

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Basic Financial Statements
June 30, 2004 and 2003

Together with Independent Auditor's Report

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

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LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

OFFICIALS

June 30, 2004

<u>Board of Trustees</u>	<u>Address</u>	<u>Term Expires</u>
Ivan Brown, Chairman	Spirit Lake, Iowa	December 2006
Gary Moeller, Vice-Chairman	Milford, Iowa	December 2006
Doug Dingel, Secretary/Treasurer	Terril, Iowa	December 2008
Marc Jacobsen	Arnolds Park, Iowa	December 2008
Mark Fisher	Milford, Iowa	December 2004
Deb Goetzinger	Spirit Lake, Iowa	December 2008
Denny Perry	Spirit Lake, Iowa	December 2004
<u>Chief Executive Officer</u>		
Richard Kielman	Okoboji, Iowa	Indefinite
<u>Chief Financial Officer</u>		
Gordon Larson	Spirit Lake, Iowa	Indefinite



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Independent Auditor's Report

To the Board of Trustees
Lakes Regional Healthcare
Spirit Lake, Iowa:

Harvey D. Johnson, CPA
Wendell L. Quist, CPA
Clifford C. Huntington, CPA
Roger E. Howard, CPA
Roger E. Thompson, CPA
Tom H. Schnack, CPA
Daniel L. Hassel, CPA
Dennis K. Grindle, CPA
Dennis R. Hein, CPA
Brent T. Frieauf, CPA
Barbara J. Fajen, CPA
Brian D. Green, CPA

We have audited the accompanying basic financial statements of LAKES REGIONAL HEALTHCARE as of and for the years ended June 30, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, Chapter 11 of the Code of Iowa, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards and provisions 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 Lakes Regional Healthcare as of June 30, 2004 and 2003, and the results of its operations, changes in fund balances and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, during the year ended June 30, 2004, Lakes Regional Healthcare adopted Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments; Statement No. 37, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus; and Statement No. 38, Certain Financial Statement Note Disclosures.

In accordance with Government Auditing Standards, we have also issued our report dated August 27, 2004 on our consideration of Lakes Regional Healthcare's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of the 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. Those reports are an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Management's Discussion and Analysis and Budgetary Comparison Information on pages 4 through 8 and page 26 are not required parts of the basic financial statements but are supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The other supplementary information, included in Exhibits 1 through 7, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Seim, Johnson, Sestak & Quist, LLP

Omaha, Nebraska,
August 27, 2004.

LAKES REGIONAL HEALTHCARE

Spirit Lake, Iowa

Management's Discussion and Analysis June 30, 2004 and 2003

This discussion and analysis of Lakes Regional Healthcare's (LRH) financial performance provides an overview of financial activities for the fiscal years ended June 30, 2004 and 2003. This discussion and analysis should be read in conjunction with financial statements, which begin on page 9.

Financial Highlights

- LRH net assets increased in 2004 by \$1,582,547 or 5.9%. In 2003, net assets increased by \$1,503,164 or 5.9%.
- LRH reported operating income in 2004 of \$1,248,615 compared to \$1,020,947 in 2003, an increase of 22.2%.
- LRH nonoperating revenues decreased by \$148,285 in 2004 compared to 2003.

Using This Annual Report

LRH 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 financial statements and related notes provide information about the activities of LRH, including resources held by LRH but restricted for specific purposes by contributors, grantors, or enabling legislation.

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

Analysis of LRH finances begins on page 9. The Balance Sheet and the Statement of Revenues, Expenses, and Changes in Net Assets report information about LRH resources and activities in a way that helps answer the question of whether LRH, as a whole, is better or worse off as a result of the year's activities. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. 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 LRH net assets and changes in them. Over time, increases or decreases in net assets are an indicator of whether its financial health is improving or deteriorating. To assess the overall health of LRH, non-financial factors, such as changes in the patient base of LRH and measures of the quality of service it provides to the community, as well as local economic factors, need to be considered.

The Statement of Cash Flows

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It shows where cash came from and what the cash was used for. It also provides the change in cash balance during the reporting period.

Net Assets

LRH net assets are the difference between assets and liabilities reported in the Balance Sheet on page 9. LRH net assets increased this past year by \$1,582,547 or 5.9% in 2004, as shown in **Table 1**.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2004 and 2003

Table 1: Assets, Liabilities, and Net Assets

	<u>2004</u>	<u>2003</u>	<u>Change from Prior Year</u>	<u>% Change</u>
Assets:				
Current assets	\$ 17,571,799	15,283,390	2,288,409	15.0%
Capital assets, net	15,797,826	13,742,160	2,055,666	15.0%
Other non-current assets	4,376,669	7,442,832	(3,066,163)	(41.2%)
Total assets	<u>37,746,294</u>	<u>36,468,382</u>	<u>1,277,912</u>	<u>3.5%</u>
Liabilities:				
Long-term debt outstanding	6,450,000	6,990,000	(540,000)	7.7%
Other current and noncurrent liabilities	3,102,359	2,866,994	235,365	8.2%
Total liabilities	<u>9,552,359</u>	<u>9,856,994</u>	<u>(304,635)</u>	<u>3.0%</u>
Net assets:				
Invested in capital assets, net of related debt	8,807,826	6,237,160	2,570,666	41.2%
Restricted for debt service	646,143	617,842	28,301	4.5%
Restricted expendable net assets	2,099,185	5,236,464	(3,137,279)	60.0%
Restricted nonexpendable net assets	25,000	25,000	0	0%
Unrestricted	16,615,781	14,494,922	2,120,859	14.6%
Total net assets	<u>\$ 28,193,935</u>	<u>26,611,388</u>	<u>1,582,547</u>	<u>5.9%</u>

A significant component of the change in LRH assets in 2004 is the decrease in patient accounts receivable. While net patient service revenue increased by \$1,640,162 or 8.7%, patient accounts receivable, net of estimated uncollectible amounts, decreased by \$884,381 or 25.2%. In 2003 compared to 2002, patient service revenue increased by \$1,587,089 while receivables decreased by \$813,351 or 18.8%. In both 2004 and 2003, the decrease in accounts receivable is primarily the result of increased emphasis on effective billing processes.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2004 and 2003

Operating Results and Changes in LRH Net Assets

In 2004, LRH net assets increased by \$1,582,547 or 5.9%, as shown in **Table 2**. This increase is made up of several different components.

