

LAKES REGIONAL HEALTHCARE
Spirit Lake, Iowa

Basic Financial Statements
June 30, 2008 and 2007

Together with Independent Auditor's Report

Table of Contents

	<u>Page No.</u>
Officials -- June 30, 2008	1
Independent Auditor's Report	2
Management's Discussion and Analysis	3 – 7
Basic Financial Statements:	
Balance Sheets	
June 30, 2008 and 2007	8 – 9
Statements of Revenue, Expenses and Changes in Net Assets	
For the Years Ended June 30, 2008 and 2007	10
Statements of Cash Flows	
For the Years Ended June 30, 2008 and 2007	11 – 12
Notes to Financial Statements	
June 30, 2008 and 2007	13 – 22
Required Supplementary Information:	
Budgetary Comparison Schedule of Revenues, Expenses and Changes in Net Assets – Budget and Actual (Cash Basis)	23
Other Supplementary Information:	
Exhibit 1 - Patient Service Revenue	
For the Years Ended June 30, 2008 and 2007	24
Exhibit 2 - Other Operating Revenue	
For the Years Ended June 30, 2008 and 2007	25
Exhibit 3 - Departmental Expenses	
For the Years Ended June 30, 2008 and 2007	26
Exhibit 4 - Patient Receivables and Allowance for Doubtful Accounts	
For the Years Ended June 30, 2008 and 2007	27
Exhibit 5 - Inventory/Prepaid Expenses	
For the Years Ended June 30, 2008 and 2007	28
Exhibit 6 - Financial and Statistical Highlights	
For the Years Ended June 30, 2008 and 2007	29
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	30 – 31
Schedule of Findings and Questioned Costs	32
Audit Staff	33

Lakes Regional Healthcare
Spirit Lake, Iowa

Officials
June 30, 2008

<u>Board of Trustees</u>	<u>Address</u>	<u>Term Expires</u>
Mark Fisher, Chairman	Milford, Iowa	December 2010
Denny Perry, Vice-Chairman	Spirit Lake, 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
Ivan Brown	Spirit Lake, Iowa	December 2012
 <u>Chief Executive Officer</u>		
Richard Kielman	Okoboji, Iowa	Indefinite
 <u>Chief Financial Officer</u>		
Gordon Larson	Spirit Lake, Iowa	Indefinite

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, 2008 and 2007, 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, 2008 and 2007, 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 8, 2008 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 23 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 8, 2008.

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, 2008, 2007 and 2006. This discussion and analysis should be read in conjunction with financial statements, which start on page 8.

Financial Highlights

- LRH net assets increased in 2008 by \$1,625,861 or 5.2%. In 2007, net assets increased by \$1,471,795 or 4.9%. In 2006, net assets increased \$249,881 or 0.8%.
- LRH reported an operating income in 2008 of \$404,946 compared to an operating income of \$73,709 in 2007. In 2006 the loss from operations was \$375,098.
- LRH non-operating revenues decreased by \$177,171 in 2008 compared to 2007. From 2006 to 2007 non-operating revenues increased \$773,107.

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.

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 \$1,625,861 or 5.2%, as shown in **Table 1**. This compares to an increase in 2007 of \$1,471,795 and an increase of \$249,881 in 2006.

Lakes Regional Healthcare
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2008 and 2007

Table 1: Assets, Liabilities, and Net Assets

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2008 Change</u>
Assets:				
Current assets	\$ 21,451,335	19,422,362	17,724,528	10.5%
Capital assets, net	15,912,116	16,846,783	18,250,466	(5.6%)
Other non-current assets	3,097,539	2,952,349	2,640,963	4.9%
Total assets	<u>40,460,990</u>	<u>39,221,494</u>	<u>38,615,957</u>	<u>3.2%</u>
Liabilities:				
Long-term debt outstanding	4,435,000	4,680,000	5,295,000	(5.2%)
Other current and noncurrent liabilities	3,031,392	3,172,757	3,424,015	(4.5%)
Total liabilities	<u>7,466,392</u>	<u>7,852,757</u>	<u>8,719,015</u>	<u>-4.9%</u>
Net assets:				
Invested in capital assets, net of related debt	11,232,116	11,551,783	12,365,466	(2.8%)
Restricted for debt service	294,758	134,979	120,728	118.4%
Restricted expendable net assets	178,124	179,121	178,084	(0.6%)
Restricted nonexpendable net assets	25,000	25,000	25,000	
Unrestricted	21,264,600	19,477,854	17,207,664	9.2%
Total net assets	<u>\$ 32,994,598</u>	<u>31,368,737</u>	<u>29,896,942</u>	<u>5.2%</u>

Operating Results and Changes in LRH Net Assets

In 2008, LRH net assets increased by \$1,625,861 or 5.2%, as shown in **Table 2**. This increase is due to an increase in total operating revenue of \$1,436,451 or 6.3% in 2008, while operating expenses increased \$1,105,214 or 4.9%. Non-operating revenue decreased \$177,171 or 12.7% due to a reduced tax levy for the operation of the County ambulance service.

