



Management's Discussion and Analysis  
and Financial Statements

September 30, 2011 and 2010

**Pawhuska Hospital, Inc.**

Independent Auditor's Report.....	1
Management's Discussion and Analysis .....	3
Financial Statements	
Balance Sheets .....	7
Statements of Revenues, Expenses, and Changes in Net Assets .....	8
Statements of Cash Flows .....	9
Notes to Financial Statements .....	11
Independent Auditor's Report on Supplementary Information.....	22
Supplementary Information	
Schedules of Net Patient Service Revenue .....	23
Schedules of Other Revenue .....	24
Schedules of Expenses.....	25
Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i> .....	26
Schedule of Findings .....	28



## **Independent Auditor's Report**

The Board of Trustees  
Pawhuska Hospital, Inc.  
Pawhuska, Oklahoma

We have audited the accompanying balance sheets of Pawhuska Hospital, Inc. (the Hospital) as of September 30, 2011 and 2010 and the related statements of revenues, expenses, and changes in net assets and statements of 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 audits 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 provided 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 Pawhuska Hospital, Inc. as of September 30, 2011 and 2010 and the results of its operations, changes in net assets, 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 April 30, 2012 on our consideration of Pawhuska Hospital, Inc.'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 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 audits.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 be presented to supplement the basic financial statements. Such information, although not a 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 supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Eide Bailly LLP*

Oklahoma City, Oklahoma  
April 30, 2012

This discussion and analysis of the financial performance of Pawhuska Hospital, Inc. (the Hospital) provides an overall review of the Hospital's financial activities and balances as of and for the years ended September 30, 2011 and 2010. The intent of this discussion and analysis is to provide further information on the Hospital's performance as a whole; readers should also review the basic financial statements and the notes thereto to enhance their understanding of the Hospital's financial status.

### **Financial Highlights – Financial Statements**

- The Hospital's net assets increased by \$148,126 or 7% percent in 2011 and decreased by \$178,464 or 8% in 2010.
- The Hospital reported a decrease in operating losses in 2011. Losses in 2011 decreased by \$344,102 or 105% compared to an increase in the operating losses of \$22,661 or 7% in 2010.
- Capital grants and contributions increased in 2011 by \$573 or 2% compared with a decrease of \$168,744 or 85% in 2010.

### **Organization Highlights**

- The Hospital continues to provide 24-hour emergency care in a timely manner to the community.
- The Hospital continues to increase service offerings, including the opening of a wound care clinic during 2011.
- The Hospital continues to upgrade equipment to provide the best care to patients.
- The Hospital provides charity care for those who are unable to pay for services.

### **Overview of the Financial Statements**

The financial statements include the balance sheets, statements of revenues, expenses, and changes in net assets, and statements of cash flows.

The balance sheet at September 30, 2011 indicated total assets of \$3,700,829, total liabilities of \$1,480,173, and net assets of \$2,220,756. Total current assets were \$2,365,536 and total current liabilities were \$1,071,719 for a current ratio of 2.2:1.

The statements of revenues, expenses, and changes in net assets for the year ended September 30, 2011 indicated total operating revenues of \$3,798,889 and operating expenses of \$3,782,014, operating income of \$16,875, net non-operating revenues of \$(11,165), water fees from the City of Pawhuska of \$112,542, and capital grants and contributions of \$29,874. The net assets increased by \$148,126 from \$2,072,630 at September 30, 2010 to \$2,220,756 at September 30, 2011.

As reported in the statements of cash flows, cash and cash equivalents increased from \$382,879 at September 30, 2010 to \$504,331 at September 30, 2011.

Please review the notes to the financial statements included in the report.

The following table summarizes the Hospital's assets, liabilities, and net assets at September 30:

	2011	2010	2009
Assets			
Current assets	\$ 2,365,536	\$ 1,562,351	\$ 1,472,815
Capital assets, net	1,335,293	853,656	932,001
Assets limited as to use	-	-	148,004
Non-current assets	-	-	110,878
Total assets	<u>\$ 3,700,829</u>	<u>\$ 2,416,007</u>	<u>\$ 2,663,698</u>
Liabilities			
Current liabilities	\$ 1,071,719	\$ 343,377	\$ 412,604
Long-term debt outstanding	408,354	-	-
Total liabilities	<u>1,480,073</u>	<u>343,377</u>	<u>412,604</u>
Net Assets			
Invested in capital assets, net of related debt	821,821	853,656	932,001
Unrestricted	1,398,935	1,218,974	1,319,093
Total net assets	<u>2,220,756</u>	<u>2,072,630</u>	<u>2,251,094</u>
Total liabilities and net assets	<u>\$ 3,700,829</u>	<u>\$ 2,416,007</u>	<u>\$ 2,663,698</u>

The following table summarizes the Hospital's revenues, expenses, and changes in net assets for the year ended September 30:

	1900	1900	1900
Operating Revenue			
Net patient service revenue	\$ 3,793,466	\$ 2,913,951	\$ 2,847,527
Other revenue	5,423	6,985	9,227
Total operating revenue	<u>3,798,889</u>	<u>2,920,936</u>	<u>2,856,754</u>
Operating Expenses			
Daily patient services	733,422	715,705	677,244
Other nursing services	311,472	254,568	261,909
Other professional services	1,209,068	882,235	974,976
General services	420,530	362,330	360,964
Administrative services	943,324	910,840	774,263
Depreciation	164,198	122,485	111,964
Total operating expenses	<u>3,782,014</u>	<u>3,248,163</u>	<u>3,161,320</u>
Operating Income (Loss)	<u>16,875</u>	<u>(327,227)</u>	<u>(304,566)</u>

