

Lakes Regional Healthcare
Spirit Lake, Iowa

Basic Financial Statements
June 30, 2012 and 2011

Together with Independent Auditor's Report

Lakes Regional Healthcare

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Lakes Regional Healthcare

Officials
June 30, 2012

<u>Board of Trustees</u>	<u>Address</u>	<u>Term Expires</u>
Denny Perry, Chairman	Spirit Lake, Iowa	December 2016
Kris Walker, Vice-Chairman	Arnolds Park, Iowa	December 2012
Doug Dingel, Secretary/Treasurer	Terril, Iowa	December 2014
Steve Feld	Milford, Iowa	December 2016
Dan Sedlacek	Spirit Lake, Iowa	December 2014
Deb Goetzinger	Spirit Lake, Iowa	December 2014
Mary Kay Bates	Spirit Lake, Iowa	December 2012
<u>Chief Executive Officer</u>		
Jason Harrington	Spirit Lake, Iowa	Indefinite
<u>Chief Financial Officer</u>		
Steve Alger	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 (Hospital) as of and for the years ended June 30, 2012 and 2011, 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 the Hospital as of June 30, 2012 and 2011, and the results of its operations, changes in net assets 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 October 16, 2012 on our consideration of the Hospital'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.

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis and Budgetary Comparison Information on pages 4 through 8 and page 24 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion on or provide any assurance.

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 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the other supplementary information is fairly stated in all material respects in relation to the financial statements as a whole.

Seim Johnson, LLP

Omaha, Nebraska,
October 16, 2012.

Lakes Regional Healthcare

Balance Sheets June 30, 2012 and 2011

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, 2012, 2011 and 2010. This discussion and analysis should be read in conjunction with financial statements, which start on page 8.

Financial Highlights

- LRH net assets increased in 2012 by \$1,356,147 or 3.9%. In 2011, net assets increased by \$388,055 or 1.1%. In 2010, net assets decreased by \$518,190 or 1.5%.
- LRH reported operating income in 2012 of \$924,425 compared to operating losses of \$421,770 and \$1,334,315 in 2011 and 2010, respectively.
- LRH reported non-operating revenues in 2012 of \$431,722 compared to non-operating revenues of \$809,825 and \$816,125 in 2011 and 2010, respectively.

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

Balance Sheets June 30, 2012 and 2011

Table 1: Assets, Liabilities, and Net Assets

Table 1:

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012 Change</u>
Assets:				
Current assets	\$ 24,207,198	24,455,277	23,524,541	-1.0%
Capital assets, net	15,731,421	14,324,000	14,193,206	9.8%
Other non-current assets	<u>2,791,401</u>	<u>2,771,883</u>	<u>3,222,271</u>	<u>0.7%</u>
Total assets	<u><u>42,730,020</u></u>	<u><u>41,551,160</u></u>	<u><u>40,940,018</u></u>	<u><u>2.8%</u></u>
Liabilities:				
Long-term debt outstanding	3,330,000	3,625,000	3,905,000	-8.1%
Other current and noncurrent liabilities	<u>3,636,200</u>	<u>3,518,487</u>	<u>3,015,400</u>	<u>3.3%</u>
Total liabilities	<u><u>6,966,200</u></u>	<u><u>7,143,487</u></u>	<u><u>6,920,400</u></u>	<u><u>-2.5%</u></u>
Net assets:				
Invested in capital assets, net of related debt	12,106,421	10,419,000	10,018,206	16.2%
Restricted for debt service	269,007	258,530	250,704	4.1%
Restricted expendable net assets	200,023	307,210	190,535	-34.9%
Restricted nonexpendable net assets	25,000	25,000	25,000	0.0%
Unrestricted	<u>23,163,369</u>	<u>23,397,933</u>	<u>23,535,173</u>	<u>-1.0%</u>
Total net assets	<u><u>\$ 35,763,820</u></u>	<u><u>34,407,673</u></u>	<u><u>34,019,618</u></u>	<u><u>3.9%</u></u>

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 \$1,356,147 or 3.9%, as shown in Table 1. This compares to an increase in 2011 of \$388,055 and a decrease of \$518,190 in 2010.

Lakes Regional Healthcare

Balance Sheets June 30, 2012 and 2011

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

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012 Change</u>
Operating Revenue:				
Net patient service revenue	\$ 27,432,141	26,521,963	24,355,795	3.4%
Provision for bad debt	(1,144,815)	(1,327,960)	(1,423,356)	-13.8%
Other operating revenues	2,096,611	767,587	595,379	173.1%
Net assets released for operations	119,940	2,039	26,302	5782.3%
Total operating revenue	<u>28,503,877</u>	<u>25,963,629</u>	<u>23,554,120</u>	<u>9.8%</u>
Operating Expenses:				
Salaries and benefits	13,784,591	13,181,923	13,095,524	4.6%
Purchased services and other	11,362,281	10,999,192	9,430,973	3.3%
Depreciation and amortization	2,254,755	2,001,534	2,146,102	12.7%
Interest	177,825	202,750	215,836	-12.3%
Total operating expenses	<u>27,579,452</u>	<u>26,385,399</u>	<u>24,888,435</u>	<u>4.5%</u>
Operating income (loss)	<u>924,425</u>	<u>(421,770)</u>	<u>(1,334,315)</u>	<u>-319.2%</u>
Non-operating Revenues and Expenses				
Investment income	188,559	332,472	474,496	-43.3%
Property taxes	350,000	350,000	350,000	0.0%
Non-capital grants and contributions	350	--	525	0.0%
Other non-operating revenue and expenses, net	(107,187)	127,353	(8,896)	-184.2%
Total non-operating revenue, net	<u>431,722</u>	<u>809,825</u>	<u>816,125</u>	<u>-46.7%</u>
Increase (decrease) in net assets	1,356,147	388,055	(518,190)	249.5%
Net assets beginning of year	<u>34,407,673</u>	<u>34,019,618</u>	<u>34,537,808</u>	<u>1.1%</u>
Net assets end of year	<u>\$ 35,763,820</u>	<u>34,407,673</u>	<u>34,019,618</u>	<u>3.9%</u>

Statement of Revenues, Expenses and Changes in Net Assets

In 2012, LRH net assets increased by \$1,356,147 or 3.9%, as shown in Table 2. This increase is due to an increase in total operating revenue of \$2,540,248 or 9.8% in 2012, while operating expenses increased \$1,194,053 or 4.5%. Non-operating revenue decreased \$378,103 or 46.7%.

