Harper County Community Hospital
A Component Unit of Harper County, Oklahoma
Auditor's Reports and Financial Statements

September 30, 2014 and 2013

BKD LLP
CPAs & Advisors

Harper County Community Hospital
A Component Unit of Harper County, Oklahoma
September 30, 2014 and 2013

Contents

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Independent Auditor's Report

Board of Control
Harper County Community Hospital
Buffalo, Oklahoma

Report on the Financial Statements

We have audited the accompanying balance sheets of Harper County Community Hospital (the Hospital), a component unit of Harper County, Oklahoma, as of September 30, 2014 and 2013, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the 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 audits 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 Harper County Community Hospital as of September 30, 2014 and 2013, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 2, 2015, on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control over financial reporting and compliance.

BKD, LLP

Tulsa, Oklahoma
March 2, 2015

Harper County Community Hospital
A Component Unit of Harper County, Oklahoma
Management's Discussion and Analysis
Years Ended September 30, 2014 and 2013

Introduction

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

Financial Highlights

- Cash, cash equivalents and short-term certificates of deposit increased in 2014 by $11,986 or 1% and decreased in 2013 by $290,079 or 23%.
- The Hospital's net position increased in 2014 by $500,196 or 28% and decreased in 2013 by $92,210 or 5%.
- The Hospital reported operating losses of $30,569 in 2014 and $690,593 in 2013.
- The Hospital's unrestricted appropriations from Harper County, Oklahoma, decreased $63,654 or 11% in 2014 compared to 2013 and decreased $63,041 or 10% in 2013 compared to 2012.

Using This Annual Report

The Hospital's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and changes in net position; and a statement of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors, contributors, grantors or enabling legislation. The Hospital is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

The Balance Sheet and Statement of Revenues, Expenses and Changes in Net Position

One of the most important questions asked about any hospital's finances is, "Is the hospital 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 Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. Using the accrual basis of accounting means that all of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net position and changes in it. The Hospital's total net position—the difference between assets and liabilities—is one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net position are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors, should also be considered to assess the overall financial health of the Hospital.

The Statement of Cash Flows

The statement of cash flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of activities. It provides answers to such questions as where did cash come from, what was cash used for and what was the change in cash and cash equivalents during the reporting period.

The Hospital's Net Position

The Hospital's net position is the difference between its assets and liabilities reported in the balance sheet. The Hospital's net position increased by $500,196 or 28% in 2014 and decreased by $92,210 or 5% in 2013 as shown in Table 1.

Table 1: Assets, Liabilities and Net Position

	2014	2013	2012
Assets			
Cash, cash equivalents and short-term certificates of deposit	$ 993,041	$ 981,055	$ 1,271,134
Patient accounts receivable, net	441,944	455,396	410,805
Other current assets	1,113,783	362,133	298,546
Capital assets, net	1,062,538	1,415,319	448,211
Total assets	$ 3,611,306	$ 3,213,903	$ 2,428,696
Liabilities			
Long-term debt (including current maturities)	$ 234,242	$ 325,849	$ 149,356
Other current and noncurrent liabilities	1,120,463	1,131,649	430,725
Total liabilities	1,354,705	1,457,498	580,081
Net Position			
Net investment in capital assets	172,249	433,423	298,855
Unrestricted	2,084,352	1,322,982	1,549,760
Total net position	2,256,601	1,756,405	1,848,615
Total liabilities and net position	$ 3,611,306	$ 3,213,903	$ 2,428,696

A significant change in the Hospital's financial position in 2014 was an increase in other current assets due to approximately $986,000 due from Medicare and Medicaid under the Electronic Health Records (EHR) Incentive Program at year-end.

A significant change in the Hospital's financial position in 2013 was an increase in capital assets and a corresponding increase in long-term debt, primarily due to the purchase of EHR technology and a new CT scanner during the year.

Operating Results and Changes in the Hospital's Net Position

In 2014, the Hospital's net position increased by $500,196 or 28% as shown in Table 2. This increase is made up of several different components and represents an increase of $592,406 compared with the decrease in net position for 2013 of $92,210. The Hospital's change in net position decreased from $66,621 in 2012, a decrease of $158,471 or 239%.

