Choctaw County – City of Hugo Hospital Authority

Auditor's Reports and Financial Statements

June 30, 2014 and 2013

BKD LLP
CPAs & Advisors

Choctaw County – City of Hugo Hospital Authority
June 30, 2014 and 2013

Contents

BKD LLP
CPAs & Advisors

Two Warren Place // 6120 S. Yale Avenue, Suite 1400 // Tulsa, OK 74136-4223
918.584.2900 // fax 918.584.2931 // bkd.com

Independent Auditor's Report

Board of Trustees
Choctaw County – City of Hugo Hospital Authority
Hugo, Oklahoma

Report on the Financial Statements

We have audited the accompanying financial statements of Choctaw County – City of Hugo Hospital Authority (the Authority), which comprise the balance sheets as of June 30, 2014 and 2013, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of 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 entity'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 entity'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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Choctaw County – City of Hugo Hospital Authority as of June 30, 2014 and 2013, 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.

Required Supplementary Information

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 audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated January 31, 2015, on our consideration of the Authority'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* in considering the Authority's internal control over financial reporting and compliance.

BKD, LLP

Tulsa, Oklahoma
January 31, 2015

Choctaw County – City of Hugo Hospital Authority
Management's Discussion and Analysis
Years Ended June 30, 2014 and 2013

Introduction

This management's discussion and analysis of the financial performance of Choctaw County – City of Hugo Hospital Authority (the Authority) provides an overview of the Authority's financial activities for the years ended June 30, 2014 and 2013. It should be read in conjunction with the accompanying financial statements of the Authority.

Financial Highlights

- Cash and certificates of deposit increased in 2014 and 2013 by $242,200 or 4.2% and $1,150,233 or 24.8%, respectively.
- The Authority's net position increased in each of the past two years with a $70,136 or 0.8% increase in 2014 and a $2,279,520 or 32.8% increase in 2013.
- The Authority reported an operating loss of $798,276 in 2014, a decrease of $2,193,896 or 157.2% from 2013. In 2013, the Authority reported operating income of $1,395,620, which was an increase of $1,271,158 or 1,021.3% over the operating income reported in 2012.

Using This Annual Report

The Authority's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net position; and a statement of cash flows. These statements provide information about the activities of the Authority, including resources held by the Authority but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Authority 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 Position

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 position report information about the Authority'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 Authority's net position and changes in them. The Authority's total net position—the difference between assets and liabilities—is one measure of the Authority's financial health or financial position. Over time, increases or decreases in the Authority's net position are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Authority'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 Authority.

The Statement of Cash Flows

The statement of cash flows reports cash receipts, cash payments and net changes in cash 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 during the reporting period.

The Authority's Net Position

The Authority's net position is the difference between its assets and liabilities reported in the balance sheet. The Authority's net position increased by $70,136 or 0.8% in 2014 over 2013 and by $2,279,520 or 32.8% in 2013 over 2012 as shown in Table 1.

Table 1: Assets, Liabilities and Net Position

	2014	2013	2012
Assets			
Cash and certificates of deposit	$ 6,029,405	$ 5,787,205	$ 4,636,972
Patient accounts receivable, net	1,565,634	1,380,432	1,452,878
Other current assets	1,106,579	1,369,059	1,151,218
Capital assets, net	2,125,894	1,624,474	1,630,182
Other noncurrent assets	-	171,931	18,523
Total assets	$ 10,827,512	$ 10,333,101	$ 8,889,773
Liabilities			
Long-term debt, including current maturities	$ 193,677	$ 263,850	$ 683,174
Other current liabilities	1,333,921	839,473	1,256,341
Total liabilities	1,527,598	1,103,323	1,939,515
Net Position			
Net investment in capital assets	1,598,757	1,360,624	947,008
Restricted	333,460	-	171,931
Unrestricted	7,367,697	7,869,154	5,831,319
Total net position	9,299,914	9,229,778	6,950,258
Total liabilities and net position	$ 10,827,512	$ 10,333,101	$ 8,889,773

