

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Basic Financial Statements
June 30, 2007 and 2006

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, 2007

<u>Board of Trustees</u>	<u>Address</u>	<u>Term Expires</u>
Ivan Brown, Chairman	Spirit Lake, Iowa	December 2012
Mark Fisher, Vice-Chairman	Milford, Iowa	December 2010
Doug Dingel, Secretary/Treasurer	Terril, Iowa	December 2008
Kris Walker	Arnolds Park, Iowa	December 2012
Dan Sedlacek	Spirit Lake, Iowa	December 2008
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

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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
Marty Dubas, CPA
Jerry O'Doherty, CPA

Independent Auditor's Report

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, 2007 and 2006, 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, 2007 and 2006, 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 17, 2007 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. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

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 6, 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 17, 2007.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2007 and 2006

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, 2007, 2006 and 2005. This discussion and analysis should be read in conjunction with financial statements, which start on page 8.

Financial Highlights

- LRH net assets increased in 2007 by \$1,471,795 or 4.9%. In 2006, net assets increased by \$249,881 or 0.8%.
- LRH reported an operating income in 2007 of \$73,709 compared to an operating loss of \$375,098 in 2006. In 2005 operating income was \$955,512.
- LRH non-operating revenues increased by \$779,234 in 2007 compared to 2006. From 2005 to 2006 non-operating revenues increased \$127,365.

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 starts 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 whether LRH, as a whole, is better or worse off from this year's activities. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All 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. Increases or decreases in net assets are an indicator of whether its financial health is improving or deteriorating. To assess the 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, and 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, 2007 and 2006

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 \$1,471,795 or 4.9%, as shown in **Table 1**. This compares to an increase in 2006 of \$249,881 and an increase of \$1,453,126 in 2005.

Table 1: Assets, Liabilities, and Net Assets

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2007 Change</u>
Assets:				
Current assets	\$ 19,422,362	17,724,528	17,656,152	9.6%
Capital assets, net	16,846,783	18,250,466	17,762,007	(7.7%)
Other non-current assets	2,952,349	2,640,963	2,917,833	11.8%
Total assets	<u>39,221,494</u>	<u>38,615,957</u>	<u>38,335,992</u>	<u>1.6%</u>
Liabilities:				
Long-term debt outstanding	4,680,000	5,295,000	5,885,000	(11.6%)
Other current and noncurrent liabilities	3,172,757	3,424,015	2,803,931	(7.3%)
Total liabilities	<u>7,852,757</u>	<u>8,719,015</u>	<u>8,688,931</u>	<u>(9.9%)</u>
Net assets:				
Invested in capital assets, net of related debt	11,551,783	12,365,466	11,312,007	(6.6%)
Restricted for debt service	134,979	120,728	107,823	11.8%
Restricted expendable net assets	179,121	178,084	552,750	0.6%
Restricted nonexpendable net assets	25,000	25,000	25,000	0%
Unrestricted	19,477,854	17,207,664	17,649,481	13.2%
Total net assets	<u>\$ 31,368,737</u>	<u>29,896,942</u>	<u>29,647,061</u>	<u>4.9%</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2007 and 2006

Operating Results and Changes in LRH Net Assets

In 2007, LRH net assets increased by \$1,471,795 or 4.9%, as shown in **Table 2**. This increase is due to an increase in operating revenue of 9.5% in 2007, while expenses increased 7.2%. Non-operating revenue increased 123.7% due to increased taxes for the operation of the County ambulance service and Public Health departments, as well as increased investment income.

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

	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>Percent Change 2007/2006</u>
Operating Revenue:				
Net patient service revenue	\$ 22,955,690	21,174,339	21,543,142	8.4%
Provision for bad debt	(765,667)	(975,000)	(625,000)	21.5%
Other operating revenue	487,776	506,982	476,160	(3.8)%
Net assets released for operations	1,648	1,056	21,054	56.1%
Total operating revenue	<u>22,679,447</u>	<u>20,707,377</u>	<u>21,415,356</u>	<u>9.5%</u>
Operating Expenses:				
Salaries and benefits	11,384,938	10,559,463	10,042,325	7.8%
Purchased services and other	8,731,035	7,918,392	7,987,045	10.2%
Depreciation and amortization	2,225,468	2,315,664	2,152,529	(3.8)%
Interest	264,297	288,956	277,945	(8.5)%
Total operating expenses	<u>22,605,738</u>	<u>21,082,475</u>	<u>20,459,844</u>	<u>7.2%</u>
Operating income (loss)	73,709	(375,098)	955,512	119.6%
Non-operating Revenues and Expenses				
Property taxes	484,106	102,996	102,996	370.0%
Investment income	782,538	568,882	401,680	37.5%
Non-capital grants and contributions	178,780	3,294	35,364	5,327.4%
Other non-operating revenues and expenses, net	(47,338)	(50,193)	(42,426)	5.6%
Total non-operating revenues (Expenses), net	<u>1,398,086</u>	<u>624,979</u>	<u>497,614</u>	<u>123.7%</u>
Increase in net assets	1,471,795	249,881	1,453,126	489.0%
Net assets beginning of year	<u>29,896,942</u>	<u>29,647,061</u>	<u>28,193,935</u>	<u>0.8%</u>
Net assets end of year	<u>\$ 31,368,737</u>	<u>29,896,942</u>	<u>29,647,061</u>	<u>4.9%</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2007 and 2006

