Choctaw County – City of Hugo Hospital Authority

Accountants' Reports and Financial Statements

June 30, 2012 and 2011

BKD LLP
CPAs & Advisors

Choctaw County – City of Hugo Hospital Authority
June 30, 2012 and 2011

Contents

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Independent Accountants' Report on Financial Statements and Supplementary Information

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

We have audited the accompanying balance sheets of Choctaw County – City of Hugo Hospital Authority (the Authority) as of June 30, 2012 and 2011, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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, 2012 and 2011, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 29, 2013, 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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

BKD, LLP

January 29, 2013

Choctaw County – City of Hugo Hospital Authority

Management's Discussion and Analysis

Years Ended June 30, 2012 and 2011

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, 2012 and 2011. It should be read in conjunction with the accompanying financial statements of the Authority.

Financial Highlights

- Cash and investments increased in 2012 by $1,735,687 or 59.8%.
- The Authority's net assets increased by $917,761 or 15.2% in 2012.
- The Authority reported operating income of $124,462 in 2012. The operating income in 2012 increased by $501,191 or 133.0% over the operating loss reported in 2011.

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 assets; 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 Assets

One of the most important questions asked about any organization's finances is, "Is the organization as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement of revenues, expenses and changes in net assets report information about the 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 assets and changes in them. The Authority's total net assets—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 assets 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 Assets

The Authority's net assets are the difference between its assets and liabilities reported in the balance sheet. The Authority's net assets increased by $917,761 or 15.2% in 2012 over 2011 as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets

	2012	2011
Assets		
Cash and deposits	$ 4,636,972	$ 2,901,285
Patient accounts receivable, net	1,452,878	1,923,402
Other current assets	1,151,218	1,178,281
Capital assets, net	1,630,182	1,444,059
Other noncurrent assets	18,523	18,523
Total assets	$ 8,889,773	$ 7,465,550
Liabilities		
Long-term debt, including current maturities	$ 683,174	$ 570,365
Other current liabilities	1,256,341	862,688
Total liabilities	1,939,515	1,433,053
Net Assets		
Restricted	171,931	-
Invested in capital assets, net of related debt	947,008	873,694
Unrestricted	5,831,319	5,158,803
Total net assets	6,950,258	6,032,497
Total liabilities and net assets	$ 8,889,773	$ 7,465,550

A significant change in the Authority's assets in 2012 is the increase in cash and decrease in patient accounts receivable, net. Cash and deposits increased $1,735,687 or 59.8% primarily due to cash received from the Electronic Health Records Incentive Program (EHR) and the State of Oklahoma's Supplemental Hospital Offset Payment Program (SHOPP) revenues. Patient accounts receivable decreased by $470,324 or 24.5% due primarily to writing off old patient balances that were deemed to be uncollectible during the year.

A significant change in the Authority's 2012 liabilities is the increase in the estimated amounts due to third-party payers of $416,000 or 277% primarily due to changes in estimated amounts due to Medicare for prior years and the current year cost report settlement estimate.

Operating Results and Changes in the Authority's Net Assets

In 2012, the Authority's net assets increased by $917,761 or 15.2%, as shown in Table 2. This increase is made up of several different components.

Table 2: Operating Results and Changes in Net Assets

	2012	2011
Operating Revenues		
Net patient service revenue	$ 9,855,099	$ 10,290,013
Other operating revenues	1,548,929	492,429
Total operating revenues	11,404,028	10,782,442
Operating Expenses		
Salaries and wages and employee benefits	6,363,378	6,429,703
Purchased services and professional fees	2,165,455	2,130,537
Depreciation	390,062	582,708
Supplies and other	2,360,671	2,016,223
Total operating expenses	11,279,566	11,159,171
Operating Income (Loss)	124,462	(376,729)
Nonoperating Revenues (Expenses)		
County appropriations – unrestricted	813,985	796,037
Investment income	17,012	21,480
Noncapital gifts	7,504	8,755
Interest expense	(45,202)	(44,918)
Total nonoperating revenues (expenses)	793,299	781,354
Increase in Net Assets	$ 917,761	$ 404,625

Operating Income

The first component of the overall change in the Authority's net assets is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In 2012, the Authority reported operating income compared to an operating loss in 2011.