Table 2: Condensed Statements of Revenues, Expenses and Changes in Net Assets

	<u>2004</u>	<u>2003</u>	<u>Change from Prior Year</u>	<u>% Change</u>
Operating Revenue:				
Net patient service revenue	\$ 20,315,882	18,675,720	1,640,162	8.7%
Other operating revenues	492,337	523,411	(31,074)	(5.9%)
Total operating revenue	20,808,219	19,199,131	1,609,088	8.3%
Operating Expenses:				
Salaries and benefits	9,404,469	8,881,461	523,008	5.9%
Purchased services and other	7,509,156	6,447,878	1,061,278	16.5%
Provision for bad debt	600,000	742,000	(142,000)	(19.1%)
Depreciation and amortization	1,930,784	2,018,653	(87,869)	(4.3%)
Interest	115,195	88,192	27,003	30.6%
Total operating expenses	19,559,604	18,178,184	1,381,420	7.5%
Operating income	1,248,615	1,020,947	227,668	22.2%
Nonoperating Revenues and Expenses				
Property taxes	102,996	103,887	(891)	.8%
Investment income	310,184	269,180	41,004	15.2%
Grants and contributions, net	26,739	161,400	(134,661)	(83.4%)
Other nonoperating revenues and expenses, net	(105,987)	(52,250)	(53,737)	102.8%
Total nonoperating revenues (expenses), net	333,932	482,217	(148,285)	(30.7%)
Increase in net assets	1,582,547	1,503,164	79,383	5.2%
Net assets beginning of year	26,611,388	25,108,224	1,503,164	5.9%
Net assets end of year	\$ 28,193,935	26,611,388	1,582,547	5.9%

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2004 and 2003

Operating Income

The first component of the overall change in LRH net assets is its operating income—generally, the difference between net patient service revenues and the expenses incurred to perform those services. In each of the past two years, LRH has reported an operating income. This is consistent with the last 12 years of operating history.

The primary components affecting operating income are:

- Increased patient days of 182 or 2.7% in 2004 and 101 or 1.5% in 2003.
- Increased outpatient revenue, \$1,339,400 or 7.7% in 2004 and \$3,001,502 or 21% in 2003. Increases in 2004 were due to increased volumes in many outpatient departments in conjunction with price changes. Increases in 2003 were due to increased volumes and price changes.
- Increased salary and benefit costs for employees of \$523,008 or 5.9% in 2004 and \$424,874 or 5.0% in 2003.
- Increased medical supply and drug costs of \$718,858 or 17.6% in 2004 and of \$214,811 or 5.5% in 2003.
- Increased net patient service revenues in 2004 primarily because of increased patient volumes and increased charges, similar to changes seen in 2003.

The rate of healthcare inflation has a direct impact on the cost of services provided by LRH. A component of LRH costs are expenses for medical supplies and prescription drugs. In 2004 medical supplies and prescription drug costs totaled \$4,790,242. In 2003 medical supplies and prescription drug costs totaled \$4,071,384. Some of the major factors contributing to increased medical supply and drug costs include the introduction of new drugs that cannot be obtained in generic form and changes in therapeutic mix.

LRH at times provides care for patients who have little or no health insurance or other means of repayment. The level of services provided to these patients decreased by \$567,075 in 2004 compared to 2003. Because there is no expectation of repayment, charity care is not reported as patient service revenues of LRH.

Nonoperating Revenues and Expenses

Nonoperating revenues consist primarily of property taxes levied by LRH, interest revenue, and investment earnings. The county tax levy was at \$0.08920 per \$1,000 of valuation for 2004 and \$0.09776 in 2003.

Cash Flows

Changes in cash flows are consistent with changes in operating income and nonoperating revenues and expenses, discussed earlier, with one exception. Cash flows provided by operating activities increased slightly less than operating income in 2004 and slightly more than operating income in 2003 due to capital purchases, including a construction project that is underway.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2004 and 2003

Capital Asset and Debt Administration

Capital Assets

At the end of 2004, LRH had \$15,797,826 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. In 2004, LRH purchased new equipment costing \$3,823,189. Slightly less, \$2,709,593 was spent to acquire new equipment in 2003. Both of these amounts are more than 2002, when LRH spent \$2,108,353 for new equipment.

Debt

At year-end, LRH had \$6,990,000 in capital loan notes outstanding. No new debt was issued in 2004 or 2003. The amount of debt issued is subject to limitations that apply to the County and its component units as a whole. There have been no changes in LRH debt ratings in the past two years.

Other Economic Factors

The 2004 fiscal year provided LRH substantial challenges due federal program reimbursement requirements, pressures from other insurers, and the fluctuation of patient demand.

Inflation continued in 2004 with supply and equipment costs increasing at market rates and the pressure on nursing and other salary costs being driven by the shortage of supply of these health care professionals.

Contacting LRH Financial Management

This financial report is designed to provide patients, suppliers, taxpayers, and creditors with a general overview of LRH finances. Questions about this report or requests for additional information should be directed to:

Gordon Larson
Vice President and Chief Financial Officer
Lakes Regional Healthcare
Highway 71 South
Spirit Lake, Iowa 51360
712-336-8796

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Balance Sheets
June 30, 2004 and 2003

ASSETS	<u>2004</u>	<u>2003</u>
Current assets:		
Cash and cash equivalents	\$ 8,077,997	6,727,851
Short-term investments, primarily certificates of deposit	5,434,168	3,689,305
Assets limited as to use - required for current liabilities	646,143	617,842
Receivables -		
Patients, net of allowance for doubtful accounts of \$1,367,110 in 2004 and \$1,688,840 in 2003	2,620,978	3,505,359
Other	46,753	73,386
Inventories	633,858	607,901
Prepaid expenses	<u>111,902</u>	<u>61,746</u>
Total current assets	<u>17,571,799</u>	<u>15,283,390</u>
Assets limited as to use:		
By Board for -		
Capital improvements	394,661	390,929
Endowments	1,886,463	1,818,396
Employee health insurance claims	7,260	1,433
Under Public Hospital Revenue Capital Loan Notes Agreements	1,912,356	5,048,358
By Donor	<u>136,750</u>	<u>141,620</u>
	<u>4,337,490</u>	<u>7,400,736</u>
Capital assets, net of accumulated depreciation	<u>15,797,826</u>	<u>13,742,160</u>
Other assets, net	<u>39,179</u>	<u>42,096</u>
Total assets	<u>\$ 37,746,294</u>	<u>36,468,382</u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Current portion of long-term debt	\$ 540,000	515,000
Accounts payable -		
Trade	443,741	375,807
Construction	599,387	472,854
Salaries, wages and accrued vacation payable	875,542	816,016
Payroll taxes withheld and accrued	82,113	74,615
Accrued interest payable	25,825	27,758
Other accrued liabilities	122,002	138,594
Deferred revenue - Mandelbaum Endowment	6,429	6,382
Estimated third-party payor settlements	<u>407,320</u>	<u>439,968</u>
Total current liabilities	3,102,359	2,866,994
Long-term debt, net of current portion	<u>6,450,000</u>	<u>6,990,000</u>
Total liabilities	<u>9,552,359</u>	<u>9,856,994</u>
Net assets:		
Invested in capital assets, net of related debt	8,807,826	6,237,160
Restricted -		
For capital acquisitions	1,912,356	5,048,358
For debt service	646,143	617,842
Expendable for capital acquisitions & operating activities	186,829	188,106
Nonexpendable	25,000	25,000
Unrestricted	<u>16,615,781</u>	<u>14,494,922</u>
Total net assets	<u>28,193,935</u>	<u>26,611,388</u>
Total liabilities and net assets	<u>\$ 37,746,294</u>	<u>36,468,382</u>

See notes to financial statements

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Statements of Revenue, Expenses and Changes in Net Assets
For the Years Ended June 30, 2004 and 2003

