

**Lakes Regional Healthcare**  
Spirit Lake, Iowa

**Basic Financial Statements and  
Supplementary Information  
June 30, 2013 and 2012**

**Together with Independent Auditor's Report**

# Lakes Regional Healthcare

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## Lakes Regional Healthcare

Officials  
June 30, 2013

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### Board of Trustees

	<u>Address</u>	<u>Term Expires</u>
Denny Perry, Chairman	Spirit Lake, Iowa	December 2016
Kris Walker, Vice-Chairman	Arnolds Park, Iowa	December 2018
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 2018
Jeremy Bolluyt	Spirit Lake, Iowa	December 2014

### Chief Executive Officer

Jason Harrington	Spirit Lake, Iowa	Indefinite
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### Chief Financial Officer

Steve Alger	Spirit Lake, Iowa	Indefinite
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## Independent Auditor's Report

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

### Report on the Financial Statements

We have audited the accompanying financial statements of Lakes Regional Healthcare (Hospital) as of and for the years ended June 30, 2013 and 2012, and the related notes to the financial statements, which collectively comprise the Hospital's basic financial statements as listed in the table of contents.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

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 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### 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, 2013 and 2012, and the respective change in its financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Other Matters**

### Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 4 - 8 and 26 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 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 or provide any assurance.

### Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Hospital's basic financial statements. The other supplementary statements (Exhibits 1 – 6) are presented for the purposes of additional analysis and are not a required part of the basic financial statements.

The supplementary information in Exhibits 1-6 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information in Exhibits 1 – 6 is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

## **Other Reporting Required by Government Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated October 14, 2013 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, and grant agreements and other matters. The purpose of that 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* in considering the Hospital's internal control over financial reporting and compliance.

*Spim Johnson, LLP*

Omaha, Nebraska,  
October 14, 2013.

# Lakes Regional Healthcare

## Management's Discussion and Analysis June 30, 2013 and 2012

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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, 2013, 2012 and 2011. This discussion and analysis should be read in conjunction with financial statements, which start on page 9.

### Financial Highlights

- LRH net position increased in 2013 by \$1,258,766 or 3.5%. In 2012, the net position increased by \$1,356,147 or 3.9%. In 2011, the net position increased by \$388,055 or 1.1%.
- LRH reported operating income in 2013 of \$798,183 compared to an operating income of \$924,425 in 2012 and an operating loss of \$421,770 in 2011.
- LRH reported non-operating revenues in 2013 of \$460,583 compared to non-operating revenues of \$431,722 and \$809,825 in 2012 and 2011, respectively.

### Using This Annual Report

LRH financial statements consist of three statements—a Statement of Net Position; a Statement of Revenues, Expenses, and Changes in Net Position; and a Statement of Cash Flows. These financial statements and the 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 Statement of Net Position and Statement of Revenues, Expenses, and Changes in Net Position

Analysis of LRH finances starts on page 9. The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position 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 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 position and changes in them. Increases or decreases in net position 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 also 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

## Management's Discussion and Analysis June 30, 2013 and 2012

*Table 1: Assets, Liabilities, and Net Position*

	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2013 Change</u>
<b>Assets:</b>				
Current assets	\$ 33,991,315	24,207,198	24,455,277	40.4%
Capital assets, net	23,436,858	15,731,421	14,324,000	49.0%
Other non-current assets	4,013,856	2,791,401	2,771,883	43.8%
<b>Total assets</b>	<u>61,442,029</u>	<u>42,730,020</u>	<u>41,551,160</u>	<u>43.8%</u>
<b>Liabilities:</b>				
Current Liabilities	6,833,981	3,636,200	3,518,487	87.9%
Long-term debt outstanding	17,585,462	3,330,000	3,625,000	428.1%
<b>Total liabilities</b>	<u>24,419,443</u>	<u>6,966,200</u>	<u>7,143,487</u>	<u>250.5%</u>
<b>Net position:</b>				
Net investment in capital assets	13,199,015	12,106,421	10,419,000	9.0%
Restricted for debt service	1,342,437	269,007	258,530	399.0%
Restricted expendable	189,832	200,023	307,210	-5.1%
Restricted nonexpendable	25,000	25,000	25,000	0.0%
Unrestricted	22,266,302	23,163,369	23,397,933	-3.9%
<b>Total net position</b>	<u>\$ 37,022,586</u>	<u>35,763,820</u>	<u>34,407,673</u>	<u>3.5%</u>

### Net Position

LRH net position is the difference between assets and liabilities reported in the Statement of Net Position on pages 9 and 10. LRH net position increased this past year by \$1,258,766 or 3.5%, as shown in Table 1. This compares to an increase of \$1,356,147 in 2012 and an increase of \$388,055 in 2011.

