

**Sequoyah County – City of Sallisaw Hospital Authority
d/b/a Sequoyah Memorial Hospital**

Auditor's Reports and Financial Statements

March 31, 2013 and 2012



**Sequoyah County – City of Sallisaw Hospital Authority
d/b/a Sequoyah Memorial Hospital**

March 31, 2013 and 2012

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Independent Auditor's Report on Financial Statements and Supplementary Information

Board of Trustees
Sequoyah County – City of Sallisaw Hospital Authority
d/b/a Sequoyah Memorial Hospital
Sallisaw, Oklahoma

We have audited the accompanying financial statements of Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital (the Hospital), which comprise the balance sheets as of March 31, 2013 and 2012, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital as of March 31, 2013 and 2012, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Required Supplementary Information

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated April 4, 2014, on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control over financial reporting and compliance.

BKD, LLP

Tulsa, Oklahoma
April 4, 2014

Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital

Management’s Discussion and Analysis Years Ended March 31, 2013 and 2012

Introduction

This management’s discussion and analysis of the financial performance of Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital (the Hospital) provides an overview of the Hospital’s financial activities for the years ended March 31, 2013 and 2012. It should be read in conjunction with the accompanying financial statements of the Hospital.

Financial Highlights

- Total cash, certificates of deposit and noncurrent cash decreased in 2013 by \$2,103,786 (43.0%) compared to 2012 and increased in 2012 by \$771,407 (18.7%) compared to 2011.
- Net patient accounts receivable increased by \$280,205 (13.9%) in 2013 compared to 2012 and decreased by \$63,294 (3.0%) in 2012 compared to 2011.
- The Hospital’s net position decreased by \$1,225,800 (13.7%) in 2013 compared to 2012 and increased by \$729,862 (8.9%) in 2012 compared to 2011.
- The Hospital reported operating loss in 2013 of \$1,887,777 and an operating income in 2012 of \$38,664. The operating loss in 2013 represents a decrease of \$1,926,441 (4982.5%) compared to the operating income reported in 2012. The operating income in 2012 increased by \$597,211 (106.9%) over the operating loss reported in 2011.

Using This Annual Report

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

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

One of the most important questions asked about any hospital’s finances is, “Is the hospital as a whole better or worse off as a result of the year’s activities?” The balance sheet and the statement of revenues, expenses and changes in net position report information about the Hospital’s resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. Using the accrual basis of accounting means that all of the current year’s revenues and expenses are taken into account regardless of when cash is received or paid.

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

The Statement of Cash Flows

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

The Hospital's Net Position

The Hospital's net position is the difference between its assets and liabilities reported in the balance sheet. The Hospital's net position decreased by \$1,225,800 (13.7%) in 2013 over 2012 and increased by \$729,862 (8.9%) in 2012 over 2011 as shown in Table 1.

Table 1: Assets, Liabilities and Net Position

	2013	2012	2011
Assets			
Cash	\$ 453,314	\$ 318,254	\$ 235,234
Certificates of deposit	527,775	1,943,317	1,917,829
Patient accounts receivable, net	2,299,461	2,019,256	2,082,550
Other current and noncurrent assets	1,049,583	1,139,515	599,209
Noncurrent cash	1,809,743	2,633,047	1,970,148
Capital assets, net	<u>2,623,427</u>	<u>2,576,685</u>	<u>2,647,039</u>
Total assets	<u>\$ 8,763,303</u>	<u>\$ 10,630,074</u>	<u>\$ 9,452,009</u>
Liabilities			
Note payable to bank	\$ -	\$ 625,274	\$ 479,027
Other current liabilities	<u>1,033,008</u>	<u>1,048,705</u>	<u>746,749</u>
Total liabilities	<u>1,033,008</u>	<u>1,673,979</u>	<u>1,225,776</u>
Net Position			
Net investment in capital assets	2,670,227	1,805,381	2,164,594
Restricted expendable	1,863,828	2,877,884	2,023,380
Unrestricted	<u>3,196,240</u>	<u>4,272,830</u>	<u>4,038,259</u>
Total net position	<u>7,730,295</u>	<u>8,956,095</u>	<u>8,226,233</u>
Total liabilities and net position	<u>\$ 8,763,303</u>	<u>\$ 10,630,074</u>	<u>\$ 9,452,009</u>