Table 2: Operating Results and Changes in Net Position

	2014	2013	2012
Operating Revenues			
Net patient service revenue	$ 3,733,715	$ 3,148,154	$ 3,050,119
Other operating revenues	421,419	88,955	49,753
Total operating revenues	4,155,134	3,237,109	3,099,872
Operating Expenses			
Salaries and wages and employee benefits	2,548,673	2,682,287	2,434,700
Purchased services and professional fees	422,554	418,597	426,770
Depreciation	369,802	87,813	89,786
Other operating expenses	844,674	739,005	775,812
Total operating expenses	4,185,703	3,927,702	3,727,068
Operating Loss	(30,569)	(690,593)	(627,196)
Nonoperating Revenues (Expenses)			
County appropriations – unrestricted	532,822	596,476	659,517
Investment income	2,001	3,802	3,920
Interest expense	(13,038)	(10,087)	(5,724)
Noncapital gifts	8,980	8,192	35,744
Total nonoperating revenues (expenses)	530,765	598,383	693,457
Increase (Decrease) in Net Position	$ 500,196	$ (92,210)	$ 66,261

Operating Losses

The first component of the overall change in the Hospital'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 each of the last three years, the Hospital has reported an operating loss. This is consistent with the Hospital's recent operating history as the Hospital was formed and is operated primarily to serve residents of Harper County, Oklahoma, and the surrounding area. Harper County levies sales taxes which are provided to the Hospital as unrestricted appropriations to assist with operations and capital improvements.

The operating loss improved by $660,024 for 2014 as compared to 2013. The primary components of the improved operating loss for 2014 are:

- An increase in net patient service revenue of $555,561 or 18.6% primarily due to recording revenue related to the Medicare EHR incentive payment earned in 2014
- An increase in other operating revenue of $332,464 or 373.7% primarily due to recording revenue related to the Medicaid EHR incentive payment earned in 2014
- An increase in other operating expenses of $105,669 or 14% primarily due to additional support costs for the new EHR system
- An increase in depreciation of $281,989 or 321% primarily due to the first year of depreciation on the EHR system put in service late in 2013

The operating loss increased by $63,397 for 2013 as compared to 2012. The primary components of the changes in operating losses for 2013 are:

- An increase in net patient service revenue of $98,035 or 3% as compared to 2012 primarily due to an increase of activity at both Buffalo Family Health Clinic and Laverne Family Health Clinic over the prior year
- An increase in other operating revenues of $39,202 or 79% primarily due to receipt of the Medicaid HER incentive payment for Buffalo Family Health Clinic of $21,250
- An increase in salaries and wages and employee benefits of $247,587 or 10% due to an increase in the number of employees as well as the addition of a new physician late in 2012

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of unrestricted county appropriations, noncapital gifts, investment income and interest expense. County appropriations from sales taxes decreased by $63,654 or 11% in 2014 compared to 2013 and decreased by $63,041 or 10% in 2013 compared to 2012.

The Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with changes in operating results and nonoperating revenues and expenses for 2014 and 2013 as discussed earlier.

Capital Asset and Debt Administration

Capital Assets

In 2014 and 2013, the Hospital acquired new capital assets costing $17,021 and $1,054,921, respectively. In 2013, the Hospital acquired $167,000 through incursion of a capital lease obligation.

Debt

The Hospital issued no new debt during 2014. During 2013, the Hospital incurred two new notes payable totaling $51,335 and a capital lease arrangement for $167,000. Additionally, the Hospital added $21,197 to an existing note payable for capital additions.

Contacting the Hospital’s Financial Management

This financial report is designed to provide the Hospital’s patients, suppliers, taxpayers and creditors with a general overview of the Hospital’s finances and to show the Hospital’s accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Hospital’s administration office by telephoning 580.735.2555.

Harper County Community Hospital
A Component Unit of Harper County, Oklahoma
Balance Sheets
September 30, 2014 and 2013

Assets

	2014	2013
Current Assets		
Cash and cash equivalents	$ 818,822	$ 782,046
Short-term certificates of deposit	174,219	199,009
Patient accounts receivable, net of allowance; 2014 – $592,000, 2013 – $737,000	441,944	455,396
Estimated amounts due from third-party payers	870,000	120,000
Supplies and prepaid expenses	140,417	184,149
Other receivables	103,366	57,984
Total current assets	2,548,768	1,798,584
Capital Assets, Net	1,062,538	1,415,319
Total assets	$ 3,611,306	$ 3,213,903

Liabilities and Net Position

	2014	2013
Current Liabilities		
Current maturities of long-term debt	$ 78,530	$ 88,804
Accounts payable	780,358	787,885
Accrued expenses	340,105	343,764
Total current liabilities	1,198,993	1,220,453
Long-Term Debt	155,712	237,045
Total liabilities	1,354,705	1,457,498
Net Position		
Net investment in capital assets	172,249	433,423
Unrestricted	2,084,352	1,322,982
Total net position	2,256,601	1,756,405
Total liabilities and net position	$ 3,611,306	$ 3,213,903