# Lakes Regional Healthcare

## Management's Discussion and Analysis June 30, 2013 and 2012

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

	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2013 Change</u>
<b>Operating Revenue:</b>				
Net patient service revenue	\$ 34,648,143	27,432,142	26,521,963	26.3%
Provision for bad debt	(1,842,480)	(1,144,815)	(1,327,960)	60.9%
Other operating revenue, net	1,326,016	2,096,610	767,587	-36.8%
Net assets released for operations	<u>1,969</u>	<u>119,940</u>	<u>2,039</u>	<u>-98.4%</u>
<b>Total operating revenue</b>	<u>34,133,648</u>	<u>28,503,877</u>	<u>25,963,629</u>	<u>19.8%</u>
<b>Operating Expenses:</b>				
Salaries and benefits	14,328,633	13,784,591	13,181,918	3.9%
Purchased services and other	16,744,846	11,362,281	10,999,198	47.4%
Depreciation and amortization	2,234,493	2,254,755	2,001,533	-0.9%
Interest	<u>27,493</u>	<u>177,825</u>	<u>202,750</u>	<u>-84.5%</u>
<b>Total operating expenses</b>	<u>33,335,465</u>	<u>27,579,452</u>	<u>26,385,399</u>	<u>20.9%</u>
<b>Operating income (loss)</b>	<u>798,183</u>	<u>924,425</u>	<u>(421,770)</u>	<u>-13.7%</u>
<b>Non-operating Revenues and Expenses</b>				
Investment income	120,773	188,559	332,472	-35.9%
County tax revenue	350,000	350,000	350,000	0.0%
Non-capital grants and contributions	--	350	--	0.0%
Other non-operating revenue and expenses, net	<u>(10,190)</u>	<u>(107,187)</u>	<u>127,353</u>	<u>-90.5%</u>
<b>Total non-operating revenue, net</b>	<u>460,583</u>	<u>431,722</u>	<u>809,825</u>	<u>6.7%</u>
<b>Increase in net position</b>	1,258,766	1,356,147	388,055	-7.2%
<b>Net position beginning of year</b>	<u>35,763,820</u>	<u>34,407,673</u>	<u>34,019,618</u>	<u>3.9%</u>
<b>Net position end of year</b>	<u>\$ 37,022,586</u>	<u>35,763,820</u>	<u>34,407,673</u>	<u>3.5%</u>

### Statement of Revenues, Expenses and Changes in Net Position

In 2013, LRH net position increased by \$1,258,766 or 3.5%, as shown in Table 2. This increase consisted of three components. Operating revenue increased by \$5,629,771 or 19.8% in 2013, while operating expenses increased by \$5,756,013 or 20.9%. Non-operating revenue increased by \$28,861 or 6.7%.

### Operating Revenue

The first component of the change in LRH net position is operating revenue. Operating revenue increased \$5,629,771 or 19.8% in 2013. The changes in operating revenue are as follows:

## Lakes Regional Healthcare

### Management's Discussion and Analysis June 30, 2013 and 2012

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- Net patient service revenue increased \$7,216,001 or 26.3% in 2013, compared to an increase of \$910,178 or 3.4% in 2012 and an increase of \$2,261,564 or 9.9% in 2011. During 2013, the hospital assumed the operations of the two primary care clinics located on the hospital campus. This accounted for additional patient service revenue of \$5,010,869. In addition, LRH received \$2,318,328 in 2013 and \$2,248,415 in 2012 of supplemental Medicare reimbursements as a member of the Rural Community Hospital Demonstration Program (see Note 3). Setting aside the positive effects of the above activity, net patient service revenue in 2013 saw steady patient volumes offset by Medicare reimbursement cuts via specific programs and sequestration. Acute patient days were 3,022 in 2013, compared to 2,871 in 2012 and 3,396 in 2011. Surgical patients were 2,044 in 2013, compared to 2,108 in 2012 and 2,148 in 2011.
- The ability to collect revenue charged to patients affects operating revenue. The provision for bad debt in 2013 was \$1,842,480, a 60.9% increase from 2012. This increase is a reflection of the steady patient volumes, and a larger number of patient balances with either no insurance or high deductible insurance plans.
- LRH at times provides care for patients who have little or no health insurance and are financially unable to make payment. The level of services provided to these patients was \$290,361 in 2013 compared to \$288,547 in 2012 and \$367,232 in 2011. Because there is no expectation of repayment, charity care affects operating revenue.
- LRH received Medicare incentive payments relating to the use of certified electronic health record technology (see Note 14). LRH recognized incentive payments of \$731,250 in 2013 compared to \$1,514,600 in 2012, and \$175,000 in 2011.

