Memorial Hospital of Texas County
A Component Unit of Texas County, Oklahoma

Accountants' Reports and Financial Statements

June 30, 2011 and 2010

BKD LLP

CPAs & Advisors

Memorial Hospital of Texas County
A Component Unit of Texas County, Oklahoma
June 30, 2011 and 2010

Contents

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Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Control
Memorial Hospital of Texas County
Guymon, Oklahoma

We have audited the accompanying balance sheets of Memorial Hospital of Texas County (the Hospital), a component unit of Texas County, Oklahoma, as of June 30, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Memorial Hospital of Texas County as of June 30, 2011 and 2010, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 24, 2012, on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

BKD, LLP

February 24, 2012

Memorial Hospital of Texas County
A Component Unit of Texas County, Oklahoma
Management's Discussion and Analysis
Years Ended June 30, 2011 and 2010

Introduction

This management's discussion and analysis of the financial performance of Memorial Hospital of Texas County (the Hospital), a component unit of Texas County, Oklahoma, provides an overview of the Hospital's financial activities for the years ended June 30, 2011 and 2010. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Cash and deposits decreased in 2011 by $658,161 or 18% and decreased in 2010 by $340,687 or 9%.
- Accounts payable increased in 2011 by $800,777 or 195% and decreased in 2010 by $26,834 or 6%.
- The Hospital's net assets decreased in 2011 by $1,668,550 or 12% and decreased in 2010 by $595,333 or 4%.
- The Hospital reported an operating loss in 2011 of $1,869,456 and 2010 of $804,174. The operating loss in 2011 increased by $1,065,282 or 133% over the operating loss reported in 2010. The operating loss in 2010 increased by $624,682 or 348% over the operating loss reported in 2009.

Using This Annual Report

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

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

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

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

The Statement of Cash Flows

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

The Hospital's Net Assets

The Hospital's net assets are the difference between its assets and liabilities reported in the balance sheet. The Hospital's net assets decreased by $1,668,550 (12%) in 2011 over 2010 and decreased by $595,333 (4%) in 2010 over 2009 as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets

	2011	2010	2009
Assets			
Cash and short-term deposits	$ 2,976,036	$ 3,634,197	$ 3,974,884
Patient accounts receivable, net	2,548,111	2,386,634	2,683,922
Capital assets, net	7,655,581	7,990,166	8,485,342
Other current and noncurrent assets	1,630,945	1,768,881	1,277,316
Total assets	$ 14,810,673	$ 15,779,878	$ 16,421,464
Liabilities			
Long-term debt, including current maturities	$ 736,732	$ 974,811	$ 1,202,300
Other current and noncurrent liabilities	2,287,227	1,349,803	1,168,567
Total liabilities	3,023,959	2,324,614	2,370,867
Net Assets			
Invested in capital assets, net of related debt	6,863,915	7,013,129	7,263,599
Unrestricted	4,922,799	6,442,135	6,786,998
Total net assets	11,786,714	13,455,264	14,050,597
Total liabilities and net assets	$ 14,810,673	$ 15,779,878	$ 16,421,464

Some significant changes in the Hospital's assets and liabilities in 2011 were the decrease in cash and short-term deposits and the increase in accounts payable and other current liabilities. The decrease in cash and short-term deposits of $658,161 (18%) is due primarily to purchasing capital assets using cash reserves. The increase in accounts payable of $800,777 (195%) primarily relates to the Hospital changing its cash flow management policy on timing of payments to vendors.

Some significant changes in the Hospital's assets in 2010 were the decrease in cash and short-term deposits and the decrease in patient accounts receivable. The decrease in cash and short-term deposits is $340,687 due primarily to an operating loss. The decrease in patient accounts receivable of $297,288 (11%) is due primarily to increases in allowances for contractual adjustments and bad debts. Some significant changes in the Hospital's liabilities in 2010 were the increase in other current and noncurrent liabilities. This increase is due primarily to an increase in accrued expenses of $208,070 or 29% due to increases in self-insured health claims payable and employee PTO liability.

Operating Results and Changes in the Hospital's Net Assets

In 2011, the Hospital's net assets decreased by $1,668,550 (12%) as shown in Table 2. This decrease is made up of several different components and represents an increase of $1,073,217 compared with the decrease in net assets for 2010 of $595,333.

Table 2: Operating Results and Changes in Net Assets

	2011	2010	2009
Operating Revenues			
Net patient service revenue	$ 17,888,070	$ 16,063,391	$ 17,143,522
Other operating revenues	289,874	515,819	574,740
Total operating revenues	18,177,944	16,579,210	17,718,262
Operating Expenses			
Salaries and wages and employee benefits	10,219,853	9,966,228	8,545,384
Purchased services and professional fees	3,539,109	1,964,537	2,442,243
Other operating expenses	5,019,310	4,292,424	5,591,786
Depreciation	1,269,128	1,160,195	1,318,341
Total operating expenses	20,047,400	17,383,384	17,897,754
Operating Loss	(1,869,456)	(804,174)	(179,492)
Nonoperating Revenues (Expenses)			
Gain on investment in joint venture	124,632	86,370	315,464
Investment income	49,468	65,687	81,001
Interest expense	(47,540)	(53,491)	(62,085)
Total nonoperating revenues (expenses)	126,560	98,566	334,380
Excess (Deficiency) of Revenues over Expenses Before Capital Grants and Gifts	(1,742,896)	(705,608)	154,888
Capital Grants and Gifts	74,346	110,275	149,369
Increase (Decrease) in Net Assets	$ (1,668,550)	$ (595,333)	$ 304,257

Operating Loss

The first component of the overall change in the Hospital's net assets is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In each of the past 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 Guymon, Oklahoma, and the surrounding area.