Operating Income

The first component of the change in LRH net assets is its operating income, the difference between net patient service revenues and the expenses incurred to perform those services. Operating income increased this year due to the recruitment of an orthopedic surgeon that started practice in September 2006, and also better operating results.

The primary components affecting operating income are:

- Net patient revenue increased \$1,781,351 or 8.4% in 2007, compared to a reduction of \$368,803 or – 1.7% in 2006. In 2005 net patient revenue increased \$1,202,260 or 6.0%. Increased revenue in 2007 was mainly the result of price changes, and a new basis for Medicare payment. Decreased revenue in 2006 was due to reduced volumes in surgery as an orthopedic surgeon left the area.
- Salary and benefit costs for employees increased \$825,475 or 7.8% in 2007 compared to an increase of \$517,138 or 5.1% in 2006 and \$637,857 or 6.7% in 2005.
- Medical supply and drug costs increased in 2007 by \$630,883 or 16.8%, compared to a reduction of \$221,875 or 5.6% in 2006 and an increase of \$170,257 or 17.6% in 2005.
- Acute care patient days were 4,420 in 2007, compared to 4,598 in 2006 and 4,603 in 2005.

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 2007 medical supplies and prescription drugs cost \$4,387,715, which was a 16.8% increase from 2006. In 2006 medical supplies and prescription drugs cost \$3,756,832. In 2005 medical supplies and prescription drugs cost \$3,978,707. The cost of prescription drugs is the single largest factor in the increase this year.

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 increased to \$171,978 in 2007 compared to \$77,033 in 2006 and \$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 for ambulance and public health), interest revenue, and investment earnings. The county tax levy was \$0.33459 per \$1,000 of valuation for 2007, \$0.08771 in 2006 and \$0.08993 in 2005. The county tax levy amounted to \$467,696 in 2007 and \$102,996 in 2006 and 2005.

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 2007 as more money was invested. Non-cash expenses for depreciation and amortization exceeded cash related expenditures for capital by \$419,934 during the year.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2007 and 2006

Capital Asset and Debt Administration

Capital Assets

As of June 30, 2007 LRH had \$16,846,783 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. At June 30, 2006, LRH had \$18,250,466 invested in capital assets, net of accumulated depreciation. In 2007, LRH purchased new equipment costing \$950,709 and disposed of \$2,839,658 of discarded equipment. Capital spending in 2006 was \$2,942,452 due to a new information system and other capital acquisitions. Slightly more, \$4,538,838 was spent to acquire new equipment in 2005.

Debt

At year-end, LRH had \$5,295,000 in capital loan notes outstanding. No new debt was issued in 2007, 2006 or 2005. The 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 three years.

Other Economic Factors

The 2006 fiscal year provided LRH substantial challenges due to federal program reimbursement requirements, pressures from other insurers, and fluctuating patient demand.

Inflation continued in 2007 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 more information should be directed to:

Gordon Larson
Senior Vice President
Lakes Regional Healthcare
Highway 71 South
Spirit Lake, Iowa 51360
712-336-8796

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Balance Sheets
June 30, 2007 and 2006

ASSETS	<u>2007</u>	<u>2006</u>
Current assets:		
Cash and cash equivalents	\$ 2,820,617	3,554,567
Certificates of deposit	11,506,476	9,009,839
Assets limited as to use - required for current liabilities	134,979	120,728
Receivables -		
Patients, net of allowance for doubtful accounts of \$1,411,663 in 2007 and \$1,420,474 in 2006	3,516,184	3,526,966
Succeeding year property tax	350,000	475,000
Other	21,926	14,421
Inventories	878,375	804,814
Prepaid expenses	<u>193,805</u>	<u>218,193</u>
Total current assets	<u>19,422,362</u>	<u>17,724,528</u>
Assets limited as to use:		
By Board for -		
Capital improvements	439,815	418,823
Endowments	2,360,093	2,064,613
By Donor	<u>133,681</u>	<u>137,517</u>
	<u>2,933,589</u>	<u>2,620,953</u>
Capital assets, net of accumulated depreciation	<u>16,846,783</u>	<u>18,250,466</u>
Other assets, net	<u>18,760</u>	<u>20,010</u>
Total assets	<u>\$ 39,221,494</u>	<u>38,615,957</u>