Pawhuska Hospital, Inc.  
Management's Discussion and Analysis  
September 30, 2011 and 2010

	1900	1900	1900
Non-Operating Revenue (Expense)			
Investment income	\$ 8,143	\$ 9,526	\$ 23,349
Interest expense	(19,308)	(4,609)	(2,303)
Net non-operating revenue	(11,165)	4,917	21,046
Revenues in excess (less than) Expenses	5,710	(322,310)	(283,520)
Water fees - City of Pawhuska	112,542	114,545	114,707
Capital grants and contributions	29,874	29,301	198,045
Change in Net Assets	148,126	(178,464)	29,232
Net Assets, Beginning of the Year	2,072,630	2,251,094	2,221,862
Net Assets, End of the Year	\$ 2,220,756	\$ 2,072,630	\$ 2,251,094

Total net patient service revenues were \$3,793,466 and \$2,913,951 for the years ended September 30, 2011 and 2010, respectively. Factors impacting total patient service revenues in 2011 compared to 2010 include increased services and increased patient utilization.

Operating expenses for September 30, 2011 and 2010, totaled \$3,782,014 and \$3,248,163, respectively. The largest components of operating expenses are other professional services and administrative services. Other professional services expenses and administrative services expenses for the years ended September 30, 2011 and 2010 accounted for 57% and 55%, respectively, of total operating expenses.

### Capital Assets

The Hospital had capital assets net of accumulated depreciation at September 30, 2011, amounting to \$1,335,293. The investment in capital assets includes land, land improvements, building and improvements, and equipment.

Capital assets consisted of the following at September 30:

	1900	1900	1900
Land	\$ 34,360	\$ 34,360	\$ 34,360
Construction in progress	-	27,124	-
Land improvements	35,979	35,979	35,979
Buildings and improvements	973,428	939,309	939,310
Equipment	2,477,323	1,838,483	1,820,914
Accumulated depreciation	(2,185,797)	(2,021,599)	(1,898,562)
Total capital assets, net	\$ 1,335,293	\$ 853,656	\$ 932,001

### **Economic Factors and Next Year's Budget**

The Hospital has increased their rates and expanded services, which should increase revenues for the upcoming year. The Hospital continues to monitor costs throughout the year. The 2012 operating budget indicates a conservative net revenue of \$129,806. The Hospital's continued mission is to provide acute care to Pawhuska and the surrounding area.

### **Requests for Information**

This financial report is designed to provide our 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. If you have questions about this report or need additional information, contact Pawhuska Hospital, Inc., 1101 E 15th St, Pawhuska, Oklahoma 74056.



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	<u>2011</u>	
Assets		
Current Assets		
Cash and cash equivalents	\$ 504,331	\$ 382,879
Short-term investments	1,024,121	667,352
Patient receivables, net of estimated uncollectibles of \$304,941 in 2011 and \$216,698 in 2010	673,445	374,747
Related-party receivable	8,852	12,428
Supplies	136,334	109,865
Prepays	<u>18,453</u>	<u>15,080</u>
Total current assets	<u>2,365,536</u>	<u>1,562,351</u>
Capital Assets		
Land	34,360	34,360
Construction in progress	-	27,124
Depreciable capital assets, net of accumulated depreciation	<u>1,300,933</u>	<u>792,172</u>
Total capital assets, net of accumulated depreciation	<u>1,335,293</u>	<u>853,656</u>
Total assets	<u><u>\$ 3,700,829</u></u>	<u><u>\$ 2,416,007</u></u>

See Notes to Financial Statements

Pawhuska Hospital, Inc.  
Balance Sheets  
September 30, 2011 and 2010

	<u>1900</u>	
Liabilities and Net Assets		
Current Liabilities		
Current maturities of long-term debt	\$ 105,118	\$ -
Accounts payable - trade	52,679	91,785
Accrued expenses		
Payroll and taxes	91,989	131,579
Vacation	53,140	49,468
Estimated third-party payor settlements	<u>768,793</u>	<u>70,545</u>
Total current liabilities	1,071,719	343,377
Long-term Debt, Less Current Maturities	<u>408,354</u>	<u>-</u>
Total liabilities	<u>1,480,073</u>	<u>343,377</u>
Net Assets		
Invested in capital assets, net of related debt	821,821	853,656
Unrestricted	<u>1,398,935</u>	<u>1,218,974</u>
Total net assets	<u>2,220,756</u>	<u>2,072,630</u>
Total liabilities and net assets	<u><u>\$ 3,700,829</u></u>	<u><u>\$ 2,416,007</u></u>

Pawhuska Hospital, Inc.  
Statements of Revenues, Expenses, and Changes in Net Assets  
Years Ended September 30, 2011 and 2010

