

Grady Memorial Hospital Authority

Accountants' Reports and Financial Statements

December 31, 2011 and 2010



Grady Memorial Hospital Authority
December 31, 2011 and 2010

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Independent Accountants' Report on Financial Statements

Board of Trustees
Grady Memorial Hospital Authority
Chickasha, Oklahoma

We have audited the accompanying balance sheets of Grady Memorial Hospital Authority (the Authority) as of December 31, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Grady Memorial Hospital Authority as of December 31, 2011 and 2010, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 16, 2012, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary and pension information 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 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.

BKD, LLP

April 16, 2012

Grady Memorial Hospital Authority

Management's Discussion and Analysis

Years Ended December 31, 2011 and 2010

Introduction

This management's discussion and analysis of the financial performance of Grady Memorial Hospital Authority (the Authority) provides an overview of the Authority's financial activities for the years ended December 31, 2011 and 2010. It should be read in conjunction with the accompanying financial statements of the Authority.

Financial Highlights

- Cash and cash equivalents and short-term investments decreased in 2011 by \$168,084 or 9% and in 2010 by \$336,568 or 15%.
- Patient accounts receivable increased in 2011 by \$407,720 or 9% and decreased in 2010 by \$1,317,386 or 22%.
- The Authority reported operating losses in 2011 of \$608,963 and in 2010 of \$1,838,383. The operating loss in 2011 improved by \$1,229,420 or 67% compared to the operating loss reported in 2010. The operating loss in 2010 was \$1,628,037 or 774% worse than the operating income reported in 2009.

Using This Annual Report

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

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

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

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

The Statement of Cash Flows

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

The Authority's Net Assets

The Authority's net assets are the difference between its assets and liabilities reported in the accompanying balance sheets. The Authority's net assets decreased by \$616,350 or 5% in 2011 from 2010 and decreased by \$1,848,541 or 13% in 2010 from 2009, as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets

	2011	2010	2009
Assets			
Cash and cash equivalents	\$ 1,304,574	\$ 1,175,652	\$ 1,014,556
Short-term investments	403,250	700,256	1,197,920
Patient accounts receivable, net	4,981,988	4,574,268	5,891,654
Other current assets	1,460,428	1,725,534	1,953,933
Capital assets, net	12,185,837	11,990,539	12,408,506
Other noncurrent assets	557,759	612,609	486,381
	<u>20,893,836</u>	<u>20,778,858</u>	<u>22,952,950</u>
Total assets	<u>\$ 20,893,836</u>	<u>\$ 20,778,858</u>	<u>\$ 22,952,950</u>
Liabilities			
Long-term debt (including current portion)	\$ 4,393,998	\$ 3,899,079	\$ 4,222,133
Other current and noncurrent liabilities	4,226,940	3,990,531	3,993,028
	<u>8,620,938</u>	<u>7,889,610</u>	<u>8,215,161</u>
Total liabilities	<u>8,620,938</u>	<u>7,889,610</u>	<u>8,215,161</u>
Net Assets			
Invested in capital assets, net of related debt	7,741,981	8,077,280	8,186,373
Unrestricted	4,530,917	4,811,968	6,551,416
	<u>12,272,898</u>	<u>12,889,248</u>	<u>14,737,789</u>
Total net assets	<u>12,272,898</u>	<u>12,889,248</u>	<u>14,737,789</u>
Total liabilities and net assets	<u>\$ 20,893,836</u>	<u>\$ 20,778,858</u>	<u>\$ 22,952,950</u>

Significant changes in the Authority's 2011 assets are found in the categories of cash and cash equivalents, short-term investments and patient accounts receivable. Cash and cash equivalents and short-term investments decreased in 2011 by \$168,084 or 9%. This decrease was the result of capital equipment projects paid for with available funds. Patient accounts receivable increased in 2011 by \$407,720 or 9%. Days' net revenue in net accounts receivable was 49 days at December 31, 2011, and 46 days at December 31, 2010. This increase in days' revenue in accounts receivable is attributable to an increase in patient census during fiscal year 2011.

Significant changes in the Authority's 2011 liabilities are related to long-term debt. Long-term debt increased by \$494,919 or 13% in 2011 from 2010. This increase was due to additional debt related to capital asset additions incurred during 2011. See *Note 9* of the financial statements.

