Choctaw County – City of Hugo Hospital Authority

Independent Auditor's Reports and Financial Statements

June 30, 2016 and 2015

BKD LLP
CPAs & Advisors

Choctaw County – City of Hugo Hospital Authority
June 30, 2016 and 2015

Contents

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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 balance sheets of Choctaw County – City of Hugo Hospital Authority (the Authority) as of June 30, 2016 and 2015, 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 basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 the Authority as of June 30, 2016 and 2015, 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 basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2016, 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
December 21, 2016

Choctaw County – City of Hugo Hospital Authority
Management's Discussion and Analysis
Years Ended June 30, 2016 and 2015

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, 2016 and 2015. It should be read in conjunction with the accompanying financial statements of the Authority.

Financial Highlights

- Cash and certificates of deposit decreased in 2016 by $594,118 or 10.3% and in 2015 by $285,148 or 4.7%.
- Capital assets, net decreased in 2016 by $327,177 or 8.4% and increased in 2015 by $1,787,694 or 84.1%.
- The Authority's net position decreased in 2016 by $448,045 or 4.6% and increased in 2015 by $457,079 or 4.9%.
- In 2016, the Authority reported an operating loss of $1,318,916, which was $882,541 or 202.2% greater than the operating loss reported in 2015. In 2015, the Authority reported an operating loss of $436,375, which was an improvement of $361,901 or 45.3% over the operating loss reported in 2014.

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 decreased by $448,045 or 4.6% in 2016 over 2015 and increased by $457,079 or 4.9% in 2015 over 2014 as shown in Table 1.

Table 1: Assets, Liabilities and Net Position

	2016	2015	2014
Assets			
Cash and certificates of deposit	$ 5,150,139	$ 5,744,257	$ 6,029,405
Patient accounts receivable, net	1,647,094	1,568,343	1,565,634
Other current assets	1,142,736	1,225,355	1,106,579
Capital assets, net	3,586,411	3,913,588	2,125,894
Total assets	$ 11,526,380	$ 12,451,543	$ 10,827,512
Liabilities			
Long-term debt, including current maturities	$ 325,104	$ 467,882	$ 193,677
Other current liabilities	1,892,328	2,226,668	1,333,921
Total liabilities	2,217,432	2,694,550	1,527,598
Net Position			
Net investment in capital assets	1,934,782	1,986,010	1,598,757
Restricted	1,326,525	1,459,696	333,460
Unrestricted	6,047,641	6,311,287	7,367,697
Total net position	9,308,948	9,756,993	9,299,914
Total liabilities and net position	$ 11,526,380	$ 12,451,543	$ 10,827,512

Significant changes in the Authority's assets in 2016 compared to 2015 are the decrease in capital assets, net and the decrease in cash and certificates of deposit. Capital assets, net decreased primarily due to depreciation of capital assets, including the new emergency room expansion that was put into service during the year, and minimal capital asset additions during the year. In addition to a reduction in cash received from patients, cash and certificates of deposit decreased due to the Authority paying down liabilities relating to long-term leases and the note payable related to construction of the emergency room.

Significant changes in the Authority's assets in 2015 compared to 2014 are the increase in capital assets, net and the decrease in cash and certificates of deposit. Capital assets, net increased and cash and certificates of deposit decreased due primarily to the emergency room expansion and renovation of approximately $2,377,000, which is included in construction in progress at June 30, 2015. Significant changes in the Authority's liabilities in 2015 are the increases in long-term debt and other current liabilities. The Authority entered into a new capital lease for a CT scanner causing an increase in long-term debt of approximately $384,000. The increase in other current liabilities is primarily due to additional draws on a short-term construction note payable of approximately $1,161,000 to finance the emergency room project noted above.

Operating Results and Changes in the Authority's Net Position

In 2016, the Authority's net position decreased by $448,045 or 4.6% as shown in Table 2. This decrease is made up of several components and represents a decrease of 198.0% compared with the increase in net position for 2015 of $457,079. The Authority's change in net position increased from $70,136 in 2014 to $457,079 in 2015, an increase of 551.7%.