	1900	
Operating Revenue		
Patient service revenue, net of provision for bad debt of \$480,821 for 2011 and \$386,236 for 2010	\$ 3,793,466	\$ 2,913,951
Other revenue	5,423	6,985
Total operating revenue	3,798,889	2,920,936
Operating Expenses		
Daily patient services	733,422	715,705
Other nursing services	311,472	254,568
Other professional services	1,209,068	882,235
General services	420,530	362,330
Administrative services	943,324	910,840
Depreciation	164,198	122,485
Total operating expenses	3,782,014	3,248,163
Operating Loss	16,875	(327,227)
Non-operating Revenue (Expense)		
Investment income	8,143	9,526
Interest expense	(19,308)	(4,609)
Net non-operating revenue	(11,165)	4,917
Revenues in excess (less than) Expenses	5,710	(322,310)
Water fees - City of Pawhuska	112,542	114,545
Capital contributions	29,874	29,301
Change in Net Assets	148,126	(178,464)
Net Assets, Beginning of the Year	2,072,630	2,251,094
Net Assets, End of the Year	\$ 2,220,756	\$ 2,072,630

Pawhuska Hospital, Inc.  
Statements of Cash Flows  
Years Ended September 30, 2011 and 2010

	<u>1900</u>	<u></u>
Operating Activities		
Patients and third-party payors	\$ 4,193,016	\$ 3,589,323
Other revenue	8,999	4,045
Payments to vendors and suppliers	(1,794,919)	(1,390,719)
Payments to employees	<u>(1,927,763)</u>	<u>(1,769,347)</u>
Net Cash Provided by Operating Activities	<u>479,333</u>	<u>433,302</u>
Capital and Capital Related Financing Activities		
Principal payments on notes payable	(52,940)	(242,000)
Purchase of equipment	(79,423)	(44,140)
Interest paid	(19,308)	(4,609)
Water fees - City of Pawhuska	112,542	114,545
Capital contributions	29,874	29,301
Proceeds from issuance of debt	<u>-</u>	<u>97,000</u>
Net Cash used for Capital and Capital-Related Financing Activities	<u>(9,255)</u>	<u>(49,903)</u>
Investing Activities		
Proceeds from sale of investments	665,106	376,378
Purchases of investments	(1,021,875)	(667,352)
Interest income	<u>8,143</u>	<u>9,526</u>
Net Cash used for Investing Activities	<u>(348,626)</u>	<u>(281,448)</u>
Increase in Cash and Cash Equivalents	121,452	101,951
Cash and Cash Equivalents, Beginning of Year	<u>382,879</u>	<u>280,928</u>
Cash and Cash Equivalents, End of Year	<u><u>\$ 504,331</u></u>	<u><u>\$ 382,879</u></u>
Supplementary Disclosure of Cash Flow Information		
Non-cash Investing, Capital, and Financing Activities		
Property and equipment purchased through capital leases	<u><u>\$ 566,412</u></u>	<u><u>\$ -</u></u>

Pawhuska Hospital, Inc.  
Statements of Cash Flows  
Years Ended September 30, 2011 and 2010

	<u>1900</u>	<u>2010</u>
Reconciliation of Operating Loss to		
Net Cash from Operating Activities		
Operating loss	\$ 16,875	\$ (327,227)
Adjustments to reconcile operating loss to net		
cash from operating activities		
Provision for bad debt	480,821	386,236
Depreciation	164,198	122,485
Changes in assets and liabilities		
Patient receivables	(779,519)	(426,409)
Related party receivable	3,576	(2,940)
Supplies and prepaid expenses	(29,842)	(39,616)
Estimated third-party payor settlements	698,248	715,545
Accounts payable	(39,106)	1,532
Accrued expenses	(35,918)	3,696
	<u>\$ 479,333</u>	<u>\$ 433,302</u>
Net Cash from Operating Activities		

## **Note 1 - Organization and Significant Accounting Policies**

### **Organization**

Pawhuska Hospital, Inc. (the Hospital) is a private, not-for-profit corporation organized on January 7, 1972, under the laws of the State of Oklahoma, for the purpose of operating a medical care institution. The Board of Trustees consists of five members. These members are appointed and approved by the Board of Incorporators. The Board of Incorporators is determined by the City Council of Pawhuska. As the City Council of Pawhuska indirectly determines the Hospital's Board of Trustees, the Hospital must adhere to standards set by the Governmental Accounting Standards Board. The Hospital earns revenue by providing inpatient and outpatient care and community services to meet the patients physiological, emotional, chronological maturation process, and spiritual needs.

### **Income Taxes**

The Hospital is organized as an Oklahoma nonprofit corporation and has been recognized by the Internal Revenue Service (IRS) as exempt from federal income taxes under Internal Revenue Code Section 501(c)(3). The Hospital is annually required to file a Return of Organization Exempt from Income Tax (Form 990) with the IRS. In addition, the Hospital is subject to income tax on net income that is derived from business activities that are unrelated to its exempt purpose. The Hospital has determined it is not subject to unrelated business income tax and has not filed an Exempt Organization Business Income Tax Return (Form 990T) with the IRS.

The Hospital believes that it has appropriate support for any tax positions taken affecting its annual filing requirements and, as such, does not have any uncertain tax positions that are material to the financial statements. The Hospital would recognize future accrued interest and penalties related to unrecognized tax benefits and liabilities in income tax expense if such interest and penalties are incurred.