Significant changes in the Authority's 2010 assets are found in the categories of cash and cash equivalents, short-term investments and patient accounts receivable. Cash and cash equivalents and short-term investments decreased in 2010 by \$336,568 or 15%. This decrease was the result of capital equipment projects paid for with available funds. Patient accounts receivable decreased in 2010 by \$1,317,386 or 22%. Days' net revenue in net accounts receivable was 46 days at December 31, 2010, and 55 days at December 31, 2009. This decrease in days' revenue in accounts receivable is attributable to a decrease in patient census during fiscal year 2010 and an increase in contractual adjustments in fiscal year 2010.

Significant changes in the Authority's 2010 liabilities are related to long-term debt. Long-term debt decreased by \$323,054 or 8% in 2010 from 2009. This decrease was due to normal amortization of the long-term debt. See *Note 9* of the financial statements.

Operating Results and Changes in the Authority's Net Assets

In 2011, the Authority's net assets decreased by \$616,350, as shown in Table 2. This decrease is made up of several different components and represents a change of \$1,232,191 or 67% compared with the decrease in net assets for 2010 of \$1,848,541.

Table 2: Operating Results and Changes in Net Assets

	2011	2010	2009
Operating Revenues			
Net patient service revenue	\$ 37,133,292	\$ 36,543,004	\$ 39,159,670
Capitation revenue	136,817	116,538	127,297
Other operating revenues	1,345,586	825,497	773,268
Total operating revenues	<u>38,615,695</u>	<u>37,485,039</u>	<u>40,060,235</u>
Operating Expenses			
Salaries, wages and employee benefits	23,012,251	23,684,161	24,470,029
Purchased services and professional fees	4,685,203	4,240,274	3,951,925
Supplies and other expenses	9,829,858	9,644,743	10,136,724
Depreciation and amortization	1,697,346	1,754,244	1,711,903
Total operating expenses	<u>39,224,658</u>	<u>39,323,422</u>	<u>40,270,581</u>
Operating Loss	<u>(608,963)</u>	<u>(1,838,383)</u>	<u>(210,346)</u>
Nonoperating Revenues (Expenses)			
Noncapital gifts and grants	38,646	10,783	63,256
Investment income	99,681	161,445	120,107
Interest expense	(198,283)	(216,273)	(251,621)
Total nonoperating revenues (expenses)	<u>(59,956)</u>	<u>(44,045)</u>	<u>(68,258)</u>
Deficiency of Revenues over Expenses Before Capital Grants and Gifts	(668,919)	(1,882,428)	(278,604)
Gifts to Purchase Capital Assets and Other Capital Grants	<u>52,569</u>	<u>33,887</u>	<u>26,123</u>
Change in Net Assets	<u>\$ (616,350)</u>	<u>\$ (1,848,541)</u>	<u>\$ (252,481)</u>

Operating Income (Loss)

The first component of the overall change in the Authority's net assets is its operating income or loss—generally, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. The Authority has reported an operating loss in each of the past three years. This is consistent with the Authority's recent operating history as the Authority was formed and is operated primarily to serve residents of Chickasha, Oklahoma, and the surrounding area.

Operating loss for 2011 decreased by \$1,229,420 or 67% as compared to 2010. The primary components of the improvement in operating loss in 2011 were:

- An increase in net patient service revenue of \$590,288 or 2% from 2010 to 2011 due primarily to an overall increase in volumes.
- An increase in other operating revenues of \$520,089 or 63% from 2010 to 2011 due primarily to the Authority earning revenue under the state Medicaid electronic health record incentive program.
- A decrease in salaries, wages and employee benefits of \$671,910 or 3% from 2010 to 2011 due primarily to staffing adjustments.
- An increase in purchased services and professional fees expenses of \$444,929 or 11% from 2010 to 2011 due primarily to the use of additional contract nursing during the year.