The operating income for 2012 increased by $501,191 or 133.0% as compared to 2011. The primary components of the increase of operating income are:

- Other operating revenue increased $1,056,500 or 214.5% due to the receipt of incentive funds for the implementation of electronic health records (EHR) technology of approximately $1,412,000.
- A decrease in net patient service revenue of $434,914 or 4.2% due to a significant decrease in utilization but also increased with the receipt of SHOPP revenues.
- An increase in supplies and other expenses of $344,448 or 17.1% due primarily to the payment of SHOPP funds of $254,618.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of investment income, noncapital gifts and grants, county appropriations and interest expense, all of which remained relatively constant in 2012 as compared to 2011.

The Authority's Cash Flows

Changes in the Authority's cash flows are consistent with changes in operating income (loss) and nonoperating revenues and expenses for 2012 and 2011.

Capital Asset and Debt Administration

Capital Assets

At the end of 2012 and 2011, the Authority had $1,630,182 and $1,444,059, respectively, invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2012, the Authority made capital improvements and purchased new equipment costing $576,185 of which $367,758 was acquired through incursion of capital lease obligations. In 2011, the Authority made capital improvements and purchased new equipment costing $342,751.

Debt

At June 30, 2012 and 2011, the Authority had $683,174 and $570,365, respectively, in notes payable and capital lease obligations outstanding, as detailed in *Note 7* to the financial statements. During 2012, the Authority purchased equipment under a capital lease for $367,758. The Authority incurred $155,120 in a new note payable to bank in 2011.

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, 2012 and 2011

Assets

	2012	2011
Current Assets		
Cash	$ 4,088,870	$ 2,356,721
Short-term certificates of deposit	-	544,564
Patient accounts receivable, net of allowance; 2012 – $4,373,000, 2011 – $6,330,000	1,452,878	1,923,402
County appropriations receivable	672,029	629,893
Supplies	392,376	400,886
Prepaid expenses and other	86,813	147,502
Total current assets	6,692,966	6,002,968
Noncurrent Investments		
Long-term certificates of deposit	376,171	-
Restricted long-term certificate of deposit	171,931	-
	548,102	-
Capital Assets, Net	1,630,182	1,444,059
Other Assets	18,523	18,523
Total assets	$ 8,889,773	$ 7,465,550

Liabilities and Net Assets

	2012	2011
Current Liabilities		
Current maturities of long-term debt	$ 300,921	$ 218,960
Accounts payable	238,384	290,061
Accrued expenses	451,957	422,627
Estimated amounts due to third-party payer	566,000	150,000
Total current liabilities	1,557,262	1,081,648
Long-Term Debt	382,253	351,405
Total liabilities	1,939,515	1,433,053
Net Assets		
Restricted – other	171,931	-
Invested in capital assets, net of related debt	947,008	873,694
Unrestricted	5,831,319	5,158,803
Total net assets	6,950,258	6,032,497
Total liabilities and net assets	$ 8,889,773	$ 7,465,550

See Notes to Financial Statements

Choctaw County – City of Hugo Hospital Authority
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2012 and 2011

	2012	2011
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2012 – $3,480,188, 2011 – $3,566,891	$ 9,855,099	$ 10,290,013
Other	1,548,929	492,429
Total operating revenues	11,404,028	10,782,442
Operating Expenses		
Salaries and wages	5,400,929	5,451,025
Employee benefits	962,449	978,678
Purchased services and professional fees	2,165,455	2,130,537
Supplies and other	2,360,671	2,016,223
Depreciation	390,062	582,708
Total operating expenses	11,279,566	11,159,171
Operating Income (Loss)	124,462	(376,729)
Nonoperating Revenues (Expenses)		
County appropriations – unrestricted	813,985	796,037
Investment income	17,012	21,480
Noncapital gifts	7,504	8,755
Interest expense	(45,202)	(44,918)
Total nonoperating revenues (expenses)	793,299	781,354
Excess of Revenues over Expenses and Increase in Net Assets	917,761	404,625
Net Assets, Beginning of Year	6,032,497	5,627,872
Net Assets, End of Year	$ 6,950,258	$ 6,032,497