### **Proprietary Fund Accounting**

The Hospital uses proprietary fund accounting. Revenues and expenses are recognized on the accrual basis. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989 that do not conflict with or contradict GASB pronouncements.

### **Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### **Cash and Cash Equivalents**

Cash and cash equivalents include highly liquid investments with an original maturity of three months or less.

### **Short-term investments**

Short-term investments include certificates of deposit and U.S. Treasury securities with an original maturity of three to twelve months.

### **Patient Receivables**

Patient receivables are uncollateralized non-interest bearing customer and third-party payor obligations.

Payments of patient receivables are allocated to the specific claims identified on the remittance advice or, if unspecified, are applied to the earliest unpaid claim.

The carrying amount of patient receivables is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from patients and third-party payors. Management reviews patient receivables by payor class and applies percentages to determine estimated amounts that will not be collected from third parties under contractual agreements and amounts that will not be collected from patients due to bad debts. Management considers historical write-off and recovery information in determining the estimated bad debt provision.

### **Supplies**

Supplies are stated at lower of cost (first-in, first-out) or market.

### **Capital Assets**

Capital asset acquisitions in excess of \$5,000 are capitalized and recorded at cost. Depreciation is provided over the estimated useful life of each depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Amortization is included in depreciation and amortization in the financial statements. The estimated useful lives of capital assets are as follows:

Land improvements	3-15 years
Buildings and improvements	5-40 years
Moveable equipment	5-20 years

Gifts of long-lived assets such as land, buildings, or equipment are reported as additions to unrestricted net assets, and are excluded from revenues in excess (less than) expenses, unless explicit donor stipulations specify how the donated asset must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted net assets. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when donated or when acquired long-lived assets are placed in service.



### **Grants and Contributions**

From time to time, the Hospital receives contributions from individuals and private organizations. Revenues from grants and contributions, including contributions of capital assets, are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as non-operating revenues. Amounts restricted to capital acquisitions are reported after non-operating revenues and expenses.

### **Revenues Less Than Expenses**

Revenues less than expenses excludes water fees provided by the City of Pawhuska and capital contributions.

### **Net Patient Service Revenue**

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

### **Operating Revenues and Expenses**

The Hospital's statement of revenues, expenses, and changes in net assets distinguishes between operating and non-operating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the Hospital's principal activity. Non-exchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as non-operating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

### **Charity Care**

To fulfill its mission of community service, the Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as patient service revenue.

### **Advertising Costs**

The Hospital expenses advertising costs as incurred.

### **Compensated Absences**

The Hospital's employees earn vacation at varying rates depending on years of service. Vacation times accrue during the year and any days not used at year-end roll over to the next year, up to the maximum allowance which is also determined by years of service. Additionally, employees earn sick leave benefits based on varying rates depending on years of services up to a maximum. If proper notice of termination is given, employees can receive

75 percent of accumulated time. Employees have the option to sell back up to 40 hours of accrued paid time off at 100% of their pay rate; however, this option is restricted to the employee's anniversary date only.

### **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.

### **Reclassification**

Certain amounts in the 2010 financial statements have been reclassified to conform to the 2011 presentation. The reclassification had no impact on previously reported changes in net assets.

### **Note 2 - Charity Care**

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy and equivalent service statistics. Uninsured individuals are eligible to receive an upfront 25% charity care discount. Additional discounts are available based on the individual's income. The amounts of charges foregone, based on established rates, were \$106,667 and \$82,097 for the years ended September 30, 2011 and 2010, respectively.

### **Note 3 - Net Patient Service Revenue**

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

**Medicare:** The Hospital is licensed as a Critical Access Hospital (CAH). The Hospital is reimbursed for most inpatient and outpatient services at cost with final settlement determined after submission of an annual cost report by the Hospital and are subject to audits thereof by the Medicare intermediary. The Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through the year ended September 30, 2010. The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Hospital.

**Medicaid:** Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Outpatient services related to Medicaid beneficiaries are paid based on the lower of customary charges, allowable costs as determined through the Hospital's Medicare cost report, or rates as established by the Medicaid program.

**Other:** The Hospital has also entered into payment agreements with certain commercial insurance carriers and other 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.

Revenue from the Medicare and Medicaid programs accounted for approximately 55% and 15%, respectively, of the Hospital's net patient service revenue for the year ended September 30, 2011 and 54% and 18%, respectively, for the year ended September 30, 2010. Laws and regulations governing the Medicare, Medicaid, and other programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The net patient service revenue for the years ended September 30, 2011 and 2010 was not impacted due to changes in allowances as a result of final settlements and for years that are no longer likely subject to audits, reviews, and investigations.

The Centers for Medicare and Medicaid Services (CMS) has implemented a Recovery Audit Contractor (RAC) program under which claims subsequent to October 1, 2007 are reviewed by contractors for validity, accuracy, and proper documentation. A demonstration project completed in several other states resulted in the identification of potential overpayments, some being significant. If selected for audit, the potential exists that the Hospital may incur a liability for claims overpayment at a future date. The Hospital is unable to determine if it will be audited and, if so, the extent of the liability of overpayments, if any. As the outcome of such potential reviews is unknown and cannot be reasonably estimated, it is the Hospital's policy to adjust revenue for deductions for overpayment amounts or additions from underpayment amounts determined under the RAC audits at the time a charge reimbursement is agreed upon between the Hospital and CMS.