Operating loss for 2010 increased by \$1,628,037 or 774% as compared to 2009. The primary components of the decrease in operating results in 2010 were:

- A decrease in net patient service revenue of \$2,616,666 or 7% from 2009 to 2010 due primarily to an overall decrease in volumes.
- A decrease in salaries, wages and employee benefits of \$785,868 or 3% from 2009 to 2010 due primarily to staffing adjustments related to reduced volumes.
- A decrease in supplies and other expenses of \$491,981 or 5% from 2009 to 2010 due primarily to the use of a purchasing group that resulted in better pricing and changes in the service mix of patients.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of noncapital gifts, investment income and interest expense. There was no significant change in these amounts between 2010 and 2011.

The Authority's Cash Flows

Net cash provided by operating activities in 2011 decreased by \$253,749 or 16% from 2010. Receipts from and on behalf of patients decreased by approximately \$971,000 due to increased patient receivables and volume. Payments to suppliers, contractors and employees increased by approximately \$197,000 due to the increase of supplies and other expenses.

Capital Assets and Debt Administration

Capital Assets

At December 31, 2011 and 2010, the Authority had \$12,185,837 and \$11,990,539, respectively, invested in capital assets, net of accumulated depreciation, as detailed in *Note 5* to the financial statements. In 2011, the Authority had major additions in computer equipment related to the electronic health record system implementation and scanner equipment and the purchase of an MRI. In 2010, the Authority had major additions in their scanner and monitoring equipment.

Debt

At December 31, 2011 and 2010, the Authority had \$4,393,998 and \$3,899,079, respectively, in notes payable and capital lease obligations outstanding. In 2011, the Authority entered into new long-term note payable agreements totaling \$1,789,807 and refinanced \$1,618,590 of an existing revenue note. In 2010, the Authority entered into new long-term note payable agreements totaling \$280,982 and capital lease obligations of \$616,271.

Contacting the Authority's Financial Management

This financial report is designed to provide the Authority's patients, suppliers, taxpayers and creditors with a general overview of the Authority's finances and to show the Authority's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Authority's Business Administration by mail at 2220 Iowa Avenue, Chickasha, Oklahoma 73018.

Grady Memorial Hospital Authority

Balance Sheets

December 31, 2011 and 2010

Assets

	<u>2011</u>	<u>2010</u>
Current Assets		
Cash and cash equivalents	\$ 1,304,574	\$ 1,175,652
Short-term investments	403,250	700,256
Patient accounts receivable, net of allowance; 2011 – \$1,600,000, 2010 – \$1,200,000	4,981,988	4,574,268
Estimated amounts due from third-party payers	270,000	565,000
Supplies	681,301	744,968
Prepaid expenses and other	509,127	415,566
	<u>8,150,240</u>	<u>8,175,710</u>
Capital Assets, Net	12,185,837	11,990,539
Other Assets	<u>557,759</u>	<u>612,609</u>
Total assets	<u>\$ 20,893,836</u>	<u>\$ 20,778,858</u>

Liabilities and Net Assets

Current Liabilities		
Note payable	\$ 233,761	\$ 210,564
Current maturities of long-term debt	1,345,887	1,204,042
Accounts payable	1,540,821	1,297,938
Accrued payroll and expenses	2,452,358	2,482,029
	<u>5,572,827</u>	<u>5,194,573</u>
Long-term Debt	<u>3,048,111</u>	<u>2,695,037</u>
Total liabilities	<u>8,620,938</u>	<u>7,889,610</u>
Net Assets		
Invested in capital assets, net of related debt	7,741,981	8,077,280
Unrestricted	4,530,917	4,811,968
	<u>12,272,898</u>	<u>12,889,248</u>
Total liabilities and net assets	<u>\$ 20,893,836</u>	<u>\$ 20,778,858</u>

Grady Memorial Hospital Authority
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended December 31, 2011 and 2010