See notes to financial statements

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Balance Sheets
June 30, 2007 and 2006

LIABILITIES AND NET ASSETS	<u>2007</u>	<u>2006</u>
Current liabilities:		
Current portion of long-term debt	\$ 615,000	590,000
Accounts payable -		
Trade	471,328	474,339
Construction	12,425	98,060
Salaries, wages and accrued vacation payable	1,143,756	1,055,485
Payroll taxes withheld and accrued	102,134	94,145
Accrued interest payable	21,238	21,766
Other accrued liabilities	128,935	124,441
Deferred revenue - Mandelbaum Endowment	7,327	7,006
Estimated third-party payor settlements	320,614	483,773
Deferred revenue for succeeding year property tax receivable	<u>350,000</u>	<u>475,000</u>
Total current liabilities	3,172,757	3,424,015
Long-term debt, net of current portion	<u>4,680,000</u>	<u>5,295,000</u>
Total liabilities	<u>7,852,757</u>	<u>8,719,015</u>
Net assets:		
Invested in capital assets, net of related debt	11,551,783	12,365,466
Restricted -		
For debt service	134,979	120,728
Expendable for capital acquisitions & operating activities	179,121	178,084
Nonexpendable	25,000	25,000
Unrestricted	<u>19,477,854</u>	<u>17,207,664</u>
Total net assets	<u>31,368,737</u>	<u>29,896,942</u>
Total liabilities and net assets	\$ <u>39,221,494</u>	<u>38,615,957</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, 2007 and 2006

	<u>2007</u>	<u>2006</u>
OPERATING REVENUE:		
Net patient service revenue before provision for bad debt \$	22,955,690	21,174,339
Provision for bad debt	<u>(765,667)</u>	<u>(975,000)</u>
Net patient service revenue	22,190,023	20,199,339
Other revenue	487,776	506,982
Net assets released for operations	<u>1,648</u>	<u>1,056</u>
Total revenue	<u>22,679,447</u>	<u>20,707,377</u>
OPERATING EXPENSES:		
Salaries	8,806,409	8,166,252
Employee benefits	2,578,529	2,393,211
Purchased services and professional fees	2,402,872	2,373,884
Utilities	586,115	591,476
Supplies and other expenses	5,536,440	4,762,492
Depreciation and amortization	2,225,468	2,315,664
Insurance	205,608	190,540
Interest	<u>264,297</u>	<u>288,956</u>
Total expenses	<u>22,605,738</u>	<u>21,082,475</u>
OPERATING INCOME (LOSS)	<u>73,709</u>	<u>(375,098)</u>
NONOPERATING REVENUE, NET:		
Investment income	782,538	568,882
County tax revenue	484,106	102,996
Unrestricted gifts, grants and bequests	178,780	3,294
Loss on disposal of property and equipment	<u>(44,539)</u>	<u>(53,521)</u>
Nonoperating revenue, net	<u>1,400,885</u>	<u>621,651</u>
EXCESS REVENUE OVER EXPENSES BEFORE GRANTS AND CONTRIBUTIONS	1,474,594	246,553
GRANTS AND CONTRIBUTIONS, NET	<u>(2,799)</u>	<u>3,328</u>
INCREASE IN NET ASSETS	1,471,795	249,881
NET ASSETS, beginning of year	<u>29,896,942</u>	<u>29,647,061</u>
NET ASSETS, end of year	\$ <u>31,368,737</u>	<u>29,896,942</u>

See notes to financial statements

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Statements of Cash Flows
For the Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third party payors	\$ 22,033,810	20,133,405
Cash paid to employees for salaries and benefits	(11,288,678)	(10,474,862)
Cash paid to suppliers and contractors	(8,778,725)	(7,992,131)
Other receipts and payments, net	<u>486,792</u>	<u>516,034</u>
Net cash provided by operating activities	<u>2,453,199</u>	<u>2,182,446</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
County taxes received	484,106	102,996
Unrestricted gifts, grants and bequests	<u>178,780</u>	<u>3,294</u>
Net cash provided by noncapital financing activities	<u>662,886</u>	<u>106,290</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of property and equipment, net	(950,709)	(2,942,452)
Payments on long-term debt	(590,000)	(565,000)
Interest paid on long-term debt	<u>(264,825)</u>	<u>(290,250)</u>
Net cash used in capital and related financing activities	<u>(1,805,534)</u>	<u>(3,797,702)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Withdrawals from (deposits to) assets limited as to use, net	(330,723)	262,738
Withdrawals from (deposits to) short-term investments	(2,496,637)	984,791
Interest on investments	<u>782,859</u>	<u>569,914</u>
Net cash provided by (used in) investing activities	<u>(2,044,501)</u>	<u>1,817,443</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(733,950)	308,477
CASH AND CASH EQUIVALENTS - Beginning of year	<u>3,554,567</u>	<u>3,246,090</u>
CASH AND CASH EQUIVALENTS - End of year	<u>\$ 2,820,617</u>	<u>3,554,567</u>

