

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Basic Financial Statements
June 30, 2006 and 2005

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, 2006

<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 2010
Deb Goetzinger	Spirit Lake, Iowa	December 2008
Denny Perry	Spirit Lake, Iowa	December 2010
<u>Chief Executive Officer</u>		
Richard Kielman	Okoboji, Iowa	Indefinite
<u>Chief Financial Officer</u>		
Gordon Larson	Spirit Lake, Iowa	Indefinite



SEIM
JOHNSON
SESTAK &
QUIST, LLP

CONSULTANTS
& ACCOUNTANTS

Independent Auditor's Report

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

We have audited the accompanying basic financial statements of LAKES REGIONAL HEALTHCARE as of and for the years ended June 30, 2006 and 2005, 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, 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, 2006 and 2005, 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.

In accordance with Government Auditing Standards, we have also issued our report dated September 1, 2006 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 3 through 7 and page 25 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,
September 1, 2006.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2006 and 2005

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, 2006 and 2005. This discussion and analysis should be read in conjunction with financial statements, which begin on page 8.

Financial Highlights

- LRH net assets increased in 2006 by \$249,881 or 0.8%. In 2005, net assets increased by \$1,453,126 or 5.1%.
- LRH reported an operating loss in 2006 of \$375,098 compared to an operating income of \$955,512 in 2005.
- LRH non-operating revenues increased by \$111,964 in 2006 compared to 2005.

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 8. 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.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2006 and 2005

Net Assets

LRH net assets are the difference between assets and liabilities reported in the Balance Sheet on page 8. LRH net assets increased this past year by \$249,881 or 0.8%, as shown in **Table 1**.

Table 1: Assets, Liabilities, and Net Assets

	<u>2006</u>	<u>2005</u>	<u>Change from Prior Year</u>	<u>% Change</u>
Assets:				
Current assets	\$ 17,249,528	17,656,152	-406,624	-2.3%
Capital assets, net	18,250,466	17,762,007	488,459	2.7%
Other non-current assets	2,640,963	2,917,833	-276,870	-9.4%
Total assets	<u>38,140,957</u>	<u>38,335,992</u>	<u>-195,035</u>	<u>-0.5%</u>
Liabilities:				
Long-term debt outstanding	5,295,000	5,885,000	-590,000	-10.0%
Other current and noncurrent liabilities	2,949,015	2,803,931	145,084	5.1%
Total liabilities	<u>8,244,015</u>	<u>8,688,931</u>	<u>-444,916</u>	<u>-5.1%</u>
Net assets:				
Invested in capital assets, net of related debt	12,365,466	11,312,007	1,053,459	9.3%
Restricted for debt service	120,728	107,823	12,905	11.9%
Restricted expendable net assets	178,084	552,750	-374,666	-67.7%
Restricted nonexpendable net assets	25,000	25,000	0	0%
Unrestricted	17,207,664	17,649,481	-441,817	-2.5%
Total net assets	<u>\$ 29,896,942</u>	<u>29,647,061</u>	<u>249,881</u>	<u>0.8%</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2006 and 2005

Operating Results and Changes in LRH Net Assets

In 2006, LRH net assets increased by \$249,881 or 0.8%, 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>2006</u>	<u>2005</u>	<u>Change from Prior Year</u>	<u>Percent Change</u>
Operating Revenue:				
Net patient service revenue	\$ 21,174,339	21,543,142	(368,803)	(1.7%)
Provision for bad debt	(975,000)	(625,000)	(350,000)	56.0%
Other operating revenues	506,982	476,160	30,822	6.4%
Net assets released for operations	1,056	21,054	(19,998)	(95.0%)
Total operating revenue	20,707,377	21,415,356	(707,929)	(3.3%)
Operating Expenses:				
Salaries and benefits	10,559,463	10,042,325	517,138	5.1%
Purchased services and other	7,918,392	7,987,045	(68,653)	(0.98%)
Depreciation and amortization	2,315,664	2,152,529	163,135	7.5%
Interest	288,956	277,945	11,011	3.9%
Total operating expenses	21,082,475	20,459,844	622,631	3.0%
Operating income (loss)	(375,098)	955,512	(1,330,610)	(139.2%)
Non-operating Revenues and Expenses				
Property taxes	102,996	102,996	--	--
Investment income	568,882	401,680	167,202	41.6%
Non-capital grants and contributions	3,294	35,364	(32,070)	90.1%
Other non-operating revenues and expenses, net	(50,193)	(42,426)	(7,767)	(18.3%)
Total non-operating revenues (Expenses), net	624,979	497,614	127,365	25.5%
Increase in net assets	249,881	1,453,126	(1,302,245)	(82.8%)
Net assets beginning of year	29,647,061	28,193,935	1,453,126	5.1%
Net assets end of year	\$ 29,896,942	29,647,061	249,881	0.8%

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2006 and 2005

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. Net income decreased markedly this year due to an orthopedic surgeon leaving the area. This operating loss is inconsistent with a fifteen-year history of operating gains.