Operating Revenue

The first component of the change in LRH net assets is its operating revenue. Operating revenue increased \$2,540,248 or 9.8% in 2012. The primary components affecting operating revenue are:

- Net patient revenue increased \$910,178 or 3.4% in 2012, compared to an increase of \$2,166,168 or 8.9% in 2011 and a decrease of \$1,728,784 or 6.6% in 2010. Factors contributing to the increase consisted of approximately \$2.2 million of additional Medicare reimbursements received as a member of the Rural Community Hospital Demonstration Program (see Note 3). Offsetting this increase was a decline in both acute patient days and surgical procedures. Acute patient days were 2,871 in 2012, compared to 3,396 in 2011 and 3,358 in 2010. Surgical procedures were 3,285 in 2012, compared to 3,635 in 2011 and 3,609 in 2010.

Lakes Regional Healthcare

Balance Sheets June 30, 2012 and 2011

- The ability to collect revenue charged to patients affects operating revenue. The provision for bad debt in 2012 was \$1,144,815, a 13.8% decrease from 2011. This decrease is a reflection of the decreased patient volumes and continued emphasis on the revenue collection cycle.
- 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 was \$288,547 in 2012 compared to \$367,232 in 2011 and \$331,967 in 2010. Because there is no expectation of repayment, charity care affects operating revenue.
- LRH received Medicare and Medicaid incentive payments related to meeting Stage 1 of Meaningful Use (see Note 13). Payments received and recognized as operating revenue in 2012 were \$1,514,600 compared to \$175,000 in 2011.

Operating Expenses

The second component of the change in LRH net assets is its operating expenses. Operating expenses increased \$1,194,053 or 4.5% in 2012. The primary components affecting operating expenses are:

- Salary and benefit costs for employees increased \$602,668 or 4.6% in 2012, compared to an increase of \$86,399 or .7% in 2011, and an increase of \$213,422 or 1.7% in 2010. The 2012 increase was largely due to unfavorable claims experience from the self funded Health Care Plan (see Note 11) combined with annual wage increases.
- Purchased services and other expenses increased \$363,089 or 3.3% in 2012, compared to an increase of \$1,568,219 or 16.6% in 2011, and an increase of \$26,017 or 0.0% in 2010. The majority of this increase relates to changes in professional services agreement arrangements combined with the impact on supply costs of the high rate of healthcare inflation.

Non-operating Revenue and Expenses

The third and final component of the change in LRH net assets is its non-operating revenue. Non-operating revenue decreased \$378,103 or 46.7% in 2012. The primary components affecting non-operating revenue are:

- Property tax income was \$350,000 in 2012, 2011, and 2010 respectively. Dickinson County provides property tax revenue to LRH for the ambulance service. The county tax levy was \$0.16999 per \$1000 of valuation for 2012, \$0.18613 in 2011 and \$0.19187 in 2010.
- Investment income was \$188,559 for 2012, \$332,472 in 2011, and \$474,496 in 2010. Excess cash is maintained in interest bearing checking, savings, and short term certificates of deposits. These low risk investments continued to have very low rates of return.
- Other non-operating expenses, net were \$107,187 in 2012. In 2011, LRH had other non-operating revenue, net of \$127,353. In 2010, LRH had other non-operating expenses, net of \$8,896. This change reflects restricted income that was received and recognized in 2011, and subsequently utilized for its restricted purpose in 2012. When utilized in 2012, the income was matched with associated expenses as unrestricted funds.

Cash Flows

Changes in cash flows are consistent with changes in operating income (loss) and non-operating revenues and expenses, discussed earlier. Cash flows provided by investing activities were \$2,836,255 in 2012. Cash related expenditures for capital assets exceeded non-cash expenses for depreciation and amortization by \$1,446,872 during the year.

Lakes Regional Healthcare

Balance Sheets June 30, 2012 and 2011

Capital Asset and Debt Administration

Capital Assets

As of June 30, 2012 LRH had \$15,731,421 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. At June 30, 2011, LRH had \$14,324,000 invested in capital assets, net of accumulated depreciation. In 2012, LRH purchased new capital assets costing \$3,704,627. Capital spending was \$2,233,971 and \$1,375,172 in 2011 and 2010, respectively.

Debt

At year-end, LRH had \$3,625,000 in capital loan notes outstanding. No new debt was issued in 2012, 2011 or 2010. See note 14 for new debt issued subsequent to year end 2012.

Other Factors

Inflation continued in 2012 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.

A focus of the 2012 fiscal year was preparing for "Value-based Purchasing" that will impact hospital payments beginning October 1, 2012. In addition, emphasis was made on preventing 30-day readmissions and hospital acquired conditions due to the impact of future payment penalties. Early indications are that LRH will perform well in the first year of the program.

The 2012 fiscal year provided LRH with temporary relief as it pertained to Medicare reimbursement levels due to favorable legislation within the Patient Protection and Affordable Care Act. A continued recessionary economy caused inpatient volumes to remain lower than historical levels.

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:

Steve Alger
Chief Financial Officer
Lakes Regional Healthcare
Highway 71 South
Spirit Lake, Iowa 51360
712-336-8796

Lakes Regional Healthcare

Balance Sheets June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 14,466,014	12,716,769
Certificates of deposit	3,802,653	6,359,592
Assets limited as to use - current portion	269,007	376,390
Receivables -		
Patients, net of allowance for doubtful accounts of \$1,402,198 in 2012 and \$1,402,759 in 2011	3,822,222	3,494,376
Succeeding year property tax	350,000	350,000
Other	593,855	264,729
Inventories	736,397	732,527
Prepaid expenses	167,050	140,720
Estimated third-party payor settlements, net	--	20,174
	<u>24,207,198</u>	<u>24,455,277</u>
Assets limited as to use:		
By Board for -		
Endowments - unrestricted	2,553,871	2,543,776
By Donor - restricted	225,023	214,350
	<u>2,778,894</u>	<u>2,758,126</u>
Capital assets, net of accumulated depreciation	<u>15,731,421</u>	<u>14,324,000</u>
Other assets, net	<u>12,507</u>	<u>13,757</u>
Total assets	<u>\$ 42,730,020</u>	<u>41,551,160</u>