#### Operating Expenses

The second component of the change in LRH net position is operating expenses. Operating expenses increased \$5,756,013 or 20.9% in 2013. The primary components affecting operating expenses are:

- As noted above, the hospital assumed the operations of the two primary care clinics located on the hospital campus during 2013. This resulted in an increase of \$4,918,279 in operating expenses, with the majority classified as professional fees and purchased services.
- Salary and benefit costs for employees increased \$544,042 or 3.9% in 2013, compared to an increase of \$602,673 or 4.6% in 2012, and an increase of \$86,399 or .7% in 2011. The 2013 increase included \$168,881 for the newly added primary care clinics and the remainder for hospital wide wage and benefit increases.
- Purchased services and other expenses increased \$5,382,565 or 47.4% in 2013, compared to an increase of \$363,083 or 3.3% in 2012, and an increase of \$1,568,219 or 16.6% in 2011. The 2013 increase included \$4,924,411 for the primary care clinic operations with the majority of the remainder being supply costs which continue to be impacted by the high rate of healthcare inflation.

#### Non-operating Revenue and Expenses

The third and final component of the change in LRH net position is its non-operating revenue. Non-operating revenue increased \$28,861 or 6.7% in 2013. The primary components affecting non-operating revenue are:

- County tax revenue was \$350,000 in 2013, 2012, and 2011 respectively. Dickinson County provides property tax revenue to LRH for the ambulance service. The county tax levy was \$0.16291 per \$1,000 of valuation for 2013, \$0.16999 in 2012 and \$0.18613 in 2011. LRH has one of the lowest tax levies of Iowa county hospitals.
- Investment income was \$120,773 for 2013, \$188,559 in 2012, and \$332,472 in 2011. Excess cash is maintained in interest bearing checking, savings, and short term certificates of deposits. These low risk investments continue to have very low rates of return.
- Other non-operating revenues (expenses), net, which includes restricted and Auxillary activity, were (\$10,190) in 2013, (\$107,187) in 2012, and \$127,353 in 2011. The majority of this expense in 2013 related to Auxillary activity associated with the hospital gift shop.

# Lakes Regional Healthcare

## Management's Discussion and Analysis June 30, 2013 and 2012

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### Cash Flows

Changes in cash flows are consistent with changes in operating income (loss) and non-operating revenues and expenses, discussed earlier.

### Capital Asset and Debt Administration

#### Capital Assets

As of June 30, 2013 LRH had \$23,436,858 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. At June 30, 2012, LRH had \$15,731,421 invested in capital assets, net of accumulated depreciation. In 2013, LRH purchased new capital assets costing \$8,258,475. Capital spending was \$3,947,750 and \$2,233,971 in 2012 and 2011, respectively. The increased capital spending in 2013 is the result of construction in progress on 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.

#### Debt

At year-end, LRH had \$18,515,280 in capital loan notes outstanding. In conjunction with the construction project noted above, new debt totaling \$15,193,100 was issued in 2013.

#### Other Economic Factors

The 2013 fiscal year provided LRH with a combination of favorable and unfavorable Medicare reimbursement decisions. LRH was affected unfavorably by discontinuation of the Outpatient Hold Harmless provisions within the OPPS payment system along with the 2% Medicare reimbursement cuts that started in the spring of 2013 as a result of the government sequestration. The effects of these cuts were lessened somewhat by the favorable continued participation in the Rural Community Hospital Demonstration Program. 2013 was the second year of participation in this five year program.