	2004	2003
OPERATING REVENUE:		
Net patient service revenue	\$ 20,315,882	18,675,720
Other revenue	492,337	523,411
Total revenue	20,808,219	19,199,131
OPERATING EXPENSES:		
Salaries	7,397,830	6,985,265
Employee benefits	2,006,639	1,896,196
Purchased services and professional fees	2,132,943	1,884,076
Utilities	433,505	365,765
Supplies and other expenses	4,790,242	4,071,384
Depreciation and amortization	1,930,784	2,018,653
Insurance	152,466	126,653
Interest	115,195	88,192
Provision for bad debts	600,000	742,000
Total expenses	19,559,604	18,178,184
OPERATING INCOME	1,248,615	1,020,947
NONOPERATING REVENUES, NET:		
Investment income	310,184	269,180
County tax revenue	102,996	103,887
Unrestricted gifts, grants and bequests	28,016	135,804
Loss on disposal of property and equipment	(105,987)	(52,250)
Nonoperating revenues, net	335,209	456,621
EXCESS REVENUES OVER EXPENSES BEFORE GRANTS AND CONTRIBUTIONS	1,583,824	1,477,568
GRANTS AND CONTRIBUTIONS, NET	(1,277)	25,596
INCREASE IN NET ASSETS	1,582,547	1,503,164
NET ASSETS, beginning of year	26,611,388	25,108,224
NET ASSETS, end of year	\$ 28,193,935	26,611,388

See notes to financial statements

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Statements of Cash Flows
For the Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third party payors	\$ 20,567,615	19,224,172
Cash paid to employees for salaries and benefits	(9,337,445)	(8,813,761)
Cash paid to suppliers and contractors	(7,533,927)	(6,983,163)
Other receipts and payments, net	<u>522,563</u>	<u>524,431</u>
Net cash provided by operating activities	<u>4,218,806</u>	<u>3,951,679</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
County taxes received	102,996	103,887
Unrestricted gifts, grants and bequests	<u>28,016</u>	<u>135,804</u>
Net cash provided by noncapital financing activities	<u>131,012</u>	<u>239,691</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of property and equipment, net	(3,823,189)	(2,709,593)
Payments on long-term debt	(515,000)	(2,735,000)
Interest paid on long-term debt	<u>(337,724)</u>	<u>(450,985)</u>
Net cash used in capital and related financing activities	<u>(4,675,913)</u>	<u>(5,895,578)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Withdrawals from assets limited as to use, net	3,030,075	3,189,692
Withdrawals from (deposits to) short-term investments	(1,744,863)	1,887,735
Interest on investments	<u>391,029</u>	<u>413,305</u>
Net cash provided by investing activities	<u>1,676,241</u>	<u>5,490,732</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,350,146	3,786,524
CASH AND CASH EQUIVALENTS - Beginning of year	<u>6,727,851</u>	<u>2,941,327</u>
CASH AND CASH EQUIVALENTS - End of year	\$ <u>8,077,997</u>	<u>6,727,851</u>

See notes to financial statements

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Statements of Cash Flows
For the Years Ended June 30, 2004 and 2003

	2004	2003
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 1,248,615	1,020,947
Adjustments to reconcile operating income to net cash provided by operating activities -		
Depreciation and amortization	1,930,784	2,018,653
Interest expense	115,195	88,192
(Increase) decrease in current assets -		
Receivables -		
Patients	884,381	813,351
Other	26,633	(21,535)
Inventories	(25,957)	(413,620)
Prepaid expenses	(50,156)	40,532
Estimated third-party payor settlements	--	37,133
Increase (decrease) in current liabilities -		
Accounts payable	67,934	(97,177)
Due to restricted funds	3,593	22,555
Salaries, wages and accrued vacation payable	59,526	63,099
Payroll taxes withheld and accrued	7,498	4,601
Other accrued liabilities	(16,592)	(65,020)
Estimated third-party payor settlements	(32,648)	439,968
Net cash provided by operating activities	\$ 4,218,806	3,951,679

See notes to financial statements

LAKES REGIONAL HEALTHCARE

Spirit Lake, Iowa

Notes to Financial Statements June 30, 2004 and 2003

(1) Summary of Significant Accounting Policies

The following is a summary of significant accounting policies of Lakes Regional Healthcare (Hospital). These policies are in accordance with accounting principles generally accepted in the United States of America. The Hospital is a county public hospital organized under Chapter 347 of the Code of Iowa and governed by a seven member Board of Trustees elected for terms of six years.

A. *Reporting Entity*

For financial reporting purposes, the Hospital has included all funds, organizations, account groups, agencies, boards, commissions and authorities. The Hospital has also considered all potential component units for which it is financially accountable, and other organizations for which the nature and significance of their relationship with the Hospital are such that exclusion would cause the Hospital's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Hospital to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Hospital. The Hospital has no component units which meet the Governmental Accounting Standards Board criteria.

B. *Industry Environment*

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursements for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Hospital is in compliance with government laws and regulations as they apply to the areas of fraud and abuse. While no regulatory inquiries have been made which are expected to have a material effect on the Hospital's financial statements, compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

C. *Basis of Presentation*

During the year ended June 30, 2004, the Hospital implemented the following new accounting standards issued by the Governmental Accounting Standards Board (GASB): Statement No. 34, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments; Statement No. 37, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments: Omnibus; and Statement No. 38, Certain Financial Statement Note Disclosures.

GASB Statement No. 34, as amended by GASB Statement No. 37, establishes new financial reporting standards for state and local governments, which include a Statement of Net Assets (Balance Sheet), a Statement of Revenues, Expenses and Changes in Net Assets, and a Statement of Cash Flows. GASB Statement No. 38, requires certain note disclosures when GASB Statement No. 34 is implemented.

The Statement of Net Assets displays the Hospital’s assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt attributable to the acquisition, construction or improvement of those assets.

Restricted net assets result when constraints placed on net asset use are either externally imposed or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets not meeting the definition of the two preceding categories. Unrestricted net assets often have constraints on resources imposed by management which can be removed or modified.

When both restricted and unrestricted resources are available for use, generally it is the Hospital’s policy to use restricted resources first.

The financial statements as of and for the year ended June 30, 2003 have been reclassified to conform to the current year’s presentation.

D. *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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

E. *Measurement Focus and Basis of Accounting*

Basis of accounting refers to when revenue and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The accompanying financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Revenue is recognized when earned and expenses are recorded when the liability is incurred.

In reporting the financial activity of its proprietary funds, the Hospital applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure.

F. *Cash and Cash Equivalents*

Cash and cash equivalents for purposes of the statements of cash flows include investments in highly liquid debt instruments with original maturities of three months or less, excluding amounts limited as to use by donor and bond indenture agreements.

G. *Patient Receivables*

Patient receivables are uncollateralized customer and third-party payor obligations. Unpaid patient receivables are not assessed interest.

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

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

H. *Investments in Debt Securities*

Held-to-maturity securities, which include any debt security for which the Hospital has the positive intent and ability to hold until maturity, are carried at historical cost adjusted for amortization of premiums and accretion of discounts. Premiums and discounts are amortized and accreted, respectively, to interest income using the interest method over the period to maturity.

Interest and dividends on investments in debt securities are included in nonoperating income when earned.

I. *Assets Limited as to Use*

By Board of Trustees - Periodically, the Hospital's Board of Trustees has set aside assets for future capital improvements, endowments and employee health insurance claims. The Board retains control over these assets and may, at its discretion, subsequently use them for other purposes.

Under Public Hospital Revenue Capital Loan Notes Agreements - These funds are used for the payment of principal and interest on the notes and to provide funds for the construction of additions to and remodeling of the existing Hospital facilities.