Lakes Regional Healthcare
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2008 and 2007

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

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2008 Change</u>
Operating Revenue:				
Net patient service revenue	\$ 24,755,494	22,955,690	21,174,339	7.8%
Provision for bad debt	(1,179,949)	(765,667)	(975,000)	54.1%
Other operating revenues	533,388	487,776	506,982	9.4%
Net assets released for operations	6,965	1,648	1,056	322.6%
Total operating revenue	24,115,898	22,679,447	20,707,377	6.3%
Operating Expenses:				
Salaries and benefits	12,295,509	11,384,938	10,559,463	8.0%
Purchased services and other	8,999,192	8,731,035	7,918,392	3.1%
Depreciation and amortization	2,160,422	2,225,468	2,315,664	(2.9%)
Interest	255,829	264,297	288,956	(3.2%)
Total operating expenses	23,710,952	22,605,738	21,082,475	4.9%
Operating income (loss)	404,946	73,709	-375,098	449.4%
Non-operating Revenues and Expenses				
Property taxes	350,000	484,106	102,996	(27.7%)
Investment income	860,294	782,538	568,882	9.9%
Non-capital grants and contributions	1,643	178,780	3,294	(99.1%)
Other non-operating revenues and expenses, net	8,978	-47,338	-50,193	119.0%
Total non-operating revenues (Expenses), net	1,220,915	1,398,086	624,979	(12.7%)
Increase in net assets	1,625,861	1,471,795	249,881	10.5%
Net assets beginning of year	31,368,737	29,896,942	29,647,061	4.9%
Net assets end of year	\$ 32,994,598	31,368,737	29,896,942	5.2%

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 increased volumes for many services, and having a full-time orthopedic surgeon in Spirit Lake.

Lakes Regional Healthcare
Spirit Lake, Iowa

Management's Discussion and Analysis
June 30, 2008 and 2007

The primary components affecting operating income are:

- Net patient revenue increased \$1,799,804 or 7.8% in 2008, compared to an increase of \$1,781,351 or 8.4% in 2007. In 2006 net patient revenue decreased \$368,803 or -1.7%. Increased revenue in 2008 was the result of higher patient volumes, along with price changes.
- Salary and benefit costs for employees increased \$910,571 or 8.0% in 2008 compared to an increase of \$825,475 or 7.8% in 2007 and \$517,138 or 5.1% in 2006.
- Medical supply and drug costs increased in 2008 by \$7,675 or 0.1%, compared to an increase of \$630,883 or 16.8% in 2007 and a reduction of \$221,875 or 5.6% in 2006.
- Acute care patient days were 4,699 in 2008, compared to 4,420 in 2007 and 4,598 in 2006.

The ability to collect the revenue charged to patients affects net patient revenue. The provision for bad debt in 2008 was \$1,179,949, a 54.1% increase from 2007. This increase is due to changes in the collection process and the use of outside collection agencies.

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 2008 medical supplies and prescription drugs cost \$5,544,115, which was a 0.1% increase from 2007. In 2007 medical supplies and prescription drugs cost \$5,536,440. In 2006 medical supplies and prescription drugs cost \$4,762,492. New supplier agreements had an impact on these costs 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 \$216,207 in 2008 compared to \$171,978 in 2007 and \$77,033 in 2006. 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 of taxes levied by LRH for the ambulance service, and investment earnings. The county tax levy was \$0.20633 per \$1,000 of valuation for 2008, \$0.33459 in 2007 and \$0.08771 in 2006. The county tax levy amounted to \$350,000 in 2008, \$484,106 in 2007 and \$102,996 in 2006.

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 2008 as more money was invested. Non-cash expenses for depreciation and amortization exceeded cash related expenditures for capital by \$106,659 during the year.

Capital Asset and Debt Administration

Capital Assets

As of June 30, 2008 LRH had \$15,912,116 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. At June 30, 2007, LRH had \$16,846,783 invested in capital assets, net of accumulated depreciation. In 2008, LRH purchased new equipment costing \$1,180,467. Capital spending in 2007 was \$950,709 and \$2,942,452 in 2006 when a new information system was installed.