	2011	2010
Operating Revenues		
Net patient service revenue, net of provision for uncollectible accounts; 2011 – \$7,232,868, 2010 – \$7,582,737	\$ 37,133,292	\$ 36,543,004
Capitation revenue	136,817	116,538
Other	1,345,586	825,497
Total operating revenues	38,615,695	37,485,039
Operating Expenses		
Salaries and wages	18,941,614	19,434,645
Employee benefits	4,070,637	4,249,516
Purchased services and professional fees	4,685,203	4,240,274
Supplies and other expenses	9,829,858	9,644,743
Depreciation and amortization	1,697,346	1,754,244
Total operating expenses	39,224,658	39,323,422
Operating Loss	(608,963)	(1,838,383)
Nonoperating Revenues (Expenses)		
Noncapital gifts and grants	38,646	10,783
Investment income	99,681	161,445
Interest expense	(198,283)	(216,273)
Total nonoperating revenues (expenses)	(59,956)	(44,045)
Deficiency of Revenues over Expenses Before Capital Grants and Gifts	(668,919)	(1,882,428)
Gifts to Purchase Capital Assets and Other Capital Grants	52,569	33,887
Decrease in Net Assets	(616,350)	(1,848,541)
Net Assets, Beginning of Year	12,889,248	14,737,789
Net Assets, End of Year	\$ 12,272,898	\$ 12,889,248

Grady Memorial Hospital Authority
Statements of Cash Flows
Years Ended December 31, 2011 and 2010

	2011	2010
Operating Activities		
Receipts from and on behalf of patients	\$ 37,157,389	\$ 38,128,441
Payments to suppliers and contractors	(14,078,155)	(13,324,396)
Payments to employees	(23,041,922)	(23,992,895)
Other receipts and payments, net	1,345,586	825,497
Net cash provided by operating activities	1,382,898	1,636,647
Noncapital Financing Activities		
Noncapital gifts and grants	38,646	10,783
Proceeds from issuance of note payable	201,495	198,075
Principal paid on notes payable	(412,059)	(418,055)
Interest paid on notes payable	(6,542)	(8,645)
Net cash used in noncapital financing activities	(178,460)	(217,842)
Capital and Related Financing Activities		
Principal paid on long-term debt	(1,294,888)	(1,220,307)
Interest paid on long-term debt	(191,741)	(207,628)
Proceeds from issuance of long-term debt	1,789,807	280,982
Payment of deferred financing costs	(26,307)	-
Purchase of capital assets	(1,851,676)	(705,485)
Proceeds from sales of capital assets	1,200	38,168
Capital grants and gifts	52,569	33,887
Net cash used in capital and related financing activities	(1,521,036)	(1,780,383)
Investing Activities		
Purchases of short-term investments	(297,019)	(594,061)
Sale of short-term investments	594,025	1,091,725
Investment income received	148,514	25,010
Net cash provided by investing activities	445,520	522,674
Increase in Cash and Cash Equivalents	128,922	161,096
Cash and Cash Equivalents, Beginning of Year	1,175,652	1,014,556
Cash and Cash Equivalents, End of Year	\$ 1,304,574	\$ 1,175,652

See Notes to Financial Statements

	<u>2011</u>	<u>2010</u>
Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided by Operating Activities		
Operating loss	\$ (608,963)	\$ (1,838,383)
Depreciation and amortization	1,697,346	1,754,244
(Gain) loss on disposal of capital assets	25,834	(28,302)
Changes in operating assets and liabilities		
Patient and other accounts receivable, net	(407,720)	1,317,386
Supplies and prepaid expenses	214,175	299,646
Estimated amounts due from third-party payers	295,000	151,513
Accounts payable and accrued expenses	<u>167,226</u>	<u>(19,457)</u>
Net cash provided by operating activities	<u>\$ 1,382,898</u>	<u>\$ 1,636,647</u>
Supplemental Cash Flows Information		
Capital lease obligation incurred for capital assets	\$ -	\$ 616,271
Financed insurance premiums	\$ 233,761	\$ 210,564
Capital asset additions in accounts payable	\$ 49,858	\$ 14,180
Prepaid expenses in accounts payable	\$ 22,504	\$ 12,196

Grady Memorial Hospital Authority

Notes to Financial Statements

December 31, 2011 and 2010

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

Nature of Operations and Reporting Entity

Grady Memorial Hospital Authority (the Authority) is a public trust which operates Grady Memorial Hospital (the Hospital). Grady County (the County) owns the Hospital's capital assets, and on September 1, 1982, the Board of County Commissioners of Grady County created the Authority to operate, control and manage all matters concerning the Hospital and the public trust. A lease agreement was entered into on January 1, 1983, between the County and the Authority. The lease term is for 50 years for a nominal rental amount. The Board of County Commissioners appoints the members of the Authority's Board of Trustees.