The operating loss for 2011 increased by $1,065,282 or 133% as compared to 2010. The primary components of the increased operating loss are:

- An increase in net patient service revenue of $1,824,679 or 11% as a result of higher outpatient patient volumes related to the growth and expansion of new specialty physicians recruited to the Hospital's clinics.
- An increase in salaries and wages and employee benefits for the Hospital's employees of $253,625 or 3%. This increase resulted from the Hospital's recruiting and employing new physicians in orthopedics and OB/GYN.
- An increase in purchased services and professional fees of $1,574,572 or 80% as the result of the Hospital's decision to outsource the business office functions to a third party and increased use of contracted nursing staff.
- An increase in supplies and other expenses of $732,916 or 17% as a result of the increased outpatient volumes.

The operating loss for 2010 increased by $624,682 or 348% as compared to 2009. The primary components of the increased operating loss are:

- A decrease in net patient service revenue of $1,080,131 or 6% as a result of lower inpatient and outpatient patient volumes.
- An increase in salaries and wages and employee benefits for the Hospital's employees of $1,420,844 or 17%. Employee salaries and wages increased by $1,247,862 or 18% in 2010 as a result of the Hospital recruiting and employing new physicians in internal medicine, OB/GYN and radiology. Employee benefits increased by $172,982 or 12% primarily as a result of hiring new physicians.
- A decrease in purchased services and professional fees of $477,706 or 20% as a result of the Hospital hiring CRNAs in place of utilizing contracted CRNAs for anesthesia coverage.
- Other operating expenses decreased by $1,299,362 or 23% as a result of purchasing fewer medical supplies consistent with decreases in patient volumes and completion of contractual benefits under physician income guarantee contracts.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist of investment income, interest expense and changes in the Hospital's investment in the Heartland Healthcare Reciprocal Risk Retention Group (Heartland) joint venture (see *Note 13*). Investment income decreased by $16,219 or 25% in 2011 due to fewer amounts invested in certificates of deposit throughout the year. The Hospital recorded a gain on its investment in the Heartland joint venture during 2011 of $124,632 due to positive earnings by Heartland that were allocated to the Hospital's capital account.

The Hospital's Cash Flows

While the Hospital has reported operating losses in each of the last three years, the Hospital has been able to produce positive cash flows from operating activities. Cash and short-term deposits decreased in 2011 by $658,161 or 18%. Cash and short-term deposits decreased by $340,687 or 9% in 2010 compared to 2009.

Capital Assets

At June 30, 2011, the Hospital had $7,655,581 invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2011, the Hospital purchased new capital assets costing $939,796.

At June 30, 2010, the Hospital had $7,990,166 invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2010, the Hospital purchased new equipment costing $705,235.

Debt

At June 30, 2011 and 2010, the Hospital had $736,732 and $974,811, respectively, in a capital lease obligation outstanding as detailed in *Note 8* to the financial statements. The Hospital issued no new debt in 2011 and 2010.

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 hospital administration by telephoning 580.338.6515.

Memorial Hospital of Texas County
A Component Unit of Texas County, Oklahoma
Balance Sheets
June 30, 2011 and 2010

Assets

	2011	2010
Current Assets		
Cash	$ 828,885	$ 859,755
Short-term deposits	2,147,151	2,774,442
Patient accounts receivable, net of allowance; 2011 – $5,575,000, 2010 – $4,197,000	2,548,111	2,386,634
Estimated amounts due from third-party payer	-	117,000
Supplies	524,291	379,725
Prepaid expenses	317,314	380,708
Total current assets	6,365,752	6,898,264
Capital Assets, Net	7,655,581	7,990,166
Investment in Joint Venture	501,834	501,834
Other Assets	287,506	389,614
Total assets	$ 14,810,673	$ 15,779,878

Liabilities and Net Assets

	2011	2010
Current Liabilities		
Current maturities of long-term debt	$ 249,090	$ 238,053
Estimated amounts due to third-party payer	105,000	-
Accounts payable	1,212,567	411,790
Accrued expenses	969,660	938,013
Total current liabilities	2,536,317	1,587,856
Long-term Debt	487,642	736,758
Total liabilities	3,023,959	2,324,614
Net Assets		
Invested in capital assets, net of related debt	6,863,915	7,013,129
Unrestricted	4,922,799	6,442,135
Total net assets	11,786,714	13,455,264
Total liabilities and net assets	$ 14,810,673	$ 15,779,878

Memorial Hospital of Texas County
A Component Unit of Texas County, Oklahoma
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2011 and 2010

	2011	2010
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2011 – $4,867,000, 2010 – $3,761,000	$ 17,888,070	$ 16,063,391
Other	289,874	515,819
Total operating revenues	18,177,944	16,579,210
Operating Expenses		
Salaries and wages	8,620,781	8,361,898
Employee benefits	1,599,072	1,604,330
Purchased services and professional fees	3,539,109	1,964,537
Supplies and other	5,017,115	4,284,199
Depreciation	1,269,128	1,160,195
Loss on sale of capital assets	2,195	8,225
Total operating expenses	20,047,400	17,383,384
Operating Loss	(1,869,456)	(804,174)
Nonoperating Revenues (Expenses)		
Gain on investment in joint venture	124,632	86,370
Investment income	49,468	65,687
Interest expense	(47,540)	(53,491)
Total nonoperating revenues (expenses)	126,560	98,566
Deficiency of Revenues over Expenses Before Capital Grants and Gifts	(1,742,896)	(705,608)
Capital Grants and Gifts	74,346	110,275
Decrease in Net Assets	(1,668,550)	(595,333)
Net Assets, Beginning of Year	13,455,264	14,050,597
Net Assets, End of Year	$ 11,786,714	$ 13,455,264

Memorial Hospital of Texas County
A Component Unit of Texas County, Oklahoma
Statements of Cash Flows
Year Ended June 30, 2011 and 2010