See notes to financial statements

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Statements of Cash Flows (Continued)
For the Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income (loss)	\$ 73,709	(375,098)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities -		
Depreciation and amortization	2,225,468	2,315,664
Interest expense	264,297	288,956
(Increase) decrease in current assets -		
Receivables -		
Patients	10,782	(78,397)
Other	(7,505)	4,692
Inventories	(73,561)	(145,112)
Prepaid expenses	24,388	(37,968)
Increase (decrease) in current liabilities -		
Accounts payable	(3,011)	126,832
Due to restricted funds	1,037	3,304
Salaries, wages and accrued vacation payable	88,271	78,235
Payroll taxes withheld and accrued	7,989	6,366
Other accrued liabilities	4,494	(17,491)
Estimated third-party payor settlements	<u>(163,159)</u>	<u>12,463</u>
Net cash provided by operating activities	\$ <u>2,453,199</u>	<u>2,182,446</u>

See notes to financial statements

LAKES REGIONAL HEALTHCARE

Spirit Lake, Iowa

Notes to Financial Statements June 30, 2007 and 2006

(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. Property Tax Receivable

Property tax receivable is recognized on the levy or lien date, which is the date the tax asking is certified by the County Board of Supervisors. Delinquent property tax receivable represents unpaid taxes for the current and prior years. The succeeding year property tax receivable represents taxes certified by the Board of Trustees to be collected in the next fiscal year for the purposes set out in the budget for the next fiscal year. By statute, the Board of Trustees is required to certify the budget in March of each year for the subsequent fiscal year. However, by statute, the tax asking and budget certification for the following fiscal year becomes effective on the first day of that year. Although the succeeding year property tax receivable has been recorded, the related revenue is deferred and will not be recognized as revenue until the year for which it is levied.

K. 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

L. 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 \$1,251 for 2007 and 2006, respectively, is included in the accompanying statements of revenues, expenses and changes in net assets.

M. 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, 2007 and 2006 was \$629,062 and \$620,996, respectively.

N. Deferred Revenue

Although certain revenues are measurable, they are not available. Available means collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period. Deferred revenue represents the amount of assets that have been recognized but the related revenue has not been recognized since the assets are not collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period. Deferred revenue consists of the succeeding year property tax receivable.

O. 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.

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. 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.

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. *Reclassification*

Certain amounts in the 2006 financial statements have been reclassified to conform to the 2007 reporting format.

(2) **Cash and Investments**

The Hospital's deposits in banks at June 30, 2007 and 2006 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, 2007 and 2006.

(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, 2005.

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, 2007 and 2006, are summarized as follows:

	<u>2007</u>	<u>2006</u>
Capital Improvements -		
Cash	\$ 1,874	15,440
Certificates of deposit	435,000	400,000
Interest receivable	<u>2,941</u>	<u>3,383</u>
	<u>\$ 439,815</u>	<u>418,823</u>
Endowments -		
Cash	\$ 12,759	16,236
Certificates of deposit	2,314,061	2,027,596
Interest receivable	<u>33,273</u>	<u>20,781</u>
	<u>\$ 2,360,093</u>	<u>2,064,613</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).

The amounts as of June 30, 2007 and 2006 are as follows:

	<u>2007</u>	<u>2006</u>
Bond Fund, cash	\$ <u>134,979</u>	<u>120,728</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, 2007 and 2006 are as follows:

	<u>2007</u>	<u>2006</u>
Mandelbaum Endowment fund Certificate of deposit	\$ 25,000	25,000
Hospital auxiliary assets, primarily cash and temporary cash investments	<u>108,681</u>	<u>112,517</u>
	<u>\$ 133,681</u>	<u>137,517</u>

(5) Capital Assets

Capital assets activity for the years ended June 30, 2007 and 2006 were as follows:

	June 30, 2006	Additions	Transfers and Disposals	June 30, 2007
Capital assets, not being depreciated:				
Land	\$ 737,552	--	(15,000)	722,552
Construction in progress	--	--	--	--
Total capital assets, not being depreciated	<u>737,552</u>	<u>--</u>	<u>(15,000)</u>	<u>722,552</u>
Capital assets, being depreciated:				
Land improvements	534,811	42,317	--	577,128
Hospital buildings	14,155,692	291,697	(23,981)	14,423,408
Medical Office building	3,792,034	2,000	--	3,794,034
Fixed equipment	3,207,352	16,000	(36,138)	3,187,214
Major moveable equipment	13,579,396	535,604	(3,097,829)	11,017,171
Total capital assets, being depreciated	<u>35,269,285</u>	<u>887,618</u>	<u>(3,157,948)</u>	<u>32,998,955</u>
Less accumulated depreciation:				
Land improvements	227,841	29,718	--	257,559
Hospital buildings	5,040,704	578,027	(22,705)	5,596,026
Medical Office building	1,541,035	140,289	--	1,681,324
Fixed equipment	2,897,515	48,347	(22,047)	2,923,815
Major moveable equipment	8,049,276	1,427,836	(3,061,112)	6,416,000
Total accumulated depreciation	<u>17,756,371</u>	<u>2,224,217</u>	<u>(3,105,864)</u>	<u>16,874,724</u>
Total capital assets, being depreciated, net	<u>17,512,914</u>	<u>(1,336,599)</u>	<u>(52,084)</u>	<u>16,124,231</u>
Total capital assets, net	<u>\$ 18,250,466</u>	<u>(1,336,599)</u>	<u>(67,084)</u>	<u>16,846,783</u>
	June 30, 2005	Additions	Transfers and Disposals	June 30, 2006
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>

(6) Long-Term Debt

Long-term debt activity of the Hospital as of June 30, 2007 and 2006 consisted of the following:

	<u>June 30, 2006</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30, 2007</u>	<u>Due Within One Year</u>
Capital loan notes (A)	\$ 5,885,000	--	590,000	5,295,000	615,000

	<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

(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 4.88% and will reset on June 1 of the years 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 4.88% interest rate are as follows:

<u>Year</u>	<u>Interest Rates</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	4.88	\$ 615,000	261,037	876,037
2009	4.88	245,000	230,719	475,719
2010	4.88	260,000	218,640	478,640
2011	4.88	270,000	205,823	475,823
2012	4.88	280,000	192,512	472,512
2013 – 2017	4.88	1,610,000	741,454	2,351,454
2018 – 2022	4.88	2,015,000	306,639	2,321,639
		\$ 5,295,000	2,156,824	7,451,824

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.

The Hospital recognized interest expense of \$264,297 and \$288,956 during the years ended June 30, 2007 and 2006, respectively.

(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, 2007, 2006 and 2005 were \$491,935, \$462,932 and \$439,237, 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:

2008	\$	288,560
2009		288,560
2010		124,189
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>2007</u>	<u>2006</u>
Medicare	29.9%	28.2%
Medicaid	4.8	3.9
Blue Cross	15.6	12.8
Other third-party payors	16.5	22.8
Private pay	<u>33.2</u>	<u>32.3</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, 2007 and 2006**

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 resulting from the Hospital preparing a budget on the cash basis of accounting.

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.

For the year ended June 30, 2007, the Hospital's expenditures did not exceed the amount budgeted.

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

	Actual Accrual Basis	Accrual Adjustments	Actual Cash Basis	Budgeted Amounts	Variance Favorable (Unfavorable)
Estimated amount to be raised by taxation	\$ 484,106	-	484,106	467,696	16,410
Estimated other revenues / receipts	<u>23,593,427</u>	<u>(142,707)</u>	<u>23,450,720</u>	<u>23,492,379</u>	<u>(41,659)</u>
	24,077,533	(142,707)	23,934,826	23,960,075	(25,249)
Expenses / Disbursements	<u>22,605,738</u>	<u>(732,801)</u>	<u>21,872,937</u>	<u>30,562,300</u>	<u>(8,689,363)</u>
Net	1,471,795	590,094	2,061,889	\$ <u>(6,602,225)</u>	<u>8,664,114</u>
Balance beginning of year	<u>29,896,942</u>	<u>(14,702,919)</u>	<u>15,194,023</u>		
Balance end of year	\$ <u><u>31,368,737</u></u>	<u><u>(14,112,825)</u></u>	<u><u>17,255,912</u></u>		

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Patient Service Revenue
For the Years Ended June 30, 2007 and 2006