The primary components affecting operating income are:

- Decreased acute care patient days of 707 or 13.4% in 2006 compared to an increase of 217 or 4.3% in 2005.
- Net patient revenue decreased \$718,803 or 3.4% in 2006 compared to an increase of \$1,202,260 or 6.0% in 2005. Decreases in 2006 were due to reduced volumes in surgery due to an orthopedic surgeon leaving the area.
- Increased salary and benefit costs for employees of \$517,138 or 5.1% in 2006 and \$637,857 or 6.7% in 2005.
- Medical supply and drug costs decreased \$221,875 or 5.6% in 2006 and increased \$170,257 or 17.6% in 2005.
- Decreased patient service revenues in 2006 were primarily because of decreased patient volumes.

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 2006 medical supplies and prescription drug costs totaled \$3,756,832. In 2005 medical supplies and prescription drug costs totaled \$3,978,707. Part of the reason for this change is that inventories increased \$145,212 or 22.0% in 2006.

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 to \$77,033 in 2006 compared to \$144,835 in 2005. Because there is no expectation of repayment, charity care is not reported as patient service revenues of LRH.

Nonoperating Revenues and Expenses

Non-operating revenues consist primarily of property taxes levied by LRH, interest revenue, and investment earnings. The county tax levy was at \$0.08771 per \$1,000 of valuation for 2006 and \$0.08993 in 2005. The county tax levy amounted to \$102,996 in each year.

Cash Flows

Changes in cash flows are consistent with changes in operating income and nonoperating revenues and expenses, discussed earlier. Cash flows provided by operating activities decreased in 2006 due to capital purchases, including a construction project that was completed.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2006 and 2005

Capital Asset and Debt Administration

Capital Assets

At the end of 2006, LRH had \$18,250,466 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. In 2006, the LRH purchased new equipment costing \$2,942,452. Slightly more, \$4,538,838 was spent to acquire new equipment in 2005.

Debt

At year-end, the LRH had \$5,885,000 in capital loan notes outstanding. No new debt was issued in 2006 or 2005. 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 2006 fiscal year provided LRH substantial challenges due to federal program reimbursement requirements, pressures from other insurers, and the fluctuation of patient demand.

Inflation continued in 2006 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, 2006 and 2005

ASSETS	<u>2006</u>	<u>2005</u>
Current assets:		
Cash and cash equivalents	\$ 3,554,567	3,246,090
Certificates of deposit	9,009,839	9,994,630
Assets limited as to use - required for current liabilities	120,728	107,823
Receivables -		
Patients, net of allowance for doubtful accounts of \$1,420,474 in 2006 and \$1,280,133 in 2005	3,526,966	3,448,569
Other	14,421	19,113
Inventories	804,814	659,702
Prepaid expenses	<u>218,193</u>	<u>180,225</u>
Total current assets	<u>17,249,528</u>	<u>17,656,152</u>
Assets limited as to use:		
By Board for -		
Capital improvements	418,823	403,330
Endowments	2,064,613	1,977,755
Under Public Hospital Revenue Capital Loan Notes Agreement	--	377,994
By Donor	<u>137,517</u>	<u>137,493</u>
	<u>2,620,953</u>	<u>2,896,572</u>
Capital assets, net of accumulated depreciation	<u>18,250,466</u>	<u>17,762,007</u>
Other assets, net	<u>20,010</u>	<u>21,261</u>
Total assets	<u>\$ 38,140,957</u>	<u>38,335,992</u>

See notes to financial statements

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Balance Sheets
June 30, 2006 and 2005

LIABILITIES AND NET ASSETS	<u>2006</u>	<u>2005</u>
Current liabilities:		
Current portion of long-term debt	\$ 590,000	565,000
Accounts payable -		
Trade	474,339	347,507
Construction	98,060	184,119
Salaries, wages and accrued vacation payable	1,055,485	977,250
Payroll taxes withheld and accrued	94,145	87,779
Accrued interest payable	21,766	23,060
Other accrued liabilities	124,441	141,932
Deferred revenue - Mandelbaum Endowment	7,006	5,974
Estimated third-party payor settlements	<u>483,773</u>	<u>471,310</u>
Total current liabilities	2,949,015	2,803,931
Long-term debt, net of current portion	<u>5,295,000</u>	<u>5,885,000</u>
Total liabilities	<u>8,244,015</u>	<u>8,688,931</u>
Net assets:		
Invested in capital assets, net of related debt	12,365,466	11,312,007
Restricted -		
For capital acquisitions	--	377,994
For debt service	120,728	107,823
Expendable for capital acquisitions & operating activities	178,084	174,756
Nonexpendable	25,000	25,000
Unrestricted	<u>17,207,664</u>	<u>17,649,481</u>
Total net assets	<u>29,896,942</u>	<u>29,647,061</u>
Total liabilities and net assets	<u>\$ 38,140,957</u>	<u>38,335,992</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, 2006 and 2005