The Authority primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in Chickasha, Oklahoma, and the surrounding area. The Authority also operates a physicians' clinic in the same geographic area.

Basis of Accounting and Presentation

The financial statements of the Authority have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally, federal and state grants) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Authority first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

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

Use of Estimates

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

Grady Memorial Hospital Authority

Notes to Financial Statements

December 31, 2011 and 2010

Cash and Cash Equivalents

The Authority considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2011 and 2010, cash equivalents consisted primarily of money market accounts with brokers.

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

Risk Management

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

The Authority is self-insured for a portion of the risks related to workers' compensation and employee health claims. Annual estimated provisions are accrued for the self-insured portion of these claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Investments and Investment Income

Investments in nonnegotiable certificates of deposit are carried at amortized cost. Investment income includes interest income.

Patient Accounts Receivable

The Authority reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Authority provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions. As a service to the patient, the Authority bills third-party payers directly and bills the patient when the patient's liability is determined. Patient accounts receivable are due in full when billed. Accounts are considered delinquent and subsequently written off as bad debts based on individual credit evaluation and specific circumstances of the account.

Supplies

Supply inventories are stated at the lower of cost, determined using the weighted-average cost method, or market.

Grady Memorial Hospital Authority

Notes to Financial Statements

December 31, 2011 and 2010

Capital Assets

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

Land improvements	10–12 years
Buildings and leasehold improvements	5–40 years
Equipment	3–25 years

Deferred Financing Costs

Deferred financing costs represent costs incurred in connection with the issuance of long-term debt. Such costs are being amortized over the term of the respective debt using the straight-line method and are included in other assets on the accompanying balance sheets.

Investment in Joint Venture

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

Compensated Absences

Authority policies permit most employees to accumulate paid time off benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay 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 Assets

Net assets of the Authority are classified in four components. Net assets invested in capital assets, net of related debt, consist of capital assets net of accumulated depreciation and reduced by the outstanding balances of borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital assets that must be used for a particular purpose as specified by creditors, grantors or donors external to the Authority, including amounts deposited with trustees as required by bond indentures, reduced by the outstanding balances of any related borrowings. Restricted nonexpendable net assets are noncapital assets that are required to be maintained in perpetuity as specified by parties external to the Authority, such as permanent endowments. Unrestricted net assets are remaining assets less remaining liabilities that do not meet the above definitions.

Grady Memorial Hospital Authority

Notes to Financial Statements

December 31, 2011 and 2010

Net Patient Service Revenue

The Authority has agreements with third-party payers that provide for payments to the Authority at amounts different from its established rates. 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 Authority provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Authority does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue.

Income Taxes

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

Electronic Health Records Incentive Program

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

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

In 2011, the Authority completed the first-year requirements under the Oklahoma Medicaid program and has recorded revenue of approximately \$484,000, which is included in other revenue within operating revenues in the accompanying statements of revenues, expenses and changes in net assets.

Grady Memorial Hospital Authority
Notes to Financial Statements
December 31, 2011 and 2010

Note 2: Net Patient Service Revenue

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

Medicare – Inpatient acute care services and substantially all outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge or visit. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. The Authority is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Authority and audits thereof by the Medicare administrative contractor. The Medicare administrative contractor has audited the Authority's cost reports through December 31, 2008.

Medicaid – The Authority has also been reimbursed for services rendered to patients covered by the state Medicaid program at prospectively determined rates per discharge and fee schedules with no retroactive adjustments. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

Approximately 60% and 59% of net patient service revenue are from participation in the Medicare and state-sponsored Medicaid programs for the years ended December 31, 2011 and 2010, respectively. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Authority has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Authority 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 Authority's deposit policy for custodial credit risk requires compliance with the provisions of state law.

State law requires collateralization of all deposits with federal depository insurance; bonds and other obligations of the U.S. Treasury, U.S. agencies or instrumentalities or the state of Oklahoma; bonds of any city, county, school district or special road district of the state of Oklahoma; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits.