Harper County Community Hospital
A Component Unit of Harper County, Oklahoma
Statements of Revenues, Expenses and Changes in Net Position
Years Ended September 30, 2014 and 2013

	2014	2013
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2014 – $222,438, 2013 – $217,154	$ 3,733,715	$ 3,148,154
Other	421,419	88,955
Total operating revenues	4,155,134	3,237,109
Operating Expenses		
Salaries and wages	2,135,473	2,239,224
Employee benefits	413,200	443,063
Purchased services and professional fees	422,554	418,597
Medical supplies and drugs	108,980	107,516
Supplies and other	735,694	631,489
Depreciation	369,802	87,813
Total operating expenses	4,185,703	3,927,702
Operating Loss	(30,569)	(690,593)
Nonoperating Revenues (Expenses)		
County appropriations – unrestricted	532,822	596,476
Investment income	2,001	3,802
Interest expense	(13,038)	(10,087)
Noncapital gifts	8,980	8,192
Total nonoperating revenues (expenses)	530,765	598,383
Excess (Deficiency) of Revenues over Expenses and Increase (Decrease) in Net Position	500,196	(92,210)
Net Position, Beginning of Year	1,756,405	1,848,615
Net Position, End of Year	$ 2,256,601	$ 1,756,405

Harper County Community Hospital
A Component Unit of Harper County, Oklahoma
Statements of Cash Flows
Years Ended September 30, 2014 and 2013

	2014	2013
Operating Activities		
Receipts from and on behalf of patients	$ 2,997,167	$ 3,088,563
Payments to suppliers and contractors	(1,231,023)	(1,198,092)
Payments to and on behalf of employees	(2,552,332)	(2,632,651)
Other receipts and payments, net	421,419	78,455
Net cash used in operating activities	(364,769)	(663,725)
Noncapital Financing Activities		
Noncapital appropriations – Harper County	487,440	583,620
Noncapital gifts	8,980	8,192
Net cash provided by noncapital financing activities	496,420	591,812
Capital and Related Financing Activities		
Principal paid on long-term debt	(91,607)	(63,039)
Interest paid on long-term debt	(13,038)	(10,087)
Proceeds from disposal of capital assets	-	10,500
Purchase of capital assets	(17,021)	(231,874)
Proceeds from issuance of notes payable to bank	-	72,532
Net cash used in capital and related financing activities	(121,666)	(221,968)
Investing Activities		
Interest on investments	2,001	3,802
Net sales of certificates of deposit	24,790	404,485
Net cash provided by investing activities	26,791	408,287
Increase in Cash and Cash Equivalents	36,776	114,406
Cash and Cash Equivalents, Beginning of Year	782,046	667,640
Cash and Cash Equivalents, End of Year	$ 818,822	$ 782,046

	2014	2013
Reconciliation of Operating Loss to Net Cash Used in Operating Activities		
Operating loss	$ (30,569)	$ (690,593)
Depreciation	369,802	87,813
Gain on disposal of capital assets	-	(10,500)
Provision for uncollectible accounts	222,438	217,154
Changes in operating assets and liabilities		
Patient accounts receivable, net	(208,986)	(261,745)
Estimated amounts due from or to third-party payers	(750,000)	(15,000)
Accounts payable and accrued expenses	(11,186)	44,877
Supplies and prepaid expenses	43,732	(35,731)
Net cash used in operating activities	$ (364,769)	$ (663,725)
Supplemental Cash Flows Information		
Capital asset acquisitions included in accounts payable	$ 656,047	$ 656,047
Capital lease obligations incurred for capital assets	$ -	$ 167,000

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

Nature of Operations and Reporting Entity

Harper County Community Hospital (the Hospital) is a critical access hospital located in Buffalo, Oklahoma. The Hospital is a component unit of Harper County, Oklahoma (the County). The Board of County Commissioners of Harper County, Oklahoma, appoints members to the Board of Control of the Hospital. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in northwestern Oklahoma and also operates physician clinics in the same geographic area.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally, unrestricted 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 unrestricted county appropriations), investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital 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 Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At September 30, 2014 and 2013, cash equivalents consisted of certificates of deposit.

Risk Management

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

Investments and Investment Income

Investments consist of certificates of deposit, which are carried at amortized cost. Investment income consists of interest income.