	2011	2010
Operating Activities		
Receipts from and on behalf of patients	$ 17,948,593	$ 16,244,679
Payments to and on behalf of employees	(10,188,206)	(9,758,158)
Payments to suppliers and contractors	(7,889,327)	(6,258,753)
Other receipts (payments), net	391,982	227,024
Net cash provided by operating activities	263,042	454,792
Capital and Related Financing Activities		
Principal paid on long-term debt	(238,079)	(227,489)
Interest paid on long-term debt	(47,540)	(53,491)
Purchase of capital assets	(887,088)	(722,452)
Contributions for purchase of capital assets	74,346	110,275
Proceeds from sale of capital assets	3,058	31,991
Net cash used in capital and related financing activities	(1,095,303)	(861,166)
Investing Activities		
Purchase of deposits	(49,366)	(281,402)
Proceeds from disposition of deposits	676,657	220,677
Dividends received from investment in joint venture	124,632	-
Interest on deposits	49,468	65,687
Net cash provided by investing activities	801,391	4,962
Decrease in Cash	(30,870)	(401,412)
Cash, Beginning of Year	859,755	1,261,167
Cash, End of Year	$ 828,885	$ 859,755
Reconciliation of Operating Loss to Net Cash Provided by Operating Activities		
Operating loss	$ (1,869,456)	$ (804,174)
Depreciation	1,269,128	1,160,195
Loss on sale of capital assets	2,195	8,225
Changes in operating assets and liabilities		
Patient accounts receivable, net	(161,477)	297,288
Other assets and liabilities	60,805	(284,396)
Estimated amount due from and to third-party payer	222,000	(116,000)
Accounts payable and accrued expenses	739,847	193,654
Net cash provided by operating activities	$ 263,042	$ 454,792
Supplemental Cash Flows Information		
Capital asset acquisitions included in accounts payable	$ 54,934	$ 2,226
Prepaid assets included in accounts payable	$ 53,947	$ 14,078

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

Nature of Operations and Reporting Entity

Memorial Hospital of Texas County (the Hospital) is an acute care hospital located in Guymon, Oklahoma. The Hospital is owned by Texas County, Oklahoma, and is considered a component unit of Texas County, Oklahoma. The County Commissioners of Texas County, Oklahoma, appoint members to the Board of Control of the Hospital.

The Hospital primarily earns revenue by providing inpatient, outpatient and emergency care services to patients in and around the Guymon, Oklahoma, area. The Hospital also operates a home health agency and physician clinics in the same geographic area.

MHTC Health Care Corporation (MHTC HCC) was formed by the Hospital during 2008. MHTC HCC is a nonprofit corporation organized to support certain charitable health care activities of the Hospital and, accordingly, is included as a component unit in the Hospital's financial statements using the blended method. All significant intercompany accounts and transactions between the Hospital and MHTC HCC have been eliminated in the financial statements.

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. Operating revenues and expenses include exchange transactions. Investment income and interest on capital asset-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

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

Use of Estimates

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

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At June 30, 2011 and 2010, the Hospital had no cash equivalents.

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; and employee health, dental and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters other than employee health claims. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

The Hospital is self-insured for a portion of its exposure to risk of loss from employee health claims. Annual estimated provisions are accrued for the self-insured portion of these claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Investments and Investment Income

Investments in nonnegotiable certificates of deposit are carried at amortized cost. Investment income includes 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 and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital:

Land improvements	15–20 years
Buildings, improvements and fixed equipment	20–40 years
Major moveable equipment, computers and furniture	3–7 years

Investment in Joint Venture

The Hospital has an ownership (equity) interest in a joint venture – Heartland Healthcare Reciprocal Risk Retention Group (Heartland). The investment in Heartland is recorded using the equity method of accounting (cost plus equity of Heartland's undistributed net income or loss since acquisition). See *Note 13* for additional information regarding Heartland.

Compensated Absences

Hospital policies permit most employees to accumulate paid days off 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 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.

Net Assets

Net assets of the Hospital are classified in three components. Net assets invested in capital assets, net of related debt, consist of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital assets that must be used for a particular purpose as specified by creditors, grantors or donors external to the Hospital. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the definition of invested in capital assets, net of related debt or restricted expendable. At June 30, 2011 and 2010, there were no restricted expendable net 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.

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. MHTC HCC is generally exempt from federal and state income taxes under Section 501 of the Internal Revenue Code and a similar provision of state law. However, the Hospital and MHTC HCC are subject to federal income tax on any unrelated business taxable income.

Note 2: Net Patient Service Revenue

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

- **Medicare –** Substantially all inpatient acute care and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. Those 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 based on the patients' acuity and expected resource utilization. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare administrative contractor. The Medicare administrative contractor has audited the Hospital's cost reports through June 30, 2009.

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

Approximately 39% and 40% of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the years ended June 30, 2011 and 2010, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

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

Note 3: Deposits, Investments and Investment Income

Deposits

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

Effective July 21, 2010, the FDIC 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, 2011 and 2010, respectively, none of the Hospital's bank balances of $3,401,943 and $3,868,200 were exposed to custodial credit risk.

The Hospital's investment policy is to invest operating and excess funds in interest-bearing checking accounts and certificates of deposit with financial institutions. These investments are included as deposits.

Summary of Carrying Values

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

	2011	2010
Carrying values		
Deposits	$ 2,972,096	$ 3,627,320
Accrued interest income	2,312	4,779
Petty cash	1,628	2,098
	$ 2,976,036	$ 3,634,197
Included in the following balance sheet captions		
Cash	$ 828,885	$ 859,755
Short-term deposits	2,147,151	2,774,442
	$ 2,976,036	$ 3,634,197

Note 4: Patient Accounts Receivable

The Hospital grants credit without collateral to its patients, most of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at June 30, 2011 and 2010, consisted of:

	2011	2010
Medicare	$ 601,197	$ 528,354
Medicaid	410,677	349,659
Other third-party payers	1,794,008	1,414,081
Patients	5,317,229	4,291,540
	8,123,111	6,583,634
Less allowance for uncollectible amounts	5,575,000	4,197,000
	$ 2,548,111	$ 2,386,634

Note 5: Capital Assets

Capital assets activity for the years ended June 30 was:

	2011				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 335,035	$ -	$ -	$ -	$ 335,035
Land improvements	180,665	-	-	-	180,665
Buildings, improvements and fixed equipment	15,557,421	53,262	-	329,220	15,939,903
Major moveable equipment	10,292,051	388,969	(194,634)	196,389	10,682,775
Construction in progress	77,237	497,565	-	(525,609)	49,193
	26,442,409	939,796	(194,634)	-	27,187,571
Less accumulated depreciation					
Land improvements	167,883	2,115	-	-	169,998
Buildings, improvements and fixed equipment	9,619,536	616,081	-	-	10,235,617
Major moveable equipment	8,664,824	650,932	(189,381)	-	9,126,375
	18,452,243	1,269,128	(189,381)	-	19,531,990
Capital assets, net	$ 7,990,166	$ (329,332)	$ (5,253)	$ -	$ 7,655,581

	2010				
	Beginning Balance	Additions	Disposals	Transfers	Ending Balance
Land	$ 335,035	$ -	$ -	$ -	$ 335,035
Land improvements	176,214	4,451	-	-	180,665
Buildings, improvements and fixed equipment	15,327,880	269,638	(40,097)	-	15,557,421
Major moveable equipment	10,021,201	353,909	(103,303)	20,244	10,292,051
Construction in progress	20,244	77,237	-	(20,244)	77,237
	25,880,574	705,235	(143,400)	-	26,442,409
Less accumulated depreciation					
Land improvements	165,965	1,918	-	-	167,883
Buildings, improvements and fixed equipment	9,083,761	564,376	(28,601)	-	9,619,536
Major moveable equipment	8,145,506	593,901	(74,583)	-	8,664,824
	17,395,232	1,160,195	(103,184)	-	18,452,243
Capital assets, net	$ 8,485,342	$ (454,960)	$ (40,216)	$ -	$ 7,990,166

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.

The Hospital is a member of Heartland Healthcare Reciprocal Risk Retention Group (Heartland), an entity approved by the state of Vermont to provide hospital professional and general liability coverage to its subscribers. Heartland 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. Heartland members are provided hospital professional and general liability insurance under claims-made policies on a fixed premium basis. See *Note 13* for additional information about Heartland.

Note 7: Employee Health Claims

Substantially all of the Hospital's employees and their dependents are eligible to participate in the Hospital's employee health insurance program. The Hospital is self-insured for health claims of participating employees and dependents up to an annual aggregate amount of $75,000. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount. A provision is accrued for self-insured claims, including both claims reported and claims incurred but not yet reported. The accrual is estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is reasonably possible that the Hospital's estimate will change by a material amount in the near term.

Activity in the Hospital's accrued employee health claims liability during 2011 and 2010 is summarized as follows:

	2011	2010
Balance, beginning of year	$ 190,000	$ 123,000
Current year claims incurred and changes in estimates for claims incurred in prior years	1,119,202	985,166
Claims and expenses paid	(1,050,202)	(918,166)
Balance, end of year	$ 259,000	$ 190,000

Note 8: Long-Term Debt

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

2011	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Capital lease obligation	$ 974,811	$ -	$ (238,079)	$ 736,732	$ 249,090

2010	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Capital lease obligation	$ 1,202,300	$ -	$ (227,489)	$ 974,811	$ 238,053

Capital Lease Obligation

The Hospital is obligated under a lease for medical equipment that is accounted for as a capital lease. Assets under capital lease at June 30, 2011 and 2010, totaled $1,625,433, net of accumulated depreciation of $1,430,816 and $1,143,467, respectively. The following is a schedule by year of future minimum lease payments under the capital lease, including interest at 4.5% together with the present value of the future minimum lease payments, as of June 30, 2011:

Year Ending June 30,	
2012	$ 277,604
2013	277,103
2014	231,651
Total minimum lease payments	786,358
Less amount representing interest	49,626
Present value of future minimum lease payments	$ 736,732

Note 9: Designated Net Assets

At June 30, 2011 and 2010, unrestricted net assets have been designated by the Hospital's Board of Control for the following purposes:

	2011	2010
Capital acquisitions	$ 124,424	$ 781,688
Self-insured health claims	45,026	51,620
	$ 169,450	$ 833,308

Designated net assets remain under the control of the Board of Control which may, at its discretion, later use these net assets for other purposes.

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 the state Medicaid welfare program. The state Medicaid welfare program pays 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:

	2011	2010
Charity allowances	$ 41,000	$ 69,000
State Medicaid welfare program	6,201,000	4,987,000
	$ 6,242,000	$ 5,056,000

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

Note 11: Retirement Plan

The Hospital contributes to a defined contribution annuity plan covering substantially all employees. Pension expense is recorded for the amount of the Hospital's required contributions determined in accordance with the terms of the plan. The plan is administered by the Hospital's Board of Control. 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 Board of Control. Contribution rates for plan members and the Hospital expressed as a percentage of covered payroll were 3.6% and 1.9% for 2011 and 4.0% and 2.1% for 2010, respectively. Contributions actually made by plan members and the Hospital aggregated $201,000 and $106,000 during 2011 and $228,000 and $120,000 during 2010, respectively.

Note 12: 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.

Current Economic Conditions

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

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

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

Note 13: Investment in Joint Venture

The Hospital is a subscriber (member) of Heartland Healthcare Reciprocal Risk Retention Group (Heartland) and, at June 30, 2011, has an approximate 7% ownership (equity) interest in Heartland. Heartland was formed as an unincorporated association approved by the state of Vermont to provide hospital professional liability and general liability coverage to its subscribers. The Hospital's investment in Heartland amounted to $501,834 at June 30, 2011 and 2010.

The Hospital purchases its professional liability (medical malpractice) and general liability insurance coverages from Heartland (see *Note 6*). For the years ended June 30, 2011 and 2010, the Hospital paid approximately $249,000 and $231,000, respectively, to Heartland for the coverage.

Financial position and results of operations summarized from Heartland's audited financial statements for the fiscal year ended December 31, 2010 and 2009, are shown below:

	2010	2009
Cash and cash equivalents	$ 1,498,472	$ 1,964,558
Investments at fair value	12,842,373	10,676,944
Other assets	389,227	192,276
Total assets	14,730,072	12,833,778
Unpaid losses and loss adjustment expenses	5,392,522	5,702,679
Other liabilities	382,042	176,340
Total liabilities	5,774,564	5,879,019
Subscribers' surplus	$ 8,955,508	$ 6,954,759
Revenues	$ 3,681,912	$ 3,682,022
Net income	$ 1,835,714	$ 1,208,987

Complete financial statements of Heartland may be obtained by contacting hospital administration at 580.338.6515.