At December 31, 2011 and 2010, of the Authority's bank balances of approximately \$2,489,000 and \$2,220,000, approximately \$1,952,000 and \$1,583,000, respectively, were uninsured with collateral held by the pledging financial institution.

Grady Memorial Hospital Authority
Notes to Financial Statements
December 31, 2011 and 2010

Summary of Carrying Values

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

	2011	2010
Cash and cash equivalents	\$ 1,304,574	\$ 1,175,652
Short-term investments	403,250	700,256
	\$ 1,707,824	\$ 1,875,908

Investment Income

Investment income for the years ended December 31, 2011 and 2010, consisted of interest income and income from investment in joint venture.

Note 4: Patient Accounts Receivable

The Authority grants credit without collateral to its patients, many of whom are area residents and are insured under third-party payer agreements. Patient accounts receivable at December 31, 2011 and 2010, consisted of:

	2011	2010
Medicare	\$ 1,542,862	\$ 952,427
Medicaid	700,266	587,365
Other third-party payers	2,770,345	2,852,880
Patients	1,568,515	1,381,596
	6,581,988	5,774,268
Less allowance for uncollectible accounts	1,600,000	1,200,000
	\$ 4,981,988	\$ 4,574,268

Grady Memorial Hospital Authority

Notes to Financial Statements

December 31, 2011 and 2010

Note 6: Self-Insured Claims

Substantially all of the Authority's employees and their dependents are eligible to participate in the Authority's workers' compensation and employee health insurance plans. The Authority is self-insured for health claims of participating employees and dependents up to an annual amount of \$80,000 per person. The Authority is self-insured for workers' compensation claims of participating employees up to an annual amount of \$350,000. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amounts.

A provision is accrued for self-insured employee health claims and workers' compensation claims, including both claims reported and claims incurred but not yet reported. The accruals are estimated based on consideration of prior claims experience, recently settled claims, frequency of claims and other economic and social factors. It is reasonably possible that the Authority's estimates will change by a material amount in the near term.

Activity in the Authority's accrued claims liabilities during 2011 and 2010 is summarized as follows:

	December 31, 2011	
	Workers' Compensation	Employee Health
Balance, beginning of year	\$ 54,791	\$ 368,211
Current year claims incurred and changes in estimates for claims incurred in prior years	172,492	2,311,058
Claims and expenses paid	(150,590)	(2,382,380)
Balance, end of year	\$ 76,693	\$ 296,889

	December 31, 2010	
	Workers' Compensation	Employee Health
Balance, beginning of year	\$ 227,558	\$ 292,021
Current year claims incurred and changes in estimates for claims incurred in prior years	19,496	2,541,285
Claims and expenses paid	(192,263)	(2,465,095)
Balance, end of year	\$ 54,791	\$ 368,211

Grady Memorial Hospital Authority
Notes to Financial Statements
December 31, 2011 and 2010

Note 7: Medical Malpractice Claims

The Authority 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 Authority's claims experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

The Authority is a member of Heartland Healthcare Reciprocal Risk Retention Group (Heartland), an entity approved by the state of Vermont to provide hospital professional liability and general liability coverage to its subscribers. Heartland was formed in order to stabilize the cost and availability of hospital professional and general liability insurance by taking advantage of the self-funding capabilities of a homogenous group of health care providers. Heartland members are provided hospital professional and general liability insurance under claims-made policies on a fixed premium basis. See *Note 13* for additional information about Heartland.

Note 8: Short-Term Notes Payable

The Authority finances certain insurance premium amounts with short-term notes payable. The following is a summary of short-term notes payable transactions for the Authority for the years ended December 31, 2011 and 2010:

	2011	2010
Balance, beginning of year	\$ 210,564	\$ 219,980
Additions	435,256	408,639
Deductions	(412,059)	(418,055)
Balance, end of year	\$ 233,761	\$ 210,564

Grady Memorial Hospital Authority
Notes to Financial Statements
December 31, 2011 and 2010

Note 9: Long-Term Obligations

The following is a summary of long-term obligation transactions for the Authority for the years ended December 31, 2011 and 2010:

	2011				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Revenue note, Series 2002 (A)	\$ 2,285,426	\$ -	\$ (2,285,426)	\$ -	\$ -
Note payable, bank (B)	816,129	-	(196,201)	619,928	199,729
Note payable, GE (C)	110,000	1,208,594	(202,219)	1,116,375	284,057
Revenue note, Series 2011 (D)	-	2,199,811	-	2,199,811	682,496
Capital lease obligations	687,524	-	(229,640)	457,884	179,605
	<u>\$ 3,899,079</u>	<u>\$ 3,408,405</u>	<u>\$ (2,913,486)</u>	<u>\$ 4,393,998</u>	<u>\$ 1,345,887</u>

	2010				
	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Long-term debt					
Revenue note, Series 2002 (A)	\$ 2,868,844	\$ -	\$ (583,418)	\$ 2,285,426	\$ 672,302
Note payable, bank (B)	829,113	170,982	(183,966)	816,129	192,101
Note payable, GE (C)	-	110,000	-	110,000	110,000
Capital lease obligations	524,176	616,271	(452,923)	687,524	229,639
	<u>\$ 4,222,133</u>	<u>\$ 897,253</u>	<u>\$ (1,220,307)</u>	<u>\$ 3,899,079</u>	<u>\$ 1,204,042</u>

- (A) Originally due February 6, 2014; principal and interest at 5.49% payable monthly in the amount of \$65,086; secured by pledge of the Authority's gross revenues and a security interest in a mortgage and lien on certain of the Authority's real property. This note was refinanced in December 2011, see (D) below.
- (B) Due December 16, 2014; principal and interest at 3.90% payable annually beginning January 16, 2010, in the amount of \$18,374; secured by certain equipment of the Authority.
- (C) Due May 1, 2016; monthly interest only payments at 3.05% through May 1, 2011, then principal and interest at 3.05% payable monthly in the amount of \$28,334; secured by certain equipment of the Authority.
- (D) Due December 22, 2017; monthly interest only payments at 4.0% through January 2012 then principal and interest at 4.0% payable monthly in the amount of \$63,000; secured by certain equipment of the Authority. Total loan commitment is for \$4,000,000, of which \$1,800,189 had not been drawn by the Authority as of December 31, 2011.

Grady Memorial Hospital Authority

Notes to Financial Statements

December 31, 2011 and 2010

The debt service requirements of the revenue note and notes payable as of December 31, 2011, are as follows:

Year Ending December 31,	Total to be Paid	Principal	Interest
2012	\$ 1,288,163	\$ 1,166,282	\$ 121,881
2013	1,316,497	1,234,917	81,580
2014	1,228,405	1,193,143	35,262
2015	267,102	261,235	5,867
2016	81,152	80,537	615
	<u>\$ 4,181,319</u>	<u>\$ 3,936,114</u>	<u>\$ 245,205</u>

Capital Lease Obligations

The Authority is obligated under leases for equipment that are accounted for as capital leases. Assets under capital leases at December 31, 2011 and 2010, had total costs of \$676,212 and \$1,097,134 and accumulated depreciation of \$211,555 and \$357,092, respectively. The following is a schedule by year of future minimum lease payments under the capital lease, including interest from 2.98% to 8.69%, together with the present value of the future minimum lease payments, at December 31, 2011:

Year Ending December 31,	
2012	\$ 195,240
2013	162,575
2014	68,138
2015	47,376
2016	9,149
Total minimum lease payments	<u>482,478</u>
Less amount representing interest	<u>24,594</u>
Present value of future minimum lease payments	<u>\$ 457,884</u>

Grady Memorial Hospital Authority
Notes to Financial Statements
December 31, 2011 and 2010

Note 10: Internally Designated Net Assets

At December 31, 2011 and 2010, unrestricted net assets have been designated by the Authority's Board of Trustees for capital acquisitions and self-insured claims. These funds were designated for the following purposes:

	2011	2010
Capital acquisitions	\$ 817,001	\$ 1,065,857
Self-insured claims	68,430	76,412
Total designated net assets	\$ 885,431	\$ 1,142,269

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

Note 11: Charity Care and Uncompensated Care

In support of its mission, the Authority voluntarily provides free care to patients who lack financial resources and are deemed to be medically indigent. Because the Authority does not pursue collection of amounts determined to qualify as charity care, they are not reported in net patient service revenue. In addition, the Authority provides services to other medically indigent patients under the state welfare program. The state welfare program pays providers amounts which are less than established charges for the services provided to the recipients and many times the payments are less than the cost of rendering the services provided.