Patient Accounts Receivable

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

Supplies

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

Capital Assets

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

Land improvements	10–20 years
Buildings	5–50 years
Equipment	3–20 years

Compensated Absences

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

Net Position

Net position of the Hospital is classified in two 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. Unrestricted net position is the remaining net position that does not meet the definition of net investment in capital assets.

Net Patient Service Revenue

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

County Appropriations

Effective May 1, 1990, the citizens of Harper County, Oklahoma, approved a 1% sales tax for the operations and capital improvements of county health care facilities. The previous tax expired April 30, 2013. On May 6, 2012, the voters of the County approved an extension of the sales tax beginning May 1, 2013 and expiring April 30, 2018. The County appropriates these amounts monthly to the Hospital. The Hospital received approximately 11% and 16% in 2014 and 2013, respectively, of its financial support from county appropriations related to the sales tax. Revenue from county appropriations is recognized in the year in which the sales taxes are earned.

Charity Care

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

Income Taxes

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

Electronic Health Records Incentive Programs

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records (EHR) technology. Critical access hospitals (CAH) are eligible to receive incentive payments in the cost reporting period beginning in the federal fiscal year in which meaningful use criteria have been met. The Medicare incentive payment is for qualifying costs of the purchase of certified EHR technology multiplied by the Hospital's Medicare share fraction, which includes up to a 20% incentive. This payment is an acceleration of amounts that would have been received in future periods based on reimbursable costs incurred, including depreciation. If meaningful use criteria are not met in future periods, the Hospital is subject to penalties that would reduce future payments for services. 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). The final amount for any payment year under both programs is determined based upon an audit by the administrative contractor. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

The Hospital recognized the incentive payment revenue received for qualified EHR technology expenditures during 2014, which was the period during which management was reasonably assured meaningful use was achieved and the earning process was complete. Management believes the incentive payments reflect a change in how "allowable costs" are determined in CAHs for providing services to Medicare beneficiaries. The Hospital recorded revenue of approximately $716,000, which is included in net patient service revenue in the accompanying statements of revenues, expenses and changes in net position for the year ended September 30, 2014.

In 2014, the Hospital also met criteria for the second year of the Medicaid program and recorded revenue of $270,000, which is included in other revenue in the accompanying statements of revenues, expenses and changes in net position. The requirements for the first year of the Medicaid program were previously met and revenue recorded in 2011.

In 2014 and 2013, the Hospital met criteria for attestation for its clinic operations and recognized approximately $8,500 and $21,000, respectively, of revenue for Medicare, which is included in other revenue in the accompanying statements of revenues, expenses and changes in net position.

Supplemental Hospital Offset Payment Program

On January 17, 2012, CMS approved the State of Oklahoma's Supplemental Hospital Offset Payment Program (SHOPP). The SHOPP program is retroactive back to July 1, 2011, and is currently scheduled to sunset on December 31, 2017. The SHOPP program is designed to assess Oklahoma hospitals a supplemental hospital offset fee which will be placed in pools after receiving federal matching funds. The total fees and matching funds will then be allocated to hospitals as directed by legislation.

CAHs are excluded from paying the supplemental hospital offset fee but are still eligible to receive SHOPP funds. During 2014 and 2013, the Hospital received approximately $32,000 and $24,000, respectively, in SHOPP funds. The SHOPP revenue is recorded as part of net patient service revenue in the accompanying statements of revenues, expenses and changes in net position.

The annual amounts to be received by the Hospital over the term of the SHOPP program are subject to change annually based on various factors involved in determining the amount of federal matching funds. Based on the current information available, the annual net benefit to the Hospital over the term of the SHOPP program is not expected to be materially different than the amounts received in 2014.

Note 2: Net Patient Service Revenue

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

- **Medicare** – The Hospital is reimbursed based on a cost reimbursement methodology for inpatient and outpatient services provided to Medicare program beneficiaries as a CAH. The Hospital is reimbursed at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare administrative contractor. The Hospital's Medicare cost reports have been audited by the Medicare administrative contractor through the year ended September 30, 2012.

- **Medicaid** – The Hospital 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 42% and 56% of net patient service revenues are from participation in the Medicare and state-sponsored Medicaid programs for the years ended September 30, 2014 and 2013, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The 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

Custodial credit risk is the risk that in the event of a bank failure a government's deposits may not be returned to it. The Hospital does not have a formal policy to address custodial credit risk.

At September 30, 2014 and 2013, none of the Hospital's bank balances of $1,057,671 and $1,043,649, respectively, were exposed to custodial credit risk.