	<u>2006</u>	<u>2005</u>
OPERATING REVENUE:		
Net patient service revenue before provision for bad debt \$	21,174,339	21,543,142
Provision for bad debt	<u>(975,000)</u>	<u>(625,000)</u>
Net patient service revenue	20,199,339	20,918,142
Other revenue	506,982	476,160
Net assets released for operations	<u>1,056</u>	<u>21,054</u>
Total revenue	<u>20,707,377</u>	<u>21,415,356</u>
OPERATING EXPENSES:		
Salaries	8,166,252	7,879,837
Employee benefits	2,393,211	2,162,488
Purchased services and professional fees	2,373,884	2,352,296
Utilities	591,476	500,309
Supplies and other expenses	4,762,492	4,963,129
Depreciation and amortization	2,315,664	2,152,529
Insurance	190,540	171,311
Interest	<u>288,956</u>	<u>277,945</u>
Total expenses	<u>21,082,475</u>	<u>20,459,844</u>
OPERATING INCOME (LOSS)	<u>(375,098)</u>	<u>955,512</u>
NONOPERATING REVENUE, NET:		
Investment income	568,882	401,680
County tax revenue	102,996	102,996
Unrestricted gifts, grants and bequests	3,294	35,364
Loss on disposal of property and equipment	<u>(53,521)</u>	<u>(30,353)</u>
Nonoperating revenue, net	<u>621,651</u>	<u>509,687</u>
EXCESS REVENUE OVER EXPENSES BEFORE GRANTS AND CONTRIBUTIONS	246,553	1,465,199
GRANTS AND CONTRIBUTIONS, NET	<u>3,328</u>	<u>(12,073)</u>
INCREASE IN NET ASSETS	249,881	1,453,126
NET ASSETS, beginning of year	<u>29,647,061</u>	<u>28,193,935</u>
NET ASSETS, end of year	<u>\$ 29,896,942</u>	<u>29,647,061</u>

See notes to financial statements

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Statements of Cash Flows
For the Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third party payors	\$ 20,133,405	20,133,487
Cash paid to employees for salaries and benefits	(10,474,862)	(9,934,951)
Cash paid to suppliers and contractors	(7,992,131)	(8,136,462)
Other receipts and payments, net	<u>516,034</u>	<u>512,038</u>
Net cash provided by operating activities	<u>2,182,446</u>	<u>2,574,112</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
County taxes received	102,996	102,996
Unrestricted gifts, grants and bequests	<u>3,294</u>	<u>35,364</u>
Net cash provided by noncapital financing activities	<u>106,290</u>	<u>138,360</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of property and equipment, net	(2,942,452)	(4,538,838)
Payments on long-term debt	(565,000)	(540,000)
Interest paid on long-term debt	<u>(290,250)</u>	<u>(314,551)</u>
Net cash used in capital and related financing activities	<u>(3,797,702)</u>	<u>(5,393,389)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Withdrawals from assets limited as to use, net	262,738	1,972,721
Withdrawals from (deposits to) short-term investments	984,791	(4,560,462)
Interest on investments	<u>569,914</u>	<u>429,491</u>
Net cash provided by (used in) investing activities	<u>1,817,443</u>	<u>(2,158,250)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALE	308,477	(4,839,167)
CASH AND CASH EQUIVALENTS - Beginning of year	<u>3,246,090</u>	<u>8,085,257</u>
CASH AND CASH EQUIVALENTS - End of year	\$ <u>3,554,567</u>	<u>3,246,090</u>

See notes to financial statements

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Statements of Cash Flows (Continued)
For the Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ (375,098)	955,512
Adjustments to reconcile operating income to net cash provided by operating activities -		
Depreciation and amortization	2,315,664	2,152,529
Interest expense	288,956	277,945
(Increase) decrease in current assets -		
Receivables -		
Patients	(78,397)	(827,591)
Other	4,692	27,640
Inventories	(145,112)	(25,844)
Prepaid expenses	(37,968)	(68,323)
Increase (decrease) in current liabilities -		
Accounts payable	126,832	(96,234)
Due to restricted funds	3,304	(12,816)
Salaries, wages and accrued vacation payable	78,235	101,708
Payroll taxes withheld and accrued	6,366	5,666
Other accrued liabilities	(17,491)	19,930
Estimated third-party payor settlements	<u>12,463</u>	<u>63,990</u>
Net cash provided by operating activities	\$ <u>2,182,446</u>	<u>2,574,112</u>

See notes to financial statements

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Notes to Financial Statements
June 30, 2006 and 2005

(1) Description of Reporting Entity and Summary of Significant Accounting Policies

The following describes the reporting entity and 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*

The Balance Sheets display 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.

D. *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.

E. *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.

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. *Assets Limited as to Use*

By Board of Trustees - Periodically, the Hospital's Board of Trustees has set aside assets for future capital improvements and endowments. 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.

I. *Restricted Assets*

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

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

K. *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 \$1,250 for 2006 and 2005, respectively, is included in the accompanying statements of revenues, expenses and changes in net assets.