Uncompensated charges for the years ended December 31, 2011 and 2010, related to these services were approximately:

	2011	2010
Medicaid contractual allowance	\$ 12,149,000	\$ 12,163,000
Charity care charges	1,788,000	1,769,000
	\$ 13,937,000	\$ 13,932,000

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

Grady Memorial Hospital Authority

Notes to Financial Statements

December 31, 2011 and 2010

Note 12: Pension Plans

The Authority contributes to a defined contribution pension plan covering substantially all employees. Pension expense is recorded for the amount of the Authority's required contributions, determined in accordance with the terms of the plan. The plan is administered by the Authority's governing body. 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 Authority's governing body. Contribution rates made by the Authority, expressed as a percentage of covered payroll, were 1.8% and 2.2% for 2011 and 2010, respectively. Contributions actually made by the Authority were approximately \$173,000 and \$236,000 during the years ended December 31, 2011 and 2010, respectively.

Note 13: Investment in Joint Venture

The Authority is a subscriber (member) of Heartland and at December 31, 2011 and 2010, had an approximate 7% ownership (equity) interest in Heartland. Heartland was formed as an unincorporated association approved by the state of Vermont to provide hospital professional liability and general liability coverage to its subscribers. The Authority's investment in Heartland amounted to approximately \$531,000 and \$580,000 at December 31, 2011 and 2010, respectively.

The Authority purchases its professional liability (medical malpractice) and general liability insurance coverages from Heartland (see *Note 7*). For the years ended December 31, 2011 and 2010, the Authority paid approximately \$323,000 and \$326,000, respectively, to Heartland for the coverage.

Grady Memorial Hospital Authority
Notes to Financial Statements
December 31, 2011 and 2010

Financial position and results of operations summarized from Heartland’s unaudited financial statements for the year ended December 31, 2011, and the audited financial statements for the fiscal year ended December 31, 2010, are shown below:

	2011 (Unaudited)	2010 (Audited)
Cash and cash equivalents	\$ 1,343,002	\$ 1,498,473
Investments at fair value	11,598,786	12,842,373
Other assets	543,541	389,226
Total assets	13,485,329	14,730,072
Unpaid losses and loss adjustment expenses	5,120,702	5,392,522
Other liabilities	240,716	382,042
Total liabilities	5,361,418	5,774,564
Subscribers’ surplus	\$ 8,123,911	\$ 8,955,508
Revenues	\$ 3,691,924	\$ 3,681,912
Net income	\$ 1,156,919	\$ 1,835,714

Complete financial statements of Heartland may be obtained by contacting the Authority’s management at 405.224.2300.

Note 14: Contingencies and Other Matters

Litigation

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

Grady Memorial Hospital Authority

Notes to Financial Statements

December 31, 2011 and 2010

Current Economic Conditions

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

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

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

Subsequent Event

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, 2014. The SHOPP program is designed to assess Oklahoma hospitals a supplemental hospital offset fee which will be placed in pools after receiving federal matching funds. The total fees and matching funds will then be allocated to hospitals as directed by legislation. Based on preliminary estimates, the Hospital will receive approximately \$1,899,000 in SHOPP funds and pay the SHOPP assessment fee of approximately \$820,000 annually. As final approval by CMS was not obtained as of December 31, 2011, the accompanying 2011 financial statements do not include any activity related to the SHOPP program.

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

Board of Trustees
Grady Memorial Hospital Authority
Chickasha, Oklahoma

We have audited the financial statements of Grady Memorial Hospital Authority (the Authority) as of and for the year ended December 31, 2011, and have issued our report thereon dated April 16, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above.

Compliance and Other Matters

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

Board of Trustees
Grady Memorial Hospital Authority

We noted certain matters that we reported to the Authority's management in a separate letter dated April 16, 2012.

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

BKD, LLP

April 16, 2012

Grady Memorial Hospital Authority
Schedule of Findings and Responses
Year Ended December 31, 2011

Reference Number	Finding
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No matters are reportable.