See notes to financial statements

Lakes Regional Healthcare

Balance Sheets (Continued) June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
LIABILITIES AND NET ASSETS		
Current liabilities:		
Current portion of long-term debt	\$ 295,000	280,000
Accounts payable -		
Trade	900,067	709,944
Construction	108,630	354,753
Salaries, wages and accrued vacation payable	1,273,797	1,164,544
Payroll taxes withheld and accrued	197,366	220,242
Accrued interest payable	2,905	15,663
Other accrued liabilities	432,554	423,341
Deferred revenue for succeeding year property tax receivable	350,000	350,000
Estimated third-party payor settlements, net	75,881	--
	<u>3,636,200</u>	<u>3,518,487</u>
Total current liabilities		
Long-term debt, net of current portion	<u>3,330,000</u>	<u>3,625,000</u>
Total liabilities	<u>6,966,200</u>	<u>7,143,487</u>
Net assets:		
Invested in capital assets, net of related debt	12,106,421	10,419,000
Restricted -		
For debt service	269,007	258,530
Expendable for capital acquisitions & operating activities	200,023	307,210
Nonexpendable	25,000	25,000
Unrestricted	<u>23,163,369</u>	<u>23,397,933</u>
Total net assets	<u>35,763,820</u>	<u>34,407,673</u>
Total liabilities and net assets	<u>\$ 42,730,020</u>	<u>41,551,160</u>

See notes to financial statements

Lakes Regional Healthcare

Statements of Revenue, Expenses and Changes in Net Assets For the Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
OPERATING REVENUE:		
Net patient service revenue before provision for bad debt	\$ 27,432,141	26,521,963
Provision for bad debt	(1,144,815)	(1,327,960)
Net patient service revenue	26,287,326	25,194,003
Other revenue, net	2,096,611	767,587
Net assets released for operations	119,940	2,039
Total revenue	<u>28,503,877</u>	<u>25,963,629</u>
OPERATING EXPENSES:		
Salaries	10,527,173	10,462,552
Employee benefits	3,257,418	2,719,371
Purchased services and professional fees	4,033,675	3,457,966
Utilities	437,097	516,876
Supplies and other expenses	6,696,205	6,781,395
Depreciation and amortization	2,254,755	2,001,534
Insurance	195,304	242,955
Interest	177,825	202,750
Total expenses	<u>27,579,452</u>	<u>26,385,399</u>
OPERATING INCOME (LOSS)	<u>924,425</u>	<u>(421,770)</u>
NONOPERATING REVENUE:		
Investment income	188,559	332,472
County tax revenue	350,000	350,000
Unrestricted gifts, grants and bequests	350	--
Total nonoperating revenue	<u>538,909</u>	<u>682,472</u>
EXCESS REVENUE OVER EXPENSES BEFORE RESTRICTED AND AUXILIARY ACTIVITY, NET	1,463,334	260,702
RESTRICTED AND AUXILIARY ACTIVITY, NET	<u>(107,187)</u>	<u>127,353</u>
INCREASE IN NET ASSETS	1,356,147	388,055
NET ASSETS, beginning of year	<u>34,407,673</u>	<u>34,019,618</u>
NET ASSETS, end of year	<u>\$ 35,763,820</u>	<u>34,407,673</u>

See notes to financial statements

Lakes Regional Healthcare

Statements of Cash Flows For the Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third party payors	\$ 26,055,536	25,244,377
Cash paid to employees for salaries and benefits	(13,698,214)	(13,337,138)
Cash paid to suppliers and contractors	(11,193,146)	(10,680,571)
Other receipts and payments, net	1,816,797	973,960
	<u>2,980,973</u>	<u>2,200,628</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
County taxes received	350,000	350,000
Unrestricted gifts, grants and bequests	350	--
	<u>350,350</u>	<u>350,000</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of property and equipment, net	(3,947,750)	(1,865,800)
Payments on long-term debt	(280,000)	(270,000)
Interest paid on long-term debt	(190,583)	(203,833)
	<u>(4,418,333)</u>	<u>(2,339,633)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Withdrawals from assets limited as to use	4,116,757	5,233,027
Deposits to assets limited as to use	(4,026,000)	(4,906,860)
Withdrawals from certificates of deposit	10,757,537	16,704,333
Deposits to certificates of deposit	(8,200,598)	(14,400,000)
Interest on investments	188,559	331,739
	<u>2,836,255</u>	<u>2,962,239</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,749,245	3,173,234
CASH AND CASH EQUIVALENTS - Beginning of year	<u>12,716,769</u>	<u>9,543,535</u>
CASH AND CASH EQUIVALENTS - End of year	<u>\$ 14,466,014</u>	<u>12,716,769</u>

See notes to financial statements

Lakes Regional Healthcare

Statements of Cash Flows (Continued) For the Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income (loss)	\$ 924,425	(421,770)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities -		
Depreciation and amortization	2,254,755	2,001,534
Interest expense	177,825	202,750
Loss on disposal of property and equipment	40,701	46,102
(Increase) decrease in current assets -		
Receivables -		
Patients	(327,846)	66,547
Other	(329,126)	33,597
Inventories	(3,870)	(54,449)
Prepaid expenses	(26,330)	34,330
Estimated third-party payor settlements	20,174	(16,174)
Increase (decrease) in current liabilities -		
Accounts payable	190,123	151,150
Due to restricted funds	(111,329)	124,635
Salaries, wages and accrued vacation payable	109,253	(251,195)
Payroll taxes withheld and accrued	(22,876)	95,980
Other accrued liabilities	9,213	187,591
Estimated third-party payor settlements	75,881	--
Net cash provided by operating activities	\$ <u>2,980,973</u>	<u>2,200,628</u>

See notes to financial statements

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2012 and 2011

(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.

As a result of recently enacted federal healthcare reform legislation, substantial changes are anticipated in the United States healthcare system. Such legislation includes numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, reimbursement of healthcare providers and the legal obligations of health insurers, providers and employers. These provisions are currently slated to take effect at specified times over approximately the next decade.