Significant changes in the Authority's assets in 2014 are the increase in patient accounts receivable and capital assets and decrease in other current assets. Patient accounts receivable increased primarily due to a receivable from Medicare for low volume adjustments of approximately $233,000. Net capital assets increased primarily due to the emergency room expansion and renovation included in construction in progress at year-end of approximately $714,000. Other current assets decreased due to Electronic Health Records (EHR) Incentive Program revenue not being recognized at June 30, 2014, due to the attestation period to demonstrate meaningful use. A significant change in the Authority's liabilities in 2014 is the increase in other current liabilities due to the short-term construction note payable of approximately $333,500 to finance the emergency room project noted above, as well as approximately $130,000 due to Medicare for the 2014 cost report.

A significant change in the Authority's assets in 2013 is the increase in cash and certificates of deposit, increase in other current assets and increase in other noncurrent assets. Cash and certificates of deposit increased $1,150,233 or 24.8% primarily due to cash received from the EHR Incentive Program and the State of Oklahoma's Supplemental Hospital Offset Payment Program (SHOPP) revenues. Other current assets increased due to the recognition of EHR funds receivable at year-end. Other noncurrent assets increased due to the investment in Cimarron Insurance Exchange, RRG. A significant change in the Authority's liabilities in 2013 is the decrease in long-term debt, as discussed in the *Debt* section below and the decrease in estimated amounts due to third-party payers. Estimated amounts due to third-party payers decreased $566,000 or 100% due primarily to the final settlement of several open Medicare cost reports during the current fiscal year and the receivable for EHR funds noted above.

Operating Results and Changes in the Authority's Net Position

In 2014, the Authority's net position increased by $70,136 or 0.8% as shown in Table 2. This increase is made up of several components and represents a decrease of 96.9% compared with the increase in net position for 2013 of $2,279,520. The Authority's change in net position increased from $917,761 in 2012 to $2,279,520 in 2013, an increase of 148.4%.

Table 2: Operating Results and Changes in Net Position

	2014	2013	2012
Operating Revenues			
Net patient service revenue	$ 10,530,519	$ 11,631,910	$ 9,855,099
Other operating revenues	462,864	1,266,701	1,548,929
Total operating revenues	10,993,383	12,898,611	11,404,028
Operating Expenses			
Salaries and wages and employee benefits	6,475,277	6,514,424	6,363,378
Purchased services and professional fees	2,653,438	2,422,552	2,165,455
Depreciation	393,128	423,171	390,062
Supplies and other	2,269,816	2,142,844	2,360,671
Total operating expenses	11,791,659	11,502,991	11,279,566
Operating Income (Loss)	(798,276)	1,395,620	124,462
Nonoperating Revenues (Expenses)			
County appropriations – unrestricted	830,316	855,162	813,985
Investment income	46,707	47,854	17,012
Noncapital gifts	11,215	21,258	7,504
Interest expense	(19,826)	(40,374)	(45,202)
Total nonoperating revenues (expenses)	868,412	883,900	793,299
Increase in Net Position	$ 70,136	$ 2,279,520	$ 917,761

Operating Income (Loss)

The first component of the overall change in the Authority's net position is its operating results—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In 2014, the Authority reported an operating loss compared to operating income in both 2013 and 2012.

The operating results for 2014 decreased by $2,193,896 or 157.2% as compared to 2013. The primary components of the decrease in operating results are:

- A decrease in net patient service revenue of $1,101,391 or 9.5% due primarily to a decrease in reimbursement rates and a decrease in inpatient volume
- A decrease in other operating revenue of $803,837 or 63.5% due to reductions in EHR incentive revenue earned in 2014
- An increase in purchased services and professional fees of $230,886 or 9.5% due primarily to an increase in physician fees

The operating results for 2013 increased by $1,271,158 or 1,021.3% as compared to 2012. The primary components of the increase in operating results are:

- An increase in net patient service revenue of $1,776,811 or 18.0% due primarily to an increase in utilization and a new surgeon performing additional surgeries during the year
- A decrease in other operating revenue of $282,228 or 18.2% due to the reduction in Medicare EHR incentive revenue recognized in 2013
- An increase in purchased services and professional fees of $257,097 or 11.9% due primarily to an increase in physician fees

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income, noncapital gifts and grants, county appropriations and interest expense. Interest expense decreased $20,548 or 50.9% due primarily to the payoff of a note payable during 2013. All other nonoperating revenues and expenses remained relatively consistent year over year.