A summary of net patient service revenue for the years ended September 30, 2011 and 2010 is as follows:

	1900	
Total patient service revenue	\$ 4,138,142	\$ 2,733,690
Contractual adjustments	136,145	566,497
Provision for bad debts	(480,821)	(386,236)
Net patient service revenue	<u>\$ 3,793,466</u>	<u>\$ 2,913,951</u>

It should be noted that many of the Hospital's charges are set at levels less than the prevailing rates paid by Medicare and Medicaid; therefore, the contractual adjustments for these account classifications increase total revenue.

#### **Note 4 - Investments and Investment Income**

##### **Short-term Investments**

Short-term investments include certificates of deposit with an original maturity date between three and twelve months. Short-term investments are stated at their historical cost, plus accrued interest.

## Investment Income

Investment income and gains and losses on short-term investments and cash equivalents consist of the following for the years ended September 30, 2011 and 2010:

	1900	
Other income		
Investment income	\$ 8,143	\$ 9,526

## Note 5 - Capital Assets

Capital assets additions, retirements, and balances for the year ended September 30, 2011 and 2010 were as follows:

	Balance September 30,	Additions	Disposals/ Transfers	Balance September 30,
Land	\$ 34,360	\$ -	\$ -	\$ 34,360
Land improvements	35,979	-	-	35,979
Buildings and improvements	939,309	34,119	-	973,428
Equipment	1,838,483	611,716	27,124	2,477,323
Construction in progress	27,124	-	(27,124)	-
Total, at historical cost	2,875,255	645,835	-	3,521,090
Less accumulated depreciation for				
Land improvements	28,004	984	-	28,988
Buildings and improvements	567,060	36,889	13,743	617,692
Equipment	1,426,535	126,325	(13,743)	1,539,117
Total accumulated depreciation	2,021,599	164,198	-	2,185,797
Capital assets, net	\$ 853,656	\$ 481,637	\$ -	\$ 1,335,293

	Balance September 30,	Additions	Disposals/ Transfers	Balance September 30,
Land	\$ 34,360	\$ -	\$ -	\$ 34,360
Land improvements	35,979	-	-	35,979
Buildings and improvements	939,309	-	-	939,309
Equipment	1,821,467	17,016	-	1,838,483
Construction in progress	-	27,124	-	27,124
Total, at historical cost	2,831,115	44,140	-	2,875,255
Less accumulated depreciation for				
Land improvements	27,020	984	-	28,004
Buildings and improvements	530,260	36,800	-	567,060
Equipment	1,341,834	84,701	-	1,426,535
Total accumulated depreciation	1,899,114	122,485	-	2,021,599
Capital assets, net	\$ 932,001	\$ (78,345)	\$ -	\$ 853,656

#### Note 6 - Cash and Deposits

At September 30, 2011 and 2010, the Hospital had bank balances as follows:

	1900	
Insured (FDIC)	\$ 1,115,260	\$ 829,720
Collateralized by securities held by the pledging financial institution's trust department in the Authority's name	507,479	293,341
Total	\$ 1,622,739	\$ 1,123,061
Carrying value	\$ 1,528,452	\$ 1,050,231

The Hospital's bank balances at September 30, 2011 and 2010 are shown on the balance sheets as follows:

Cash and cash equivalents	\$ 504,331	\$ 382,879
Short-term investments	1,024,121	667,352
Total	\$ 1,528,452	\$ 1,050,231

### **Custodial Credit Risk**

Exposure to custodial credit related to deposits exists when the Hospital holds deposits that are uninsured and uncollateralized; collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the Hospital's name; or collateralized without a written or approved collateral agreement. Exposure to custodial credit risk related to investments exists when the Hospital holds investments that are uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the Hospital's name.

### **Investment Credit Risk**

Investment credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Hospital's investment policy limits investments to certificates of deposit, savings accounts, and other trusted funds.

### **Concentration of Investment Credit Risk**

Exposure to concentration of credit risk is considered to exist when investments in any one issuer represent a significant percent of total investments. Investments issued or explicitly guaranteed by the U.S. government and investment in mutual funds, external investment pools, and other pooled investments are excluded from this consideration.

### **Note 7 - Leases**

The Hospital leases certain equipment under non-cancelable, long-term lease agreements. Certain leases have been recorded as capitalized leases and others as operating leases. For the years ended September 30, 2011 and 2010, total lease expense for all operating leases was \$37,757 and \$39,985, respectively. The capitalized leased assets consisted of:

Major movable equipment	\$ 566,412	\$ -
Less accumulated amortization (included as depreciation on the accompanying financial statements)	(47,201)	-
Total	<u>\$ 519,211</u>	<u>\$ -</u>

## Note 8 - Long-term Debt

A summary of long-term debt as of September 30, 2011 and 2010, follows:

	Balance September 30,	Additions	Reductions	Balance September 30, 2011	Amounts Due Within One Year
Notes payable					
Capital leases (2)	\$ -	\$ 566,412	\$ 52,940	\$ 513,472	\$ 105,118
	Balance September 30,	Additions	Reductions	Balance September 30,	Amounts Due Within One Year
Notes payable:					
Line of credit with a financial institution (1)	\$ 145,000	\$ 97,000	\$ 242,000	\$ -	\$ -

