash flows related to the Medicaid program.

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the accompanying financial statements could change rapidly, resulting in material future adjustments in investment values and allowances for accounts receivable that could negatively impact the Hospital's ability to meet debt covenants or maintain sufficient liquidity.

Note 12: Pension Plan

The Hospital contributes to 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 Hospital. 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 governing body.

Contribution rates for plan members and the Hospital expressed as a percentage of covered payroll were 1.8% and 0.3% for 2011 and 2.0% and 0.5%, for 2010, respectively. Contributions actually made by plan members and the Hospital aggregated $67,000 and $11,000 during 2011 and $73,000 and $17,000 during 2010, respectively.

Note 13: Contingencies

Litigation

In the normal course of business, the Hospital is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Note 14: Subsequent Events

SHOPP Program

On January 17, 2012, the Centers for Medicare and Medicaid Services (CMS) approved the State of Oklahoma's Supplemental Hospital Offset Payment Program (SHOPP). The SHOPP program is retroactive back to July 1, 2011, and is currently scheduled to sunset on December 31, 2014. The SHOPP program is designed to assess certain Oklahoma hospitals a supplemental hospital offset fee which will be placed in pools after receiving federal matching funds. The total fees and matching funds will then be allocated to hospitals as directed by legislation.

Critical access hospitals are excluded from paying an assessment fee but are still eligible to receive SHOPP funds. Based on preliminary estimates, the Hospital will receive approximately $538,000 in SHOPP funds annually. As final approval by CMS was not obtained as of December 31, 2011, the accompanying 2011 financial statements do not include any activity related to the SHOPP program. In fiscal year 2012, the Hospital expects to recognize approximately $807,000 of revenue related to the SHOPP program. In April 2012, the Hospital received $269,000 of SHOPP funds.

Electronic Health Records Incentive Program

As described in *Note 1*, in 2012 the Hospital completed the first-year requirements under the Medicare program and received an initial payment of approximately $772,000 under this program.

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

Board of Trustees
Atoka County Healthcare Authority
Atoka, Oklahoma

We have audited the financial statements of Atoka County Healthcare Authority (the Hospital) as of and for the year ended December 31, 2011, and have issued our report thereon dated July 11, 2012, which expressed a qualified opinion because of a departure from accounting principles generally accepted in the United States of America. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the Hospital is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Hospital's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control over financial reporting.

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 deficiencies, significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. However, as discussed in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that 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 and responses as items 2011-2, 2011-3 and 2011-4 to be material weaknesses.

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 deficiency described in the accompanying schedule of findings and responses as item 2011-1 to be a significant deficiency.

Board of Trustees
Atoka County Healthcare Authority

Compliance and Other Matters

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

We also noted certain matters that we reported to the Hospital's management in a separate letter dated July 11, 2012.

The Hospital's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the Hospital's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the governing body, management and others within the Hospital and is not intended to be and should not be used by anyone other than these specified parties.

BKD, LLP

July 11, 2012

Atoka County Healthcare Authority

Schedule of Findings and Responses

Year Ended December 31, 2011

Reference Number	Finding
2011-1	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition – Employee duties are not adequately segregated among access, accounting and monitoring in the patient revenues, cash receipts and accounts receivable transactions cycle. Context – The data entry clerk and the business office coordinator have the ability to receive payments and post adjustments to patient accounts. Additionally, review procedures related to recording adjustments are insufficient. Effect – Potentially material misstatements in the financial statements or material misappropriations of assets could occur and not be prevented or detected in a timely manner. Cause – Duties in the patient revenues, cash receipts and accounts receivable transactions cycle are not adequately segregated and monitoring or other compensating controls are insufficient. Recommendation – Management should periodically evaluate the costs and the benefits of further segregation of duties or addition of monitoring or other compensating controls and implement those changes it deems appropriate for which benefits are determined to exceed costs. Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and will perform the suggested evaluation within the next year.

Atoka County Healthcare Authority
Schedule of Findings and Responses
Year Ended December 31, 2011

Reference Number	Finding
2011-2	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition – Reconciliation processes surrounding cash accounts are inadequate. Context – The monthly bank reconciliation process did not result in corrections for differences between the reconciled bank balance and the general ledger accounts. Effect – Errors or misappropriations could occur and not be prevented or detected. Cause – The bank reconciliation process does not cause identification and resolution of errors in related accounting records. Recommendation – The monthly bank reconciliation should be used to identify errors in the accounting records and to make required entries to correct the errors noted. A member of management should also review the reconciliation and ensure all variances and errors are properly resolved. Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and will implement the recommended changes to the bank reconciliation processes and management reviews of the reconciliations.

Atoka County Healthcare Authority

Schedule of Findings and Responses

Year Ended December 31, 2011

Reference Number	Finding
2011-3	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition – Several adjusting journal entries were required to correct material misstatements in the accompanying financial statements. Context – Errors existed in several balance sheet accounts related to errors in reconciliations, control accounts not reconciling to supporting documentation and estimates being materially over- or understated. Effect – Potentially material adjustments could be made to the financial statements previously presented to the Board. Cause – The reconciliation processes in place were not sufficient to properly state balances, including capital assets, inventory, long-term debt and accrued liabilities. In addition, the process of preparing estimates of allowances for contractual adjustments and bad debts and estimated amounts due from or to Medicare were inadequate. Recommendation – Management should revise the monthly procedures of evaluation and reconciliation of the general ledger accounts to underlying supporting documents and computing key significant estimates. Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and will perform the evaluation and implement corrections that are considered cost-effective within the next year.

Atoka County Healthcare Authority

Schedule of Findings and Responses

Year Ended December 31, 2011

Reference Number	Finding
2011-4	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition – Several journal entries lacked documentation of review by someone other than the preparer. Context – Our testing of controls surrounding interim journal entries indicated review of journal entries during the year was either not performed or not documented consistently. Effect – Errors or misappropriations could occur and not be prevented or detected. Cause – Controls surrounding journal entries are insufficient to make sure the entries are reviewed and the review is documented. Recommendation – Management should review procedures to ensure review and documentation of the review of adjusting journal entries as part of the month-end closing procedures are performed in accordance with its policy. Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and will implement the suggested actions within the next year.