By Donor – These funds are restricted for specified purposes as directed by the grantor or donor.

J. *Capital Assets*

Capital asset acquisitions in excess of \$1,500 are capitalized and recorded at cost. Depreciation is provided over the estimated life of each depreciable asset and is computed using the straight-line method.

Useful lives are determined using guidelines from the American Hospital Association Guide for Estimated Useful Lives of Depreciable Hospital Assets. Lives range by capital asset classification as follows:

Land improvements	10 to 50 years
Buildings and building improvements	10 to 50 years
Equipment, computers, and furniture	3 to 25 years

Gifts of capital assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire capital assets are reported as capital grants and contributions.

K. *Restricted Assets*

Restricted assets consist primarily of funds designated by the donor or grantor for specified purposes.

L. *Compensated Absences*

Sick leave does not vest and is accounted for as an expenditure or an expense when it is paid. Vacation leave vests and may be carried forward by an employee in an amount not to exceed 480 hours. Vacation expense is accrued as an expense and a liability as it is earned. Vacation leave expenditures are recognized to the extent it is paid during the year and the vested amount is recorded as a current liability. Accrued vacation leave payable at June 30, 2004 and 2003 was \$524,222 and \$497,862, respectively.

M. *Bond Financing Costs*

Bond financing costs related to the issuance of the Public Hospital Revenue Capital Loan Notes are included with other assets in the balance sheet and are being amortized over the life of the related notes on a straight-line basis. Amortization expense of \$1,251 and \$33,893 for 2004 and 2003, respectively, is included in the accompanying statements of revenues, expenses and changes in net assets.

N. *Statement of Revenues, Expenses and Changes in Net Assets*

For purposes of display, transactions deemed by management to be on-going, major or central to the provision of health care services are reported as operating revenues and expenses. Peripheral or incidental transactions are reported as nonoperating revenues and expenses.

O. *Grants and Contributions*

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

P. *Net Patient Service Revenue*

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Q. *Operating Income*

Operating income includes transactions deemed by management to be ongoing, major or central to the provision of medical services provided by the Hospital. Revenue and expenses to provide these services are reported as operating income for the reporting period. Operating revenues result from exchange transactions associated with the provision of health care services – the Hospital's principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

R. *Charity Care*

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Revenue from services to these patients is automatically recorded in the accounting system at the established rates, but the Hospital does not pursue collection of the amounts. The resulting adjustments are recorded as adjustments to patient service revenue at the time of the charity determination.

S. *County Tax Revenue*

Taxes are included in nonoperating gains when received and distributed by the County Treasurer. No provision is made in the financial statements for taxes levied in the current year to be collected in a subsequent year.

T. *2003 Financial Statements*

Certain amounts in the 2003 financial statements have been reclassified to conform to the 2004 reporting format.

(2) Cash and Investments

The Hospital's deposits in banks at June 30, 2004 were entirely covered by federal depository insurance or the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Hospital is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentality's; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees; prime eligible bankers acceptances; certain high-rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; and certain joint investment trusts, and warrants or improvement certificates of a drainage district.

The Hospital's investments are categorized to give an indication of the level of risk assumed by the Hospital at year end. The Hospital's investments are all category 1 which means that the investments are insured or registered or the securities are held by the Hospital or its agent in the Hospital's name. The Hospital had no investments as defined by Government Accounting Standards Board Statement 3 at June 30, 2004.

(3) Net Patient Service Revenue

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

Medicare. Inpatient acute care 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. Outpatient services are paid based on ambulatory payment classifications or fee schedule amounts. Home health services are paid at prospectively determined rates per episode of care. The Hospital is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

The Hospital's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Hospital. The Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2001.

Medicaid. Inpatient acute services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Outpatient services related to Medicaid beneficiaries are paid based on ambulatory patient groups or fee schedule amounts.

The Hospital has also entered into payment agreements with certain commercial insurance carriers. The basis for payment to the Hospital under these agreements primarily includes discounts from established charges.

(4) Assets Limited as to Use

By Board

Cash deposits and investments designated by the Board for future capital improvements, endowments and employee health insurance claims as of June 30, 2004 and 2003, are summarized as follows:

	<u>2004</u>	<u>2003</u>
Capital Improvements -		
Cash	\$ <u>394,661</u>	<u>390,929</u>
Endowments -		
Cash	\$ 4,263	9,063
Certificates of deposit	1,874,948	1,804,377
Interest receivable	<u>7,252</u>	<u>4,956</u>
	\$ <u>1,886,463</u>	<u>1,818,396</u>
Employee health insurance claims, cash	\$ <u>7,260</u>	<u>1,433</u>

Hospital Revenue Capital Loan Notes Agreements -

In connection with the issuance of Lakes Regional Healthcare Revenue Capital Loan Notes, Series 2002, the Hospital is required to maintain the following funds:

Bond Fund – Established for the monthly deposit by the Hospital of 1/12th of the next annual principal payment and 1/6th of the next semi-annual interest payment (Series 2002).

Project Fund – Established from the proceeds of the Revenue Capital Loan Notes, Series 2002, to provide funds for the construction of additions to and remodeling of the existing Hospital facilities.

The amounts segregated as of June 30, 2004 and 2003 are as follows:

	<u>2004</u>	<u>2003</u>
Bond Fund, cash	\$ 646,143	617,842
Project Fund -		
Cash and certificate of deposits	\$ 1,912,111	5,047,797
Interest receivable	245	561
	<u>\$ 1,912,356</u>	<u>5,048,358</u>

By Donor –

The Mandelbaum Endowment Fund consists of a bequest of \$25,000 received in June 1988. The principal amount of \$25,000 is to remain intact with the interest earned to be used for nurse training.

The Hospital Auxiliary conducts various projects to raise funds which are used to satisfy needs of the Hospital as determined by its executive Board and the Hospital Board of Trustees.

The amounts segregated as of June 30, 2004 and 2003 are as follows:

	<u>2004</u>	<u>2003</u>
Mandelbaum Endowment fund		
Certificate of deposit	\$ 25,000	25,000
Hospital auxiliary assets, primarily cash and temporary cash investments	111,750	116,620
	<u>\$ 136,750</u>	<u>141,620</u>

(5) Capital Assets

Capital assets activity for the years ended June 30, 2004 and 2003 were as follows:

	<u>June 30,</u> <u>2003</u>	<u>Additions</u>	<u>Transfers</u> <u>and Disposals</u>	<u>June 30,</u> <u>2004</u>
Capital assets, not being depreciated:				
Land	\$ 162,552	--	--	162,552
Construction in progress	<u>2,281,481</u>	<u>3,326,573</u>	<u>(5,175,275)</u>	<u>432,779</u>
Total capital assets, not being depreciated	<u>2,444,033</u>	<u>3,326,573</u>	<u>(5,175,275)</u>	<u>595,331</u>
Capital assets, being depreciated:				
Land improvements	234,275	7,773	182,290	424,338
Hospital buildings	8,383,980	88,711	4,639,473	13,112,164
Medical Office building	3,184,500	1,947	--	3,186,447
Fixed equipment	3,249,452	--	(97,378)	3,152,074
Major moveable equipment	<u>8,669,096</u>	<u>803,029</u>	<u>(131,314)</u>	<u>9,340,811</u>
Total capital assets, being depreciated	<u>23,721,303</u>	<u>901,460</u>	<u>4,593,071</u>	<u>29,215,834</u>
Less accumulated depreciation:				
Land improvements	151,455	20,278	--	171,733
Hospital buildings	3,554,623	379,808	--	3,934,431
Medical Office building	1,120,782	137,280	--	1,258,062
Fixed equipment	2,060,672	338,884	(96,271)	2,303,285
Major moveable equipment	<u>5,535,644</u>	<u>1,051,616</u>	<u>(241,432)</u>	<u>6,345,828</u>
Total accumulated depreciation	<u>12,423,176</u>	<u>1,927,866</u>	<u>(337,703)</u>	<u>14,013,339</u>
Total capital assets, being depreciated, net	<u>11,298,127</u>	<u>(1,026,406)</u>	<u>4,930,774</u>	<u>15,202,495</u>
Total capital assets, net	<u>\$ 13,742,160</u>	<u>2,300,167</u>	<u>(244,501)</u>	<u>15,797,826</u>
	<u>June 30,</u> <u>2002</u>	<u>Additions</u>	<u>Transfers</u> <u>and Disposals</u>	<u>June 30,</u> <u>2003</u>
Capital assets, not being depreciated:				
Land	\$ 162,552	--	--	162,552
Construction in progress	<u>141,538</u>	<u>2,303,271</u>	<u>(163,328)</u>	<u>2,281,481</u>
Total capital assets, not being depreciated	<u>304,090</u>	<u>2,303,271</u>	<u>(163,328)</u>	<u>2,444,033</u>
Capital assets, being depreciated:				
Land improvements	223,878	10,397	--	234,275
Hospital buildings	8,199,327	184,653	--	8,383,980
Medical Office building	3,184,500	--	--	3,184,500
Fixed equipment	3,228,473	20,979	--	3,249,452
Major moveable equipment	<u>9,425,225</u>	<u>776,650</u>	<u>(1,542,779)</u>	<u>8,669,096</u>
Total capital assets, being depreciated	<u>24,271,403</u>	<u>992,679</u>	<u>(1,542,779)</u>	<u>23,721,303</u>
Less accumulated depreciation:				
Land improvements	135,538	15,917	--	151,455
Hospital buildings	3,211,352	343,271	--	3,554,623
Medical Office building	983,551	137,231	--	1,120,782
Fixed equipment	1,726,003	334,669	--	2,060,672
Major moveable equipment	<u>6,032,831</u>	<u>1,152,005</u>	<u>(1,649,192)</u>	<u>5,535,644</u>
Total accumulated depreciation	<u>12,089,275</u>	<u>1,983,093</u>	<u>(1,649,192)</u>	<u>12,423,176</u>
Total capital assets, being depreciated, net	<u>12,182,128</u>	<u>(990,414)</u>	<u>106,413</u>	<u>11,298,127</u>
Total capital assets, net	<u>\$ 12,486,218</u>	<u>1,312,857</u>	<u>(56,915)</u>	<u>13,742,160</u>

Construction work in process includes costs of various projects for the Hospital related to the construction of additions to and remodeling of the existing facilities. Phase I of a three phase construction project was completed during the year at a cost of approximately \$4,800,000. Estimated costs to complete Phase II and III of the project are \$1,300,000, with completion expected during the fiscal year ending June 30, 2005. These projects will be funded primarily from the proceeds of the Hospital Revenue Capital Loan Notes, Series 2002 and cash and cash equivalents. The composition of construction work in process at June 30, 2004 and 2003 is as follows:

	<u>2004</u>	<u>2003</u>
Construction costs	\$ 401,759	1,704,133
Architect and engineering costs	2,557	373,619
Interest expense	7,814	310,965
Interest earned	(8,582)	(167,731)
All other	--	60,495
Computer project	<u>29,231</u>	<u>--</u>
	<u>\$ 432,779</u>	<u>2,281,481</u>

Subsequent to year-end, the Hospital signed commitments to purchase a new CT Scanner at a cost of approximately \$900,000 and approved and began construction of a \$500,000 addition to the building leased by Lakes Family Practice.

(6) Professional Liability Insurance

The Hospital carries a professional liability policy (including malpractice) providing coverage of \$1,000,000 for injuries per occurrence and \$3,000,000 aggregate coverage. In addition, the Hospital carries an umbrella policy which also provides \$2,000,000 per occurrence and aggregate coverage. These policies provide coverage on a claims-made basis covering only those claims which have occurred and are reported to the insurance company while the coverage is in force. In the event the Hospital should elect not to purchase insurance from the present carrier or the carrier should elect not to renew the policy, any unreported claims which occurred during the policy year may not be recoverable from the carrier.

(7) Employee Retirement and Defined Benefit Pension Plan

The Hospital contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by State statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, PO Box 9117, Des Moines, Iowa 50360-9117.

Plan members are required to contribute 3.70% of their annual salary and the Hospital is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Hospital's contribution to IPERS for the years ended June 30, 2004, 2003 and 2002 were \$415,929, \$388,701 and \$362,922, respectively, equal to the required contributions for each year.

(8) Long-Term Debt

Long-term debt activity of the Hospital as of June 30, 2004 and 2003 consisted of the following:

	<u>June 30, 2003</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30, 2004</u>	<u>Due Within One Year</u>
Capital loan notes (A)	\$ 7,505,000	--	515,000	6,990,000	540,000
	<u>June 30, 2002</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30, 2003</u>	<u>Due Within One Year</u>
Capital loan notes (A)	\$ 8,000,000	--	495,000	7,505,000	515,000
Capital loan notes (B)	2,240,000	--	2,240,000	--	--
	<u>\$ 10,240,000</u>	<u>--</u>	<u>2,735,000</u>	<u>7,505,000</u>	<u>515,000</u>

(A) On May 6, 2002, \$8,000,000 of Hospital Revenue Capital Loan Notes were issued by Lakes Regional Healthcare pursuant to the provisions of Chapter 331 and 347 of the Code of Iowa, as amended, and in conformity with a resolution of the Lakes Regional Healthcare Board of Trustees. The proceeds of the Notes will be used to retire the outstanding principal amount of Public Hospital Revenue Capital Loan Notes, Series 1993(B), and to provide funds for the construction of additions to and remodeling of the existing Hospital facilities. The interest rate on the notes is 4.50% and will reset on June 1 of the years 2007, 2012 and 2017 at the rate equal to the five-year United States Treasury Note Index plus .25%.

(B) On July 1, 1993, \$4,000,000 of Public Hospital Revenue Capital Loan Notes were issued by Dickinson County, Iowa, pursuant to the provisions of Chapters 331 and 347, of the Code of Iowa, as amended, and in conformity with a resolution of the Dickinson County Board of Supervisors. The proceeds of the Notes were used to finance the Hospital's construction and renovation project. Interest rates on the Notes vary from 5.35% to 6.40%, depending on the maturity dates. The Series 1993 notes were retired on July 1, 2002.