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, 2006 and 2005 was \$620,996 and \$576,563, respectively.

M. *Statement of Revenue, 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 revenue and expenses. Peripheral or incidental transactions are reported as nonoperating revenue and expenses.

N. *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.

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. *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.

Q. *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.

R. *Reclassification*

Certain amounts in the 2005 financial statements have been reclassified to conform to the 2006 reporting format.

(2) Cash and Investments

The Hospital's deposits in banks at June 30, 2006 and 2005 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, 2006 and 2005.

(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, 2004.

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 certificates of deposit designated by the Board for future capital improvements, endowments and employee health insurance claims as of June 30, 2006 and 2005, are summarized as follows:

	<u>2006</u>	<u>2005</u>
Capital Improvements -		
Cash	\$ 15,440	21,316
Certificates of deposit	400,000	380,066
Interest receivable	3,383	1,948
	<u>\$ 418,823</u>	<u>403,330</u>
Endowments -		
Cash	\$ 16,236	19,399
Certificates of deposit	2,027,596	1,940,082
Interest receivable	20,781	18,274
	<u>\$ 2,064,613</u>	<u>1,977,755</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, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Bond Fund, cash	\$ <u>120,728</u>	<u>107,823</u>
Project Fund -		
Cash and certificate of deposits	\$ --	377,965
Interest receivable	<u>--</u>	<u>29</u>
	\$ <u><u>--</u></u>	<u><u>377,994</u></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, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Mandelbaum Endowment fund		
Certificate of deposit	\$ 25,000	25,000
Hospital auxiliary assets, primarily cash and temporary cash investments	<u>112,517</u>	<u>112,493</u>
	\$ <u><u>137,517</u></u>	<u><u>137,493</u></u>

(5) **Capital Assets**

Capital assets activity for the years ended June 30, 2006 and 2005 were as follows:

	<u>June 30, 2005</u>	<u>Additions</u>	<u>Transfers and Disposals</u>	<u>June 30, 2006</u>
Capital assets, not being depreciated:				
Land	\$ 580,052	157,500	--	737,552
Construction in progress	687,427	1,628,536	(2,315,963)	--
Total capital assets, not being depreciated	<u>1,267,479</u>	<u>1,786,036</u>	<u>(2,315,963)</u>	<u>737,552</u>
Capital assets, being depreciated:				
Land improvements	504,451	30,360	--	534,811
Hospital buildings	14,186,930	136,060	(167,298)	14,155,692
Medical Office building	3,234,460	12,672	544,902	3,792,034
Fixed equipment	3,205,673	1,679	--	3,207,352
Major moveable equipment	11,386,440	1,110,672	1,082,284	13,579,396
Total capital assets, being depreciated	<u>32,517,954</u>	<u>1,291,443</u>	<u>1,459,888</u>	<u>35,269,285</u>
Less accumulated depreciation:				
Land improvements	197,847	29,994	--	227,841
Hospital buildings	4,473,328	567,376	--	5,040,704
Medical Office building	1,396,090	144,945	--	1,541,035
Fixed equipment	2,623,305	274,210	--	2,897,515
Major moveable equipment	7,332,856	1,297,888	(581,468)	8,049,276
Total accumulated depreciation	<u>16,023,426</u>	<u>2,314,413</u>	<u>(581,468)</u>	<u>17,756,371</u>
Total capital assets, being depreciated, net	<u>16,494,528</u>	<u>(1,022,970)</u>	<u>2,041,356</u>	<u>17,512,914</u>
Total capital assets, net	<u>\$ 17,762,007</u>	<u>763,066</u>	<u>(274,607)</u>	<u>18,250,466</u>
	<u>June 30, 2004</u>	<u>Additions</u>	<u>Transfers and Disposals</u>	<u>June 30, 2005</u>
Capital assets, not being depreciated:				
Land	\$ 162,552	417,500	--	580,052
Construction in progress	432,779	1,298,065	(1,043,417)	687,427
Total capital assets, not being depreciated	<u>595,331</u>	<u>1,715,565</u>	<u>(1,043,417)</u>	<u>1,267,479</u>
Capital assets, being depreciated:				
Land improvements	424,338	60,113	20,000	504,451
Hospital buildings	13,112,164	136,838	937,928	14,186,930
Medical Office building	3,186,447	48,013	--	3,234,460
Fixed equipment	3,152,074	53,599	--	3,205,673
Major moveable equipment	9,340,811	2,125,748	(80,119)	11,386,440
Total capital assets, being depreciated	<u>29,215,834</u>	<u>2,424,311</u>	<u>877,809</u>	<u>32,517,954</u>
Less accumulated depreciation:				
Land improvements	171,733	26,114	--	197,847
Hospital buildings	3,934,431	538,897	--	4,473,328
Medical Office building	1,258,062	138,028	--	1,396,090
Fixed equipment	2,303,285	320,020	--	2,623,305
Major moveable equipment	6,345,828	1,126,554	(139,526)	7,332,856
Total accumulated depreciation	<u>14,013,339</u>	<u>2,149,613</u>	<u>(139,526)</u>	<u>16,023,426</u>
Total capital assets, being depreciated, net	<u>15,202,495</u>	<u>274,698</u>	<u>1,017,335</u>	<u>16,494,528</u>
Total capital assets, net	<u>\$ 15,797,826</u>	<u>1,990,263</u>	<u>(26,082)</u>	<u>17,762,007</u>