Debt

At year-end, LRH had \$4,680,000 in capital loan notes outstanding. No new debt was issued in 2008, 2007 or 2006.

Other Economic Factors

The 2007 fiscal year provided LRH substantial challenges due to federal program reimbursement requirements, pressures from other insurers, and fluctuating patient demand.

Inflation continued in 2008 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, and the result of union contracts that represent employees of various departments.

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, 2008 and 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 9,568,808	2,820,617
Certificates of deposit	6,380,651	11,506,476
Assets limited as to use - required for current liabilities	294,758	134,979
Receivables -		
Patients, net of allowance for doubtful accounts of \$1,233,220 in 2008 and \$1,411,663 in 2007	3,794,612	3,516,184
Succeeding year property tax	350,000	350,000
Other	32,909	21,926
Inventories	781,802	878,375
Prepaid expenses	<u>247,795</u>	<u>193,805</u>
Total current assets	<u>21,451,335</u>	<u>19,422,362</u>
Assets limited as to use:		
By Board for -		
Capital improvements	460,536	439,815
Endowments	2,478,135	2,360,093
By Donor	<u>141,359</u>	<u>133,681</u>
	<u>3,080,030</u>	<u>2,933,589</u>
Capital assets, net of accumulated depreciation	<u>15,912,116</u>	<u>16,846,783</u>
Other assets, net	<u>17,509</u>	<u>18,760</u>
Total assets	<u>\$ 40,460,990</u>	<u>39,221,494</u>

See notes to financial statements

Lakes Regional Healthcare
Spirit Lake, Iowa

Balance Sheets (Continued)
June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Current portion of long-term debt	\$ 245,000	615,000
Accounts payable -		
Trade	601,831	471,328
Construction	58,000	12,425
Salaries, wages and accrued vacation payable	1,250,885	1,143,756
Payroll taxes withheld and accrued	110,235	102,134
Accrued interest payable	18,771	21,238
Other accrued liabilities	139,849	128,935
Deferred revenue - Mandelbaum Endowment	7,221	7,327
Estimated third-party payor settlements	249,600	320,614
Deferred revenue for succeeding year property tax receivable	<u>350,000</u>	<u>350,000</u>
Total current liabilities	3,031,392	3,172,757
Long-term debt, net of current portion	<u>4,435,000</u>	<u>4,680,000</u>
Total liabilities	<u>7,466,392</u>	<u>7,852,757</u>
Net assets:		
Invested in capital assets, net of related debt	11,232,116	11,551,783
Restricted -		
For debt service	294,758	134,979
Expendable for capital acquisitions & operating activities	178,124	179,121
Nonexpendable	25,000	25,000
Unrestricted	<u>21,264,600</u>	<u>19,477,854</u>
Total net assets	<u>32,994,598</u>	<u>31,368,737</u>
Total liabilities and net assets	<u>\$ 40,460,990</u>	<u>39,221,494</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, 2008 and 2007

	<u>2008</u>	<u>2007</u>
OPERATING REVENUE:		
Net patient service revenue before provision for bad debt	\$ 24,755,494	22,955,690
Provision for bad debt	<u>(1,179,949)</u>	<u>(765,667)</u>
Net patient service revenue	23,575,545	22,190,023
Other revenue	533,388	487,776
Net assets released for operations	<u>6,965</u>	<u>1,648</u>
Total revenue	<u>24,115,898</u>	<u>22,679,447</u>
OPERATING EXPENSES:		
Salaries	9,609,496	8,806,409
Employee benefits	2,686,013	2,578,529
Purchased services and professional fees	2,650,153	2,402,872
Utilities	593,691	586,115
Supplies and other expenses	5,544,115	5,536,440
Depreciation and amortization	2,160,422	2,225,468
Insurance	211,233	205,608
Interest	<u>255,829</u>	<u>264,297</u>
Total expenses	<u>23,710,952</u>	<u>22,605,738</u>
OPERATING INCOME	<u>404,946</u>	<u>73,709</u>
NONOPERATING REVENUE, NET:		
Investment income	860,294	782,538
County tax revenue	350,000	484,106
Unrestricted gifts, grants and bequests	1,643	178,780
Loss on disposal of property and equipment	<u>(1,538)</u>	<u>(44,539)</u>
Nonoperating revenue, net	<u>1,210,399</u>	<u>1,400,885</u>
EXCESS REVENUE OVER EXPENSES BEFORE GRANTS AND CONTRIBUTIONS	1,615,345	1,474,594
GRANTS AND CONTRIBUTIONS, NET	<u>10,516</u>	<u>(2,799)</u>
INCREASE IN NET ASSETS	1,625,861	1,471,795
NET ASSETS, beginning of year	<u>31,368,737</u>	<u>29,896,942</u>
NET ASSETS, end of year	<u>\$ 32,994,598</u>	<u>31,368,737</u>