Choctaw County – City of Hugo Hospital Authority

Statements of Cash Flows

Years Ended June 30, 2012 and 2011

	2012	2011
Operating Activities		
Receipts from and on behalf of patients	$ 10,741,623	$ 10,012,131
Payments to suppliers and contractors	(4,508,604)	(4,296,666)
Payments to and on behalf of employees	(6,334,048)	(6,417,418)
Other receipts and payments, net	1,548,929	492,429
Net cash provided by (used in) operating activities	1,447,900	(209,524)
Noncapital Financing Activities		
Noncapital gifts	7,504	8,755
County appropriations received	771,849	670,047
Net cash provided by noncapital financing activities	779,353	678,802
Capital and Related Financing Activities		
Principal paid on long-term debt	(254,949)	(192,509)
Interest paid on long-term debt	(45,202)	(44,918)
Proceeds from issuance of long-term debt	-	155,120
Purchase of capital assets	(208,427)	(342,751)
Net cash used in capital and related financing activities	(508,578)	(425,058)
Investing Activities		
Change in certificates of deposit	(3,538)	486,916
Interest on investments	17,012	21,480
Net cash provided by investing activities	13,474	508,396
Increase in Cash	1,732,149	552,616
Cash, Beginning of Year	2,356,721	1,804,105
Cash, End of Year	$ 4,088,870	$ 2,356,721

	2012		2011	
Reconciliation of Operating Loss to Net Cash Used in Operating Activities				
Operating gain (loss)	$	124,462	$	(376,729)
Depreciation		390,062		582,708
Changes in operating assets and liabilities				
Patient accounts receivable, net		470,524		(190,459)
Supplies and prepaid expenses		69,199		(156,190)
Estimated amounts due to third-party payer		416,000		(87,423)
Accounts payable and accrued expenses		(22,347)		18,569
Net cash provided by (used in) operating activities	$	1,447,900	$	(209,524)
Supplemental Cash Flows Information				
Capital lease obligations incurred for capital assets	$	367,758	$	-

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 assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

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

Use of Estimates

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

Cash and Cash Equivalents

The Authority considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2012 and 2011, 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 nonnegotiable 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 and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Authority:

Land improvements	15 years
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. The estimated compensated absences liability expected to be paid more than one year after the balance sheet date, if any, is included in other long-term liabilities. At June 30, 2012 and 2011, all of the compensated absence liability was considered short-term.

Net Assets

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

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.

County Appropriations

Effective April 1, 2009, the citizens of Choctaw County, Oklahoma, approved a .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% of its financial support from county appropriations related to the sales tax during the years ended June 30, 2012 and 2011. Revenue from county appropriations is recognized in the year in which the sales taxes are earned.

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.

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). 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 are contingent on the Hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The 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 Hospital recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

In 2011, the Hospital completed the first-year requirements under the Medicaid program and has recorded revenue of approximately $370,000, which is included in other revenue within operating revenues in the accompanying statements of revenues, expenses and changes in net assets.

In 2012, the Hospital completed the first-year requirements under the Medicare program and has recorded revenue of approximately $1,412,000, which is included in other revenue within operating revenues in the accompanying statements of revenues, expenses and changes in net assets.

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.

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, 2014. 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.

During the current year, the Hospital received approximately $685,000 in SHOPP funds and paid approximately $255,000 in SHOPP assessment fees, which are the estimated annual amounts to be received and paid by the Authority over the term of the SHOPP program. 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 assets.

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 per discharge. 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 Hospital's Medicare cost reports have been audited by the Medicare administrative contractor through June 30, 2010.
- **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 86% and 79% of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended June 30, 2012 and 2011, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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

Note 3: Deposits, Investments and Investment Income

Deposits

Custodial credit risk is the risk that in the event of a bank failure a government's deposits may not be returned to it. The 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.