Annual debt service requirements related to the Notes assuming a 4.5% interest rate are as follows:

<u>Year</u>	<u>Interest Rates</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	4.50	\$ 540,000	314,550	854,550
2006	4.50	565,000	290,250	855,250
2007	4.50	590,000	264,826	854,826
2008	4.50	615,000	238,276	853,276
2009	4.50	245,000	210,600	455,600
2010 – 2014	4.50	1,415,000	876,150	2,291,150
2015 – 2019	4.50	1,760,000	528,525	2,288,525
2020 – 2022	4.50	1,260,000	115,200	1,375,200
		<u>\$ 6,990,000</u>	<u>2,838,377</u>	<u>9,828,377</u>

Under the terms of the Notes Agreements, the Hospital is required to maintain certain funds which are included in the assets whose use is limited in the financial statements.

A summary of interest expense and investment income on borrowed funds during the years ended June 30, 2004 and 2003 follows:

	<u>2004</u>	<u>2003</u>
Interest cost:		
Capitalized	\$ 220,596	269,333
Expensed	<u>115,195</u>	<u>88,192</u>
	<u>\$ 335,791</u>	<u>357,525</u>
Investment income:		
Capitalized	<u>\$ 80,798</u>	<u>144,602</u>

(10) Rental Income

The Hospital is the lessor of certain office space leased under various noncancelable operating leases through 2010. Rental income is recorded monthly as earned in other operating revenue. The future minimum rentals under these leases are as follows:

2005	\$	264,579
2006		301,084
2007		208,185
2008		199,740
2009		199,740
2010		25,576

(11) Contingencies

The Hospital is involved in litigation arising in the normal course of business. These claims are covered under policies of their previous insurance carrier. After consultation with legal counsel, management estimates these matters will be resolved without material adverse affect on the Hospital's future financial position or results from operations.

(13) Concentrations of Credit Risk

The Hospital is located in Spirit Lake, Iowa. The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors was as follows:

	<u>2004</u>	<u>2003</u>
Medicare	32.6%	37.5%
Medicaid	3.7	6.0
Blue Cross	17.2	16.6
Other third-party payors	29.6	25.3
Private pay	<u>16.9</u>	<u>14.6</u>
	<u>100.0%</u>	<u>100.0%</u>

The Hospital is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees; and natural disasters. These risks are covered by commercial insurance purchased from independent third parties. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

(14) Subsequent Events

On August 27, 2004, the Hospital purchased approximately 2.75 acres of undeveloped land for \$400,000. The use of this land is for the future expansion of hospital services.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

**Budgetary Comparison Schedule of Revenues, Expenses
and Changes in Net Assets – Budget and Actual (Cash Basis)
June 30, 2004 and 2003**

In accordance with Chapters 24 and 347 of the Code of Iowa, the Board of Trustees annually prepares and adopts a budget designating the amount necessary for the improvement and maintenance of the Hospital on the cash basis following required public notice and hearing. The Board of Trustees certifies the approved budget to the appropriate county auditors. The annual budget may be amended during the year utilizing similar statutorily-prescribed procedures. Formal and legal budgetary control is based on total expenditures.

The following is a reconciliation between reported amounts and cash disbursements and a comparison to budget:

	Actual	Accrual Adjustments	Actual	Budgeted Amounts		Variance
	Accrual Basis		Cash Basis	Original	Amended	Favorable (Unfavorable)
Estimated amount to be raised by taxation	\$ 102,996	-	102,996	100,720	100,720	2,276
Estimated other revenues / receipts	21,039,155	452,132	21,491,287	19,164,280	19,164,280	2,327,007
	21,142,151	452,132	21,594,283	19,265,000	19,265,000	2,329,283
Expenses / Disbursements	19,559,604	1,987,681	21,547,285	19,225,451	23,180,925	1,633,640
Net	1,582,547	(1,535,549)	46,998	39,549	(3,915,925)	\$ 3,962,923
Balance beginning of year	26,611,388	(8,188,081)	18,423,307	26,231,333	26,231,333	
Balance end of year	\$ 28,193,935	(9,723,630)	18,470,305	26,270,882	22,315,408	

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Patient Service Revenue
For the Years Ended June 30, 2004 and 2003

	2004				2003			
	Inpatient	Outpatient	Swing Bed	Total	Inpatient	Outpatient	Swing Bed	Total
NURSING SERVICES:								
Medical, surgical and obstetrics	\$ 2,429,367	--	--	2,429,367	2,404,995	--	--	2,404,995
Swing bed	--	--	431,588	431,588	--	--	378,656	378,656
Observation	47,957	246,644	--	294,601	62,477	217,841	--	280,318
Nursery	174,408	--	--	174,408	148,428	--	--	148,428
Coronary care	167,832	--	--	167,832	209,626	1,940	--	211,566
Telemetry	73,748	--	4,388	78,136	139,554	244	3,900	143,698
	<u>\$ 2,893,312</u>	<u>246,644</u>	<u>435,976</u>	<u>3,575,932</u>	<u>2,965,080</u>	<u>220,025</u>	<u>382,556</u>	<u>3,567,661</u>
OTHER PROFESSIONAL SERVICES:								
Operating and recovery rooms	1,599,445	3,490,896	7,439	5,097,780	1,576,111	3,223,814	--	4,799,925
Pharmacy	1,395,267	2,090,234	198,494	3,683,995	1,430,704	1,960,626	126,325	3,517,655
Central services and supply	2,347,614	1,100,614	10,185	3,458,413	2,089,182	985,803	33,920	3,108,905
Emergency and outpatient service	579,966	2,500,281	--	3,080,247	566,862	2,333,632	--	2,900,494
Laboratory	882,135	1,541,295	44,746	2,468,176	791,307	1,410,251	28,667	2,230,225
Respiratory therapy	1,291,152	70,551	277,332	1,639,035	1,275,375	103,516	197,902	1,576,793
CT scanner	440,416	1,122,874	8,663	1,571,953	410,769	1,009,633	--	1,420,402
MRI	80,059	1,369,964	6,602	1,456,625	75,058	1,201,017	2,272	1,278,347
Radiology	272,864	730,280	8,603	1,011,747	266,883	708,196	4,960	980,039
Physical therapy	164,403	689,265	88,593	942,261	180,098	572,950	93,450	846,498
Ambulance	37,349	813,200	--	850,549	92,048	746,787	--	838,835
Anesthesiology	292,592	525,882	1,333	819,807	298,192	533,542	--	831,734
Intravenous therapy	322,249	185,347	10,479	518,075	369,475	211,488	5,282	586,245
Ultrasound	78,725	402,243	5,825	486,793	77,653	435,280	399	513,332
Home Health	--	468,603	--	468,603	--	490,820	--	490,820
Electrocardiology	116,134	218,703	3,650	338,487	123,312	251,115	3,733	378,160
Blood	176,702	99,778	9,679	286,159	147,648	57,344	5,939	210,931
Oncology	1,912	260,300	1,782	263,994	1,182	232,124	74	233,380
Public Health	--	214,990	--	214,990	--	223,108	--	223,108
Hospice	214,115	--	--	214,115	59,189	--	--	59,189
Delivery and labor room	153,100	46,277	--	199,377	121,932	47,959	--	169,891
Nuclear medicine	16,009	142,313	924	159,246	18,713	--	--	18,713
Cardiac Rehab	306	132,779	--	133,085	229	123,236	--	123,465
Stress testing	5,869	92,668	--	98,537	13,731	136,256	--	149,987
Occupational therapy	13,257	28,076	17,983	59,316	11,235	33,500	22,269	67,004
Enterostomal therapy	8,110	20,875	4,665	33,650	--	--	--	--
Speech therapy	4,351	10,368	4,622	19,341	2,070	22,696	848	25,614
Electroencephalography	1,312	4,920	--	6,232	656	6,102	--	6,758
	<u>10,495,413</u>	<u>18,373,576</u>	<u>711,599</u>	<u>29,580,588</u>	<u>9,999,614</u>	<u>17,060,795</u>	<u>526,040</u>	<u>27,586,449</u>
GROSS PATIENT SERVICE REVENUE	<u>\$ 13,388,725</u>	<u>18,620,220</u>	<u>1,147,575</u>	<u>33,156,520</u>	<u>12,964,694</u>	<u>17,280,820</u>	<u>908,596</u>	<u>31,154,110</u>
LESS:								
Contractual allowances and other deductions, primarily Medicare and Medicaid				(12,655,323)				(11,726,000)
Charity care services and other discounts, based on charges forgone				(185,315)				(752,390)
NET PATIENT SERVICE REVENUE				<u>\$ 20,315,882</u>				<u>18,675,720</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Other Operating Revenue
For the Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Rental income	\$ 285,002	288,104
Meals sold	88,752	85,622
Lifeline	47,930	39,013
Meals on Wheels	47,363	48,489
Other	13,383	11,760
Home Health immunizations	3,714	8,670
Health screen	2,750	5,753
Dietary instruction	2,403	1,961
Medical records transcriptions	1,040	1,508
Physical therapy adjustment	--	32,531
	<u>\$ 492,337</u>	<u>523,411</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Departmental Expenses
For the Years Ended June 30, 2004 and 2003