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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 Control
Memorial Hospital of Texas County
Guymon, Oklahoma

We have audited the financial statements of Memorial Hospital of Texas County (the Hospital), a component unit of Texas County, Oklahoma, as of and for the year ended June 30, 2011, and have issued our report thereon dated February 24, 2012. 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

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies or material weaknesses have been identified. However, as discussed in the accompanying schedule of findings and responses, we identified a deficiency in internal control over financial reporting 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 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 2011-1 to be a material weakness.

Compliance and Other Matters

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

We also noted certain additional matters that we reported to the Hospital's management in a separate letter dated February 24, 2012.

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

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

BKD, LLP

February 24, 2012

Memorial Hospital of Texas County
A Component Unit of Texas County, Oklahoma
Schedule of Findings and Responses
Year Ended June 30, 2011

Reference Number	Finding
2011-1	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal controls to promote accurate recording and classification of accounting transactions. Condition – Management's procedures for recording and classifying accounting transactions and procedures for preparing general ledger reconciliations did not always prevent inaccurate recording of transactions. Context – Potential 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. Effect – Material journal entries were made to numerous general ledger accounts during the audit to correct misstatements not identified by management. Cause – Recording and monitoring procedures in the internal control over financial reporting process were not performed accurately. Recommendation – Management should ensure that controls are adequate to properly record accounting entries. Management should also ensure that monthly general ledger reconciliations are completed timely and accurately and all reconciling items are researched and resolved on a timely basis. Views of Responsible Officials and Planned Corrective Actions – Management concurs with the finding and recommendation. Management will take steps to evaluate the current internal controls over the recording and classification of accounting transactions and prepare accurate monthly reconciliations, including resolving any variances.

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Board of Control, Finance Committee and Management
Memorial Hospital of Texas County
Guymon, Oklahoma

As part of our audit of the financial statements of Memorial Hospital of Texas County (the Hospital) as of and for the year ended June 30, 2011, we wish to communicate the following to you.

AUDIT SCOPE AND RESULTS

Auditor's Responsibility Under 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

An audit performed 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, is designed to obtain reasonable, rather than absolute, assurance about the financial statements. In performing auditing procedures, we establish scopes of audit tests in relation to the financial statements taken as a whole. Our engagement does not include a detailed audit of every transaction. Our engagement letter more specifically describes our responsibilities.

These standards require communication of significant matters related to the financial statement audit that are relevant to the responsibilities of those charged with governance in overseeing the financial reporting process. Such matters are communicated in the remainder of this letter or have previously been communicated during other phases of the audit. The standards do not require the auditor to design procedures for the purpose of identifying other matters to be communicated with those charged with governance.

An audit of the financial statements does not relieve management or those charged with governance of their responsibilities. Our engagement letter more specifically describes your responsibilities.

Qualitative Aspects of Significant Accounting Policies and Practices

Significant Accounting Policies

The Hospital's significant accounting policies are described in Note 1 of the audited financial statements.

Alternative Accounting Treatments

No matters are reportable.

Management Judgments and Accounting Estimates

Accounting estimates are an integral part of financial statement preparation by management, based on its judgments. The following areas involve significant areas of such estimates for which we are prepared to discuss management's estimation process and our procedures for testing the reasonableness of those estimates:

- Allowances for contractual adjustments and uncollectible accounts
- Liability for self-insured health claims

Financial Statement Disclosures

No matters are reportable.

Audit Adjustments

During the course of any audit, an auditor may propose adjustments to financial statement amounts. Management evaluates our proposals and records those adjustments which, in its judgment, are required to prevent the financial statements from being materially misstated. Some adjustments proposed were not recorded because their aggregate effect is not currently material; however, they involve areas in which adjustments in the future could be material, individually or in the aggregate.

Areas in which adjustments were proposed include:

Proposed Audit Adjustments Recorded

- Adjust accrued payroll
- Adjust accounts payable
- Adjust patient accounts receivable for estimated Encompass anesthesia uncollectible amounts
- Adjust allowances for uncollectible accounts and contractual adjustments
- Adjust estimated amounts due to third-party payer for Medicare cost report settlements

Proposed Audit Adjustments Not Recorded

- Attached is a summary of uncorrected misstatements we aggregated during the current engagement and pertaining to the latest period presented that were determined by management to be immaterial, both individually and in the aggregate, to the financial statements as a whole.

Auditor's Judgments About the Quality of the Entity's Accounting Principles

No matters are reportable.

Other Material Written Communication

Listed below is another material written communication between management and us related to the audit:

- Management representation letter (attached)

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements of Memorial Hospital of Texas County as of and for the year ended June 30, 2011, 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, we considered the Hospital's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. 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 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 below, we identified a deficiency in internal control that we consider to be a material weakness.

A deficiency 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 of the Hospital's financial statements on a timely basis. A deficiency in design exists when a control necessary to meet a control objective is missing or an existing control is not properly designed so that, even if the control operates as designed, a control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or competence to perform the control effectively.

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.

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 observed the following matters that we consider to be deficiencies or a material weakness.

Material Weakness

Refer to the 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*.

Deficiencies

Segregation of Duties

Management is responsible for establishing and maintaining effective internal controls over financial reporting. Various individuals within the accounting department have incompatible duties in several financial statement reporting transactions cycles. Duties in these transactions cycles are not adequately segregated to safeguard the Hospital's assets.

One individual has incompatible duties in the purchases, cash disbursements and accounts payable transactions cycle. Individuals with the ability to generate payments should have separate duties from individuals with recording and monitoring duties.

- The accounting manager has the ability to generate purchase orders and payments, record checks issued, add or make changes to vendor profiles in the computer system, record journal entries and prepare and review account reconciliations.

One individual has incompatible duties in the payroll transactions cycle. Individuals with the ability to generate payments should have separate duties from individuals with recording and monitoring duties.