The Authority's Cash Flows

Changes in the Authority's cash flows are consistent with changes in operating results and nonoperating revenues and expenses for 2014, 2013 and 2012, with the exception of changes in estimated amounts due to or from third-party payers, as discussed previously. In 2014, cash from operations decreased from 2013 by approximately $986,000 due to changes in current assets and liabilities, as discussed previously.

Capital Asset and Debt Administration

Capital Assets

At the end of 2014 and 2013, the Authority had $2,125,894 and $1,624,474, respectively, invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2014, the Authority made capital improvements and purchased new equipment costing $940,473, of which $333,460 was acquired through a revolving note payable as detailed in *Note 7*. In 2013, the Authority made capital improvements and purchased new equipment costing $417,463.

Debt

At June 30, 2014 and 2013, the Authority had $193,677 and $263,850, respectively, in capital lease obligations outstanding, as detailed in *Note 8* to the financial statements. During 2014, a new short-term note payable was obtained (see *Note 7*) and had an outstanding balance at June 30, 2014, of $333,460.

Contacting the Authority's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers and creditors with a general overview of the Authority's finances and to show the Authority's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Hospital Business Administration by telephoning 580.317.9500.

Choctaw County – City of Hugo Hospital Authority
Balance Sheets
June 30, 2014 and 2013

Assets

	2014	2013
Current Assets		
Cash	$ 3,029,405	$ 2,779,692
Short-term certificates of deposit	550,000	557,513
Patient accounts receivable, net of allowance; 2014 – $2,180,000, 2013 – $2,192,000	1,565,634	1,380,432
County appropriations receivable	498,080	454,795
Estimated amounts due from third-party payers	-	350,000
Supplies	446,393	457,396
Prepaid expenses and other	162,106	106,868
Total current assets	6,251,618	6,086,696
Noncurrent Investments		
Long-term certificates of deposit	2,116,540	2,450,000
Restricted long-term certificate of deposit	333,460	-
	2,450,000	2,450,000
Capital Assets, Net	2,125,894	1,624,474
Other Assets	-	171,931
Total assets	$ 10,827,512	$ 10,333,101

Liabilities and Net Position

	2014	2013
Current Liabilities		
Note payable to bank	$ 333,460	$ -
Current maturities of long-term debt	76,052	69,921
Accounts payable	369,418	353,931
Accrued expenses	501,043	485,542
Estimated amounts due to third-party payer	130,000	-
Total current liabilities	1,409,973	909,394
Long-Term Debt	117,625	193,929
Total liabilities	1,527,598	1,103,323
Net Position		
Net investment in capital assets	1,598,757	1,360,624
Restricted – expendable for debt service	333,460	-
Unrestricted	7,367,697	7,869,154
Total net position	9,299,914	9,229,778
Total liabilities and net position	$ 10,827,512	$ 10,333,101

Choctaw County – City of Hugo Hospital Authority
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2014 and 2013

	2014	2013
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2014 – $2,939,895, 2013 – $2,641,938	$ 10,530,519	$ 11,631,910
Other	462,864	1,266,701
Total operating revenues	10,993,383	12,898,611
Operating Expenses		
Salaries and wages	5,570,480	5,581,893
Employee benefits	904,797	932,531
Purchased services and professional fees	2,653,438	2,422,552
Supplies and other	2,269,816	2,142,844
Depreciation	393,128	423,171
Total operating expenses	11,791,659	11,502,991
Operating Income (Loss)	(798,276)	1,395,620
Nonoperating Revenues (Expenses)		
County appropriations – unrestricted	830,316	855,162
Investment income	46,707	47,854
Noncapital gifts	11,215	21,258
Interest expense	(19,826)	(40,374)
Total nonoperating revenues (expenses)	868,412	883,900
Excess of Revenues over Expenses and Increase in Net Position	70,136	2,279,520
Net Position, Beginning of Year	9,229,778	6,950,258
Net Position, End of Year	$ 9,299,914	$ 9,229,778