	2007			2006				
	Inpatient	Outpatient	Swing Bed	Total	Inpatient	Outpatient	Swing Bed	Total
NURSING SERVICES:								
Medical, surgical and obstetrics	\$ 2,571,517	376,540	--	2,948,057	2,592,730	--	--	2,592,730
Swing bed	--	--	510,198	510,198	--	--	360,680	360,680
Observation	35,555	149,668	--	185,223	45,249	--	--	239,834
Coronary care	176,850	--	--	176,850	196,893	--	--	196,893
Nursery	179,415	--	--	179,415	195,806	--	--	195,806
	<u>2,963,337</u>	<u>526,208</u>	<u>510,198</u>	<u>3,999,743</u>	<u>3,030,678</u>	<u>194,585</u>	<u>360,680</u>	<u>3,585,943</u>
OTHER PROFESSIONAL SERVICES:								
Operating and recovery rooms	1,464,591	4,214,236	1,811	5,680,638	2,218,377	3,943,165	477	6,162,019
Pharmacy	1,292,076	3,786,251	341,906	5,390,233	1,333,775	2,160,264	198,549	3,692,588
Central services and supply	2,080,692	1,440,379	13,490	3,534,561	2,263,877	1,216,905	3,135	3,483,917
Emergency and outpatient service	595,070	3,073,114	467	3,668,651	435,823	2,928,442	(349)	3,363,916
Laboratory	805,491	2,265,501	81,727	3,152,719	758,132	1,987,428	53,852	2,799,412
CT scanner	391,185	1,637,784	(4,498)	2,024,471	457,960	1,849,485	16,716	2,324,161
MRI	76,948	1,279,396	--	1,356,344	79,760	1,442,592	2,020	1,524,372
Respiratory therapy	1,058,447	99,575	377,850	1,535,872	1,031,103	86,434	205,515	1,323,052
Physical therapy	156,750	751,923	124,457	1,033,130	170,464	909,412	113,772	1,193,648
Radiology	197,684	770,613	12,789	981,086	274,244	765,237	12,169	1,051,650
Anesthesiology	270,369	523,758	--	794,127	396,522	559,472	--	955,994
Ambulance	187,887	721,976	5,612	915,475	129,191	784,116	4,981	918,288
Ultrasound	66,175	522,337	5,837	594,349	66,310	497,765	3,969	588,044
Intravenous therapy	301,122	472,148	17,980	791,250	315,472	204,029	7,915	527,416
Home Health	--	676,317	--	676,317	--	443,366	--	(443,366)
Oncology	3,902	496,429	112	500,443	259	303,854	468	304,581
Electrocardiology	81,927	172,910	5,617	260,354	83,910	176,734	6,534	267,178
Blood	168,507	151,150	11,221	330,878	140,848	112,472	8,757	262,077
Nuclear medicine	13,450	199,242	3,251	215,943	17,379	230,275	--	247,654
Public Health	244,171	216,890	--	461,061	--	211,044	--	(211,044)
Delivery and labor room	152,536	27,757	--	180,293	201,681	--	--	201,681
Occupational therapy	9,333	150,244	20,521	180,098	152,188	25,710	--	177,898
Cardiac Rehab	--	115,291	--	115,291	18,331	124,678	30,979	173,988
Mammogram	1,158	193,060	--	194,218	(874)	129,582	--	128,708
Enterostomal therapy	9,800	66,855	6,960	83,415	230	125,447	5,435	125,677
Stress testing	2,642	62,728	--	65,370	9,160	60,075	--	74,670
Speech therapy	3,349	46,224	5,039	54,612	3,975	64,862	--	68,837
Outpatient Clinic	2,950	159,571	--	162,521	1,763	33,033	1,768	36,564
Electroencephalography	328	20,578	--	20,906	192	21,202	--	21,394
	<u>9,640,340</u>	<u>24,284,137</u>	<u>1,032,149</u>	<u>34,956,626</u>	<u>10,562,348</u>	<u>21,401,138</u>	<u>676,662</u>	<u>32,640,748</u>
GROSS PATIENT SERVICE REVENUE	\$ 12,603,677	\$ 24,810,345	\$ 1,542,347	\$ 38,956,369	\$ 13,593,026	\$ 21,596,323	\$ 1,037,342	\$ 36,226,691
LESS:								
Contractual allowances and other deductions, primarily Medicare and Medicaid				(15,519,707)				(14,850,936)
Charity care services and other discounts, based on charges forgone				(480,972)				(201,416)
NET PATIENT SERVICE REVENUE BEFORE PROVISION FOR BAD DEBT				\$ 22,955,690				\$ 21,174,339
PROVISION FOR BAD DEBT				(765,667)				(675,000)
NET PATIENT SERVICE REVENUE				\$ 22,190,023				\$ 20,199,339

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Other Operating Revenue
For the Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Rental income	\$ 292,693	308,152
Meals sold	92,277	88,835
Lifeline	57,350	50,054
Meals on Wheels	20,129	35,091
Other	22,573	21,625
Dietary instruction	1,552	1,616
Medical records transcriptions	<u>1,202</u>	<u>1,609</u>
	<u>\$ 487,776</u>	<u>506,982</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Departmental Expenses
For the Years Ended June 30, 2007 and 2006