- The payroll coordinator has the ability to generate, authorize and distribute payroll payments, modify employee pay rate and EFT deposit information, record payroll transactions and reconcile employee payroll records and payroll distributions.

Certain individuals have incompatible duties in the patient revenues, cash receipts and accounts receivable transactions cycle. Individuals with the ability to receive payments or authorize adjustments should have separate duties from individuals with recording and monitoring duties.

- The business office director has the ability to access cash payments, approve and post adjustments to patient accounts, record bad debt write-offs and perform other access, recording and monitoring duties.

- Cash posters have the ability to access cash payments, credit patient accounts as if payments were received and reconciles cash receipts journal to bank deposit records.

We recommend management periodically evaluate the cost versus the benefit of further segregation of duties or addition of monitoring or other compensating controls and implement those changes it deems appropriate for which the benefits are determined to exceed costs.

Adjustments to Patient Account Balances

During our review of internal controls, we noted business office personnel and CPSI staff have the ability to post adjustments to patient accounts receivable balances. Management does have a procedure for approving the adjustments. However, there is not an internal control procedure to verify all adjustments posted were actually approved. We recommend management implement this procedure to mitigate the risk of misappropriation of assets or improper adjustments to patient accounts receivable balances.

Credit Balances in Accounts Receivable

During our testing, we noted there is a significant amount of credit balances in accounts receivable. Management has indicated many of these accounts may not be amounts to be refunded to patients or third-party payers, as payments received may not have been posted to the proper patient balance. We suggest management review these credit balances in an effort to properly post payments received and identify overpayments to be refunded.

Clinic Accounts Receivable

During our testing, we noted the patient accounts receivable detail did not agree to the general ledger for various clinic locations. We recommend management establish procedures to verify payments received by the Hospital are properly posted to the patient accounts receivable detail at the clinic locations, and management should perform a monthly reconciliation to note agreement between the patient detail file and the general ledger accounts.

OTHER MATTERS

Although not considered material weaknesses, significant deficiencies or deficiencies in internal control over financial reporting, we observed the following matters and offer these comments and suggestions with respect to matters which came to our attention during the course of the audit of the financial statements. Our audit procedures are designed primarily to enable us to form an opinion on the financial statements and, therefore, may not bring to light all weaknesses in policies and procedures that may exist. However, these matters are offered as constructive suggestions for the consideration of management as part of the ongoing process of modifying and improving financial and administrative practices and procedures. We can discuss these matters further at your convenience and may provide implementation assistance for changes or improvements if you require.

Overaccrual of Vacation Hours

During our testing, we noted multiple employees with accrued hours in excess of the 160 allowable maximum accrual hours. We recommend management review employee vacation accrual hours detail to ensure no employees exceed the maximum accrual as defined in the Hospital's policy.

Medicare Skilled Nursing Facility PPS 2012 Final Rule

On July 29, 2011, the Centers for Medicare & Medicaid Services (CMS) issued its final rule (the Rule) for federal fiscal year 2012 to update payment rates under the prospective payment system (PPS) for skilled nursing facilities (SNF), which includes freestanding SNFs, hospital-based SNFs and swing beds in PPS hospitals. This final rule addresses CMS' concerns about payments and therapy utilization during the federal fiscal year ended September 30, 2011. The provisions of the Rule are effective on October 1, 2011, and include:

- An aggregate reduction in payment rates of approximately 11.1%, which includes a 2.7% market basket increase and a 1% negative productivity adjustment applied to all RUG categories, and a recalibration applied only to rehabilitation RUG categories, resulting in an additional 12.6% reduction in overall SNF payments.
- Provisions designed to address what CMS considers inappropriate payment incentives to perform group therapy. These provisions redefine group therapy as physical, occupational or speech therapy provided to exactly four patients performing similar activities. Under this new definition, the therapy minutes provided are allocated among the four participants.
- MDS assessment changes, including decreasing the assessment window for the 14-day and subsequent assessments by narrowing the assessment reference dates and eliminating some grace days.
- Creating new therapy-related Other Medicare-Required Assessments (OMRA) to more closely tie RUG rates to therapy services actually provided. These require special OMRAs when:
    - Therapy services cease to a resident (an End of Therapy OMRA or EOT)
    - Therapy resumes within five calendar days after an EOT (an End of Therapy Resumption OMRA or EOT-R)
    - Therapy intensity changes following a recent assessment (a Change of Therapy OMRA or COT)

The 11.1% reduction in payment rates is not inclusive of the therapy and assessment provisions noted above, which we expect to have an additional significant negative effect. In addition, we expect the assessment provisions to require additional monitoring processes be implemented.

We recommend SNF providers compute the impact of the rate decreases on their revenues during the federal fiscal year beginning October 1, 2012, and evaluate the impact the other provisions will have on their profitability and operations. Further, we recommend implementing immediate training for facility staff on the Rule's components, including the additional and required assessments, the assessment completion window and changes in group therapy. Finally, some additional training on SNF basics, such as MDS completion, communication, assessment of activities of daily living (ADL) and depression scoring, may help to reduce the impact of the Rule.

Current Economic Conditions

The current protracted economic decline continues to present difficult circumstances and challenges for the health care industry. As a result, hospitals are facing declines in the fair values of investments and other assets, declines in contributions, constraints on liquidity and difficulty obtaining financing. The values of the assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments to asset values, such as the allowance for accounts receivable, that could negatively impact the Hospital's ability to meet debt covenants or maintain sufficient liquidity.

Now, more than ever, we recommend management and the Board of Control vigilantly monitor and aggressively manage all of these matters, including:

- Review and monitor allowances for uncollectible accounts
- Evaluate financing needs and liquidity plans

This communication is intended solely for the information and use of management, the Finance Committee, the Board of Control and others within the Hospital and is not intended to be and should not be used by anyone other than these specified parties.