Table 2: Operating Results and Changes in Net Position

	2016	2015	2014
Operating Revenues			
Net patient service revenue	$ 10,123,398	$ 10,777,620	$ 10,530,519
Other operating revenues	460,053	744,690	462,864
Total operating revenues	10,583,451	11,522,310	10,993,383
Operating Expenses			
Salaries and wages and employee benefits	6,327,323	6,484,645	6,475,277
Purchased services and professional fees	2,808,014	2,789,631	2,653,438
Depreciation	568,021	434,488	393,128
Supplies and other	2,199,009	2,249,921	2,269,816
Total operating expenses	11,902,367	11,958,685	11,791,659
Operating Loss	(1,318,916)	(436,375)	(798,276)
Nonoperating Revenues (Expenses)			
County appropriations – unrestricted	874,679	859,134	830,316
Investment income	41,250	46,505	46,707
Noncapital gifts	8,297	7,956	11,215
Interest expense	(53,355)	(20,141)	(19,826)
Total nonoperating revenues (expenses)	870,871	893,454	868,412
Increase (Decrease) in Net Position	$ (448,045)	$ 457,079	$ 70,136

Operating 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 2016, 2015 and 2014, the Authority reported an operating loss.

The operating loss for 2016 increased by $882,541 or 202.2% as compared to 2015. The primary components of the increase in operating loss are:

- A decrease in net patient service revenue of $654,222 or 6.1% due primarily to a decrease in surgeries performed during 2016
- A decrease in other operating revenues of $284,637 or 38.2% due to a reduction in Medicare electronic health records (EHR) incentive revenue in 2016
- An increase in depreciation expense of $133,533 or 30.7% due to increased capital assets related to the new emergency room facilities put into service during 2016

The operating results for 2015 improved by $361,901 or 45.3% as compared to 2014. The primary components of the increase in operating results are:

- An increase in net patient service revenue of $247,101 or 2.3% due primarily to increased charge rates
- An increase in other operating revenues of $281,826 or 60.9% due to the receipt of Medicare EHR incentive revenue in 2015
- An increase in purchased services and professional fees of $136,193 or 5.1% due primarily to an increase in contracted physicians and fees

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income, noncapital gifts, county appropriations and interest expense. Interest expense increased by $33,214 or 164.9% in 2016 primarily due to the restructure of the line of credit for the emergency room expansion into a note payable at the end of 2015 (*Note 7*). 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 2016, 2015 and 2014, with the exception of changes in long-term debt paid and issued in 2015, as discussed previously. In 2016, cash from operations decreased from 2015 by $603,692 due to changes in current assets and liabilities and operating revenues, as discussed above.

Capital Asset and Debt Administration

Capital Assets

At June 30, 2016 and 2015, the Authority had $3,586,411 and $3,913,588, respectively, invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2016, the Authority made capital improvements and purchased new equipment costing $240,844. In 2015, the Authority made capital improvements and purchased new equipment costing $2,225,012, of which $1,160,540 was acquired through a construction note payable and $384,411 was acquired through a new capital lease.

Debt

At June 30, 2016 and 2015, the Authority had $325,104 and $467,882, respectively, in capital lease obligations outstanding, as detailed in *Note 8* to the financial statements. During 2015, a new short-term note payable was obtained (see *Note 7*) to refinance the existing construction note payable and was renewed in 2016. The short-term note payable had an outstanding balance at June 30, 2016 and 2015, of $1,326,525 and $1,459,696, respectively.

Contacting the Authority's Financial Management

This financial report is designed to provide the Authority's 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 Authority's Business Administration by telephoning 580.317.9500.