See notes to financial statements

Lakes Regional Healthcare
Spirit Lake, Iowa

Statements of Cash Flows
For the Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third party payors	\$ 23,233,780	22,033,810
Cash paid to employees for salaries and benefits	(12,180,279)	(11,288,678)
Cash paid to suppliers and contractors	(8,815,196)	(8,778,725)
Other receipts and payments, net	<u>524,535</u>	<u>486,792</u>
Net cash provided by operating activities	<u>2,762,840</u>	<u>2,453,199</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
County taxes received	350,000	484,106
Unrestricted gifts, grants and bequests	<u>1,643</u>	<u>178,780</u>
Net cash provided by noncapital financing activities	<u>351,643</u>	<u>662,886</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of property and equipment, net	(1,180,467)	(950,709)
Payments on long-term debt	(615,000)	(590,000)
Interest paid on long-term debt	<u>(258,296)</u>	<u>(264,825)</u>
Net cash used in capital and related financing activities	<u>(2,053,763)</u>	<u>(1,805,534)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Deposits to assets limited as to use, net	(298,542)	(330,723)
Withdrawals from (deposits to) short-term investments	5,125,825	(2,496,637)
Interest on investments	<u>860,188</u>	<u>782,859</u>
Net cash provided by (used in) investing activities	<u>5,687,471</u>	<u>(2,044,501)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	6,748,191	(733,950)
CASH AND CASH EQUIVALENTS - Beginning of year	<u>2,820,617</u>	<u>3,554,567</u>
CASH AND CASH EQUIVALENTS - End of year	<u>\$ 9,568,808</u>	<u>2,820,617</u>

See notes to financial statements

Lakes Regional Healthcare
Spirit Lake, Iowa

Statements of Cash Flows (Continued)
For the Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 404,946	73,709
Adjustments to reconcile operating income to net cash provided by operating activities -		
Depreciation and amortization	2,160,422	2,225,468
Interest expense	255,829	264,297
(Increase) decrease in current assets -		
Receivables -		
Patients	(278,428)	10,782
Other	(10,983)	(7,505)
Inventories	96,573	(73,561)
Prepaid expenses	(53,990)	24,388
Increase (decrease) in current liabilities -		
Accounts payable	130,503	(3,011)
Due to restricted funds	2,838	1,037
Salaries, wages and accrued vacation payable	107,129	88,271
Payroll taxes withheld and accrued	8,101	7,989
Other accrued liabilities	10,914	4,494
Estimated third-party payor settlements	<u>(71,014)</u>	<u>(163,159)</u>
Net cash provided by operating activities	\$ <u>2,762,840</u>	<u>2,453,199</u>

See notes to financial statements

(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.

Notes to Financial Statements
For the Years Ended June 30, 2008 and 2007

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 2008 and 2007, respectively, is included in the accompanying statements of revenues, expenses and changes in net assets.

Notes to Financial Statements
For the Years Ended June 30, 2008 and 2007

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, 2008 and 2007 was \$666,411 and \$629,062, 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.

Notes to Financial Statements
For the Years Ended June 30, 2008 and 2007

S. *Reclassification*

Certain amounts in the 2007 financial statements have been reclassified to conform to the 2008 reporting format.

(2) **Cash and Investments**

The Hospital's deposits in banks at June 30, 2008 and 2007 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, 2008 and 2007.

(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, 2006.

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.

Lakes Regional Healthcare
Spirit Lake, Iowa

Notes to Financial Statements
For the Years Ended June 30, 2008 and 2007

(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, 2008 and 2007, are summarized as follows:

	<u>2008</u>	<u>2007</u>
Capital Improvements -		
Cash	\$ 2,361	1,874
Certificates of deposit	446,000	435,000
Interest receivable	12,175	2,941
	<u>\$ 460,536</u>	<u>439,815</u>
Endowments -		
Cash	\$ 5,343	12,759
Certificates of deposit	2,457,000	2,314,061
Interest receivable	15,792	33,273
	<u>\$ 2,478,135</u>	<u>2,360,093</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, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Bond Fund, cash	\$ <u>294,758</u>	<u>134,979</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, 2008 and 2007 are as follows:

	<u>2008</u>	<u>2007</u>
Mandelbaum Endowment fund		
Certificate of deposit	\$ 25,000	25,000
Hospital auxiliary assets, primarily cash and temporary cash investments	116,359	108,681
	<u>\$ 141,359</u>	<u>133,681</u>