Construction work in process at June 30, 2005 includes an addition to the building leased by Lakes Family Practice and costs associated with the installation of a new information technology system that was completed and placed into service in fiscal year 2006. The composition of construction work in process at June 30, 2006 and 2005 is as follows:

	<u>2006</u>	<u>2005</u>
Construction costs	\$ --	480,253
Architect and engineering costs	--	42,211
Computer project	--	164,963
	<u>\$ --</u>	<u>687,427</u>

(6) Long-Term Debt

Long-term debt activity of the Hospital as of June 30, 2006 and 2005 consisted of the following:

	<u>June 30, 2005</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30, 2006</u>	<u>Due Within One Year</u>
Capital loan notes (A)	\$ 6,450,000	--	565,000	5,885,000	590,000

	<u>June 30, 2004</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30, 2005</u>	<u>Due Within One Year</u>
Capital loan notes (A)	\$ 6,990,000	--	540,000	6,450,000	565,000

(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 was used to retire the outstanding principal amount of Public Hospital Revenue Capital Loan Notes, Series 1993(B), and provides 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%.

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>
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	4.50	260,000	199,575	459,575
2011	4.50	270,000	187,875	457,875
2012 - 2016	4.50	1,540,000	746,100	2,286,100
2017 - 2021	4.50	1,925,000	366,525	2,291,525
2022	4.50	440,000	19,800	459,800
		<u>\$ 5,885,000</u>	<u>2,233,577</u>	<u>8,118,577</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, 2006 and 2005 follows:

	<u>2006</u>	<u>2005</u>
Interest cost:		
Capitalized	\$ --	33,840
Expensed	<u>288,956</u>	<u>277,945</u>
	<u>\$ 288,956</u>	<u>311,785</u>
Investment income:		
Capitalized	\$ --	28,266
Earned	<u>1,425</u>	<u>2,588</u>
	<u>\$ 1,425</u>	<u>30,854</u>

(7) 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.

(8) 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, 2006, 2005 and 2004 were \$462,932, \$439,237 and \$415,929, respectively, equal to the required contributions for each year.

(9) Rental Income

The Hospital is the lessor of certain office space leased under various noncancelable operating leases through 2012. Rental income is recorded monthly as earned in other operating revenue. The future minimum rentals under these leases are as follows:

2007	\$	286,593
2008		286,593
2009		286,593
2010		124,026
2011		101,344
2012		8,445

(10) 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.

(11) 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>2006</u>	<u>2005</u>
Medicare	28.2%	32.1%
Medicaid	3.9	5.5
Blue Cross	12.8	16.6
Other third-party payors	22.8	17.2
Private pay	<u>32.3</u>	<u>28.6</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.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

**Budgetary Comparison Schedule of Revenues, Expenses
and Changes in Net Assets – Budget and Actual (Cash Basis)
June 30, 2006 and 2005**

This budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary prospective differences.

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 in accordance with Chapters 24 and 347 of the Code of Iowa. The Board of Trustees certifies the approved budget to the appropriate county auditors. The 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		Actual Cash Basis	Budgeted Amounts		Variance Favorable (Unfavorable)
	Accrual Basis	Accrual Adjustments		Original	Amended	
Estimated amount to be raised by taxation	\$ 102,996	-	102,996	101,444	101,444	1,552
Estimated other revenues / receipts	<u>21,229,360</u>	<u>(18,814)</u>	<u>21,210,546</u>	<u>24,155,275</u>	<u>24,155,275</u>	<u>(2,944,729)</u>
	21,332,356	(18,814)	21,313,542	24,256,719	24,256,719	(2,943,177)
Expenses / Disbursements	<u>21,082,475</u>	<u>1,182,220</u>	<u>22,264,695</u>	<u>24,600,100</u>	<u>24,600,100</u>	<u>2,335,405</u>
Net	249,881	(1,201,034)	(951,153)	(343,381)	(343,381)	\$ <u><u>(607,772)</u></u>
Balance beginning of year	<u>29,647,061</u>	<u>(13,501,885)</u>	<u>16,145,176</u>	<u>22,148,125</u>	<u>22,148,125</u>	
Balance end of year	\$ <u><u>29,896,942</u></u>	<u><u>(14,702,919)</u></u>	<u><u>15,194,023</u></u>	<u><u>21,804,744</u></u>	<u><u>21,804,744</u></u>	

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Patient Service Revenue
For the Years Ended June 30, 2006 and 2005