Choctaw County – City of Hugo Hospital Authority

Statements of Cash Flows

Years Ended June 30, 2014 and 2013

	2014	2013
Operating Activities		
Receipts from and on behalf of patients	$ 10,825,317	$ 10,788,356
Payments to suppliers and contractors	(5,145,938)	(4,534,300)
Payments to and on behalf of employees	(6,459,776)	(6,481,463)
Other receipts and payments, net	508,789	941,362
Net cash provided by (used in) operating activities	(271,608)	713,955
Noncapital Financing Activities		
Noncapital gifts	11,215	21,258
County appropriations received	787,031	1,072,396
Net cash provided by noncapital financing activities	798,246	1,093,654
Capital and Related Financing Activities		
Principal paid on long-term debt	(70,173)	(419,324)
Interest paid on long-term debt	(19,826)	(40,374)
Proceeds from issuance of note payable to bank	333,460	-
Purchase of capital assets	(746,537)	(417,463)
Net cash used in capital and related financing activities	(503,076)	(877,161)
Investing Activities		
Purchase of certificates of deposit	(550,000)	(2,450,000)
Proceeds from disposition of certificates of deposit	557,513	334,451
(Investment in) distribution from equity investee	171,931	(171,931)
Interest on investments	46,707	47,854
Net cash provided by (used in) investing activities	226,151	(2,239,626)
Increase (Decrease) in Cash	249,713	(1,309,178)
Cash, Beginning of Year	2,779,692	4,088,870
Cash, End of Year	$ 3,029,405	$ 2,779,692

	2014	2013
Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used in) Operating Activities		
Operating income (loss)	$ (798,276)	$ 1,395,620
Depreciation	393,128	423,171
Loss on sale of capital assets	45,925	-
Provision for uncollectible accounts	2,939,895	2,641,938
Changes in operating assets and liabilities		
Patient accounts receivable, net	(3,125,097)	(2,569,492)
Supplies, prepaid expenses and other assets	(44,235)	(409,790)
Estimated amounts due to third-party payer	480,000	(916,000)
Accounts payable and accrued expenses	(162,948)	148,508
Net cash provided by (used in) operating activities	$ (271,608)	$ 713,955
Supplemental Cash Flows Information		
Capital asset acquisitions included in accounts payable	$ 193,936	$ -

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

Nature of Operations and Reporting Entity

Choctaw County – City of Hugo Hospital Authority (the Authority) was created under a trust indenture dated July 1, 1978, as a public trust under provisions of Title 60 of the Oklahoma Statutes for the benefit of the County of Choctaw, Oklahoma, and the City of Hugo, Oklahoma. The Authority operates Choctaw Memorial Hospital (the Hospital), a 34-bed short-term acute care hospital located in Hugo, Oklahoma. The governing boards of Choctaw County and the City of Hugo appoint members to the Board of Trustees of the Authority on an alternating basis.

The Authority primarily earns revenue by providing inpatient, outpatient and emergency care services to patients in Hugo, Oklahoma, and the surrounding area.

Basis of Accounting and Presentation

The accompanying financial statements of the Authority 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 Authority first applies restricted net position when an expense or outlay is incurred for purposes for which both restricted and unrestricted net position are available.

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 Authority considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2014 and 2013, the Authority held no cash equivalents.

Risk Management

The Authority 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 non-negotiable certificates of deposit are carried at amortized cost. Investment income includes interest income.

Patient Accounts Receivable

The Authority reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Authority 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 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 Authority:

Buildings and improvements	3–40 years
Equipment	3–20 years

Compensated Absences

Authority policies permit most employees to accumulate compensated absence 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 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. At June 30, 2014 and 2013, all of the compensated absence liability was considered short-term.