The terms and due dates of the Hospital's long-term debt at September 30, 2011 and 2010 were as follows:

- (1) 2.74% line of credit; due September 2010; secured by certificate of deposit; maximum balance on line is \$145,000
- (2) Capital lease obligations; imputed interest of 4.6%; collateralized by leased equipment with a cost of \$566,412

Scheduled principal and interest repayments on capital lease obligations are as follows:

Year Ending September 30,	Capital Leases	
	Principal	Interest
2012	\$ 105,118	\$ 21,422
2013	110,057	16,483
2014	115,228	11,312
2015	120,641	5,899
2016	62,428	840
Total	\$ 513,472	\$ 55,956

## Note 9 - Retirement Plan

The Hospital offers a 403(b) tax sheltered annuity plan to employees. Currently, the Hospital does not make contributions on behalf of the employee. Employees are allowed to make elective or after-tax contributions to the plan; there are certain limitations imposed by the IRS for the total amount of annual contributions that may be made to an employee's 403(b) account and limits on the amount of elective deferrals that employee may make to a 403(b) plan. Distributions may generally be made because of the employee's death, disability, severance from employment, attainment of age 59 ½, or, in the case of salary reduction, financial hardship.

### Note 10 - Related Party Transactions

The Hospital has a management agreement with Jane Phillips Medical Center. For the years ended September 30, 2011 and 2010, the Hospital incurred expenses of \$184,740 and \$137,276, respectively, under this contract. Total amounts due to Jane Phillips Medical Center as of September 30, 2011 and 2010 were \$22,088 and \$29,921, respectively.

The City of Pawhuska passed an ordinance to assess a meter fee on residential water meters. For the years ended September 30, 2011 and 2010, the City of Pawhuska transferred \$112,542 and \$114,545, respectively, to the Hospital. Total amounts due from the City of Pawhuska as of September 30, 2011 and 2010 were \$8,852 and \$12,428, respectively.

### Note 11 - Concentrations of Credit Risk

The Hospital grants credit without collateral to its patients, most of who are insured under third-party payor agreements. The mix of receivables from third-party payors and patients at September 30, 2011 and 2010 was as follows:

	1900	
Medicare and Medicaid	36%	38%
Other third-party payors	34%	38%
Patients	30%	24%
Total	100%	100%

### Note 12 - Contingencies

#### Malpractice Insurance

The Hospital has malpractice insurance coverage to provide protection for professional liability losses on a claims-made basis subject to a limit of \$1,000,000 per claim and an annual aggregate limit of \$3,000,000. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, would be uninsured.

#### Litigation

The Hospital is subject to the usual contingencies in the normal course of operations relating to the performance of its tasks under its various programs. In the opinion of management, the ultimate settlement of any litigation, claims, and disputes in process will not be material to the financial position, operations, or cash flows of the Hospital.



The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations, specifically those relating to the Medicare and Medicaid programs, can be subject to government review and interpretation, as well as regulator actions unknown and unasserted at this time. Federal government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenues from patient and resident services.

### **Note 13 - Subsequent Events**

The Hospital has evaluated subsequent events through April 30, 2012, the date the financial statements were available to be issued.

Supplementary Information  
September 30, 2011 and 2010  
**Pawhuska Hospital, Inc.**





## **Independent Auditor's Report on Supplementary Information**

The Board of Trustees  
Pawhuska Hospital, Inc.  
Pawhuska, Oklahoma

We have audited the financial statements of Pawhuska Hospital, Inc. as of and for the years ended September 30, 2011 and 2010 and our report dated April 30, 2012, which expresses an unqualified opinion on those financial statements, appears on page 1. Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedules of net patient service revenue, other revenue, and expenses on page 23-25 are presented for the purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and related directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

*Eide Bailly LLP*

Oklahoma City, Oklahoma  
April 30, 2012

Pawhuska Hospital, Inc.  
Schedules of Net Patient Service Revenue  
Years Ended September 30, 2011 and 2010

	1900					
	Inpatient	Outpatient	Total	Inpatient	Outpatient	Total
Daily Patient Services						
Routine care	\$ 171,300	\$ -	\$ 171,300	\$ 128,224	\$ -	\$ 128,224
Swing beds	333,738	-	333,738	349,355	-	349,355
Total daily patient services	505,038	-	505,038	477,579	-	477,579
Other Nursing Services						
Emergency room	-	1,063,846	1,063,846	-	860,483	860,483
Other Professional Services						
Laboratory	134,928	609,608	744,536	48,726	268,953	317,679
Pharmacy	170,298	217,912	388,210	114,474	136,911	251,385
Physical therapy	110,398	193,435	303,833	137,447	263,608	401,055
Radiology	59,719	683,243	742,962	18,123	274,556	292,679
Respiratory therapy	127,911	10,910	138,821	196,046	4,462	200,508
Wound care	-	340,923	340,923	-	-	-
Central supply	3,109	13,531	16,640	2,038	12,381	14,419
Total other professional services	606,363	2,069,562	2,675,925	516,854	960,871	1,477,725
Charity care	(106,667)	-	(106,667)	(82,097)	-	(82,097)
Gross Patient Services Revenue	\$ 1,004,734	\$ 3,133,408	4,138,142	\$ 912,336	\$ 1,821,354	2,733,690
Less Adjustments						
Medicare and Medicaid contractual			(626,927)			(648,737)
Other contractals			490,782			82,240
Provision for bad debts			480,821			386,236
Total adjustments			344,676			(180,261)
Net Patient Service Revenue			\$ 3,793,466			\$ 2,913,951