A significant change in the Hospital's assets in 2013 is a result of the decrease in cash, certificates of deposit and noncurrent cash of \$2,103,786 (43.0%) due to the Hospital having to utilize cash reserves to fund operating losses and due to repayment of a note payable to bank. Patient accounts receivable, net increased by \$280,205 (13.9%) as a result of delays in billing experienced when the Hospital converted to a new accounting and billing system. A decrease in note payable to bank of \$625,275 (100%) occurred due to the payment of the debt in full during 2013.

A significant change in the Hospital's assets in 2012 is a result of the increase in noncurrent cash of \$662,889 (33.7%) due to the receipt of capital appropriations from the City of Sallisaw, Oklahoma, that were not spent during the year. Other current and noncurrent assets increased by \$540,306 (90.2%) as a result of estimated settlement receivable from third-party payers in the amount of \$210,000 plus Supplemental Hospital Offset Payment Program (SHOPP) funds receivable of \$189,000 as further described in *Note 1*. Accounts payable increased by \$336,241 (96.6%) due to the final payment for the new electronic health record (EHR) system and the SHOPP assessment fee of \$65,000 being included in accounts payable at year-end.

Operating Results and Changes in the Hospital's Net Position

The Hospital's net position decreased by \$1,225,800 (13.7%) in 2013 and increased by \$729,862 (8.9%) in 2012 as shown in Table 2. The decrease in 2013 is made up of several different components and represents a decrease of \$1,955,622 (267.9%) compared with the increase in net position for 2012 of \$597,640 (452.0%).

Table 2: Operating Results and Changes in Net Position

	2013	2012	2011
Operating Revenues			
Net patient service revenue	\$ 11,620,254	\$ 14,202,389	\$ 14,158,357
Other	1,800,370	376,180	84,548
Total operating revenues	<u>13,420,624</u>	<u>14,578,569</u>	<u>14,242,905</u>
Operating Expenses			
Salaries, wages and employee benefits	8,730,301	8,294,571	8,484,315
Purchased services and professional fees	2,820,780	2,165,552	2,305,871
Supplies and other	3,308,381	3,596,378	3,464,607
Depreciation	448,939	479,809	552,025
Gain (loss) on sale of capital assets	-	3,595	(5,366)
Total operating expenses	<u>15,308,401</u>	<u>14,539,905</u>	<u>14,801,452</u>
Operating Income (Loss)	<u>(1,887,777)</u>	<u>38,664</u>	<u>(558,547)</u>
Nonoperating Revenues (Expenses)			
Interest income	20,108	54,117	53,652
Interest expense	(13,501)	(12,681)	(1,457)
Noncapital gifts	8,905	12,089	13,825
Total nonoperating revenues (expenses)	<u>15,512</u>	<u>53,525</u>	<u>66,020</u>
Excess (Deficiency) of Revenues over Expenses Before Capital Appropriations	<u>(1,872,265)</u>	<u>92,189</u>	<u>(492,527)</u>
Capital Appropriations – City of Sallisaw, Oklahoma	<u>646,465</u>	<u>637,673</u>	<u>624,749</u>
Increase (Decrease) in Net Position	<u>\$ (1,225,800)</u>	<u>\$ 729,862</u>	<u>\$ 132,222</u>

Operating Income (Loss)

The first component of the overall change in the Hospital's net position 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. The Hospital reported an operating loss in 2013 and operating income in 2012. The primary components of the operating loss in 2013 are:

- A decrease in net patient service revenue of \$2,582,135 (18.2%) due to lower inpatient days and discharges experienced in 2013
- An increase in other revenues in 2013 of \$1,424,190 (378.6%) compared to 2012 due to the receipt of approximately \$1,750,000 of incentive payments from Medicare and Medicaid related to implementation of EHR
- An increase in purchased services and professional fees of \$655,228 (30.3%) primarily due to an increase in contract physician fees, utilization of a contracted chief financial officer during 2013 and due to implementation and training costs incurred with the purchase of a new accounting, billing and EHR system
- An increase in salaries, wages and employee benefits of \$435,730 (5.3%) primarily due to an increase in full time equivalents during the year
- A decrease in supplies and other expense of \$287,997 (8.0%) due to fewer supplies utilized as a result of lower patient volumes

The primary components of the operating loss in 2012 are:

- An increase in other revenues in 2012 of \$291,632 (344.9%) compared to 2011 due to the receipt of a \$300,000 incentive payment from Medicaid related to implementation of EHR
- A decrease in purchased services and professional fees of \$140,319 (6.1%) due to a decrease in the use of contract labor related to a mobile MRI machine. The decrease in use of this machine is due to a drop in patient volume during the year

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of noncapital gifts, investment income and interest expense.

Capital Appropriations

The Hospital receives a 0.5% sales tax assessment from the City of Sallisaw, Oklahoma, which is restricted for capital expenditures and debt service, as defined in the sales tax indenture. The Hospital received approximately 4.6% and 4.2% of its total financial support from capital appropriations during the years ended March 31, 2013 and 2012, respectively.

The Hospital's Cash Flows

Changes in the Hospital's cash flows are consistent with changes in operating activities and nonoperating revenues and expenses for 2013 and 2012, as discussed earlier. Net cash provided by (used in) operating activities in 2013 decreased by \$1,749,978 (856.2%) as compared to 2012. Receipts from patients declined by \$2,736,191, while other receipts and payments, net increased by \$1,424,190 from 2012. The decrease in patient receipts was due to lower inpatient days and discharges during 2013 and the increase of other receipts was due in large part to the receipt of EHR funds of approximately \$1,750,000.

Capital Asset and Debt Administration

Capital Assets

At the fiscal year-end of 2013 and 2012, the Hospital had \$2,623,427 and \$2,576,685, respectively, in net investment in capital assets, as detailed in *Note 5* to the accompanying financial statements. The Hospital purchased building improvements and new equipment costing \$495,681 and \$413,050 in 2013 and 2012, respectively.

Debt

At March 31, 2013 and 2012, the Hospital had \$0 and \$625,274, respectively, of debt obligations outstanding as a result of a note payable to bank as detailed in *Note 7* to the accompanying financial statements. During 2012, the Hospital drew \$146,247 on the bank note to fund additional purchases and installation related to its new EHR system.

Contacting the Hospital's Financial Management

This financial report is designed to provide the Hospital's patients, suppliers, taxpayers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Hospital administration department by telephoning 918.774.1100.

Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital

Balance Sheets March 31, 2013 and 2012

Assets

	2013	2012
Current Assets		
Cash	\$ 453,314	\$ 318,254
Certificates of deposit	527,775	1,943,317
Patient accounts receivable, net of allowance; 2013 – \$3,925,000, 2012 – \$2,050,000	2,299,461	2,019,256
Estimated amounts due from third-party payers	272,769	210,000
Supplies	445,618	378,542
Prepaid expenses and other	271,262	508,098
Total current assets	4,270,199	5,377,467
Noncurrent Cash		
Restricted by sales tax indenture	1,809,743	2,633,047
Capital Assets, Net	2,623,427	2,576,685
Other Assets	59,934	42,875
Total assets	\$ 8,763,303	\$ 10,630,074