Net Position

Net position of the Authority is classified in three components. Net investment in capital assets consists 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 position is made up of noncapital assets that must be used for a particular purpose, as specified by creditors, grantors or donors external to the Authority. Unrestricted net position is the remaining net position that does not meet the definition of net investment in capital assets or restricted net position.

Net Patient Service Revenue

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

County Appropriations

Effective April 1, 2009, the citizens of Choctaw County, Oklahoma, approved a 0.75% sales tax for furnishing, equipping, renovating and maintaining the Hospital, including the payment of principal and interest on any indebtedness. The tax will continue until repealed by the voters. The Authority received approximately 7% and 6% of its financial support from county appropriations related to the sales tax during the years ended June 30, 2014 and 2013, respectively. Revenue from county appropriations is recognized in the year in which the sales taxes are earned.

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 (EHR) technology. Payments under the Medicare program are generally made for up to four years based on a statutory formula. 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 (CMS). Payment under both programs is contingent on the Authority continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the Medicare administrative contractor. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Authority 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. The revenue related to these programs, included in other revenue within operating revenues in the accompanying statements of revenues, expenses and changes in net position, are summarized below:

	2014	2013
Medicare program revenue	$ 274,000	$ 820,000
Medicaid program revenue	74,000	297,000
	$ 348,000	$ 1,117,000

Supplemental Hospital Offset Payment Program

On January 17, 2012, 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, 2017. The SHOPP program is designed to assess 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.

The SHOPP revenue is recorded as part of net patient service revenue and the SHOPP assessment fees are recorded as part of other expenses on the accompanying statements of revenues, expenses and changes in net position. The annual amounts to be received and paid by the Authority over the term of the SHOPP program are subject to change annually based on various factors involved in determining the amount of federal matching funds. Based on the current information available, the annual net benefit to the Authority over the term of the SHOPP program is not expected to be materially different than the net amounts received in 2014 and 2013.

	2014	2013
SHOPP funds received	$ 712,000	$ 702,000
SHOPP assessment fees paid	282,000	260,000
Net SHOPP benefit	$ 430,000	$ 442,000

Income Taxes

As an essential government function of the city and the county, the Authority 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 Authority is subject to federal income tax on any unrelated business taxable income.

Reclassifications

Certain reclassifications have been made to the 2013 financial statements to conform to the 2014 presentation. The reclassifications had no effect on the changes in financial position.

Note 2: Net Patient Service Revenue

The Authority has agreements with third-party payers that provide for payments to the Authority 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 at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient skilled nursing services are paid at prospectively determined per diem rates that are based on the patients' acuity. The Authority is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Authority and audits thereof by the Medicare administrative contractor. The Authority's Medicare cost reports have been audited by the Medicare administrative contractor through June 30, 2011.

- **Medicaid –** The Authority has also been reimbursed for services rendered to patients covered by the state Medicaid program at prospectively determined rates per discharge and fee schedules with no retroactive adjustments. The payment rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

Approximately 78% and 80% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended June 30, 2014 and 2013, 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 Authority has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Authority under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

Note 3: Deposits 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 Authority's deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires that all deposits of public trusts be insured or collateralized.

At June 30, 2014 and 2013, none of the Authority's bank balances of $5,977,950 and $5,906,399, respectively, were exposed to custodial credit risk.

Summary of Carrying Values

The carrying values of deposits noted above are included in the accompanying balance sheets as follows:

	2014	2013
Cash	$ 3,029,405	$ 2,779,692
Short-term certificates of deposit	550,000	557,513
Noncurrent investments	2,450,000	2,450,000
	$ 6,029,405	$ 5,787,205

Investment Income

Investment income of $46,707 and $47,854 for the years ended June 30, 2014 and 2013, respectively, consisted of interest income.