Lakes Regional Healthcare
Spirit Lake, Iowa

Notes to Financial Statements
For the Years Ended June 30, 2008 and 2007

(5) Capital Assets

Capital assets activity for the years ended June 30, 2008 and 2007 were as follows:

	June 30, 2007	Additions	Transfers and Disposals	June 30, 2008
Capital assets, not being depreciated:				
Land	\$ 722,552	--	--	722,552
Construction in progress	--	--	--	--
Total capital assets, not being depreciated	<u>722,552</u>	<u>--</u>	<u>--</u>	<u>722,552</u>
Capital assets, being depreciated:				
Land improvements	577,128	12,981	--	590,109
Hospital buildings	14,423,408	32,719	--	14,456,127
Medical Office building	3,794,034	--	--	3,794,034
Fixed equipment	3,187,214	419,757	--	3,606,971
Major moveable equipment	11,017,171	760,583	(30,802)	11,746,952
Total capital assets, being depreciated	<u>32,998,955</u>	<u>1,226,040</u>	<u>(30,802)</u>	<u>34,194,193</u>
Less accumulated depreciation:				
Land improvements	257,559	27,477	--	285,036
Hospital buildings	5,596,026	555,177	--	6,151,203
Medical Office building	1,681,324	139,145	--	1,820,469
Fixed equipment	2,923,815	60,012	--	2,983,827
Major moveable equipment	6,416,000	1,377,358	(29,264)	7,764,094
Total accumulated depreciation	<u>16,874,724</u>	<u>2,159,169</u>	<u>(29,264)</u>	<u>19,004,629</u>
Total capital assets, being depreciated, net	<u>16,124,231</u>	<u>(933,129)</u>	<u>(1,538)</u>	<u>15,189,564</u>
Total capital assets, net	<u>\$ 16,846,783</u>	<u>(933,129)</u>	<u>(1,538)</u>	<u>15,912,116</u>
	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>

Lakes Regional Healthcare
Spirit Lake, Iowa

Notes to Financial Statements
For the Years Ended June 30, 2008 and 2007

(6) Long-Term Debt

Long-term debt activity of the Hospital as of June 30, 2008 and 2007 consisted of the following:

	<u>June 30, 2007</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30, 2008</u>	<u>Due Within One Year</u>
Capital loan notes (A)	\$ 5,295,000	--	615,000	4,680,000	245,000

	<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

- (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, and, as such, the Hospital has pledged future revenues, net of specified operating expenses, to repay the bonds. 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>
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	4.88	295,000	178,708	473,708
2014 – 2018	4.88	1,685,000	662,083	2,347,083
2019 – 2022	4.88	1,645,000	207,302	1,852,302
		\$ 4,680,000	1,895,787	6,575,787

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 \$255,829 and \$264,297 during the years ended June 30, 2008 and 2007, 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 3.90% of their annual salary and the Hospital is required to contribute 6.05% of annual covered payroll. Contribution requirements are established by State statute. The Hospital's contribution to IPERS for the years ended June 30, 2008, 2007 and 2006 were \$555,855, \$491,935 and \$462,932, 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:

2009	\$	290,565
2010		124,357
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>2008</u>	<u>2007</u>
Medicare	30.1%	29.9%
Medicaid	4.8	4.8
Blue Cross	16.5	15.6
Other third-party payors	33.3	16.5
Private pay	15.3	33.2
	<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, 2008 and 2007

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, 2008, 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	\$ 350,000	-	350,000	344,793	5,207
Estimated other revenues / receipts	24,986,813	(265,687)	24,721,126	24,786,400	(65,274)
	25,336,813	(265,687)	25,071,126	25,131,193	(60,067)
Expenses / Disbursements	23,710,952	(661,718)	23,049,234	25,477,153	(2,427,919)
Net	1,625,861	396,031	2,021,892	<u>(345,960)</u>	<u>2,367,852</u>
Balance beginning of year	31,368,737	(14,112,825)	17,255,912		
Balance end of year	<u>\$ 32,994,598</u>	<u>(13,716,794)</u>	<u>19,277,804</u>		