Liabilities and Net Position

Current Liabilities		
Note payable to bank	\$ -	\$ 625,274
Accounts payable	586,037	684,168
Accrued expenses	446,971	364,537
Total current liabilities	1,033,008	1,673,979
Net Position		
Net investment in capital assets	2,670,227	1,805,381
Restricted expendable for capital acquisition and debt service	1,863,828	2,877,884
Unrestricted	3,196,240	4,272,830
Total net position	7,730,295	8,956,095
Total liabilities and net position	\$ 8,763,303	\$ 10,630,074

**Sequoyah County – City of Sallisaw Hospital Authority
d/b/a Sequoyah Memorial Hospital**

**Statements of Revenues, Expenses and Changes in Net Position
Years Ended March 31, 2013 and 2012**

	2013	2012
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2013 – \$3,964,718, 2012 – \$3,828,618	\$ 11,620,254	\$ 14,202,389
Other	1,800,370	376,180
Total operating revenues	13,420,624	14,578,569
Operating Expenses		
Salaries and wages	7,497,795	7,045,211
Employee benefits	1,232,506	1,249,360
Purchased services and professional fees	2,820,780	2,165,552
Supplies and other	3,308,381	3,596,378
Depreciation	448,939	479,809
Loss on sale of capital assets	-	3,595
Total operating expenses	15,308,401	14,539,905
Operating Income (Loss)	(1,887,777)	38,664
Nonoperating Revenues (Expenses)		
Interest income	20,108	54,117
Interest expense	(13,501)	(12,681)
Noncapital gifts	8,905	12,089
Total nonoperating revenues (expenses)	15,512	53,525
Excess (Deficiency) of Revenues over Expenses Before Capital Appropriations	(1,872,265)	92,189
Capital Appropriations – City of Sallisaw, Oklahoma	646,465	637,673
Increase (Decrease) in Net Position	(1,225,800)	729,862
Net Position, Beginning of Year	8,956,095	8,226,233
Net Position, End of Year	\$ 7,730,295	\$ 8,956,095

Sequoiah County – City of Sallisaw Hospital Authority d/b/a Sequoiah Memorial Hospital

Statements of Cash Flows Years Ended March 31, 2013 and 2012

	2013	2012
Operating Activities		
Receipts from and on behalf of patients	\$ 11,277,280	\$ 14,013,451
Payments to suppliers and contractors	(5,975,361)	(5,902,027)
Payments to employees	(8,647,867)	(8,283,204)
Other receipts and payments, net	1,800,370	376,180
Net cash provided by (used in) operating activities	(1,545,578)	204,400
Noncapital Financing Activities		
Noncapital gifts	8,905	12,089
Net cash provided by noncapital financing activities	8,905	12,089
Capital and Related Financing Activities		
City appropriations restricted for purchase of capital assets	646,465	637,673
Proceeds from issuance of note payable to bank	-	146,247
Principal paid on note payable to bank	(625,274)	-
Principal paid on long-term debt	-	(3,418)
Purchase of capital assets	(594,911)	(267,020)
Interest paid on long-term debt and note payable	(13,501)	(12,681)
Net cash provided by (used in) capital and related financing activities	(587,221)	500,801
Investing Activities		
Purchase of certificates of deposit	(527,775)	(1,943,317)
Proceeds from disposition of certificates of deposit	1,943,317	1,917,829
Interest income	20,108	54,117
Net cash provided by investing activities	1,435,650	28,629
Increase (Decrease) in Cash	(688,244)	745,919
Cash, Beginning of Year	2,951,301	2,205,382
Cash, End of Year	\$ 2,263,057	\$ 2,951,301
Reconciliation of Cash to the Balance Sheets		
Cash in current assets	\$ 453,314	\$ 318,254
Cash in noncurrent assets	1,809,743	2,633,047
Total cash	\$ 2,263,057	\$ 2,951,301