Choctaw County – City of Hugo Hospital Authority
Balance Sheets
June 30, 2016 and 2015

Assets

	2016	2015
Current Assets		
Cash	$ 2,408,139	$ 3,002,257
Short-term certificates of deposit	1,415,475	292,000
Restricted short-term certificate of deposit	1,326,525	-
Patient accounts receivable, net of allowance; 2016 – $1,869,000, 2015 – $1,920,000	1,647,094	1,568,343
County appropriations receivable	456,688	481,920
Estimated amounts due from third-party payers	85,000	93,000
Supplies	497,445	510,820
Prepaid expenses and other	103,603	139,615
Total current assets	7,939,969	6,087,955
Noncurrent Deposits		
Long-term certificates of deposit	-	990,304
Restricted long-term certificate of deposit	-	1,459,696
	-	2,450,000
Capital Assets, Net	3,586,411	3,913,588
Total assets	$ 11,526,380	$ 12,451,543

Liabilities and Net Position

	2016	2015
Current Liabilities		
Note payable to bank	$ 1,326,525	$ 1,459,696
Current maturities of long-term debt	88,160	133,708
Accounts payable	251,115	249,181
Accrued expenses	314,688	517,791
Total current liabilities	1,980,488	2,360,376
Long-Term Debt	236,944	334,174
Total liabilities	2,217,432	2,694,550
Net Position		
Net investment in capital assets	1,934,782	1,986,010
Restricted – expendable for debt service	1,326,525	1,459,696
Unrestricted	6,047,641	6,311,287
Total net position	9,308,948	9,756,993
Total liabilities and net position	$ 11,526,380	$ 12,451,543

Choctaw County – City of Hugo Hospital Authority
Statements of Revenues, Expenses and Changes in Net Position
Years Ended June 30, 2016 and 2015

	2016	2015
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2016 – $4,435,289, 2015 – $3,515,643	$ 10,123,398	$ 10,777,620
Other	460,053	744,690
Total operating revenues	10,583,451	11,522,310
Operating Expenses		
Salaries and wages	5,421,685	5,609,007
Employee benefits	905,638	875,638
Purchased services and professional fees	2,808,014	2,789,631
Supplies and other	2,199,009	2,249,921
Depreciation	568,021	434,488
Total operating expenses	11,902,367	11,958,685
Operating Loss	(1,318,916)	(436,375)
Nonoperating Revenues (Expenses)		
County appropriations – unrestricted	874,679	859,134
Investment income	41,250	46,505
Noncapital gifts	8,297	7,956
Interest expense	(53,355)	(20,141)
Total nonoperating revenues (expenses)	870,871	893,454
Excess (Deficiency) of Revenues over Expenses and Increase (Decrease) in Net Position	(448,045)	457,079
Net Position, Beginning of Year	9,756,993	9,299,914
Net Position, End of Year	$ 9,308,948	$ 9,756,993

Choctaw County – City of Hugo Hospital Authority

Statements of Cash Flows

Years Ended June 30, 2016 and 2015

	2016	2015
Operating Activities		
Receipts from and on behalf of patients	$ 10,052,647	$ 10,551,911
Payments to suppliers and contractors	(4,955,702)	(5,201,725)
Payments to and on behalf of employees	(6,530,426)	(6,467,897)
Other receipts and payments, net	460,053	747,520
Net cash used in operating activities	(973,428)	(370,191)
Noncapital Financing Activities		
Noncapital gifts	8,297	7,956
County appropriations received	899,911	875,294
Net cash provided by noncapital financing activities	908,208	883,250
Capital and Related Financing Activities		
Principal paid on long-term debt	(142,778)	(110,206)
Interest paid on long-term debt	(53,355)	(20,141)
Proceeds from issuance of note payable to bank	-	1,160,540
Principal paid on note payable to bank	(133,171)	(34,304)
Purchase of capital assets	(240,844)	(1,840,601)
Net cash used in capital and related financing activities	(570,148)	(844,712)
Investing Activities		
Proceeds from disposition of certificates of deposit	-	258,000
Interest on investments	41,250	46,505
Net cash provided by investing activities	41,250	304,505
Decrease in Cash	(594,118)	(27,148)
Cash, Beginning of Year	3,002,257	3,029,405
Cash, End of Year	$ 2,408,139	$ 3,002,257