	2007			2006				
	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	2,098,346	12,102	186,896	2,296,344	1,561,628	3,560	105,962	1,671,050
Administration	344,187	-	21,917	366,104	312,203	49	14,952	327,204
Obstetrics	141,312	111	21,923	163,346	151,367	202	24,532	176,101
Coronary Care	103,498	-	8,135	111,633	125,502	311	4,864	130,477
Nursery	65,422	-	3,922	69,044	60,833	-	4,812	65,845
	<u>2,752,765</u>	<u>12,213</u>	<u>241,492</u>	<u>3,006,471</u>	<u>2,211,533</u>	<u>4,122</u>	<u>154,622</u>	<u>2,370,477</u>
OTHER PROFESSIONAL SERVICES:								
Central services and supply	51,069	2,286	1,204,355	1,257,710	42,512	7,995	1,297,984	1,348,501
Pharmacy	185,691	53	1,834,106	2,019,852	182,469	540	1,155,035	1,338,044
Emergency room	370,650	912,570	34,017	1,317,237	368,476	871,390	42,106	1,281,972
Operating and recovery room	524,347	20,191	297,596	842,134	513,231	4,835	246,789	764,855
Laboratory	388,208	108,760	250,429	757,397	385,342	87,493	244,662	717,497
Ambulance	469,754	2,130	61,702	533,586	452,406	1,123	61,507	515,036
Physical therapy	-	406,192	20,078	426,270	847	495,476	17,674	513,997
Home Health	413,283	30,107	42,224	485,614	393,532	29,919	36,687	460,538
Radiology	244,340	4,954	66,997	316,291	233,696	6,670	91,497	331,863
Medical records	263,650	14,451	34,687	312,988	268,017	15,434	28,573	312,024
Respiratory therapy	141,113	8,460	53,269	202,842	168,576	192	45,696	214,464
Public health	176,308	1,055	23,426	200,789	164,542	2,934	26,639	194,115
Same day surgery	154,783	189	14,015	168,987	169,255	184	20,636	190,275
Hospice	65,856	39,363	29,591	134,810	66,415	68,420	31,058	165,893
Hospital	68,657	105	160,103	228,865	70,567	-	85,686	156,253
CT scanner	99,693	5,914	16,045	121,642	94,944	-	31,312	135,835
Oncology	-	120,477	22,343	142,820	-	92,357	22,242	114,569
Blood bank	65,068	36,883	6,794	110,745	59,946	1,373	41,966	103,285
Electrocardiology	-	89,653	-	89,653	-	100,246	-	100,246
Nuclear medicine	95,823	543	1,799	98,165	94,398	-	1,390	95,788
Quality assurance	64,411	5,536	15,720	85,667	69,885	6,986	16,231	93,102
Ultrasound	-	913	64,802	65,715	-	1,770	82,443	84,213
Anesthesiology	29,301	-	27,487	56,788	-	-	40,703	75,374
MR	51,376	-	10,475	61,851	34,671	83	4,540	53,283
Delivery and labor room	23,944	-	60	24,004	23,076	-	207	23,283
Social services	-	37,409	-	37,409	-	22,487	-	22,487
Speech therapy	-	22,484	-	22,484	-	18,055	-	18,281
Enterostomal therapy	72,005	907	1,077	73,989	11,025	30	462	11,547
Outpatient Clinic	4,268	-	20,774	25,042	6,289	-	29	6,318
Stress testing	355	550	-	905	489	-	-	2,239
Electroencephalography	-	-	-	-	-	1,770	-	-
Library	4,034,153	1,878,155	67	5,912,365	3,923,647	1,847,141	63	5,760,851
GENERAL SERVICES:								
Plant operation and maintenance	213,040	157,126	663,708	1,033,874	212,060	128,577	690,000	1,030,637
Dietary	276,289	9,836	271,868	557,993	256,812	11,272	287,410	555,494
Housekeeping	173,897	8,265	50,920	233,072	153,845	23,780	43,570	221,195
Laundry and linen	17,555	49,832	16,463	83,851	16,851	59,682	13,231	89,764
	<u>680,772</u>	<u>225,052</u>	<u>1,022,959</u>	<u>1,928,784</u>	<u>539,568</u>	<u>273,311</u>	<u>1,034,211</u>	<u>1,897,090</u>
ADMINISTRATIVE SERVICES	<u>1,338,219</u>	<u>289,465</u>	<u>542,063</u>	<u>2,169,747</u>	<u>1,391,504</u>	<u>299,308</u>	<u>490,653</u>	<u>2,181,465</u>
NONDEPARTMENTAL								
Employee Benefits	-	-	2,578,529	2,578,529	-	-	2,393,211	2,393,211
Depreciation and amortization	-	-	2,225,468	2,225,468	-	-	2,315,664	2,315,664
Interest	-	-	264,297	264,297	-	-	288,956	288,956
Insurance	-	-	205,608	205,608	-	-	190,540	190,540
	<u>8,905,409</u>	<u>2,402,872</u>	<u>11,395,457</u>	<u>22,603,738</u>	<u>8,166,252</u>	<u>2,373,883</u>	<u>10,542,349</u>	<u>21,982,475</u>
TOTAL EXPENSES								