Effective July 21, 2010, the FDIC's insurance limits were permanently increased to $250,000. Pursuant to legislation enacted in 2010, the FDIC will fully insure all noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012, at all FDIC-insured institutions.

At June 30, 2012 and 2011, none of the Authority's bank balances of $4,675,844 and $2,963,895, 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:

	2012	2011
Cash	$ 4,088,870	$ 2,356,721
Short-term certificates of deposit	-	544,564
Noncurrent investments	376,171	-
	$ 4,465,041	$ 2,901,285

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:

	2012	2011
Medicare	$ 818,817	$ 891,580
Medicaid	105,797	193,011
Other third-party payers	677,467	782,887
Patients	4,223,797	6,385,924
	5,825,878	8,253,402
Less allowance for uncollectible amounts	4,373,000	6,330,000
	$ 1,452,878	$ 1,923,402

Note 5: Capital Assets

Capital assets activity for the years ended June 30 was:

	2012				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 15,512	$ -	$ -	$ -	$ 15,512
Buildings and improvements	3,439,914	29,788	-	-	3,469,702
Equipment	7,404,745	521,575	-	-	7,926,320
Construction in progress	9,019	24,822	-	-	33,841
	10,869,190	576,185	-	-	11,445,375
Less accumulated depreciation					
Buildings and improvements	2,815,675	118,764	-	-	2,934,439
Equipment	6,609,456	271,298	-	-	6,880,754
	9,425,131	390,062	-	-	9,815,193
Capital assets, net	$ 1,444,059	$ 186,123	$ -	$ -	$ 1,630,182

	2011				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 15,512	$ -	$ -	$ -	$ 15,512
Buildings and improvements	3,321,386	79,890	-	38,638	3,439,914
Equipment	7,156,976	247,769	-	-	7,404,745
Construction in progress	32,565	15,092	-	(38,638)	9,019
	10,526,439	342,751	-	-	10,869,190
Less accumulated depreciation					
Buildings and improvements	2,699,993	115,682	-	-	2,815,675
Equipment	6,142,430	467,026	-	-	6,609,456
	8,842,423	582,708	-	-	9,425,131
Capital assets, net	$ 1,684,016	$ (239,957)	$ -	$ -	$ 1,444,059

Note 6: Medical Malpractice Claims

Through December 31, 2011, the Authority was a member of Cimarron Insurance Exchange, RRG (Reciprocal Risk Retention Group) (the RRG) approved by the State of Vermont to provide hospital professional and general liability coverage to its subscribers. The RRG was formed in order to stabilize the cost and availability of hospital professional and general liability insurance by taking advantage of the self-funding capabilities of a homogenous group of health care providers. The RRG members are provided hospital professional and general liability insurance under claims-made policies on a fixed premium basis.

The Authority obtained a letter of credit of $171,931 from a commercial bank to secure equity ownership in the RRG in accordance with the subscriber agreement set forth between the Authority and the RRG. As stated by the subscriber agreement, the beneficiary of the letter of credit is the Commissioner of Insurance of the State of Vermont. The commissioner has the authority to draw down on the letter of credit as needed to fund the RRG. As of December 31, 2011, the Authority canceled its insurance coverage with the RRG. The RRG required the Authority to keep its letter of credit for three years following cancelation to allow for claims not reported. As of June 30, 2012 and 2011, there have been no draws on the letter of credit.

Starting January 1, 2012, the Authority has purchased 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: Long-Term Debt

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

	2012				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Note payable to bank	$ 138,488	$ -	$ (29,345)	$ 109,143	$ 30,548
Capital lease obligation	431,877	367,758	(225,604)	574,031	270,373
	$ 570,365	$ 367,758	$ (254,949)	$ 683,174	$ 300,921

	2011				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Notes payable to bank	$ -	$ 155,120	$ (16,632)	$ 138,488	$ 28,700
Capital lease obligations	607,754	-	(175,877)	431,877	190,260
	$ 607,754	$ 155,120	$ (192,509)	$ 570,365	$ 218,960