Lakes Regional Healthcare
Spirit Lake, Iowa

Exhibit 1

Patient Service Revenue
For the Years Ended June 30, 2008 and 2007

	2008				2007			
	Inpatient	Outpatient	Swing Bed	Total	Inpatient	Outpatient	Swing Bed	Total
NURSING SERVICES:								
Medical, surgical and obstetrics	\$ 2,823,371	655,878	--	3,479,249	2,571,517	376,540	--	2,948,057
Swing bed	--	--	483,855	483,855	--	--	510,198	510,198
Observation	29,453	141,035	--	170,488	35,555	149,668	--	185,223
Coronary care	147,375	--	--	147,375	176,850	--	--	176,850
Nursery	175,428	--	--	175,428	179,415	--	--	179,415
	\$ 3,175,627	796,913	483,855	4,456,395	2,963,337	526,208	510,198	3,999,743
OTHER PROFESSIONAL SERVICES:								
Operating and recovery rooms	1,800,044	4,823,793	16,031	6,639,868	1,464,591	4,214,236	1,811	5,680,638
Pharmacy	1,468,998	3,256,916	292,491	5,018,405	1,292,076	3,756,251	341,906	5,390,233
Central services and supply	2,051,039	1,422,309	12,930	3,486,278	2,080,692	1,440,379	13,490	3,534,561
Emergency and outpatient service	813,356	3,627,304	514	4,441,174	595,070	3,073,114	467	3,668,651
Laboratory	913,660	2,622,448	81,806	3,617,914	805,491	2,265,501	81,727	3,152,719
CT scanner	412,605	1,962,303	6,062	2,380,970	391,185	1,637,784	(4,498)	2,024,471
MRI	86,132	1,509,186	3,988	1,599,306	78,948	1,279,396	--	1,358,344
Respiratory therapy	982,349	126,551	227,146	1,336,046	1,058,447	99,575	377,850	1,535,872
Physical therapy	166,187	747,992	98,682	1,012,861	156,750	751,923	124,457	1,033,130
Radiology	230,512	790,120	11,270	1,031,902	197,684	710,613	12,789	981,086
Anesthesiology	321,005	616,224	1,476	938,705	270,369	523,758	--	794,127
Ambulance	139,544	696,219	9,123	844,886	187,887	731,976	5,612	915,475
Ultrasound	106,710	579,631	7,161	693,502	66,175	532,337	5,837	594,349
Intravenous therapy	318,893	360,825	21,390	701,108	301,122	472,148	17,980	791,250
Home Health	--	769,424	--	769,424	--	676,317	--	676,317
Oncology	6,228	478,414	9	484,651	3,902	496,429	112	500,443
Electrocardiology	88,063	185,262	5,437	278,762	81,927	172,810	5,617	260,354
Blood	199,161	126,516	15,729	341,406	168,507	151,150	11,221	330,878
Nuclear medicine	24,271	262,177	2,135	288,583	13,450	199,242	3,251	215,943
Public Health	--	194,773	--	194,773	--	216,890	--	216,890
Hospice	491,398	--	--	491,398	244,171	--	--	244,171
Delivery and labor room	150,891	38,458	--	189,349	152,536	27,757	--	180,293
Occupational therapy	9,815	134,513	21,980	166,308	9,333	150,244	20,521	180,098
Cardiac Rehab	339	148,256	--	148,595	--	115,291	--	115,291
Mammogram	766	189,401	--	190,167	1,158	193,060	--	194,218
Enterostomal therapy	15,995	80,955	9,815	106,765	9,600	66,855	6,960	83,415
Stress testing	6,443	72,281	--	78,724	2,642	62,728	--	65,370
Speech therapy	4,793	31,100	5,825	41,718	3,349	46,224	5,039	54,612
Outpatient Clinic	2,487	257,290	192	259,969	2,950	159,571	--	162,521
Electroencephalography	1,968	50,849	--	52,817	328	20,578	--	20,906
	\$ 10,813,652	26,161,450	851,192	37,826,334	9,640,340	24,284,137	1,032,149	34,956,626
GROSS PATIENT SERVICE REVENUE	\$ 13,989,279	26,958,403	1,335,047	42,282,729	12,603,677	24,810,345	1,542,347	38,956,369
LESS:								
Contractual allowances and other deductions, primarily Medicare and Medicaid				(17,085,404)				(15,519,707)
Charity care services and other discounts, based on charges forgone				(441,831)				(480,972)
NET PATIENT SERVICE REVENUE BEFORE PROVISION FOR BAD DEBT	\$			\$ 24,755,494				22,955,690
PROVISION FOR BAD DEBT				(1,179,849)				(765,667)
NET PATIENT SERVICE REVENUE	\$			\$ 23,575,645				22,190,023

Other Operating Revenue
For the Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Rental income	295,786	292,693
Meals sold	\$ 110,564	92,277
Lifeline	59,588	57,350
Meals on Wheels	19,315	20,129
Other	42,939	22,573
Dietary instruction	4,080	1,552
Medical records transcriptions	<u>1,116</u>	<u>1,202</u>
	<u>\$ 533,388</u>	<u>487,776</u>