BKD, LLP

February 24, 2012

MEMORIAL HOSPITAL OF TEXAS COUNTY
520 Medical Drive • Guymon, Oklahoma 73942 • (580) 338-6515

February 24, 2012

BKD, LLP
Certified Public Accountants
6120 South Yale Avenue, Suite 1400
Tulsa, OK 74136

We are providing this letter in connection with your audits of our financial statements as of and for the years ended June 30, 2011 and 2010. We confirm that we are responsible for the fair presentation of the financial statements in conformity with accounting principles generally accepted in the United States of America. We are also responsible for adopting sound accounting policies, establishing and maintaining effective internal control over financial reporting, operations and compliance, and preventing and detecting fraud.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following:

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America.

2. We have reviewed and approved a draft of the financial statements and related notes referred to above, which you prepared in connection with your audit of our financial statements. We acknowledge that we are responsible for the fair presentation of the financial statements and related notes.

3. We have made available to you:

   (a) All financial records and related data.

   (b) All minutes of the Board of Control and Finance Committee meetings held through the date of this letter.

   (c) All significant contracts and grants.

   (d) All peer review organizations, fiscal intermediary and third-party payer reports and information.

4. We have informed you of all current risks of a material amount that are not adequately prevented or detected by Hospital procedures with respect to:

    (a) Misappropriation of assets.

    (b) Misrepresented or misstated assets or liabilities.

5. We believe the effects of the uncorrected financial statement misstatements summarized in the attached schedule are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

6. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.

7. We have no knowledge of any known or suspected:

    (a) Fraudulent financial reporting or misappropriation of assets involving management or employees who have significant roles in internal control.

    (b) Fraudulent financial reporting or misappropriation of assets involving others that could have a material effect on the financial statements.

    (c) Communications from regulatory agencies, governmental representatives, employees or others concerning investigations or allegations of noncompliance with laws and regulations, deficiencies in financial reporting practices or other matters that could have a material adverse effect on the financial statements.

8. We have no knowledge of any allegations of fraud or suspected fraud affecting the Hospital received in communications from employees, customers, regulators, suppliers or others.

9. Except as reflected in the financial statements, there are no:

    (a) Plans or intentions that may materially affect carrying values or classifications of assets and liabilities.

    (b) Material transactions omitted or improperly recorded in the financial records.

    (c) Material gain/loss contingencies requiring accrual or disclosure, including those arising from environmental remediation obligations.

(d) Events occurring subsequent to the balance sheet date requiring adjustment or disclosure in the financial statements.

(e) Related-party transactions, balances, arrangements or guarantees.

(f) Agreements to purchase assets previously sold.

(g) Violations of laws, regulations or requirements of regulatory agencies for which losses should be accrued or matters disclosed in the financial statements.

(h) Unasserted claims or assessments that our attorneys have advised us are probable of assertion.

(i) Restrictions on cash balances or compensating balance agreements.

(j) Guarantees, whether written or oral, under which the Hospital is contingently liable.

10. We have informed you of all pending or completed investigations by regulatory authorities of which we are aware. There are no known circumstances that could jeopardize the Hospital's participation in the Medicare or other governmental health care programs.

11. Adequate provisions and allowances have been accrued for any material losses from:

(a) Uncollectible receivables.

(b) Medicare/Medicaid and other third-party payer contractual, audit or other adjustments.

(c) Reducing obsolete or excess inventories to estimated net realizable value.

(d) Purchase commitments in excess of normal requirements or above prevailing market prices.

12. Except as disclosed in the financial statements, the Hospital has:

(a) Satisfactory title to all recorded assets, and they are not subject to any liens, pledges or other encumbrances.

(b) Complied with all aspects of contractual agreements for which noncompliance would materially affect the financial statements.

13. With respect to the Hospital's possible exposure to past or future medical malpractice assertions:

    (a) We have disclosed to you all incidents known to us that could possibly give rise to an assertion of malpractice.

    (b) All known incidents have been reported to the appropriate medical malpractice insurer.

    (c) There is no known lapse in coverage, including any lapse subsequent to the fiscal year-end, that would result in any known incidents being uninsured.

    (d) Management does not expect any claims to exceed malpractice insurance limits.

14. With regard to deposit and investment activities:

    (a) All deposit, repurchase and reverse repurchase agreements and investment transactions have been made in accordance with legal and contractual requirements.

    (b) Disclosures of deposit and investment balances and risks in the financial statements are consistent with our understanding of the applicable laws regarding enforceability of any pledges of collateral.

    (c) We understand that your audit does not represent an opinion regarding the enforceability of collateral pledges.

15. With respect to any nonattest services you have provided us during the year, such as Medicare reimbursement consultation and drafting our audited financial statements:

    (a) We have designated a qualified management-level individual to be responsible and accountable for overseeing the nonattest services.

    (b) We have established and monitored the performance of the nonattest services to ensure that they meet our objectives.

    (c) We have made any and all decisions involving management functions with respect to the nonattest services and accept full responsibility for such decisions.

    (d) We have evaluated the adequacy of the services performed and any findings that resulted.

16. The Hospital is exempt from income tax under Section 115 and MHTC Health Care Corporation is exempt from tax under Section 501(c) of the Internal Revenue Code and a similar provision of state law and, except as disclosed in the financial statements, there are no activities that would jeopardize our tax-exempt status or subject us to income tax on unrelated business income or excise tax on prohibited transactions and events.

17. We acknowledge that we are responsible for compliance with applicable laws, regulations and provisions of contracts and grant agreements.

18. We have identified and disclosed to you all laws, regulations and provisions of contracts and grant agreements that have a direct and material effect on the determination of amounts in our financial statements or other financial data significant to the audit objectives.

19. We have identified and disclosed to you any violations or possible violations of laws, regulations and provisions of contracts and grant agreements whose effects should be considered for recognition and/or disclosure in the financial statements or for your reporting on noncompliance.

20. We have taken or will take timely and appropriate steps to remedy any fraud, abuse, illegal acts or violations of provisions of contracts or grant agreements that you or other auditors report.

21. We have a process to track the status of audit findings and recommendations.

22. We have identified to you any previous financial audits, attestation engagements, performance audits or other studies related to the objectives of your audit and the corrective actions taken to address any significant findings and recommendations made in such audits, attestation engagements or other studies.