Note Payable to Bank

The note payable to bank is due November 22, 2015, with principal and interest at 3.75% payable monthly. The note is secured by certain equipment. The debt service requirements as of June 30, 2012, are as follows:

Year Ending June 30,	Total to be Paid	Principal	Interest
2013	$ 34,115	$ 30,548	$ 3,567
2014	34,115	31,714	2,401
2015	34,115	32,924	1,191
2016	14,088	13,957	131
	$ 116,433	$ 109,143	$ 7,290

Capital Lease Obligation

The Hospital is obligated under a lease for equipment that is accounted for as a capital lease. Assets under the capital lease at June 30, 2012 and 2011, totaled $1,270,595 and $902,837, net of accumulated depreciation of $906,167 and $835,527, respectively. The following is a schedule by year of future minimum lease payments under the capital lease, including interest at varying rates from 6.1% to 7.9% together with the present value of the future minimum lease payments as of June 30, 2012:

Year Ending June 30,	
2013	$ 307,526
2014	126,242
2015	90,000
2016	90,000
2017	41,491
Total minimum lease payments	655,259
Less amount representing interest	81,228
Present value of future minimum lease payments	$ 574,031

Note 8: 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 charges relating to these services are as follows:

	2012	2011
Charity allowances	$ 81,000	$ 156,000
State Medicaid programs	2,504,000	3,681,000
	$ 2,585,000	$ 3,837,000

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 screening and assessments, community educational services and various support groups.

Note 9: Risks and Uncertainties

Current Economic Conditions

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

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

Given the volatility of current economic conditions, the values of assets and liabilities recorded in the accompanying financial statements could change rapidly, resulting in material future adjustments in asset values, such as allowances for accounts receivable, that could negatively impact the Authority's ability to maintain sufficient liquidity.

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

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

We have audited the financial statements of Choctaw County – City of Hugo Hospital Authority (the Authority) as of and for the year ended June 30, 2012, and have issued our report thereon dated January 29, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. However, as discussed in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be a material weakness and other deficiencies we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Authority's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses as item 2012-1 to be a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and responses as items 2012-2 and 2012-3 to be significant deficiencies.

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 also noted certain matters that we reported to the Authority's management in a separate letter dated January 29, 2013.

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

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

BKD, LLP

January 29, 2013

Choctaw County – City of Hugo Hospital Authority
Schedule of Findings and Responses
Year Ended June 30, 2012

Reference Number	Finding
2012-1	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting.

Condition – Some journal entries are not reviewed and approved by someone other than the preparer.

Context – The Authority's chief financial officer and controller prepare some journal entries and post all journal entries, but the entries prepared by these two individuals are not reviewed by another member of management.

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 – Duties related to controls over journal entries are not adequately segregated and monitoring or other compensating controls are insufficient.

Recommendation – Management should consider a policy requiring documented review and approval for each journal entry by someone other than the preparer.

Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and recommendation and will consider implementing any necessary changes within the next year.

Reference Number	Finding
2012-2	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition – In the patient revenues, accounts receivable and cash receipts transactions cycle, two employees' duties are not adequately segregated to protect the Authority's assets. 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 – Potentially 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 – Both the biller and the accounts receivable clerk have access to patient payments and posting responsibility. Duties in the patient revenues, accounts receivable and cash receipts transactions cycle are not adequately segregated and monitoring or other compensating controls are insufficient. Recommendation – Management should evaluate the costs versus the benefits of reassigning duties or implementing compensating controls to mitigate this risk. 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.

Choctaw County – City of Hugo Hospital Authority
Schedule of Findings and Responses, continued
Year Ended June 30, 2012

Reference Number	Finding
2012-3	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting.

Condition – In the payroll transactions cycle, an employee's duties are not adequately segregated to protect the Authority's assets.

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 – Potentially 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 controller has the responsibility and access to perform nearly all functions in the payroll transactions cycle. Duties in the payroll transactions cycle are not adequately segregated and monitoring or other compensating controls are insufficient.

Recommendation – Management should evaluate the costs versus the benefits of reassigning duties or implementing compensating controls to mitigate this risk.

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.