Pawhuska Hospital, Inc.  
Schedules of Other Revenue  
Years Ended September 30, 2011 and 2010

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	<u>1900</u>	<u></u>
Other Revenue		
Cafeteria	\$ 5,139	\$ 6,288
Medical records	65	264
Vending	<u>219</u>	<u>433</u>
Total Other Revenue	<u>\$ 5,423</u>	<u>\$ 6,985</u>

Pawhuska Hospital, Inc.  
Schedules of Expenses  
Years Ended September 30, 2011 and 2010

	2011			2010		
	Salaries	Supplies and Expenses	Total	Salaries	Supplies and Expenses	Total
Daily Patient Services						
Routine care	\$ 699,078	\$ 18,124	\$ 717,202	\$ 681,163	\$ 19,656	\$ 700,819
Swing beds	15,900	320	16,220	14,886	-	14,886
Total patient services	714,978	18,444	733,422	696,049	19,656	715,705
Other Nursing Services						
Emergency room	290,755	20,717	311,472	245,334	9,234	254,568
Other Professional Services						
Laboratory	111,809	176,343	288,152	90,782	88,668	179,450
Pharmacy	32,899	70,585	103,484	31,943	29,014	60,957
Physical therapy	78,311	3,909	82,220	77,614	2,622	80,236
Radiology	127,439	15,607	143,046	119,977	13,424	133,401
Respiratory therapy	12,343	-	12,343	11,563	-	11,563
Wound care	95	-	95	-	-	-
Professional fees	-	579,728	579,728	-	416,628	416,628
Total professional services	362,896	846,172	1,209,068	331,879	550,356	882,235
General Services						
Central supply	32,969	9,801	42,770	31,910	11,138	43,048
Dietary	51,662	34,091	85,753	55,882	28,371	84,253
Housekeeping	30,892	6,354	37,246	24,313	8,035	32,348
Laundry and linen	-	18,053	18,053	-	16,954	16,954
Medical records	57,093	2,307	59,400	59,844	2,726	62,570
Operation of plant	56,384	120,924	177,308	45,210	77,947	123,157
Total general services	229,000	191,530	420,530	217,159	145,171	362,330
Administrative Services						
Administrative	294,216	126,358	420,574	285,435	138,848	424,283
Employee benefits	-	522,750	522,750	-	486,557	486,557
Total administrative services	294,216	649,108	943,324	285,435	625,405	910,840
Depreciation		164,198	164,198		122,485	122,485
Total expenses	\$ 1,891,845	\$ 1,890,169	\$ 3,782,014	\$ 1,775,856	\$ 1,472,307	\$ 3,248,163



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

The Board of Trustees  
Pawhuska Hospital, Inc.  
Pawhuska, Oklahoma

We have audited the financial statements of Pawhuska Hospital, Inc. (the Hospital), as of and for the year ended September 30, 2011, and have issued our report thereon dated April 30, 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 Pawhuska Hospital, Inc.'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 Pawhuska Hospital, Inc.'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Pawhuska Hospital, Inc.'s internal control over financial reporting.

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 such deficiencies have been identified; however, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *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 entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider items 2011-01 through 2011-03 to be material weaknesses.

## **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, non-compliance 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 did not disclose any instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

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

This report is intended solely for the information and use of the Board of Trustees, management, others within the organization and regulatory agencies and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Eric Bailly LLP".

Oklahoma City, Oklahoma  
April 30, 2012



## **Findings – Financial Statements Audit – Internal Controls over Financial Reporting**

### **2011-1 Preparation of Financial Statements**

*Condition:* As auditors, we were requested to draft the financial statements and accompanying notes to the financial statements.

*Criteria:* Statement on Auditing Standards (SAS) 115 requires the auditor to assess the Hospital's accounting staff's ability to apply General Accepted Accounting Principles (GAAP) on an ongoing basis. The Hospital does not have an internal control system over financial reporting designed to provide for the preparation of the financial statements, including the accompanying footnotes as required by generally accepted accounting standards, on a periodic or annual basis. This circumstance is not unusual in an organization of your size. It is the responsibility of management and those charged with governance to make the decisions whether to accept the degree of risk associated with this condition because of cost or other considerations.

*Effect:* We noted a material weakness in the Hospital's internal controls over financial reporting and procedures related to the preparation of the financial statements.

*Cause:* The weakness is partially due to the resources of staff charged with financial reporting.

*Auditor's Recommendation:* We recommend that the Hospital periodically assess the accounting staffing and duties and that the Board review capabilities and resources required to prepare and examine the full set of financial statements and related disclosures.

*Corrective Action Plan:* Given the size of the Hospital, we do not think it would be cost-effective to fully cure this technical deficiency at this time. In addition, given the complex and constantly changing nature of financial reporting requirements, we believe that better results can be achieved by continuing to rely on the expertise of our outside auditors regarding these matters.

### **2011-2 Rollforward of Net Assets**

*Condition:* Net assets did not properly include adjustments to net income from the prior-year audit.