	2006				2005			
	Inpatient	Outpatient	Swing Bed	Total	Inpatient	Outpatient	Swing Bed	Total
NURSING SERVICES:								
Medical, surgical and obstetrics	2,592,730	--	--	2,592,730	2,565,621	--	--	2,565,621
Swing bed	--	--	360,680	360,680	--	--	359,932	359,932
Observation	45,249	194,585	--	239,834	58,632	254,103	--	312,735
Coronary care	196,893	--	--	196,893	159,894	--	--	159,894
Nursery	195,806	--	--	195,806	198,866	--	--	198,866
	<u>\$ 3,030,678</u>	<u>194,585</u>	<u>360,680</u>	<u>3,585,943</u>	<u>2,983,013</u>	<u>254,103</u>	<u>359,932</u>	<u>3,597,048</u>
OTHER PROFESSIONAL SERVICES:								
Operating and recovery rooms	2,218,377	3,943,165	477	6,162,019	1,852,983	3,832,097	1,369	5,686,449
Pharmacy	1,333,775	2,160,264	198,549	3,692,588	1,472,149	2,196,039	180,071	3,850,259
Central services and supply	2,263,877	1,216,905	3,135	3,483,917	2,416,026	1,182,579	2,974	3,601,579
Emergency and outpatient service	455,823	2,928,442	(349)	3,383,916	583,416	2,953,980	453	3,537,849
Laboratory	758,132	1,987,428	53,852	2,799,412	966,098	1,833,036	45,483	2,844,617
CT scanner	457,960	1,849,485	16,716	2,324,161	512,336	1,467,063	4,755	1,984,154
MRI	79,760	1,442,592	2,020	1,524,372	100,161	1,681,509	--	1,781,670
Respiratory therapy	1,031,103	86,434	205,515	1,323,052	1,290,995	96,680	240,106	1,627,781
Physical therapy	170,464	909,412	113,772	1,193,648	176,185	726,881	81,248	984,314
Radiology	274,244	765,237	12,169	1,051,650	316,138	902,774	10,356	1,229,268
Anesthesiology	396,522	559,472	--	955,994	393,801	685,285	310	1,079,396
Ambulance	129,191	784,116	4,981	918,288	38,320	927,153	--	965,473
Ultrasound	66,310	497,765	3,969	568,044	74,084	455,922	2,326	532,332
Intravenous therapy	315,472	204,029	7,915	527,416	334,700	176,173	8,166	519,039
Home Health	--	443,366	--	443,366	--	441,610	--	441,610
Oncology	259	303,854	468	304,854	1,008	257,819	424	259,251
Electrocardiology	83,910	176,734	6,534	267,178	104,351	220,774	4,200	329,325
Blood	140,848	112,472	8,757	262,077	160,592	117,546	7,048	285,186
Nuclear medicine	17,379	230,275	--	247,654	31,993	250,629	1,418	284,040
Public Health	--	211,044	--	211,044	--	254,527	--	254,527
Hospice	201,681	--	--	201,681	184,536	--	--	184,536
Delivery and labor room	152,188	25,710	--	177,898	178,014	31,755	--	209,769
Occupational therapy	18,331	124,678	30,979	173,988	13,104	55,554	18,899	87,557
Cardiac Rehab	(874)	129,582	--	128,708	--	76,118	204	76,322
Mammogram	230	125,447	--	125,677	--	--	--	--
Enterostomal therapy	9,160	60,075	5,435	74,670	16,945	53,845	7,790	78,580
Stress testing	3,975	64,862	--	68,837	6,172	83,781	--	89,953
Speech therapy	1,763	33,033	1,768	36,564	5,738	5,631	1,732	13,101
Outpatient Clinic	192	21,202	--	21,394	--	--	--	--
Electroencephalography	2,296	4,658	--	6,954	1,640	6,758	--	8,398
	<u>10,562,348</u>	<u>21,401,738</u>	<u>676,662</u>	<u>32,640,748</u>	<u>11,231,485</u>	<u>20,975,518</u>	<u>619,332</u>	<u>32,826,335</u>
GROSS PATIENT SERVICE REVENUE	<u>\$ 13,593,026</u>	<u>21,596,323</u>	<u>1,037,342</u>	<u>36,226,691</u>	<u>14,214,488</u>	<u>21,229,621</u>	<u>979,264</u>	<u>36,423,383</u>
LESS:								
Contractual allowances and other deductions, primarily Medicare and Medicaid				(14,850,936)				(14,850,936)
Charity care services and other discounts, based on charges forgone				(201,416)				(212,206)
NET PATIENT SERVICE REVENUE BEFORE PROVISION FOR BAD DEBT		\$	\$	<u>21,174,339</u>				<u>21,543,142</u>
PROVISION FOR BAD DEBT				(975,000)				(625,000)
NET PATIENT SERVICE REVENUE		\$	\$	<u>20,199,339</u>				<u>20,918,142</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Other Operating Revenue
For the Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Rental income	\$ 308,152	285,725
Meals sold	88,835	79,360
Lifeline	50,054	45,516
Meals on Wheels	35,091	40,625
Other	21,625	20,362
Dietary instruction	1,616	2,928
Medical records transcriptions	<u>1,609</u>	<u>1,644</u>
	<u>\$ 506,982</u>	<u>476,160</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa
Departmental Expenses
For the Years Ended June 30, 2006 and 2005