Note 4: Patient Accounts Receivable

The Authority 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 June 30 consisted of:

	2014	2013
Medicare	$ 897,831	$ 767,285
Medicaid	129,080	245,787
Other third-party payers	338,549	559,698
Patients	2,380,174	1,999,662
	3,745,634	3,572,432
Less allowance for uncollectible accounts	2,180,000	2,192,000
	$ 1,565,634	$ 1,380,432

Note 5: Capital Assets

Capital assets activity for the years ended June 30 was:

	2014				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 15,512	$ -	$ -	$ -	$ 15,512
Buildings and improvements	3,668,263	63,467	(252,243)	444,603	3,924,090
Equipment	5,898,029	169,252	(304,632)	(424,793)	5,337,856
Construction in progress	26,610	707,754	-	(19,810)	714,554
	9,608,414	940,473	(556,875)	-	9,992,012
Less accumulated depreciation					
Buildings and improvements	2,912,319	134,740	(217,757)	244,318	3,073,620
Equipment	5,071,621	258,388	(293,193)	(244,318)	4,792,498
	7,983,940	393,128	(510,950)	-	7,866,118
Capital assets, net	$ 1,624,474	$ 547,345	$ (45,925)	$ -	$ 2,125,894

	2013				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 15,512	$ -	$ -	$ -	$ 15,512
Buildings and improvements	3,469,702	9,489	(134,322)	323,394	3,668,263
Equipment	7,926,320	91,811	(2,120,102)	-	5,898,029
Construction in progress	33,841	316,163	-	(323,394)	26,610
	11,445,375	417,463	(2,254,424)	-	9,608,414
Less accumulated depreciation					
Buildings and improvements	2,934,439	112,202	(134,322)	-	2,912,319
Equipment	6,880,754	310,969	(2,120,102)	-	5,071,621
	9,815,193	423,171	(2,254,424)	-	7,983,940
Capital assets, net	$ 1,630,182	$ (5,708)	$ -	$ -	$ 1,624,474

Note 6: Medical Malpractice Claims

The Authority 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 Authority’s claims experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

Note 7: Note Payable to Bank

In February 2014, the Authority obtained a $1,500,000 construction note payable that is due on demand, but if no demand is made then matures in January 2015. At June 30, 2014, there was $333,460 borrowed against this note. Interest at 2.5% is due upon maturity. This note is collateralized by one of the Authority’s certificates of deposit.

Note 8: Long-Term Debt

The following is a summary of long-term debt transactions for the Authority for the years ended June 30:

	2014				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Capital lease obligations	$ 263,850	$ -	$ (70,173)	$ 193,677	$ 76,052

	2013				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Note payable to bank	$ 109,143	$ -	$ (109,143)	$ -	$ -
Capital lease obligations	574,031	-	(310,181)	263,850	69,921
	$ 683,174	$ -	$ (419,324)	$ 263,850	$ 69,921

Note Payable to Bank

The note payable to bank was originally due November 22, 2015, with principal and interest at 3.75% payable monthly. The note was secured by certain equipment. The note was paid in full during 2013.

Capital Lease Obligations

The Authority is obligated under leases for equipment that are accounted for as capital leases. Assets under capital lease at June 30, 2014 and 2013, totaled $367,758 for both years, net of accumulated depreciation of $184,088 and $110,536, respectively. The following is a schedule by year of future minimum lease payments under the capital leases, including interest at varying rates from 6.1% to 12.5% together with the present value of the future minimum lease payments as of June 30, 2014:

Year Ending June 30,	
2015	$ 90,000
2016	90,000
2017	37,051
Total minimum lease payments	217,051
Less amount representing interest	23,374
Present value of future minimum lease payments	$ 193,677

Note 9: Charity Care

In support of its mission, the Authority voluntarily provides free care to patients who lack financial resources and are deemed to be medically indigent. Because the Authority does not pursue collection of amounts determined to qualify as charity care, they are not reported in net patient service revenue. In addition, the Authority 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 costs relating to charity care services for the years ended June 30, 2014 and 2013, were approximately $231,000 and $193,000, respectively.

The cost of charity care is estimated by applying the ratio of cost to gross charges to the gross uncompensated charges. In addition to uncompensated charges, the Authority 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 screenings and assessments, community educational services and various support groups.

Note 10: Contingencies

Litigation

In the normal course of business, the Authority 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 the Authority's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Authority 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.