	2004				2003			
	Salaries and Wages	Professional Fees and Purchased Services	Supplies and Other	Total	Salaries and Wages	Professional Fees and Purchased Services	Supplies and Other	Total
NURSING SERVICES:								
Medical and surgical	\$ 1,627,918	2,594	122,807	1,753,319	1,592,240	5,289	87,285	1,684,814
Obstetrics	136,887	--	27,625	164,512	167,928	158	20,571	140,986
Coronary care	127,458	--	6,351	133,809	111,794	269	7,069	119,132
Nursery	52,231	--	2,321	54,552	43,659	--	3,474	47,133
Administration	130,085	--	676	130,761	--	--	--	--
	<u>\$ 2,074,579</u>	<u>2,594</u>	<u>159,780</u>	<u>2,236,953</u>	<u>1,867,950</u>	<u>5,716</u>	<u>118,399</u>	<u>1,992,065</u>
OTHER PROFESSIONAL SERVICES:								
Operating and recovery room	506,936	2,149	195,553	704,638	512,148	3,250	137,668	653,066
Emergency room	324,555	829,078	36,034	1,189,667	292,995	795,032	36,618	1,124,645
Pharmacy	163,683	2,232	1,130,436	1,296,351	167,928	1,984	887,423	1,057,335
Laboratory	341,457	72,943	258,221	672,621	326,587	62,274	226,334	615,195
Home Health	351,853	31,780	44,311	427,944	367,931	43,747	44,645	456,323
Ambulance	403,368	51	53,629	457,048	383,706	95	58,893	442,694
Radiology	198,572	5,555	102,773	306,900	228,869	27,113	124,760	380,742
Physical therapy	--	336,111	19,448	355,559	--	297,309	18,927	316,236
Medical records	240,641	14,850	24,310	279,801	237,749	24,057	21,231	283,037
Respiratory therapy	172,335	900	49,447	222,682	150,059	1,271	60,796	212,126
Electrocardiology	51,164	18,495	56,912	126,571	52,860	21,145	73,093	147,098
Public health	128,968	989	27,858	157,815	138,433	355	44,784	183,572
Same day surgery	138,971	--	16,068	155,039	144,647	32	19,910	164,589
Central services and supply	36,277	--	1,407,656	1,443,933	35,234	--	1,059,784	1,095,018
Hospice	51,792	71,379	40,882	164,053	24,705	9,153	31,944	65,802
Blood bank	--	104,848	15,978	120,826	--	60,689	10,598	71,287
Oncology	85,707	11,186	16,098	112,991	76,438	6,807	11,180	94,425
Anesthesiology	--	--	106,247	106,247	--	48	98,511	98,559
Ultrasound	62,857	7,424	--	94,058	59,463	8,300	--	67,763
CT scanner	56,817	--	22,756	79,573	42,727	--	7,184	49,911
Quality assurance	72,566	--	2,719	75,285	54,151	--	352	54,503
MRI	46,663	--	28,474	75,137	48,357	--	33,724	82,081
Nuclear medicine	--	70,774	--	70,774	--	6,216	--	6,216
Delivery and labor room	50,348	--	2,683	53,031	36,440	--	1,438	37,878
Social services	23,139	--	610	23,749	22,414	--	72	22,486
Stress testing	9,345	--	328	9,673	13,299	3,095	--	16,394
Speech therapy	--	8,241	--	8,241	--	14,929	--	14,929
Enterostomal therapy	--	7,175	--	7,175	--	--	--	--
Electroencephalography	780	1,663	67	2,510	772	1,813	--	2,585
Library	--	--	421	421	--	16	468	484
	<u>\$ 3,518,794</u>	<u>1,597,823</u>	<u>3,659,919</u>	<u>8,800,313</u>	<u>3,417,912</u>	<u>1,388,730</u>	<u>3,010,337</u>	<u>7,816,979</u>
GENERAL SERVICES:								
Plant operation and maintenance	\$ 187,539	89,377	572,303	849,219	173,955	75,467	527,911	777,333
Dietary	270,455	1,003	284,947	556,405	245,525	8,335	279,718	533,578
Housekeeping	108,738	53,374	33,361	195,473	98,607	55,702	33,543	187,852
Laundry and linen	16,947	57,140	17,628	91,715	15,358	64,502	14,569	94,429
	<u>\$ 583,679</u>	<u>200,894</u>	<u>908,239</u>	<u>1,692,812</u>	<u>533,445</u>	<u>204,006</u>	<u>855,741</u>	<u>1,593,192</u>
ADMINISTRATIVE SERVICES	<u>\$ 1,220,778</u>	<u>331,632</u>	<u>472,032</u>	<u>2,024,442</u>	<u>1,165,958</u>	<u>285,624</u>	<u>452,672</u>	<u>1,904,254</u>
NONDEPARTMENTAL								
Employee Benefits	\$ --	--	2,006,639	2,006,639	--	--	1,896,196	1,896,196
Depreciation and amortization	--	--	1,930,784	1,930,784	--	--	2,018,653	2,018,653
Insurance	--	--	152,466	152,466	--	--	126,653	126,653
Interest	--	--	115,195	115,195	--	--	88,192	88,192
Provision for bad debts	--	--	600,000	600,000	--	--	742,000	742,000
	<u>\$ --</u>	<u>--</u>	<u>4,805,084</u>	<u>4,805,084</u>	<u>--</u>	<u>--</u>	<u>4,871,694</u>	<u>4,871,694</u>
TOTAL EXPENSES	<u>\$ 7,397,830</u>	<u>2,132,943</u>	<u>10,005,054</u>	<u>19,559,604</u>	<u>6,985,265</u>	<u>1,884,076</u>	<u>9,308,843</u>	<u>18,178,184</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Patient Receivables and Allowance for Doubtful Accounts
For the Years Ended June 30, 2004 and 2003