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Patient Receivables and Allowance for Doubtful Accounts
For the Years Ended June 30, 2007 and 2006

ANALYSIS OF AGING:

Days Since Discharge	2007		2006	
	Amount	Percent of Total	Amount	Percent of Total
0 - 60	\$ 4,441,861	66.45 %	3,955,483	59.60 %
61 - 90	465,926	6.97	392,571	5.92
91 - 180	658,002	9.84	878,421	13.24
181 - 364	482,226	7.21	893,475	13.46
> 1 year	636,798	9.53	516,921	7.78
	<u>6,684,813</u>	100.00 %	<u>6,636,871</u>	100.00 %
Less:				
Allowance for doubtful accounts	(1,411,663)		(1,420,474)	
Allowance for contractual adjustments	<u>(1,756,966)</u>		<u>(1,689,431)</u>	
	<u>\$ 3,516,184</u>		<u>\$ 3,526,966</u>	

	2007	2006
NET DAYS REVENUE IN PATIENT ACCOUNTS RECEIVABLE	56.87 days	60.80 days
ALLOWANCE FOR DOUBTFUL ACCOUNTS:		
Balance, beginning of year	\$ 1,420,474	1,280,133
Provision of uncollectible accounts	765,667	975,000
Recoveries of accounts previously written off	281,558	187,222
Accounts written off	<u>(1,056,036)</u>	<u>(1,021,881)</u>
Balance, end of year	<u>\$ 1,411,663</u>	<u>1,420,474</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Inventory / Prepaid Expenses
For the Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
INVENTORY:		
Surgical services	\$ 481,179	454,968
Pharmacy	179,250	134,193
Central storeroom	120,885	123,277
Laboratory	30,209	25,333
Fuel oil	24,997	25,955
Dietary	17,053	19,128
Radiology	12,898	18,623
Computers	7,879	--
Respiratory therapy/stress testing	4,025	3,337
	<u>\$ 878,375</u>	<u>804,814</u>
PREPAID EXPENSES:		
Insurance	\$ 125,697	181,260
Maintenance contracts	65,781	34,820
Other	2,327	2,113
	<u>\$ 193,805</u>	<u>218,193</u>

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Financial and Statistical Highlights
For the Years Ended June 30, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Patient days:		
Adult and pediatric-		
Medicare	2,954	2,991
Other	<u>1,466</u>	<u>1,612</u>
	4,420	4,603
Swing bed-		
Skilled	1,336	991
Newborn	<u>404</u>	<u>444</u>
Total	<u>6,160</u>	<u>6,038</u>
Patient discharges:		
Adult and pediatric-		
Medicare	790	779
Other	<u>538</u>	<u>597</u>
	1,328	1,376
Swing bed-		
Skilled	234	236
Newborn	<u>178</u>	<u>188</u>
Total	<u>1,740</u>	<u>1,800</u>
Average length of stay:		
Adult and pediatric-		
Medicare	3.74 days	3.84 days
Other	2.72 days	2.70 days
Swing bed-		
Skilled	5.71 days	4.20 days
Newborn	2.27 days	2.36 days
Surgical procedures	3,716	4,171
Emergency room visits	6,136	6,311
Number of employees - full-time equivalents	200.69	199.94

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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 years ended June 30, 2007 and 2006, and have issued our report thereon, dated September 17, 2007. 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 but not for the purpose of expressing our opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control over financial reporting.

A control deficiency exists when the design or operation of the control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Hospital's ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood a misstatement of the Hospital's financial statements that is more than inconsequential will not be prevented or detected by the Hospital's internal control. We noted no deficiencies in internal control that we consider to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood a material misstatement of the financial statements will not be prevented or detected by the Hospital's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses. We noted no matters involving the internal control over financial reporting and its operations 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.

Comments involving statutory and other legal matters about the Hospital's operations for the year ended June 30, 2007 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, Seaton & Quist, LLP

Omaha, Nebraska,
September 17, 2007.

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2007

Part I: Summary of the Independent Auditor's Results

- (a) An unqualified opinion was issued on the financial statements.
- (b) No significant deficiencies 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.

SIGNIFICANT DEFICIENCIES:

No significant deficiencies were identified.

Part III: Other Findings Related to Required Statutory Reporting

Certified Budget: Hospital disbursements during the year ended June 30, 2007 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, 2007

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, 2007

This audit was performed by:

Roger E. Thompson, FHFMA, CPA, Partner

Brian D. Green, FHFMA, CPA, Partner

Joseph L. Harnisch, CPA, Manager

LeAnne Kaiser, Staff Auditor