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 consist of nonexpendable and expendable net assets. Nonexpendable net assets are subject to externally imposed stipulations which require them to be maintained permanently by the Hospital. Expendable net assets result when constraints placed on net assets use are either externally imposed or imposed by law through constitutional provisions or enabling legislation.

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2012 and 2011

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. If unspecified, payments of patient receivables are allocated to unpaid accounts.

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. *Inventory*

Inventory is valued at historical cost using the first-in, first-out method.

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2012 and 2011

I. *Assets Limited as to Use*

By Board of Trustees - Periodically, the Hospital's Board of Trustees has set aside assets for endowments received. 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.

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

J. *Restricted Assets*

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

K. *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.

L. *Capital Assets*

Capital asset acquisitions in excess of \$5,000 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

M. *Bond Financing Costs*

Bond financing costs related to the issuance of the Public Hospital Revenue Capital Loan Notes are included with other assets in the balance sheet and are being amortized over the life of the related notes on a straight-line basis. Amortization expense of \$1,250 and \$1,251 for 2012 and 2011, respectively, is included in the accompanying statements of revenues, expenses and changes in net assets.

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2012 and 2011

N. 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, 2012 and 2011 was \$865,968 and \$826,474, respectively.

O. 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.

P. 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. Property tax levied to finance the current year is included in nonoperating revenues and peripheral or incidental transactions are reported as nonoperating revenues and expenses.

Q. 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.

R. 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.

S. 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.

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2012 and 2011

T. *Group Health Insurance Costs*

The Hospital is partially self-insured under its employee group health program (effective July 1, 2010), up to certain limits. Included in the employee benefits expense on the accompanying consolidated statements of operations is a provision for premiums for excess coverage and payments for claims including estimates of the ultimate costs for both reported claims and claims incurred but not yet reported at year-end. A liability for unpaid claims is included in other accrued liabilities on the accompanying consolidated balance sheets in the amount of \$201,592 and \$189,004 at June 30, 2012 and 2011, respectively.

U. *Risk Management*

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.

V. *Reclassification*

Certain amounts in the 2011 financial statements were reclassified in order to conform to the 2012 reporting format.

W. *Subsequent Events*

The Hospital considered events occurring through October 16, 2012 for recognition or disclosure in the financial statements as subsequent events. That date is the date the financial statements were available to be issued.

(2) **Cash and Investments**

The Hospital's deposits in banks at June 30, 2012 and 2011 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 instrumentalities; 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, 2012 and 2011.

(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:

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2012 and 2011

Medicare. In 2012, the Hospital was reimbursed for inpatient acute care and swing-bed services rendered to Medicare program beneficiaries based on Medicare defined costs of providing the services pursuant to the terms of the Rural Community Hospital Demonstration Program. In 2011, inpatient acute care services rendered to Medicare program beneficiaries were 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 Administrative Contractor.

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, 2010.

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 classifications 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. The 2012 and 2011 net patient service revenue increased approximately \$55,000 and \$216,000, respectively, due to removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to audits, reviews, and investigations.

(4) Assets Limited as to Use

By Board

Cash deposits and certificates of deposit designated by the Board for endowments as of June 30, 2012 and 2011, are summarized as follows:

	<u>2012</u>	<u>2011</u>
Endowments -		
Cash	\$ 12,094	3,294
Certificates of deposit	2,633,000	2,625,000
Interest receivable	2,766	2,940
Commingled donor funds (see below)	<u>(93,989)</u>	<u>(87,458)</u>
	<u>\$ 2,553,871</u>	<u>2,543,776</u>

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2012 and 2011

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, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Bond Fund, cash (included in current portion)	\$ <u>269,007</u>	<u>258,530</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 restricted grant consists of grant monies received in 2011 for use in 2012.

The Hospice and other restricted contributions are donor funds received that are commingled with the board designated endowment funds. These funds are restricted for various donor restrictions.

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, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Mandelbaum Endowment fund		
Certificate of deposit	\$ 25,000	25,000
Restricted Grant		
Cash and cash equivalents	--	117,860
Hospice and other restricted contributions		
Commingled with board designated endowment funds	\$ 93,989	87,458
Hospital auxiliary assets, primarily cash and temporary cash investments	<u>106,034</u>	<u>101,892</u>
	<u>\$ 225,023</u>	<u>332,210</u>
Current portion	<u>\$ --</u>	<u>117,860</u>

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2012 and 2011

(5) Capital Assets

Capital assets activity for the years ended June 30, 2012 and 2011 were as follows:

	June 30, 2011	Additions	Transfers and Disposals	June 30, 2012
Capital assets, not being depreciated:				
Land	\$ 918,477	540	--	919,017
Construction in progress	608,657	2,999,240	(2,845,851)	762,046
Total capital assets, not being depreciated	1,527,134	2,999,780	(2,845,851)	1,681,063
Capital assets, being depreciated:				
Land improvements	623,724	--	--	623,724
Hospital buildings	14,843,063	84,189	1,524,491	16,451,743
Medical Office building	3,811,626	30,249	--	3,841,875
Fixed equipment	3,586,009	33,488	87,491	3,706,988
Major moveable equipment	13,172,248	556,921	(263,422)	13,465,747
Total capital assets, being depreciated	36,036,670	704,847	1,348,560	38,090,077
Less accumulated depreciation:				
Land improvements	364,857	25,439	--	390,296
Hospital buildings	7,744,273	646,122	(37,912)	8,352,483
Medical Office building	2,226,791	130,403	--	2,357,194
Fixed equipment	2,957,938	334,183	(1,138,305)	2,153,816
Major moveable equipment	9,945,945	1,117,358	(277,373)	10,785,930
Total accumulated depreciation	23,239,804	2,253,505	(1,453,590)	24,039,719
Total capital assets, being depreciated, net	12,796,866	(1,548,658)	2,802,150	14,050,358
Total capital assets, net	\$ 14,324,000	1,451,122	(43,701)	15,731,421
	June 30, 2010	Additions	Transfers and Disposals	June 30, 2011
Capital assets, not being depreciated:				
Land	\$ 722,552	195,925	--	918,477
Construction in progress	22,923	585,734	--	608,657
Total capital assets, not being depreciated	745,475	781,659	--	1,527,134
Capital assets, being depreciated:				
Land improvements	622,173	1,551	--	623,724
Hospital buildings	14,552,791	311,937	(21,665)	14,843,063
Medical Office building	3,801,026	10,600	--	3,811,626
Fixed equipment	3,739,945	153,201	(307,137)	3,586,009
Major moveable equipment	13,224,286	975,023	(1,027,061)	13,172,248
Total capital assets, being depreciated	35,940,221	1,452,312	(1,355,863)	36,036,670
Less accumulated depreciation:				
Land improvements	339,210	25,647	--	364,857
Hospital buildings	7,198,324	561,749	(15,800)	7,744,273
Medical Office building	2,096,084	130,707	--	2,226,791
Fixed equipment	3,129,902	100,749	(272,713)	2,957,938
Major moveable equipment	9,728,970	1,181,431	(964,456)	9,945,945
Total accumulated depreciation	22,492,490	2,000,283	(1,252,969)	23,239,804
Total capital assets, being depreciated, net	13,447,731	(547,971)	(102,894)	12,796,866
Total capital assets, net	\$ 14,170,283	233,688	(102,894)	14,324,000