See Notes to Financial Statements

	2016	2015
Reconciliation of Operating Loss to Net Cash Used in Operating Activities		
Operating loss	$ (1,318,916)	$ (436,375)
Depreciation	568,021	434,488
Loss on sale of capital assets	-	2,830
Provision for uncollectible accounts	4,435,289	3,515,643
Changes in operating assets and liabilities		
Patient accounts receivable, net	(4,514,040)	(3,518,352)
Supplies, prepaid expenses and other assets	49,387	(41,936)
Estimated amounts due to/from third-party payers	8,000	(223,000)
Accounts payable and accrued expenses	(201,169)	(103,489)
Net cash used in operating activities	$ (973,428)	$ (370,191)
Supplemental Cash Flows Information		
Capital lease obligations incurred for capital assets	$ -	$ 384,411

Choctaw County – City of Hugo Hospital Authority

Notes to Financial Statements

June 30, 2016 and 2015

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, 2016 and 2015, 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.

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 8% and 7% of its financial support from county appropriations related to the sales tax during the years ended June 30, 2016 and 2015, respectively. Revenue from county appropriations is recognized in the year in which the sales taxes are earned.

Electronic Health Records Incentive Programs

The Electronic Health Records Incentive Programs, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provide 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 three years based on a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services (CMS). Payments under both programs are 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 on 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 programs.

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 Medicare revenue related to these programs, included in other revenue within operating revenues in the accompanying statements of revenues, expenses and changes in net position, is approximately $346,000 and $677,000 for the years ended June 30, 2016 and 2015, respectively. No Medicaid revenue was received in either year.

Supplemental Hospital Offset Payment Program

On January 17, 2012, CMS approved the State of Oklahoma's Supplemental Hospital Offset Payment Program (SHOPP). The SHOPP is retroactive back to July 1, 2011, and is currently scheduled to sunset on December 31, 2020. The SHOPP 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.

SHOPP revenue is recorded as part of net patient service revenue and 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 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 is not expected to be materially different than the net amounts received in 2016 and 2015.

	2016	2015
SHOPP funds received	$ 935,000	$ 844,000
SHOPP assessment fees paid	314,000	301,000
Net SHOPP benefit	$ 621,000	$ 543,000

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.

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, 2014.

- **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 80% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended June 30, 2016 and 2015. 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, 2016 and 2015, none of the Authority's bank balances of $5,168,045 and $5,830,241, 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:

	2016	2015
Cash	$ 2,408,139	$ 3,002,257
Short-term certificates of deposit	1,415,475	292,000
Restricted short-term certificate of deposit	1,326,525	-
Noncurrent deposits	-	2,450,000
	$ 5,150,139	$ 5,744,257

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:

	2016	2015
Medicare	$ 765,676	$ 817,727
Medicaid	118,514	64,680
Other third-party payers	532,143	526,782
Patients	2,099,761	2,079,154
	3,516,094	3,488,343
Less allowance for uncollectible accounts	1,869,000	1,920,000
	$ 1,647,094	$ 1,568,343

Note 5: Capital Assets

Capital assets activity for the years ended June 30 was:

2016

	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 15,512	$ -	$ -	$ -	$ 15,512
Buildings and improvements	3,940,014	57,524	(41,400)	2,194,903	6,151,041
Equipment	5,075,528	183,320	(30,162)	182,576	5,411,262
Construction in progress	2,377,479	-	-	(2,377,479)	-
	11,408,533	240,844	(71,562)	-	11,577,815
Less accumulated depreciation					
Buildings and improvements	3,194,349	240,987	(41,400)	-	3,393,936
Equipment	4,300,596	327,034	(30,162)	-	4,597,468
	7,494,945	568,021	(71,562)	-	7,991,404
Capital assets, net	$ 3,913,588	$ (327,177)	$ -	$ -	$ 3,586,411

2015

	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 15,512	$ -	$ -	$ -	$ 15,512
Buildings and improvements	3,924,090	15,924	-	-	3,940,014
Equipment	5,337,856	546,163	(808,491)	-	5,075,528
Construction in progress	714,554	1,662,925	-	-	2,377,479
	9,992,012	2,225,012	(808,491)	-	11,408,533
Less accumulated depreciation					
Buildings and improvements	3,073,620	120,729	-	-	3,194,349
Equipment	4,792,498	313,759	(805,661)	-	4,300,596
	7,866,118	434,488	(805,661)	-	7,494,945
Capital assets, net	$ 2,125,894	$ 1,790,524	$ (2,830)	$ -	$ 3,913,588

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 March 2015, the Authority obtained a $1,494,000 short-term note payable that is due on demand, but if no demand is made it matures in June 2016 with interest at 2.5%. In June 2016, this note was extended through February 2017. This note is collateralized by one of the Authority's certificates of deposit.