Construction Project

The Authority entered into various agreements for approximately $1,990,000 as of June 30, 2014, to perform expansion and renovation of the Hospital's emergency services department. The remaining costs as of June 30, 2014, expected to be paid under this agreement are approximately $1,470,000. The project is expected to be completed in early calendar 2015 and is funded with a bank note of $1,500,000 (see *Note 7*) and cash from the Authority's operating funds.

Note 11: Investment in Cimarron

Through December 31, 2013, the Authority was a subscriber (member) of Cimarron Insurance Exchange, RRG (Reciprocal Risk Retention Group) (Cimarron) and had less than a 10% ownership (equity) interest in Cimarron. Cimarron was originally chartered as a risk retention group by the State of Vermont to provide hospital professional liability and general liability coverage to its subscribers. The Authority no longer purchased coverage from Cimarron after December 31, 2011, but retained its ownership as it was required to maintain a letter of credit for three years following the cancellation of its policies to allow for claims not reported. During 2013, Cimarron drew on the letter of credit for the full amount of $171,931.

In 2012, Cimarron was redomiciled to Oklahoma and licensed by the Oklahoma Insurance Department to continue its operations as a risk retention group. Effective December 31, 2013, Cimarron was dissolved and the Authority's investment balance of $171,931 was returned. The Authority's investment in Cimarron amounted to $0 and $171,931 at June 30, 2014 and 2013, respectively.

Note 12: Patient Protection and Affordable Care Act

The *Patient Protection and Affordable Care Act* (PPACA) will substantially reform the United States health care system. The legislation impacts multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Starting in 2014, the legislation requires the establishment of health insurance exchanges, which will provide individuals without employer-provided health care coverage the opportunity to purchase insurance. It is anticipated that some employers currently offering insurance to employees will opt to have employees seek insurance coverage through the insurance exchanges. It is possible the reimbursement rates paid by insurers participating in the insurance exchanges may be substantially different than rates paid under current health insurance products. Another significant component of the PPACA is the expansion of the Medicaid program to a wide range of newly eligible individuals. In anticipation of this expansion, payments under certain existing programs, such as Medicare disproportionate share, will be substantially decreased. Each state's participation in an expanded Medicaid program is optional.

The state of Oklahoma has currently indicated it will not expand the Medicaid program, which may result in revenues from newly covered individuals not offsetting the Authority's reduced revenue from other Medicare/Medicaid programs.

The PPACA is extremely complex and may be difficult for the federal government and each state to implement. While the overall impact of the PPACA cannot currently be estimated, it is possible it will have a negative impact on the Authority's net patient service revenue. In addition, it is possible the Authority will experience payment delays and other operational challenges during PPACA's implementation.

BKD LLP
CPAs & Advisors

Two Warren Place // 6120 S. Yale Avenue, Suite 1400 // Tulsa, OK 74136-4223
918.584.2900 // fax 918.584.2931 // bkd.com

Independent Auditor's 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
Choctaw County – City of Hugo Hospital Authority
Hugo, Oklahoma

We have audited, in accordance with auditing standards 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 Choctaw County – City of Hugo Hospital Authority (the Authority), which comprise the balance sheet as of June 30, 2014, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and related notes to the financial statements, and have issued our report thereon dated January 31, 2015.

Internal Control over Financial Reporting

Management of the Authority is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit, we considered the Authority's internal control to determine the audit procedures that are appropriate in the circumstances 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 Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

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 Authority's financial statements will not be prevented or detected and corrected on a timely basis. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses as defined above. However, material weaknesses may exist that have not been identified.

Board of Trustees
Choctaw County – City of Hugo Hospital Authority

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority'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 noted certain matters that we reported to the Authority's management in a separate letter dated January 31, 2015.

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 Authority'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 Authority's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BKD, LLP

Tulsa, Oklahoma
January 31, 2015

Choctaw County – City of Hugo Hospital Authority
Schedule of Findings and Responses
Year Ended June 30, 2014

Reference Number	Finding
	No matters are reportable.