ANALYSIS OF AGING:

Days Since Discharge	2004		2003	
	Amount	Percent of Total	Amount	Percent of Total
0 - 60	\$ 3,466,226	65.88 %	4,350,406	61.43
61 - 90	417,682	7.94	460,127	6.50
91 - 180	533,040	10.13	729,228	10.30
181 - 364	534,297	10.16	887,887	12.54
> 1 year	246,991	4.69	497,342	7.02
> 2 years	63,139	1.20	157,015	2.22
	<u>5,261,375</u>	100.00 %	<u>7,082,005</u>	100.00
Less:				
Allowance for doubtful accounts	(1,367,110)		(1,688,840)	
Allowance for contractual adjustments	<u>(1,273,287)</u>		<u>(1,887,806)</u>	
	<u>\$ 2,620,978</u>		<u>\$ 3,505,359</u>	

	2004	2003
NET DAYS REVENUE IN PATIENT ACCOUNTS RECEIVABLE	47.22 days	68.51 days
ALLOWANCE FOR DOUBTFUL ACCOUNTS:		
Balance, beginning of year	\$ 1,688,840	1,226,744
Provision of uncollectible accounts	600,000	742,000
Recoveries of accounts previously written off	191,595	167,016
Accounts written off	<u>(1,113,325)</u>	<u>(446,920)</u>
Balance, end of year	<u>\$ 1,367,110</u>	<u>1,688,840</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Inventory / Prepaid Expenses
For the Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
INVENTORY:		
Surgical services	\$ 311,441	290,000
Pharmacy	123,636	119,699
Central storeroom	123,899	111,870
Radiology	26,050	29,936
Laboratory	22,608	26,028
Dietary	15,447	18,143
Fuel oil	8,480	8,480
Respiratory therapy/stress testing	2,297	3,745
	<u>\$ 633,858</u>	<u>607,901</u>
 PREPAID EXPENSES:		
Insurance	\$ 77,708	11,971
Maintenance contracts	32,605	46,258
Other	1,589	3,517
	<u>\$ 111,902</u>	<u>61,746</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Financial and Statistical Highlights
For the Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Patient days:		
Adult and pediatric-		
Medicare	3,526	3,467
Other	<u>1,567</u>	<u>1,624</u>
	5,093	5,091
Swing bed-		
Skilled	1,199	1,054
Newborn	<u>434</u>	<u>399</u>
Total	<u>6,726</u>	<u>6,544</u>
Patient discharges:		
Adult and pediatric-		
Medicare	919	839
Other	<u>541</u>	<u>568</u>
	1,460	1,407
Swing bed-		
Skilled	264	227
Newborn	<u>192</u>	<u>164</u>
Total	<u>1,916</u>	<u>1,798</u>
Average length of stay:		
Adult and pediatric-		
Medicare	3.84 days	4.13 days
Other	2.90 days	2.66 days
Swing bed-		
Skilled	4.54 days	4.64 days
Newborn	2.3 days	2.4 days
Surgical procedures	4,246	3,983
Emergency room visits	5,856	6,070
Number of employees - full-time equivalents	200.34	196.82



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

To the Board of Trustees
Lakes Regional Healthcare
Spirit Lake, Iowa:

We have audited the financial statements of LAKES REGIONAL HEALTHCARE as of and for the year ended June 30, 2004, and have issued our report thereon, dated August 27, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, Chapter 11 of the Code of Iowa, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance and Other Matters

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

Comments involving statutory and other legal matters about the Hospital's operations for the year ended June 30, 2004 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Hospital. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes. Prior year statutory comments have been resolved except for warrant approval.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting.

Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Hospital's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. We noted no matters involving the internal control over financial reporting and its operation that we consider to be a reportable condition.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. We noted no matters involving the internal control over financial reporting and its operation that we consider to be a material weakness.

This report, a public record by law, is intended solely for the information and use of the officials, employees and constituents of the Hospital and other parties to whom the Hospital may report. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of Lakes Regional Healthcare during the course of the audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

Seim, Johnson, Sestak & Quist, LLP

Omaha, Nebraska,
August 27, 2004.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2004

Part I: Summary of the Independent Auditor's Results

- (a) An unqualified opinion was issued on the financial statements.
- (b) No reportable conditions or material weaknesses in internal control over financial reporting were disclosed by the audit of the financial statements.
- (c) The audit did not disclose any non-compliance which is material to the financial statements.

Part II: Findings Related to the Financial Statements

INSTANCES OF NON-COMPLIANCE:

No matters were reported.

REPORTABLE CONDITIONS:

No reportable conditions were identified.

Part III: Other Findings Related to Required Statutory Reporting

Official Depositories: A resolution naming official depositories has been adopted by the Board. The maximum deposit amounts stated in the resolution were not exceeded during the year ended June 30, 2004.

Certified Budget: Hospital disbursements during the year ended June 30, 2004 did not exceed amounts budgeted.

Questionable Expenditure: We noted no expenditures that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

Travel Expense: No expenditures of Hospital money for travel expenses of spouses of Hospital officials and/or employees were noted.

Business Transactions: No business transactions between the Hospital and Hospital officials and/or employees were noted to violate Chapter 347.15 of the Code of Iowa which limits a trustee's pecuniary interest in the purchase or sale of any commodities or supplies procured for or disposed of by said hospital to \$1,500 without publicly invited and opened written competitive bids.

Board Minutes: - No transactions were found that we believe should have been approved in the Board minutes but were not.

Deposits and Investments: We noted no instances of noncompliance with the deposit and investment provisions of Chapter 12B and Chapter 12C of the Code of Iowa and the Hospital's investment policy.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2004

Publication of Bills Allowed and Salaries: Chapter 347.13(14) of the Code of Iowa states in part, "There shall be published quarterly in each of the official newspapers of the county as selected by the board of supervisors pursuant to Section 349.1 the schedule of bills allowed and there shall be published annually in such newspaper the schedule of salaries paid by job classification and category..." We noted no instances of noncompliance with the publication of bills allowed and salaries. The Hospital publishes a list of expenditures quarterly which are summarized by major classification and vendor. They also publish a schedule of salaries annually by category.

Warrant Approval: Chapter 347 of the Iowa Code requires that all warrants be approved by the Board of Trustees prior to issue. During the audit, we noted that many checks were issued during the month and were approved at the next Board meeting. We understand that all modern businesses must pay their bills, timely, which prevents compliance with the section of the law requiring approval prior to issue.

Recommendation: We recommend that the Hospital be aware that this practice is contrary to an Iowa law which is non-responsive to modern hospital business needs. In addition, the Board should establish policies and procedures to insure compliance with Chapter 347 of the Code of Iowa.

Response: The Board of Trustees is aware that this practice is contrary to Iowa law but feels that timely payment of bills is one component in providing complete quality medical care. The Board will continue to review and document its approval of the bills and to question any expenditures which may appear unusual.

Conclusion: Response accepted.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Audit Staff
For the Year Ended June 30, 2004

This audit was performed by:

Roger E. Thompson, FHFMA, CPA, Partner

Brian D. Green, FHFMA, CPA, Partner

Joseph L. Harnisch, Staff Auditor

Steven M. Eck, Staff Auditor