In addition to the above pressures on hospital revenues, expenses continue to be impacted by higher than average inflation rates on supply and medical equipment costs combined with a steady rate of increase on salary costs for 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:

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

# Lakes Regional Healthcare

## Statements of Net Position June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 14,437,877	14,466,014
Certificates of deposit	3,708,547	3,802,653
Assets limited as to use - current portion	8,625,640	269,007
Receivables -		
Patients, net of allowance for doubtful accounts of \$1,895,793 in 2013 and \$1,402,198 in 2012	4,667,179	3,822,222
Succeeding year property tax	350,000	350,000
Other	1,153,648	593,855
Inventories	734,903	736,397
Prepaid expenses	181,647	167,050
Estimated third-party payor settlements, net	131,874	--
	<u>33,991,315</u>	<u>24,207,198</u>
Assets limited as to use:		
By Board for -		
Endowments - unrestricted	2,563,607	2,553,871
Under loan agreements, less amount required to meet current portion	994,234	--
By Donor - restricted	214,832	225,023
	<u>3,772,673</u>	<u>2,778,894</u>
Capital assets, net of accumulated depreciation	<u>23,436,858</u>	<u>15,731,421</u>
Other assets, net	<u>241,183</u>	<u>12,507</u>
Total assets	\$ <u><u>61,442,029</u></u>	<u><u>42,730,020</u></u>

*See notes to financial statements*

# Lakes Regional Healthcare

## Statements of Net Position (Continued) June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<b>LIABILITIES</b>		
Current liabilities:		
Current portion of long-term debt	\$ 929,818	295,000
Accounts payable -		
Trade	1,853,823	900,067
Construction	1,578,018	108,630
Salaries, wages and accrued vacation payable	1,386,017	1,273,797
Payroll taxes withheld and accrued	214,991	197,366
Accrued interest payable	30,562	2,905
Other accrued liabilities	490,752	432,554
Deferred revenue for succeeding year property tax receivable	350,000	350,000
Estimated third-party payor settlements, net	--	75,881
	<u>6,833,981</u>	<u>3,636,200</u>
Total current liabilities	6,833,981	3,636,200
Long-term debt, net of current portion	<u>17,585,462</u>	<u>3,330,000</u>
Total liabilities	<u>24,419,443</u>	<u>6,966,200</u>
<b>NET POSITION</b>		
Net investment in capital assets	13,199,015	12,106,421
Restricted -		
For debt service	1,342,437	269,007
Expendable for capital acquisitions & operating activities	189,832	200,023
Nonexpendable	25,000	25,000
Unrestricted	<u>22,266,302</u>	<u>23,163,369</u>
Total net position	<u>37,022,586</u>	<u>35,763,820</u>
Total liabilities and net position	<u>\$ 61,442,029</u>	<u>42,730,020</u>

*See notes to financial statements*

## Lakes Regional Healthcare

### Statements of Revenue, Expenses and Changes in Net Position For the Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
OPERATING REVENUE:		
Net patient service revenue before provision for bad debt	\$ 34,648,143	27,432,141
Provision for bad debt	<u>(1,842,480)</u>	<u>(1,144,815)</u>
Net patient service revenue	32,805,663	26,287,326
Other, net	<u>1,327,985</u>	<u>2,216,551</u>
Total operating revenue	<u>34,133,648</u>	<u>28,503,877</u>
OPERATING EXPENSES:		
Salaries	11,129,951	10,527,173
Employee benefits	3,198,682	3,257,418
Purchased services and professional fees	7,899,432	4,033,675
Utilities	454,122	437,097
Supplies and other expenses	8,169,939	6,696,205
Depreciation and amortization	2,234,493	2,254,755
Insurance	221,353	195,304
Interest	<u>27,493</u>	<u>177,825</u>
Total expenses	<u>33,335,465</u>	<u>27,579,452</u>
OPERATING INCOME	<u>798,183</u>	<u>924,425</u>
NONOPERATING REVENUE:		
Investment income	120,773	188,559
County tax revenue	350,000	350,000
Unrestricted gifts, grants and bequests	<u>--</u>	<u>350</u>
Total nonoperating revenue	<u>470,773</u>	<u>538,909</u>
EXCESS REVENUE OVER EXPENSES BEFORE RESTRICTED AND AUXILIARY ACTIVITY, NET	1,268,956	1,463,334
RESTRICTED AND AUXILIARY ACTIVITY, NET	<u>(10,190)</u>	<u>(107,187)</u>
INCREASE IN NET POSITION	1,258,766	1,356,147
NET POSITION, beginning of year	<u>35,763,820</u>	<u>34,407,673</u>
NET POSITION, end of year	<u>\$ 37,022,586</u>	<u>35,763,820</u>