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2012 and 2011

Construction in progress for the Hospital as of June 30, 2012 consists of Phase 2 of a multi-phase master facility plan. Phase 2 will consist of the construction and remodeling of approximately 40,000 square feet of space that will provide improvements to the Hospital's surgery, purchasing, and facilities departments along with the Critical Care Unit and the Obstetrics Unit at the Hospital. Expected completion of Phase 2 is scheduled for February 2014. The estimated cost of Phase 2 is \$20.6 million and will be financed through a combination of existing funds, a \$10 million loan from Dickinson County (See Note 14), and an anticipated \$5 million loan from Dickinson County early in 2013.

(6) Long-Term Debt

Long-term debt activity of the Hospital as of June 30, 2012 and 2011 consisted of the following:

	<u>June 30, 2011</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30, 2012</u>	<u>Due Within One Year</u>
Capital loan notes (A)	\$ 3,905,000	--	280,000	3,625,000	295,000
	<u>June 30, 2010</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30, 2011</u>	<u>Due Within One Year</u>
Capital loan notes (A)	\$ 4,175,000	--	270,000	3,905,000	280,000

- (A) On May 6, 2002, \$8,000,000 of Hospital Revenue Capital Loan Notes were issued by the Hospital 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 were used to retire the outstanding principal amount of Public Hospital Revenue Capital Loan Notes, Series 1993(B), and provide funds for the construction of additions to and remodeling of the existing Hospital facilities. The interest rate on the notes is 0.99% and will reset on June 1 of the year 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 .99% interest rate are as follows:

<u>Year</u>	<u>Interest Rates</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	0.99	\$ 295,000	35,962	330,962
2014	0.99	310,000	33,035	343,035
2015	0.99	320,000	29,960	349,960
2016	0.99	335,000	26,785	361,785
2017	0.99	350,000	23,462	373,462
2018 – 2022	0.99	2,015,000	61,705	2,076,705
		<u>\$ 3,625,000</u>	<u>210,909</u>	<u>3,835,909</u>

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

The Hospital recognized interest expense of \$177,825 and \$202,750 during the years ended June 30, 2012 and 2011, respectively.

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2012 and 2011

(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. The Hospital could have exposure on possible incidents that have occurred for which claims will be made in the future should professional liability insurance not be obtained, should coverage be limited and/or not available.

Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probably ultimate costs of the incidents. Based upon the Hospital's claims experience, no such accrual has been made.

(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 5.38% of their annual salary and the Hospital is required to contribute 8.07% of annual covered payroll. Contribution requirements are established by State statute. The Hospital's contribution to IPERS for the years ended June 30, 2012, 2010 and 2009 were \$846,471, \$710,995 and \$658,685, 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 2021. Rental income is recorded monthly as earned in other operating revenue. The future minimum rentals under these leases are as follows:

2013	\$	90,245
2014		72,032
2015		64,125
2016		64,125
2017		64,125
2018 - 2022		224,438

(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) Health Insurance Agreement

The Hospital established a partially self-funded Health Care Plan effective July 1, 2010 with Wellmark Blue Cross and Blue Shield (BCBS). It was established for the benefit of eligible employees and their dependents. The Hospital is self-insured for health claims of participating employees and dependants up to an annual aggregate amount of \$50,000 per covered person. Commercial stop-loss insurance coverage is purchased for claims in excess of the aggregate annual amount.

Lakes Regional Healthcare

Notes to Financial Statements For the Years Ended June 30, 2012 and 2011

(12) 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>2012</u>	<u>2011</u>
Medicare	33.3%	32.7%
Medicaid	5.2	4.1
Blue Cross	21.3	17.9
Private pay	28.4	29.9
Other third-party payors	<u>11.8</u>	<u>15.4</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.

(13) Meaningful Use of Certified Electronic Health Record Technology Incentive Payments

The Health Information Technology for Economic and Clinical Health Act contains specific financial incentive payments beginning in 2011 to certain hospitals and professionals that implement and achieve meaningful use of certified electronic health record (EHR) technology in ways that demonstrate improved quality and effectiveness of care. Specific criteria is set by the Center for Medicare and Medicaid Services (CMS). Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. An initial Medicaid incentive payment is available to providers that adopt, implement, or upgrade certified EHR technology. However, in order to receive additional Medicaid incentive payments in subsequent years, providers must demonstrate continued meaningful use of EHR technology.

The Hospital accounts for meaningful use incentive payments under the grant accounting model, cliff recognition. Medicare EHR incentive payments are recognized as revenue when eligible providers demonstrate meaningful use of certified EHR technology and data is available to estimate the incentive payments for each period (a 365 day period after the initial 90 day attestation period). Medicaid EHR incentive payments are recognized as revenue when an eligible provider demonstrates meaningful use of certified EHR technology for each period. For fiscal year 2012, the Hospital recognized \$1,339,600 of Medicare meaningful use grant revenue and for fiscal years 2012 and 2011 the Hospital recognized \$175,000 of Medicaid meaningful use grant revenue in other revenue in its statement of revenue, expenses, and changes in net assets.