Summary of Carrying Values

The carrying values of deposits shown below are included in the accompanying balance sheets as follows:

	2014	2013
Cash and cash equivalents	$ 818,822	$ 782,046
Short-term certificates of deposit	174,219	199,009
	$ 993,041	$ 981,055

Note 4: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at September 30 consisted of:

	2014	2013
Medicare	$ 190,628	$ 247,378
Medicaid	17,348	68,030
Other third-party payers	171,474	117,314
Patients	654,494	759,674
	1,033,944	1,192,396
Less allowance for uncollectible accounts	592,000	737,000
	$ 441,944	$ 455,396

Note 5: Capital Assets

Capital assets activity for the years ended September 30 was:

	2014				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 8,875	$ -	$ -	$ -	$ 8,875
Land improvements	38,373	-	-	-	38,373
Buildings	557,383	-	-	-	557,383
Equipment	2,159,673	17,021	-	-	2,176,694
	2,764,304	17,021	-	-	2,781,325
Less accumulated depreciation					
Land improvements	29,381	2,473	-	-	31,854
Buildings	365,414	17,509	-	-	382,923
Equipment	954,190	349,820	-	-	1,304,010
	1,348,985	369,802	-	-	1,718,787
Capital assets, net	$ 1,415,319	$ (352,781)	$ -	$ -	$ 1,062,538

	2013				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 8,875	$ -	$ -	$ -	$ 8,875
Land improvements	38,373	-	-	-	38,373
Buildings	536,276	21,107	-	-	557,383
Equipment	1,315,759	1,033,814	(189,900)	-	2,159,673
	1,899,283	1,054,921	(189,900)	-	2,764,304
Less accumulated depreciation					
Land improvements	26,383	2,998	-	-	29,381
Buildings	347,459	17,955	-	-	365,414
Equipment	1,077,230	66,860	(189,900)	-	954,190
	1,451,072	87,813	(189,900)	-	1,348,985
Capital assets, net	$ 448,211	$ 967,108	$ -	$ -	$ 1,415,319

Note 6: Medical Malpractice Claims

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

Note 7: Long-Term Debt

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

2014

	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Note payable to bank (A)	$ 12,260	$ -	$ (11,292)	$ 968	$ 968
Note payable to bank (B)	48,199	-	(10,891)	37,308	11,160
Financing arrangement (C)	6,646	-	(5,317)	1,329	1,329
Note payable to bank (D)	46,105	-	(16,824)	29,281	17,306
Note payable to bank (E)	30,223	-	(7,523)	22,700	7,917
Note payable to bank (F)	17,839	-	(3,556)	14,283	3,745
Capital lease obligations	164,577	-	(36,204)	128,373	36,105
	$ 325,849	$ -	$ (91,607)	$ 234,242	$ 78,530

2013

	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Note payable to bank (A)	$ 23,057	$ -	$ (10,797)	$ 12,260	$ 11,250
Note payable to bank (B)	36,923	21,197	(9,921)	48,199	10,616
Financing arrangement (C)	11,962	-	(5,316)	6,646	5,168
Note payable to bank (D)	62,394	-	(16,289)	46,105	16,754
Note payable to bank (E)	-	32,060	(1,837)	30,223	7,569
Note payable to bank (F)	-	19,275	(1,436)	17,839	3,571
Capital lease obligations	15,020	167,000	(17,443)	164,577	33,876
	$ 149,356	$ 239,532	$ (63,039)	$ 325,849	$ 88,804

Notes Payable to Banks and Financing Arrangement

(A) Bank note payable dated November 11, 2010, in the original amount of $42,442 has monthly payments of $968, including interest at 4.5% and matures in 2015. The note is unsecured.

(B) Bank note payable dated June 30, 2011, in the original amount of $48,955 was refinanced on January 7, 2013, for an additional $21,197 with monthly payments of $1,073, including interest at 5.00% and matures in 2018. The note is secured by certain equipment.

(C) Financing arrangement with vendor dated November 18, 2011, payable quarterly beginning January 15, 2012, in the amount of $2,060, which includes $731 of warranty expense, principal and imputed interest at 3.25% and matures in 2015. The arrangement is secured by certain equipment.

(D) Bank note payable dated June 8, 2012, in the original amount of $67,625, has monthly payments of $1,506, including interest at 3.25% and matures in 2016. The note is secured by certain equipment.