Lakes Regional Healthcare
Spirit Lake, Iowa

Exhibit 3

Departmental Expenses
For the Years Ended June 30, 2008 and 2007

	2008				2007			
	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	\$ 2,363,332	21,163	168,470	2,552,965	2,098,346	12,192	185,896	2,296,344
Obstetrics	446,048	69	27,142	475,259	344,187	--	21,917	366,104
Coronary care	148,914	2,300	21,381	172,595	141,312	111	21,923	163,346
Nursery	105,183	--	108,102	213,285	103,498	--	8,135	111,633
	65,965	--	12,412	78,377	65,422	--	3,622	69,044
	<u>3,131,442</u>	<u>23,532</u>	<u>232,324</u>	<u>3,387,298</u>	<u>2,752,765</u>	<u>12,213</u>	<u>241,493</u>	<u>3,006,471</u>
OTHER PROFESSIONAL SERVICES:								
Central services and supply	50,718	158	1,286,950	1,337,826	51,069	2,286	1,204,355	1,257,710
Pharmacy	214,795	--	1,622,914	1,837,709	1,834,108	53	1,834,108	2,019,852
Emergency room	402,302	938,326	37,588	1,378,217	370,650	912,570	34,017	1,317,237
Operating and recovery room	548,788	3,952	354,626	907,366	524,347	20,191	297,586	842,134
Laboratory	422,808	135,669	268,266	826,743	398,208	108,760	250,429	757,397
Ambulance	451,920	1,255	86,223	539,398	469,764	2,130	65,632	537,526
Physical therapy	--	411,493	13,938	425,432	--	408,192	20,078	428,270
Home Health	481,219	32,265	57,695	571,179	413,283	30,107	42,224	485,614
Radiology	271,219	8,828	66,073	346,120	244,340	4,154	68,997	318,291
Medical records	280,017	16,778	54,529	351,324	263,850	14,251	34,887	312,988
Respiratory therapy	122,199	26,587	50,675	199,461	141,113	8,460	53,268	202,842
Public health	187,524	1,159	28,551	215,234	176,308	1,055	23,426	200,789
Same day surgery	155,181	37	177,029	332,247	154,783	-89	14,015	168,987
Hospice	105,971	171,063	160,218	437,252	65,856	39,463	29,591	134,810
CT scanner	75,679	--	235,697	311,376	68,657	105	160,103	228,865
Onology	101,882	2,934	12,279	117,075	99,663	5,914	12,115	117,712
Blood bank	75,487	127,734	18,080	311,301	--	120,177	22,343	142,820
Electrocardiology	--	59,371	137,978	197,349	65,068	120,177	6,794	110,745
Nuclear medicine	57,908	107,280	3,120	268,308	--	89,883	--	89,883
Quality assurance	72,857	55	983	73,895	95,823	543	1,799	98,165
Ultrasound	--	9,436	15,772	25,208	64,411	5,306	15,720	85,867
Anesthesiology	31,760	7,475	60,597	101,832	--	913	64,802	65,715
Delivery and labor room	51,802	--	7,182	58,984	29,301	--	27,487	56,788
Social services	24,329	--	324	24,653	51,376	--	10,475	61,851
Speech therapy	--	31,228	--	31,228	23,944	--	60	24,904
Enterostomal therapy	63,488	28,651	1,184	93,323	--	37,409	--	37,409
Outpatient Clinic	3,786	652	20,123	24,561	72,005	22,484	1,077	95,567
Stress testing	191	--	--	191	4,268	907	20,774	25,949
Electroencephalography	--	3,065	--	3,065	--	--	--	4,268
Library	--	--	139	139	--	550	--	905
	<u>4,253,810</u>	<u>2,125,681</u>	<u>4,344,324</u>	<u>10,723,815</u>	<u>4,034,133</u>	<u>1,876,135</u>	<u>4,316,040</u>	<u>10,226,328</u>
GENERAL SERVICES:								
Plant operation and maintenance	216,983	159,280	683,340	1,059,603	213,040	157,126	683,708	1,053,874
Dietary	331,682	592	265,864	598,138	276,288	9,836	271,868	557,993
Housekeeping	172,157	10,684	53,517	236,358	173,887	8,265	50,920	233,072
Laundry and linen	17,247	49,292	11,728	78,267	17,556	49,832	16,463	83,851
	<u>738,069</u>	<u>219,848</u>	<u>1,014,249</u>	<u>1,972,166</u>	<u>680,772</u>	<u>225,059</u>	<u>1,022,859</u>	<u>1,928,790</u>
ADMINISTRATIVE SERVICES:								
	<u>1,486,175</u>	<u>281,092</u>	<u>546,909</u>	<u>2,314,176</u>	<u>1,338,719</u>	<u>288,465</u>	<u>542,063</u>	<u>2,170,247</u>
NONDEPARTMENTAL:								
Employee Benefits	--	--	2,686,013	2,686,013	--	--	2,578,529	2,578,529
Depreciation and amortization	--	--	2,160,422	2,160,422	--	--	2,225,468	2,225,468
Interest	--	--	255,829	255,829	--	--	264,297	264,297
Insurance	--	--	211,233	211,233	--	--	205,608	205,608
	<u>9,609,496</u>	<u>2,650,153</u>	<u>11,451,303</u>	<u>23,710,952</u>	<u>8,806,409</u>	<u>2,402,872</u>	<u>11,306,457</u>	<u>22,605,738</u>