(14) Subsequent Events

On August 1, 2012, the Hospital entered into a \$10,000,000 loan with Dickinson County, Iowa, through the issuance of a Hospital Revenue Note (Dickinson County Hospital Project) Series 2012. Interest payments will be due on December 1st and June 1st commencing on December 1, 2012. Principal is due annually on June 1st commencing on June 1, 2020 through June 1, 2031. The interest rate of the loan is 2.2%. Proceeds from the loan will be used to fund construction activities.

On September 1, 2012, the two physician clinics attached to the Hospital became designated as "Provider Based Clinics". This structure was facilitated through the Hospital entering into a Professional Service Agreement with Avera McKennan.

Lakes Regional Healthcare

Budgetary Comparison Schedule of Revenues, Expenses and Changes in Net Assets – Budget and Actual (Cash Basis) June 30, 2012 and 2011

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, 2012, 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 Adjustments	Actual	Budgeted Amounts		Variance
	Accrual Basis		Cash Basis	Original	Amended	Favorable (Unfavorable)
Estimated amount to be raised by taxation	\$ 350,000	-	350,000	345,019	345,019	4,981
Estimated other revenues / receipts	<u>28,585,599</u>	<u>(513,013)</u>	<u>28,072,586</u>	<u>26,757,668</u>	<u>26,757,668</u>	<u>1,314,918</u>
	28,935,599	(513,013)	28,422,586	27,102,687	27,102,687	1,319,899
Expenses / Disbursements	<u>27,579,452</u>	<u>1,729,661</u>	<u>29,309,113</u>	<u>27,740,106</u>	<u>31,301,080</u>	<u>1,991,967</u>
Net	1,356,147	(2,242,674)	(886,527)	<u><u>\$ (637,419)</u></u>	<u><u>(4,198,393)</u></u>	<u><u>3,311,866</u></u>
Balance beginning of year	<u>34,407,673</u>	<u>(12,209,328)</u>	<u>22,198,345</u>			
Balance end of year	<u><u>\$ 35,763,820</u></u>	<u><u>(14,452,002)</u></u>	<u><u>21,311,818</u></u>			

See accompanying independent auditor's report

Patient Service Revenue
For the Years Ended June 30, 2012 and 2011

	2012				2011			
	Inpatient	Outpatient	Swing Bed	Total	Inpatient	Outpatient	Swing Bed	Total
NURSING SERVICES:								
Medical, surgical and obstetrics	\$ 2,417,769	22,320	--	2,440,089	2,703,862	416,852	--	3,120,714
Observation	88,638	479,521	--	568,159	85,920	402,151	--	488,071
Nursery	202,884	--	--	202,884	175,628	--	--	175,628
Swing bed	--	--	184,794	184,794	--	--	289,264	289,264
Coronary care	180,310	1,396	--	181,706	169,606	--	--	169,606
	<u>2,889,601</u>	<u>503,237</u>	<u>184,794</u>	<u>3,577,632</u>	<u>3,135,016</u>	<u>819,003</u>	<u>289,264</u>	<u>4,243,283</u>
OTHER PROFESSIONAL SERVICES:								
Operating and recovery rooms	1,483,244	6,550,726	3,022	8,036,992	1,716,017	6,100,920	14,217	7,831,154
Pharmacy	1,019,043	4,732,901	147,710	5,899,654	1,223,816	4,667,423	226,454	6,117,693
Emergency and outpatient service	489,603	4,484,838	449	4,974,890	538,484	4,444,655	332	4,983,471
Laboratory	627,576	3,345,619	48,027	4,021,222	698,057	3,231,876	62,013	3,991,946
Central services and supply	1,896,654	1,470,532	5,974	3,373,160	2,347,562	1,566,737	7,923	3,922,222
CT scanner	158,540	1,782,483	1,330	1,942,353	192,887	1,986,332	5,297	2,184,516
Radiology	117,538	1,534,508	8,185	1,660,231	150,778	1,130,810	6,957	1,288,545
MRI	42,624	1,401,922	2,762	1,447,308	28,516	1,172,553	4,731	1,205,800
Ambulance	157,524	1,235,885	3,580	1,396,989	136,570	1,050,795	1,535	1,188,900
Physical therapy	137,854	829,785	52,908	1,020,547	154,074	471,105	77,816	702,995
Anesthesiology	248,418	761,458	270	1,010,146	301,103	686,396	2,430	989,929
Ultrasound	44,011	929,072	3,012	976,095	51,538	683,498	2,208	737,244
Home Health	--	936,430	--	936,430	--	909,856	--	909,856
Intravenous therapy	211,824	697,306	5,180	914,310	274,100	744,104	9,990	1,028,194
Hospice	659,988	--	--	659,988	621,831	--	--	621,831
Respiratory therapy	401,656	98,135	53,150	552,941	537,510	119,174	84,225	740,909
Oncology	3,287	491,145	--	494,432	4,151	603,207	--	607,358
Electrocardiology	65,318	345,084	1,521	411,923	75,076	247,951	3,102	326,129
Outpatient Clinic	5,396	345,228	--	350,624	1,126	254,118	--	255,244
Public Health	--	316,464	--	316,464	--	265,414	--	265,414
Mammogram	--	302,404	--	302,404	674	280,130	--	280,804
Occupational therapy	48,475	187,460	30,110	266,045	43,494	97,660	41,692	182,846
Electroencephalography	418	232,770	--	233,188	418	98,095	--	98,513
Delivery and labor room	171,219	60,539	--	231,758	137,130	67,561	--	204,691
Nuclear medicine	2,685	181,419	--	184,104	4,317	143,033	--	147,350
Blood	79,696	98,814	4,770	183,280	150,939	115,788	11,723	278,450
Cardiac Rehab	113	130,097	--	130,210	--	121,759	--	121,759
Enterostomal therapy	4,420	95,724	1,720	101,864	16,200	123,004	8,218	147,422
Stress testing	--	81,672	--	81,672	1,018	65,801	--	66,819
Speech therapy	13,293	65,077	2,661	81,031	6,786	44,098	6,133	57,017
	<u>8,090,417</u>	<u>33,725,497</u>	<u>376,341</u>	<u>42,192,255</u>	<u>9,414,172</u>	<u>31,493,853</u>	<u>576,996</u>	<u>41,485,021</u>
GROSS PATIENT SERVICE REVENUE	\$ 10,980,018	34,228,734	561,135	45,769,887	12,549,188	32,312,856	866,260	45,728,304
LESS:								
Contractual allowances and other deductions, primarily Medicare and Medicaid				(17,817,992)				(18,568,930)
Charity care services and other discounts, based on charges forgone				(519,754)				(637,411)
NET PATIENT SERVICE REVENUE BEFORE PROVISION FOR BAD DEBT				\$ 27,432,141				\$ 26,521,963
PROVISION FOR BAD DEBT				(1,144,815)				(1,327,960)
NET PATIENT SERVICE REVENUE				\$ 26,287,326				\$ 25,194,003