	2006				2005			
	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 Administration	1,561,628	3,560	105,862	1,671,050	1,631,004	1,393	134,394	1,766,791
Obstetrics	312,203	49	14,952	327,204	293,894	--	19,237	313,131
Coronary care	151,367	202	24,532	176,101	136,057	62	19,816	155,935
Nursery	125,502	311	4,664	130,477	103,962	--	3,187	107,149
	60,833	--	4,812	65,645	57,691	--	1,407	59,098
	<u>2,211,533</u>	<u>4,122</u>	<u>154,822</u>	<u>2,370,477</u>	<u>2,222,608</u>	<u>1,455</u>	<u>178,041</u>	<u>2,402,104</u>
OTHER PROFESSIONAL SERVICES:								
Central services and supply	42,512	7,995	1,297,994	1,348,501	44,213	520	1,478,504	1,523,237
Pharmacy	182,469	540	1,155,035	1,338,044	1,171,659	1,971	1,210,489	1,384,119
Emergency room	368,476	871,390	42,106	1,281,972	342,307	847,102	40,796	1,230,205
Operating and recovery room	513,231	4,635	246,789	764,655	531,938	4,090	193,191	729,219
Laboratory	385,342	87,493	244,662	717,497	369,378	86,777	258,553	714,708
Ambulance	452,406	1,123	61,507	515,036	434,434	1,559	72,876	508,869
Physical therapy	847	495,476	17,674	513,997	--	434,397	22,614	457,011
Home Health	393,932	29,919	36,687	460,538	371,288	27,081	40,146	438,515
Radiology	233,696	6,670	91,497	331,863	199,316	7,743	89,232	296,291
Medical records	268,017	15,484	28,573	312,024	254,861	15,235	26,144	296,240
Respiratory therapy	168,576	192	45,696	214,464	175,848	3,702	55,126	234,676
Public health	164,542	2,934	26,639	194,115	173,820	1,679	51,733	227,232
Same day surgery	169,255	184	20,836	190,275	141,523	--	12,134	153,657
Hospice	66,415	68,420	31,058	165,893	46,691	42,177	40,981	129,849
CT scanner	70,567	--	85,686	156,253	77,970	2,195	16,724	96,889
Oncology	94,944	9,579	31,312	135,835	78,437	8,348	11,206	97,991
Blood bank	--	92,357	22,242	114,599	--	103,144	16,802	119,946
Electrocardiology	59,946	1,373	41,966	103,285	38,518	22,860	45,688	107,066
Nuclear medicine	--	100,246	--	100,246	--	112,895	--	112,895
Quality assurance	94,398	--	1,390	95,788	92,492	--	3,089	95,581
Ultrasound	69,885	6,986	16,231	93,102	70,566	8,093	15,931	94,590
Anesthesiology	--	1,770	82,443	84,213	--	400	106,180	106,580
MR	34,671	--	40,703	75,374	43,329	22,166	21,957	87,452
Delivery and labor room	48,661	83	4,540	53,284	52,570	--	4,121	56,691
Social services	23,076	--	207	23,283	23,015	--	214	23,229
Speech therapy	--	22,487	--	22,487	--	10,842	--	10,842
Enterosomal therapy	--	16,055	226	16,281	--	15,975	--	15,975
Outpatient Clinic	11,025	30	11,547	11,547	--	--	144	9,284
Stress testing	6,289	--	6,318	6,318	9,140	--	30	2,732
Electroencephalography	469	1,770	29	2,239	649	2,053	--	2,732
Library	--	--	63	63	--	--	1,005	1,005
	<u>3,923,647</u>	<u>1,847,141</u>	<u>3,674,283</u>	<u>9,445,071</u>	<u>3,743,962</u>	<u>1,783,004</u>	<u>3,835,610</u>	<u>9,362,576</u>
GENERAL SERVICES:								
Plant operation and maintenance	212,060	126,577	690,000	1,030,637	172,474	123,871	607,306	903,651
Dietary	256,812	11,272	287,410	555,494	274,416	3,716	287,527	565,659
Housekeeping	153,845	23,780	43,570	221,195	121,733	60,084	47,210	229,027
Laundry and linen	16,851	59,682	13,231	89,764	16,577	60,725	22,372	101,674
	<u>639,568</u>	<u>223,311</u>	<u>1,034,211</u>	<u>1,897,090</u>	<u>587,200</u>	<u>248,396</u>	<u>964,415</u>	<u>1,800,011</u>
ADMINISTRATIVE SERVICES								
	1,391,504	299,310	490,652	2,181,466	1,326,067	319,441	485,372	2,130,880
	<u>8,166,252</u>	<u>2,373,884</u>	<u>10,542,339</u>	<u>21,082,475</u>	<u>7,879,837</u>	<u>2,352,296</u>	<u>10,227,711</u>	<u>20,459,844</u>
NONDEPARTMENTAL								
Employee Benefits	--	--	2,393,211	2,393,211	--	--	2,162,488	2,162,488
Depreciation and amortization	--	--	2,315,664	2,315,664	--	--	2,152,529	2,152,529
Interest	--	--	288,956	288,956	--	--	277,945	277,945
Insurance	--	--	190,540	190,540	--	--	171,311	171,311
	<u>--</u>	<u>--</u>	<u>5,188,371</u>	<u>5,188,371</u>	<u>--</u>	<u>--</u>	<u>4,764,273</u>	<u>4,764,273</u>
TOTAL EXPENSES								
	<u>8,166,252</u>	<u>2,373,884</u>	<u>10,542,339</u>	<u>21,082,475</u>	<u>7,879,837</u>	<u>2,352,296</u>	<u>10,227,711</u>	<u>20,459,844</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Patient Receivables and Allowance for Doubtful Accounts
For the Years Ended June 30, 2006 and 2005