See Notes to Financial Statements

	<u>2013</u>	<u>2012</u>
Reconciliation of Operating Income (Loss) to Net Cash Provided by		
(Used in) Operating Activities		
Operating income (loss)	\$ (1,887,777)	\$ 38,664
Items not requiring cash		
Depreciation	448,939	479,809
Loss on sale of assets	-	3,595
Provision for uncollectible accounts	3,964,718	3,828,618
Changes in operating assets and liabilities		
Patient accounts receivable, net	(4,244,923)	(3,765,324)
Estimated amounts due to or from third-party payers	(62,769)	(252,232)
Accounts payable and accrued expenses	83,533	201,576
Supplies and prepaid expenses	152,701	(330,306)
	<u>\$ (1,545,578)</u>	<u>\$ 204,400</u>
Supplemental Cash Flows Information		
Capital asset acquisitions included in accounts payable	\$ 46,800	\$ 146,030

Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital

Notes to Financial Statements

March 31, 2013 and 2012

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

Nature of Operations and Reporting Entity

Sequoyah County – City of Sallisaw Hospital Authority (the Authority) was created under a trust indenture dated September 1, 1978, as a public trust under the provisions of Title 60 of the Oklahoma statutes for the benefit of Sequoyah County, Oklahoma, and the City of Sallisaw, Oklahoma. The Authority operates, as its sole activity, Sequoyah Memorial Hospital (the Hospital).

The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in Sallisaw, Oklahoma, and surrounding communities. The Hospital also provides home health, hospice and durable medical equipment (DME) services in the same geographic area.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally, city appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions. City appropriations, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net position when an expense or outlay is incurred for purposes for which both restricted and unrestricted net position are available.

Use of Estimates

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

Cash Equivalents

The Hospital considers all liquid investments with original maturities of three months or less to be cash equivalents. At March 31, 2013 and 2012, 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 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.

Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital

Notes to Financial Statements

March 31, 2013 and 2012

Patient Accounts Receivable

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

Supplies

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

Capital Assets

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

Land improvements	5–40 years
Building, improvements and fixed equipment	5–40 years
Major moveable equipment	3–20 years

Compensated Absences

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

Net Position

Net position of the Hospital is classified in three components. Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net position is made up of noncapital assets that must be used for a particular purpose, as specified by creditors, grantors or donors external to the Hospital. Unrestricted net position is the remaining net position that does not meet the definition of net investment in capital assets or restricted expendable.

Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital

Notes to Financial Statements

March 31, 2013 and 2012

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

City Appropriations

The Hospital benefits from a 0.5% sales tax assessment. The tax, approved by the Board of Commissioners of the City of Sallisaw, has no expiration date. The Hospital received approximately 4.6% and 4.2% of its financial support from city appropriations during the years ended March 31, 2013 and 2012, respectively. These funds are restricted for capital improvements and debt service.

Electronic Health Records Incentive Program

The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records (EHR) technology. Payments under the Medicare program are generally made for up to four years based on a statutory formula. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services. Payment under both programs are contingent on the Hospital continuing to meet escalating meaningful use criteria and any other specific requirements that are applicable for the reporting period. The final amount for any payment year is determined based upon an audit by the Medicare administrative contractor. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital

Notes to Financial Statements March 31, 2013 and 2012

The Hospital recognizes revenue ratably over the reporting period starting at the point when management is reasonably assured it will meet all of the meaningful use objectives and any other specific grant requirements applicable for the reporting period.

In 2013, the Hospital completed the first-year requirements under both the Medicare and Medicaid program. The Hospital plans to complete the second-year requirements during 2014. During 2013, the Hospital has recorded revenue of approximately \$1,750,000, which is included in other revenue within operating revenues in the accompanying statements of revenues, expenses and changes in net position.

Supplemental Hospital Offset Payment Program

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

The annual amounts to be received and paid by the Hospital over the term of the SHOPP program are subject to change annually based on various factors involved in determining the amount of federal matching funds. Based on current information available, the annual net benefit to the Hospital over the term of the SHOPP program is not expected to be materially different than the net amounts received in 2013 and 2012. The SHOPP revenue is recorded as part of net patient service revenue and the SHOPP assessment fees are recorded as part of other expenses on the accompanying statements of revenues, expenses and changes in net position. The amounts noted in the table below represent the approximate SHOPP activity recognized for the years ended March 31, 2013 and 2012.