See accompanying independent auditor's report

Other Operating Revenue
For the Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Medicare EHR incentive	\$ 1,339,600	--
Rental income	352,278	336,808
Medicaid EHR incentive	175,000	175,000
Meals sold	144,560	153,582
Lifeline	64,899	59,846
Other	31,991	59,456
Meals on Wheels	18,627	17,429
Dietary instruction	5,683	9,434
Medical record fees	4,674	2,134
Loss on disposal of property and equipment	<u>(40,701)</u>	<u>(46,102)</u>
	<u>\$ 2,096,611</u>	<u>767,587</u>

See accompanying independent auditor's report

**Departmental Expenses
For the Years Ended June 30, 2012 and 2011**

	2012				2011			
	Salaries and Wages	Professional Fees and Purchased Services	Supplies and Other	Total	Salaries and Wages	Professional Fees and Purchased Services	Supplies and Other	Total
NURSING SERVICES:								
Medical and surgical	\$ 1,761,804	26,170	93,018	1,880,992	1,805,814	8,841	122,970	1,937,625
Obstetrics	162,233	17,268	19,492	198,993	149,717	6,000	24,726	180,443
Coronary care	120,181	44,400	4,979	169,560	132,862	37,000	5,342	175,204
Administration	116,529	--	2,004	118,533	504,304	38	6,978	511,320
Nursery	72,373	--	7,330	79,703	64,882	--	6,950	71,832
	<u>2,233,120</u>	<u>87,838</u>	<u>126,823</u>	<u>2,447,781</u>	<u>2,657,579</u>	<u>51,879</u>	<u>166,966</u>	<u>2,876,424</u>
OTHER PROFESSIONAL SERVICES:								
Pharmacy	277,016	--	2,291,641	2,568,657	273,557	--	2,450,867	2,724,424
Emergency room	702,421	1,460,880	180,133	2,343,434	611,165	1,436,927	96,656	2,144,748
Central services and supply	60,256	--	1,177,118	1,237,374	59,741	--	1,409,288	1,469,029
Operating and recovery room	646,574	129,096	283,039	1,058,709	615,695	35,605	292,228	943,528
Laboratory	496,334	146,245	281,597	924,176	507,841	159,236	290,481	957,558
Home Health	663,216	79,649	58,676	801,541	634,634	66,032	55,933	756,599
Physical therapy	163,896	499,871	72,690	736,457	60,874	356,641	19,911	437,426
Ambulance	506,698	75	84,876	591,649	500,455	200	66,900	567,555
Radiology	322,715	53,516	92,817	469,048	346,774	38,817	66,975	452,566
Hospice	152,259	234,736	56,122	443,117	146,946	149,048	53,795	349,789
Medical records	343,159	600	65,309	409,068	324,937	1,650	68,673	395,260
Same day surgery	235,812	8,462	21,721	265,995	218,188	1,767	22,684	242,639
Public health	230,048	2,581	18,267	250,896	222,252	2,029	22,373	246,654
Anesthesiology	--	192,768	57,633	250,401	--	223,000	71,265	294,265
CT scanner	45,875	1,903	153,076	200,854	89,129	566	156,863	246,558
Electrocardiology	110,565	71,808	9,448	191,821	96,030	64,196	5,624	165,850
Respiratory therapy	137,389	--	39,072	176,461	131,366	125	37,055	168,546
Ultrasound	134,463	3,365	35,386	173,214	67,815	11,494	32,767	112,076
Outpatient Clinic	96,484	4,412	52,820	153,716	78,756	163	36,685	115,604
Oncology	120,459	245	23,825	144,529	120,835	2,599	19,676	143,110
Blood bank	--	109,532	--	109,532	--	165,032	13,628	178,660
Nuclear medicine	--	86,274	--	86,274	--	67,402	--	67,402
Electroencephalography	--	75,185	--	75,185	--	43,233	--	43,233
Quality assurance	62,638	--	6,772	69,410	64,214	114	6,799	71,127
Delivery and labor room	56,834	--	6,251	63,085	50,951	--	3,430	54,381
MRI	31,393	9,195	8,791	49,379	35,123	30,810	50,001	115,934
Enterostomal therapy	--	34,340	1,681	36,021	--	40,246	1,591	41,837
Speech therapy	--	33,154	265	33,419	--	27,167	101	27,268
Social services	17,262	--	3	17,265	18,119	--	88	18,207
Stress testing	4,264	--	--	4,264	4,275	--	--	4,275
	<u>5,618,030</u>	<u>3,237,892</u>	<u>5,079,029</u>	<u>13,934,972</u>	<u>5,279,672</u>	<u>2,924,099</u>	<u>5,352,337</u>	<u>13,556,108</u>
GENERAL SERVICES:								
Plant operation and maintenance	382,566	80,564	589,795	1,052,925	375,842	112,845	626,092	1,114,779
Dietary	295,325	1,038	285,140	581,503	340,153	5,020	627,574	632,747
Housekeeping	149,983	10,921	60,353	221,257	146,253	910	58,970	206,133
Laundry and linen	25,775	60,265	11,189	97,229	22,774	58,308	16,585	97,667
	<u>853,649</u>	<u>152,788</u>	<u>946,477</u>	<u>1,952,914</u>	<u>885,022</u>	<u>177,083</u>	<u>989,221</u>	<u>2,051,326</u>
ADMINISTRATIVE SERVICES								
	<u>1,822,374</u>	<u>555,157</u>	<u>980,973</u>	<u>3,358,504</u>	<u>1,640,279</u>	<u>304,905</u>	<u>789,747</u>	<u>2,734,931</u>
NONDEPARTMENTAL:								
Employee Benefits	--	--	3,257,418	3,257,418	--	--	2,719,371	2,719,371
Depreciation and amortization	--	--	2,254,755	2,254,755	--	--	2,001,534	2,001,534
Insurance	--	--	195,304	195,304	--	--	242,955	242,955
Interest	--	--	177,825	177,825	--	--	202,750	202,750
	<u>--</u>	<u>--</u>	<u>5,885,302</u>	<u>5,885,302</u>	<u>--</u>	<u>--</u>	<u>5,166,610</u>	<u>5,166,610</u>
TOTAL EXPENSES	\$ 10,527,173	4,033,675	13,018,604	27,579,452	10,462,552	3,457,966	12,464,881	26,385,399