(E) Bank note payable dated July 10, 2013, in the original amount of $32,060, has monthly payments of $731, including interest at 4.50% and matures in 2017. The note is secured by certain equipment.

(F) Bank note payable dated May 14, 2013, in the original amount of $19,275, has monthly payments of $362, including interest at 4.75% and matures in 2018. The note is secured by certain equipment.

The debt service requirements as of September 30, 2014, are as follows:

Year Ending September 30,	Total to be Paid	Principal	Interest
2015	$ 46,349	$ 42,425	$ 3,924
2016	38,141	35,912	2,229
2017	23,836	22,950	886
2018	4,662	4,582	80
	$ 112,988	$ 105,869	$ 7,119

Capital Lease Obligations

The Hospital is obligated under two leases for equipment items that are accounted for as capital leases. Assets under capital lease at September 30, 2014 and 2013, totaled $188,590, net of accumulated depreciation of $53,573 and $17,089, respectively. The following is a schedule by year of future minimum lease payments under the capital leases, including interest at rates of 5.16% to 8.00% together with the present value of the future minimum lease payments as of September 30, 2014:

Year Ending September 30,	
2015	$ 43,222
2016	39,408
2017	37,968
2018	22,990
Total minimum lease payments	143,588
Less amount representing interest	15,215
Present value of future minimum lease payments	$ 128,373

Note 8: Operating Leases

Rental expense under month-to-month and other operating lease agreements totaled approximately $57,000 and $64,000 for the years ended September 30, 2014 and 2013, respectively.

Note 9: Pension Plan

The Hospital contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital's contributions determined in accordance with the terms of the plan. The plan is administered by a third-party administrator. The plan provides retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's governing body. Contribution rates for plan members and the Hospital expressed as a percentage of covered payroll were 6% and 3% for 2014 and 2013, respectively. Contributions actually made by plan members and the Hospital aggregated approximately $87,000 and $42,000 during 2014 and $88,000 and $42,000 during 2013, respectively.

Note 10: Charity Care

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

Uncompensated costs related to these services are as follows:

	2014	2013
Charity allowances	$ 31,000	$ 33,000
Medicaid	53,000	111,000
	$ 84,000	$ 144,000

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 costs, the Hospital also commits significant time and resources to endeavors and critical services which meet otherwise unfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable.

Note 11: Contingencies

Litigation

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

Note 12: Patient Protection and Affordable Care Act

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

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

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

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 Control
Harper County Community Hospital
Buffalo, Oklahoma

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the basic financial statements of Harper County Community Hospital (the Hospital), a component unit of Harper County, Oklahoma, which comprise the balance sheet as of September 30, 2014, 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 March 2, 2015.

Internal Control over Financial Reporting

Management of the Hospital is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit, we considered the Hospital'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 Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

Our consideration of internal control 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 and therefore there can be no assurance that all material weaknesses have been identified. However, as discussed in the accompanying schedule of findings and responses, we identified a certain deficiency in internal control that we consider to be a material weakness.

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 Hospital'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 2014-1 to be a material weakness.

Board of Control
Harper County Community Hospital

Compliance and Other Matters

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

The Hospital's Response to the Finding

The Hospital's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. The Hospital's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

We also noted certain matters that we reported to the Hospital's management in a separate letter dated March 2, 2015.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Hospital's internal control or compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BKD, LLP

Tulsa, Oklahoma
March 2, 2015

Harper County Community Hospital
A Component Unit of Harper County, Oklahoma
Schedule of Findings and Responses
Year Ended September 30, 2014

Reference Number	Finding
2014-1	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition – One employee's duties are not adequately segregated among access, recording and monitoring functions in the purchases, cash disbursements and accounts payable transactions cycle (outflows); revenue, cash receipts and accounts receivable transactions cycle (inflows); and the payroll transactions cycle. Context – The chief executive officer has access rights allowing this individual to perform nearly all user activities in the accounting system and also has access to assets and reconciling responsibilities in the outflows, inflows and payroll transactions cycles. Effect – Potentially material misstatements in the financial statements or material misappropriation of assets due to error or fraud could occur and not be prevented or detected in a timely manner. Cause – Duties in the outflows, inflows and payroll transactions cycles are not adequately segregated and monitoring or other compensating controls are insufficient. Recommendation – Management should periodically evaluate the costs versus the benefits of further segregation of duties or addition of monitoring or other compensating controls and implement those changes it deems appropriate for which benefits are determined to exceed costs. Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and recommendation. Management will perform the suggested evaluation and make any changes deemed appropriate that are cost beneficial within the next year.