23. We have provided our views on any findings, conclusions and recommendations, as well as our planned corrective actions with respect thereto, to you for inclusion in the findings and recommendations referred to in your report on internal control over financial reporting and on compliance and other matters based on your audit of the financial statements performed in accordance with *Government Auditing Standards*.

24. The supplementary information required by the Governmental Accounting Standards Board (GASB), consisting of management's discussion and analysis, has been prepared and is presented in conformity with the applicable GASB pronouncements. The information contained therein is based on all facts, decisions and conditions currently known to us and is measured using the same methods and assumptions as were used in the preparation of the financial statements. There has been no change from the preceding period in the methods of measurement and presentation.

25. The financial statements disclose all significant estimates and material concentrations known to us. Significant estimates are estimates at the balance sheet date which could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply or markets for which events could occur which would significantly disrupt normal finances within the next year.

26. We have not been designated as a potentially responsible party (PRP or equivalent status) by the Environmental Protection Agency (EPA) or other cognizant regulatory agency with authority to enforce environmental laws and regulations.

27. Billings to third-party payers comply in all material respects with applicable coding guidelines, laws and regulations. Billings reflect only charges for goods and services that were medically necessary; properly approved by regulatory bodies, if required; and properly rendered.

28. With regard to cost reports filed with Medicare, Medicaid or other third parties:

    (a) All required reports have been properly filed.

    (b) Management is responsible for the accuracy and propriety of those reports.

    (c) All costs reflected on such reports are appropriate and allowable under applicable reimbursement rules and regulations and are patient-related and properly allocated to applicable payers.

    (d) The reimbursement methodologies and principles employed are in accordance with applicable rules and regulations.

    (e) All items required to be disclosed, including disputed costs that are being claimed to establish a basis for a subsequent appeal, have been fully disclosed in the cost report.

    (f) Recorded allowances for third-party settlements are necessary and are based on historical experience or new or ambiguous regulations that may be subject to differing interpretations.

29. We agree with the finding related to the inaccurate recording of transactions identified in finding 2011-1 on the schedule of findings and responses. We agree that we will take steps to evaluate the current internal controls over recording accounting transactions and prepare accurate monthly reconciliations.

30. We acknowledge the current protracted economic decline continues to present difficult circumstances and challenges for the health care industry. Hospitals are facing declines in the fair values of investments and other assets, declines in contributions, constraints on liquidity and difficulty obtaining financing. We understand the values of the assets and liabilities recorded in the financial statements could change rapidly, resulting in material future adjustments to asset values, allowances for accounts, etc., that could negatively impact the Hospital's ability to maintain sufficient liquidity. We acknowledge that you have no responsibility for future changes caused by the current economic environment and the resulting impact on the Hospital's financial statements. Further, management and the Board are solely responsible for all aspects of managing the Hospital, including questioning the quality and valuation of investments and other assets, reviewing allowances for uncollectible amounts and evaluating capital needs and liquidity plans.

Charles Johnston, Interim CEO

Steve Stewart, CFO

Michele Reust

Michele Reust, Accounting Manager

Memorial Hospital of Texas County
ATTACHMENT

This analysis and the attached "Schedule of Uncorrected Misstatements (Adjustments Passed)" reflects the effects on the financial statements if the uncorrected misstatements identified were corrected.

QUANTITATIVE ANALYSIS

	Before Misstatements	Misstatements	Subsequent to Misstatements	% Change
Current Assets	6,365,752	726,570	7,092,322	11.41%
Non-Current Assets	8,444,921		8,444,921	
Current Liabilities	(2,536,317)	(684,785)	(3,221,102)	27.00%
Non-Current Liabilities	(487,642)	(25,907)	(513,549)	5.31%
Current Ratio	2.510		2.202	-12.27%

Total Assets	14,810,673	726,570	15,537,243	4.91%
Invest in Capital Assets, net of Debt	(6,863,915)		(6,863,915)	
Restricted Net Assets				
Unrestricted Net Assets	(4,922,799)	(15,878)	(4,938,677)	0.32%
Total Net Assets	(11,786,714)	(15,878)	(11,802,592)	0.13%

Operating Revenues	(18,177,944)	7,393	(18,170,551)	-0.04%
Operating Expenses	20,047,400	(10,000)	20,037,400	-0.05%
Nonoperating Revenues (Expenses)	(126,560)		(126,560)	
Change in Net Assets	1,668,550	(2,607)	1,665,943	-0.16%

Client: Memorial Hospital of Texas County

Period Ending: June 30, 2011

SCHEDULE OF UNCORRECTED MISSTATEMENTS (ADJUSTMENTS PASSED)

Description	Type of Misstatement (Known or Likely)	Assets Current DR (CR)	Assets Non-Current DR (CR)	Liabilities Current DR (CR)	Liabilities Non-Current DR (CR)	Operating Revenues DR (CR)	Operating Expenses DR (CR)	Nonoperating Revenues (Expenses) DR (CR)	Net Assets (Beg of year) DR (CR)	Invested in Capital Assets, Net DR (CR)	Restricted Net Assets DR (CR)	Unrestricted Net Assets DR (CR)	Net Effect on Following Year: Change in Net Assets DR (CR)	Net Effect on Following Year: Net Assets DR (CR)
PRIOR YEAR PAJE'S														
2010 revenue posted into 2011	Known					23,271			(23,271)					
Accrue legal settlement	Known						(10,000)		10,000					
CURRENT YEAR PAJE'S														
Reclassify estimated long-term portion of PTC	Known			25,907	(25,907)								N/A	N/A
Credit balances in accounts receivable	Known	698,515		(698,515)									N/A	N/A
2011 revenue posted into 2012	Known	15,878				(15,878)						(15,878)	15,878	(15,878)
Adjust debit balance in AP related to Fixed Asset discount	Known	12,177		(12,177)									N/A	N/A
Total passed adjustments		726,570		(684,785)	(25,907)	7,393	(10,000)		(13,271)			(15,878)	15,878	(15,878)

Impact on Change in Net Assets	(2,607)
Impact on Net Assets	(15,878)