	2013	2012
SHOPP funds received	\$ 706,000	\$ 567,000
SHOPP assessment fees paid	(263,000)	(195,000)
Net SHOPP benefit	<u>\$ 443,000</u>	<u>\$ 372,000</u>

Reclassifications

Certain reclassifications have been made to the 2012 financial statements to conform to the 2013 presentation. The reclassifications had no effect on the changes in financial position.

Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital

Notes to Financial Statements

March 31, 2013 and 2012

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** – Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient skilled nursing services are paid at prospectively determined per diem rates that are based on the patient's acuity. 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 Hospital's Medicare cost reports have been audited by the Medicare administrative contractor through March 31, 2010.
- **Medicaid** – The Hospital has also been reimbursed for services rendered to patients covered by the state Medicaid program at prospectively determined rates per discharge and fee schedules with no retroactive adjustment. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

Approximately 70% and 81% of the Hospital's net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the years ended March 31, 2013 and 2012, respectively. Laws and regulations governing 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 and Investment Income

Deposits

Custodial credit risk is the risk that in the event of a bank failure a government's deposits may not be returned to it. The Hospital's deposit policy for custodial credit risk is to collateralize its deposits with federal depository insurance and obligations of the U.S. Treasury and U.S. agencies or instrumentalities.

At March 31, 2013 and 2012, none of the Hospital's bank balances of \$3,033,713 and \$5,095,883, respectively, were exposed to custodial credit risk as a result of being uninsured with collateral held by a pledging financial institution.

Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital

Notes to Financial Statements

March 31, 2013 and 2012

Summary of Carrying Values

The carrying values of deposits at March 31, 2013 and 2012, are included in the accompanying balance sheets as follows:

	2013	2012
Cash	\$ 453,314	\$ 318,254
Certificates of deposit	527,775	1,943,317
Noncurrent cash	1,809,743	2,633,047
	\$ 2,790,832	\$ 4,894,618

Investment Income

Investment income for the years ended March 31, 2013 and 2012, consisted of interest income in the amounts of \$20,108 and \$54,117, respectively.

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 March 31 consisted of:

	2013	2012
Medicare	\$ 683,246	\$ 960,335
Medicaid	335,503	138,453
Other third-party payers	511,631	779,517
Patients	4,694,081	2,190,951
	6,224,461	4,069,256
Less allowance for uncollectible accounts	3,925,000	2,050,000
	\$ 2,299,461	\$ 2,019,256

Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital

Notes to Financial Statements

March 31, 2013 and 2012

Note 6: Medical Malpractice Claims

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

Note 7: Note Payable to Bank

The Hospital periodically borrows funds from banks to finance capital asset acquisitions on an interim basis. The note payable has a maximum borrowing limit of \$800,000 and carried a 2.0% interest rate. The note was paid in full during January 2013. The note was secured by a certificate of deposit. At March 31, 2013 and 2012, there was \$0 and \$625,274, respectively, borrowed against the note.

Note 8: Charity Care and Other Community Benefits

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

Uncompensated charges relating to these services are as follows:

	2013	2012
Charity allowances	\$ 119,000	\$ 341,000
Medicaid welfare	3,666,000	3,384,000
	\$ 3,785,000	\$ 3,725,000

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 and community educational services.

Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital

Notes to Financial Statements

March 31, 2013 and 2012

Note 9: Pension Plan

Effective October 1, 2008, the Hospital created a defined contribution pension 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 Board of Trustees. The plan provides retirement and death benefits to plan members and their beneficiaries. Benefit provisions are contained in the plan document and were established and can be amended by action of the Hospital's Board of Trustees. As of April 1, 2010, the Hospital is no longer required by the plan to make contributions as a result of amendments to the plan by the Board of Trustees. The Hospital did not make any contributions to the plan in 2013 or 2012. Contribution rates for plan members, expressed as a percentage of covered payroll, were 1.8% for 2013 and 1.6% for 2012. Contributions actually made by plan members were approximately \$132,000 during 2013 and \$114,000 during 2012.