See accompanying independent auditor's report

**Patient Receivables and Allowance for Doubtful Accounts
For the Years Ended June 30, 2012 and 2011**

ANALYSIS OF AGING:

Days Since Discharge	2012		2011	
	Amount	Percent of Total	Amount	Percent of Total
0 - 60	\$ 5,773,234	75.4 %	4,943,321	72.6 %
61 - 90	392,157	5.1	350,741	5.2
91 - 180	819,643	10.7	739,397	10.9
181 - 364	416,363	5.4	468,338	6.9
> 1 year	260,470	3.4	302,437	4.4
	<u>7,661,867</u>	<u>100.0 %</u>	<u>6,804,234</u>	<u>100.0 %</u>
Less:				
Allowance for doubtful accounts	(1,402,198)		(1,402,759)	
Allowance for contractual adjustments	<u>(2,437,447)</u>		<u>(1,907,099)</u>	
	<u>\$ 3,822,222</u>		<u>\$ 3,494,376</u>	

	2012	2011
NET DAYS REVENUE IN PATIENT ACCOUNTS RECEIVABLE	50.9 days	48.1 days
ALLOWANCE FOR DOUBTFUL ACCOUNTS:		
Balance, beginning of year	\$ 1,402,759	1,415,619
Provision of uncollectible accounts	1,144,815	1,327,960
Recoveries of accounts previously written off	266,671	267,640
Accounts written off	<u>(1,412,047)</u>	<u>(1,608,460)</u>
Balance, end of year	<u>\$ 1,402,198</u>	<u>1,402,759</u>

See accompanying independent auditor's report

**Inventory / Prepaid Expenses
For the Years Ended June 30, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
INVENTORY:		
Surgical services	\$ 342,278	304,642
Pharmacy	203,142	227,492
Central storeroom	104,316	116,538
Laboratory	34,324	26,626
Fuel oil	25,454	25,478
Dietary	10,905	12,029
Radiology	11,671	9,844
Computers	--	1,875
Respiratory therapy/stress testing	<u>4,307</u>	<u>8,003</u>
	<u>\$ 736,397</u>	<u>732,527</u>
PREPAID EXPENSES:		
Insurance	\$ 67,921	67,932
Maintenance contracts	82,490	61,222
Other	<u>16,639</u>	<u>11,566</u>
	<u>\$ 167,050</u>	<u>140,720</u>

See accompanying independent auditor's report

**Financial and Statistical Highlights
For the Years Ended June 30, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
Patient days:		
Adult and pediatric-		
Medicare	1,913	2,280
Other	<u>958</u>	<u>1,116</u>
	2,871	3,396
Swing bed - skilled	401	713
Newborn	<u>318</u>	<u>308</u>
Total	<u>3,590</u>	<u>4,417</u>
Patient discharges:		
Adult and pediatric-		
Medicare	468	554
Other	<u>357</u>	<u>388</u>
	825	942
Swing bed - skilled	68	127
Newborn	<u>143</u>	<u>139</u>
Total	<u>1,036</u>	<u>1,208</u>
Average length of stay:		
Adult and pediatric-		
Medicare	4.09 days	4.12 days
Other	2.68 days	2.88 days
Swing bed - skilled	5.90 days	5.61 days
Newborn	2.22 days	2.22 days
Surgical procedures	3,285	3,635
Emergency room visits	6,906	6,595
Number of employees - full-time equivalents	209	208

See accompanying independent auditor's report

**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 (Hospital) as of and for the years ended June 30, 2012 and 2011, and have issued our report thereon, dated October 16, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

Compliance and Other Matters

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

Comments involving statutory and other legal matters about the Hospital's operations for the year ended June 30, 2012 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.

The Hospital's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. While we have expressed our conclusions on the Hospital's responses, we did not audit the Hospital's responses and, accordingly, we express no opinion on them.

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.

Spim Johnson, LLP

Omaha, Nebraska,
October 16, 2012.

Lakes Regional Healthcare

Schedule of Findings and Questioned Costs For the Year Ended June 30, 2012

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.

INTERNAL CONTROL DEFICIENCIES:

No deficiencies were identified that required disclosure.

Part III: Other Findings Related to Required Statutory Reporting

III-A-12

Certified Budget: Hospital disbursements during the year ended June 30, 2012 did not exceed amounts budgeted.

III-B-12

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.

III-C-12

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

III-D-12

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.

III-E-12

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

III-F-12

Deposits and Investments: 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 were noted.

Lakes Regional Healthcare

Schedule of Findings and Questioned Costs For the Year Ended June 30, 2012

III-G-12

Publication of Bills Allowed and Salaries: Chapter 347.13(11) 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 one instance of noncompliance with the publication of bills allowed. The Hospital did not publish a list of expenditures timely after the completion of each quarter.

Recommendation: We recommend that management monitor timing for publication of their quarterly expenditures in order to comply with Chapter 347.13(11) of the Code of Iowa.

Response: Quarterly expenditures related to the fiscal year were published in August and September of 2012.

Conclusion: Response accepted.

Lakes Regional Healthcare

Audit Staff For the Year Ended June 30, 2012

This audit was performed by:

- Roger E. Thompson, FHFMA, CPA, Partner
- Joseph L. Harnisch, CPA, Senior Manager
- Natalie E. Miller, CPA, Staff Auditor
- Eric J. Vrba, Staff Auditor