	2016	2015
Beginning balance	$ 1,459,696	$ 333,460
Additions	-	1,160,540
Deductions	(133,171)	(34,304)
Ending balance	$ 1,326,525	$ 1,459,696

Note 8: Long-Term Debt

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

	2016				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Capital lease obligations	$ 467,882	$ -	$ (142,778)	$ 325,104	$ 88,160

	2015				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Capital lease obligations	$ 193,677	$ 384,411	$ (110,206)	$ 467,882	$ 133,708

The Authority is obligated under leases for equipment that are accounted for as capital leases. Assets under capital lease at June 30, 2016 and 2015, totaled $752,169, net of accumulated depreciation of $465,735 and $315,301, respectively. The following is a schedule by year of future minimum lease payments under the capital leases, including interest at varying rates from 2.7% to 12.5% together with the present value of the future minimum lease payments as of June 30, 2016:

Year Ending June 30,	
2017	$ 96,950
2018	60,180
2019	60,180
2020	60,180
2021	60,180
Thereafter	11,955
Total minimum lease payments	349,625
Less amount representing interest	24,521
Present value of future minimum lease payments	$ 325,104

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, 2016 and 2015, were approximately $48,000 and $133,000, 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.

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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, 2016, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the basic financial statements, and have issued our report thereon dated December 21, 2016.

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 of the financial statements, 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.

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

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 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. 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. We consider the deficiencies described in the accompanying schedule of findings and responses as items 2016-1 and 2016-2 to be material weaknesses.

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*.

The Authority's Responses to the Findings

The Authority's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The Authority's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

We also noted certain matters that we reported to the Authority's management in a separate letter dated December 21, 2016.

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
December 21, 2016

Choctaw County – City of Hugo Hospital Authority

Schedule of Findings and Responses

Year Ended June 30, 2016

Reference Number	Finding
2016-1	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over significant estimates in the financial statements. Condition – Management's procedures for evaluating and recording significant accounts receivable allowances for contractual adjustments and uncollectible accounts do not produce materially accurate results. Context – Management is required to apply consistent, unbiased methodologies to estimate significant balances on the financial statements. Effect – A material journal entry was made to the general ledger to correct misstatements identified related to estimated allowances for contractual adjustments and uncollectible accounts on patient accounts receivable. Cause – Management is not applying consistent or accurate methodologies to make significant allowance estimates in the financial statements. Management has not reviewed the methodologies used to prepare estimates to ensure they are still appropriate when compared to actual results. Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and recommendation. Management will take steps to periodically evaluate the methodologies used in accurately estimating allowances related to patient accounts receivable.

Choctaw County – City of Hugo Hospital Authority
Schedule of Findings and Responses, continued
Year Ended June 30, 2016

Reference Number	Finding
2016-2	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting.

Condition – Two employees’ duties are not adequately segregated among access, recording and monitoring functions in the revenue, cash receipts and accounts receivable transactions cycle (inflows).

Context – Proper segregation of duties between access to assets, recording transactions and reconciling or monitoring is a key component of an effective system of internal control.

Effect – Potential material misstatements in the financial statements or misappropriation of assets due to error or fraud could occur and not be prevented or detected in a timely manner.

Cause – The business office manager and business office biller have access to payments while also having certain recording and monitoring duties, including recording discounts or adjustments to charges and/or bad debt write-offs, making changes to billing files and preparing cash receipts listings. Additionally, no review of adjustments or write-offs posted is currently required by someone other than the poster.

Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and recommendation and will implement any necessary changes that are cost-beneficial within the next year.