Note 10: 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 the Hospital's commercial insurance; for example, allegations regarding employment practices or performance of contracts. The Hospital evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Note 11: Risks and Uncertainties

Current Economic Conditions

The current economic environment continues to present hospitals with difficult circumstances and challenges, which in some cases have resulted in large declines in the fair values of assets and 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 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.

Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital

Notes to Financial Statements

March 31, 2013 and 2012

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 allowances for accounts receivable that could negatively impact the Hospital's ability to maintain sufficient liquidity.

Note 12: Patient Protection and Affordable Care Act

The *Patient Protection and Affordable Care Act* (the PPACA) will substantially reform the United States health care system. The legislation impacts multiple aspects of the health care system, including many provisions that change payments from Medicare, Medicaid and insurance companies. Starting in 2014, the legislation requires the establishment of health insurance exchanges, which will provide individuals without employer-provided health care coverage the opportunity to purchase insurance. It is anticipated that some employers currently offering insurance to employees will opt to have employees seek insurance coverage through the insurance exchanges. It is possible the reimbursement rates paid by insurers participating in the insurance exchanges may be substantially different than rates paid under current health insurance products. Another significant component of the PPACA is the expansion of the Medicaid program to a wide range of newly eligible individuals. In anticipation of this expansion, payments under certain existing programs, such as Medicare disproportionate share, will be substantially decreased. Each state's participation in an expanded Medicaid program is optional. The state of Oklahoma has currently indicated it will not participate in the Medicaid expansion program.

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

Note 13: Subsequent Events

In September 2013, the Hospital discontinued the operations of the DME department.

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

Board of Trustees
Sequoyah County – City of Sallisaw Hospital Authority
d/b/a Sequoyah Memorial Hospital
Sallisaw, Oklahoma

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of Sequoyah County – City of Sallisaw Hospital Authority d/b/a Sequoyah Memorial Hospital (the Hospital), which comprise the balance sheet as of March 31, 2013, and the related statements of revenues, expenses and changes in net position and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated April 4, 2014.

Internal Control over Financial Reporting

Management of the Hospital is responsible for establishing and maintaining effective internal control over financial reporting (internal control). In planning and performing our audit, we considered the Hospital's internal control to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Hospital's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in the accompanying schedule of findings and responses as item 2013-1 to be a material weakness.

Board of Trustees
Sequoyah County – City of Sallisaw Hospital Authority
d/b/a Sequoyah Memorial Hospital

Compliance

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*.

Hospital's Response to the Finding

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

Other Matters

We also noted certain matters that we reported to the Hospital's management in a separate letter dated April 4, 2014.

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

BKD, LLP

Tulsa, Oklahoma
April 4, 2014

**Sequoyah County – City of Sallisaw Hospital Authority
d/b/a Sequoyah Memorial Hospital
Schedule of Findings and Responses
Year Ended March 31, 2013**

Reference Number	Finding
2013-1	<p>Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal controls to promote accurate recording and classification of accounting transactions.</p> <p>Condition – Management’s procedures for recording and classifying transactions and procedures for preparing general ledger reconciliations did not prevent inaccurate recording of transactions.</p> <p>Context – Several material journal entries were required to correct misstatements not identified or corrected by management, including adjusting entries to estimated allowances for patient receivable contractual adjustments and doubtful accounts, accounts payable, accrued liabilities and capital assets.</p> <p>Effect – 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.</p> <p>Cause – Recording and monitoring procedures in the internal control over financial reporting process were not performed correctly.</p> <p>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.</p> <p>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.</p>