Patient Receivables and Allowance for Doubtful Accounts
For the Years Ended June 30, 2008 and 2007

ANALYSIS OF AGING:

Days Since Discharge	2008		2007	
	Amount	Percent of Total	Amount	Percent of Total
0 - 60	\$ 4,792,595	69.38 %	4,441,861	66.45
61 - 90	433,897	6.28	465,926	6.97
91 - 180	876,614	12.70	658,002	9.84
181 - 364	406,358	5.88	482,226	7.21
> 1 year	398,011	5.76	636,798	9.53
	<u>6,907,475</u>	<u>100.00 %</u>	<u>6,684,813</u>	<u>100.00</u>
Less:				
Allowance for doubtful accounts	(1,233,220)		(1,411,663)	
Allowance for contractual adjustments	<u>(1,879,643)</u>		<u>(1,756,966)</u>	
	<u>\$ 3,794,612</u>		<u>\$ 3,516,184</u>	

	2008	2007
NET DAYS REVENUE IN PATIENT ACCOUNTS RECEIVABLE	55.95 days	55.91 days
ALLOWANCE FOR DOUBTFUL ACCOUNTS:		
Balance, beginning of year	\$ 1,411,663	1,420,474
Provision of uncollectible accounts	1,179,949	765,667
Recoveries of accounts previously written off	335,579	281,558
Accounts written off	<u>(1,693,971)</u>	<u>(1,056,036)</u>
Balance, end of year	<u>\$ 1,233,220</u>	<u>1,411,663</u>
	1,233,220	1,411,663

Inventory / Prepaid Expenses
For the Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
INVENTORY:		
Surgical services	\$ 427,799	481,179
Pharmacy	132,260	179,250
Central storeroom	128,137	120,885
Laboratory	34,475	30,209
Fuel oil	26,486	24,997
Dietary	8,948	17,053
Radiology	13,124	12,898
Computers	7,804	7,879
Respiratory therapy/stress testing	<u>2,769</u>	<u>4,025</u>
	<u>\$ 781,802</u>	<u>878,375</u>
PREPAID EXPENSES:		
Insurance	\$ 134,686	125,697
Maintenance contracts	108,518	65,781
Other	<u>4,591</u>	<u>2,327</u>
	<u>\$ 247,795</u>	<u>193,805</u>

Financial and Statistical Highlights
For the Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Patient days:		
Adult and pediatric-		
Medicare	3,189	2,954
Other	<u>1,510</u>	<u>1,466</u>
	4,699	4,420
Swing bed-		
Skilled	1,186	1,428
Newborn	<u>398</u>	<u>404</u>
Total	<u><u>6,283</u></u>	<u><u>6,252</u></u>
Patient discharges:		
Adult and pediatric-		
Medicare	816	790
Other	<u>555</u>	<u>565</u>
	1,371	1,355
Swing bed-		
Skilled	237	252
Newborn	<u>176</u>	<u>178</u>
Total	<u><u>1,784</u></u>	<u><u>1,785</u></u>
Average length of stay:		
Adult and pediatric-		
Medicare	3.91 days	3.74 days
Other	2.72 days	2.59 days
Swing bed-		
Skilled	5.00 days	5.67 days
Newborn	2.26 days	2.27 days
Surgical procedures	3,894	3,716
Emergency room visits	6,476	6,138
Number of employees - full-time equivalents	209.75	200.69

**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, 2008 and 2007, and have issued our report thereon, dated September 8, 2008. 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, 2008 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 8, 2008.

Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2008

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, 2008 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.

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, 2008

This audit was performed by:

Roger E. Thompson, FHFMA, CPA, Partner

Brian D. Green, FHFMA, CPA, Partner

Joseph L. Harnisch, CPA, Manager

LeAnne N. Kaiser, Staff Auditor

Natalie E. Pape, Staff Auditor