*Criteria:* Net assets should rollforward from the prior year based on the audited results of the financial statements to verify proper posting of audit entries.

*Effect:* A material audit entry was required to properly state the balance in net assets.

*Cause:* Entries were posted from the audit based on conversations with the audit team instead of directly from the audit adjusting journal entries provided at the conclusion of the audit. Equity was not agreed to the audited financial statements of the prior year.

*Auditor's Recommendation:* It is recommended that the equity schedule created during the current fiscal year by the accounting team be utilized in the future, but compared to the information contained in the audit report to verify that all adjustments are recorded properly.

*Management's Corrective Action Plan:* The Regional Controller will complete an equity worksheet each year subsequent to the posting of any audit adjustments, but prior to the start of the next audit, to verify that all audit entries are properly posted and that equity agrees to the prior-year audited financial statements.

**2011-3 Capital Leases:**

*Condition:* The Hospital signed a lease that was not properly identified as a capital lease.

*Criteria:* Generally accepted account principles have established four criteria to determine if a lease should be considered a financing agreement (capital lease) or an operating lease. If the agreement constitutes a financing agreement, the associated asset should be capitalized and the corresponding debt recorded.

*Effect:* A material asset and the associated debt were not recorded, which resulted in material audit adjustments.

*Cause:* The Hospital does not have a procedure for evaluating leases to determine the proper treatment as either capital or operating.

*Auditor's Recommendation:* It is recommended that management design and implement a method for testing all approved leases. Documentation should be retained with the lease to indicate the conclusion.

*Management's Corrective Action Plan:* Management will discuss ways to track all new leases and review the accounting standards to determine which leases should be capitalized.

Prior-Year Findings

**2010-1 Preparation of Financial Statements:**

*Condition and Criteria:* Auditing standard (SAS 115) lowers the threshold for identifying significant deficiencies for internal controls over financial reporting. Based on the new standard, Pawhuska Hospital, Inc. does not currently have the necessary staff resources to prepare the full set of financial statements, included related disclosures, and provide an internal control structure to properly prevent and detect related material misstatements.

*Effect:* We noted a significant deficiency in the Hospital's internal controls over financial reporting and procedures related to the preparation of the financial statements.

*Cause:* The weakness is partially due to the time resources of staff charged with financial reporting.

*Auditor's Recommendation:* We recommend that the Hospital periodically assess the accounting staffing and duties and the Board review capabilities and resources required to prepare and examine the full set of financial statements and related disclosures.

*Management Response:* Given the size of the Hospital, we do not think it would be cost-effective to fully cure this technical deficiency at this time. In addition, given the complex and constantly changing nature of

financial reporting requirements, we believe that better results can be achieved by continuing to rely on the expertise of our outside auditors regarding these matters.

*Status:* Management has continued to accept this risk and a finding has been noted for the current year at 2011-01.

**2010-2 Prior-Year Audit Adjusting Entries:**

*Condition and Criteria:* Professional standards require us to accumulate all known and likely misstatements identified during the audit and communicate them to the appropriate level of management. Management should then ensure the posting of the journal entries to the general ledger.

*Effect:* The Hospital's net assets accounts did not properly roll forward to the current period and internal financial statements were misstated throughout the current year.

*Cause:* The Hospital did not make the necessary adjusting journal entries to reverse the income statement effect of prior-year audit adjustments that were posted in the current period.

*Auditor's Recommendation:* We recommend that the Hospital post all audit adjustments proposed by the auditors. Full and proper posting should be verified prior to the start of the next audit.

*Management Response:* We will work on posting the entries at the end of each year and working with the auditors to determine if they have been properly posted.

*Status:* Management implemented a process for recording all journal entries provided as a part of the audit, including discussion with the audit team subsequent to issuance of the audit report.

**2010-3 Current-Year Audit Adjusting Entries:**

*Condition and Criteria:* During the course of our engagement, we proposed audit adjustments that would not have been identified as a result of Pawhuska Hospital, Inc.'s existing internal controls and, therefore, could have resulted in a misstatement of the Hospital's financial statements.

*Effect:* We noted the inventory count was performed at year-end, but the count was not reflected in the general ledger.

*Cause:* Management has not completed a full review of information prior to the start of the audit.

*Auditor's Recommendation:* We recommend a thorough review and reconciliation of all accounts should take place prior to the beginning of the audit. This review should be done at both the accounting staff level and supervisor level.

*Management Response:* We will work on reviewing all accounts and ensure entries are posted correctly and in timely manner before the beginning of the audit.

*Status:* Procedures were put into place during the year to reconcile all accounts on a periodic basis.

**2010-4 Outdated Chargemaster:**

*Condition and Criteria:* The Hospital should regularly update the chargemaster so that charges are equal to or exceed the reimbursement by Medicare or Medicaid.

*Effect:* The Hospital may not be maximizing reimbursement from other third-party payors due to charges being lower than what is reasonable and customary.

*Cause:* The chargemaster has not been fully updated to proper charge amounts.

*Auditor's Recommendation:* We recommend that the Hospital frequently update the chargemaster to take advantage of all possible reimbursements.

*Management Response:* We have updated the chargemaster during the year and will work to update it fully subsequent to year-end.

*Status:* Management is now working with an outside vendor to make regular updates to the chargemaster.