ANALYSIS OF AGING:

Days Since Discharge	2006		2005	
	Amount	Percent of Total	Amount	Percent of Total
0 - 60	\$ 3,955,483	59.60 %	4,181,314	65.86
61 - 90	392,571	5.92	457,168	7.20
91 - 180	878,421	13.24	605,877	9.54
181 - 364	893,475	13.46	766,087	12.07
> 1 year	516,921	7.79	338,510	5.33
	<u>6,636,871</u>	100.00 %	<u>6,348,956</u>	100.00
Less:				
Allowance for doubtful accounts	(1,420,474)		(1,280,133)	
Allowance for contractual adjustments	<u>(1,689,431)</u>		<u>(1,620,254)</u>	
	<u>\$ 3,526,966</u>		<u>\$ 3,448,569</u>	

	2006	2005
NET DAYS REVENUE IN PATIENT ACCOUNTS RECEIVABLE	60.80 days	58.43 days
ALLOWANCE FOR DOUBTFUL ACCOUNTS:		
Balance, beginning of year	\$ 1,280,133	1,367,110
Provision of uncollectible accounts	975,000	625,000
Recoveries of accounts previously written off	187,222	168,782
Accounts written off	<u>(1,021,881)</u>	<u>(880,759)</u>
Balance, end of year	<u>\$ 1,420,474</u>	<u>1,280,133</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Inventory / Prepaid Expenses
For the Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
INVENTORY:		
Surgical services	\$ 454,968	326,186
Pharmacy	134,193	132,169
Central storeroom	123,277	113,127
Fuel oil	25,955	14,520
Laboratory	25,333	29,439
Dietary	19,128	17,718
Radiology	18,623	24,152
Respiratory therapy/stress testing	<u>3,337</u>	<u>2,391</u>
	<u>\$ 804,814</u>	<u>659,702</u>
 PREPAID EXPENSES:		
Insurance	\$ 181,260	143,605
Maintenance contracts	34,820	35,165
Other	<u>2,113</u>	<u>1,455</u>
	<u>\$ 218,193</u>	<u>180,225</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Financial and Statistical Highlights
For the Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Patient days:		
Adult and pediatric-		
Medicare	2,991	3,664
Other	<u>1,612</u>	<u>1,646</u>
	4,603	5,310
Swing bed-		
Skilled	991	994
Newborn	<u>444</u>	<u>449</u>
Total	<u>6,038</u>	<u>6,753</u>
Patient discharges:		
Adult and pediatric-		
Medicare	779	924
Other	<u>597</u>	<u>612</u>
	1,376	1,536
Swing bed-		
Skilled	236	238
Newborn	<u>188</u>	<u>195</u>
Total	<u>1,800</u>	<u>1,969</u>
Average length of stay:		
Adult and pediatric-		
Medicare	3.84 days	3.97 days
Other	2.70 days	2.67 days
Swing bed-		
Skilled	4.20 days	4.18 days
Newborn	2.36 days	2.3 days
Surgical procedures	4,171	4,301
Emergency room visits	6,311	6,409
Number of employees - full-time equivalents	199.94	200.81



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

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, 2006, and have issued our report thereon, dated September 1, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hospital's internal control over financial reporting 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.

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, 2006 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.

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, including federal awarding agencies and pass-through entities. 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,
September 1, 2006.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2006

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

Certified Budget: Hospital disbursements during the year ended June 30, 2006 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, 2006

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.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Audit Staff
For the Year Ended June 30, 2006

This audit was performed by:

Roger E. Thompson, FHFMA, CPA, Partner

Brian D. Green, FHFMA, CPA, Partner

Joseph L. Harnisch, CPA, Staff Auditor

Steven M. Eck, CPA, Staff Auditor