See notes to financial statements

## Lakes Regional Healthcare

### Statements of Cash Flows

For the Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Cash received from patients and third party payors	\$ 31,752,951	26,055,536
Cash paid for employees salaries and benefits	(14,198,788)	(13,698,214)
Cash paid to suppliers and contractors	(15,745,995)	(11,193,146)
Other receipts and payments, net	751,496	1,816,797
	<u>2,559,664</u>	<u>2,980,973</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>		
County taxes received	350,000	350,000
Unrestricted gifts, grants and bequests	--	350
	<u>350,000</u>	<u>350,350</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
Purchase of capital assets, net	(8,258,475)	(3,947,750)
Proceeds from issuance of long-term debt, net of premium	15,193,100	--
Bond issuance costs incurred	(240,343)	--
Payments on long-term debt	(295,000)	(280,000)
Interest paid on long-term debt	(204,748)	(190,583)
	<u>6,194,534</u>	<u>(4,418,333)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Withdrawals from (deposits to) assets limited as to use, net	(9,361,590)	90,757
Withdrawals from certificates of deposit, net	94,106	2,556,939
Investment income	135,149	188,559
	<u>(9,132,335)</u>	<u>2,836,255</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(28,137)	1,749,245
<b>CASH AND CASH EQUIVALENTS - Beginning of year</b>	<u>14,466,014</u>	<u>12,716,769</u>
<b>CASH AND CASH EQUIVALENTS - End of year</b>	<u>\$ 14,437,877</u>	<u>14,466,014</u>

See notes to financial statements

## Lakes Regional Healthcare

### Statements of Cash Flows (Continued) For the Years Ended June 30, 2013 and 2012

	<u>2013</u>	<u>2012</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 798,183	924,425
Adjustments to reconcile operating income to net cash provided by operating activities -		
Depreciation and amortization	2,234,493	2,254,755
Interest expense	27,493	177,825
(Gain) loss on disposal of capital assets	(17,684)	40,701
(Increase) decrease in current assets -		
Receivables -		
Patients	(844,957)	(327,846)
Other	(559,793)	(329,126)
Inventories	1,494	(3,870)
Prepaid expenses	(14,597)	(26,330)
Estimated third-party payor settlements	(131,874)	20,174
Increase (decrease) in current liabilities -		
Accounts payable - trade	953,756	190,123
Due to restricted funds	988	(111,329)
Salaries, wages and accrued vacation payable	112,220	109,253
Payroll taxes withheld and accrued	17,625	(22,876)
Other accrued liabilities	58,198	9,213
Estimated third-party payor settlements	(75,881)	75,881
Net cash provided by operating activities	\$ <u>2,559,664</u>	<u>2,980,973</u>

*See notes to financial statements*

# Lakes Regional Healthcare

## Notes to Financial Statements

For the Years Ended June 30, 2013 and 2012

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### (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.

#### A. *Reporting Entity*

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.

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 statement of net position displays the Hospital's assets and liabilities, with the differences reported as net position. Net position is reported in the following categories:

*Net investment in capital assets* – This component of net position consists of capital assets, including any restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

# Lakes Regional Healthcare

## Notes to Financial Statements

For the Years Ended June 30, 2013 and 2012

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*Restricted* – This component of net position results when constraints placed on net positions through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

*Unrestricted* – This component of net position consists of net positions that do not meet the definition of the preceding categories. Unrestricted net position often has 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.

### 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, Net*

Net 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. *Inventories*

Inventories are valued at historical cost using the first-in, first-out method.

# Lakes Regional Healthcare

## Notes to Financial Statements For the Years Ended June 30, 2013 and 2012

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### 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 Loan Agreements* - These funds are used for the payment of principal and interest on associated debt and to provide funds for the Hospital construction project.

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

### 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 \$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

### L. *Costs of Borrowing*

Except for capital assets acquired through gifts, contributions or capital grants, interest cost on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring these assets.

### M. *Long-Term Debt Financing Costs*

Long-term debt financing costs related to the issuance of long-term debt are included with other assets in the statements of net position and are being amortized over the life of the related debt on a straight-line basis. Amortization expense of \$11,667 and \$1,250 for 2013 and 2012, respectively, is included in the accompanying statements of revenues, expenses and changes in net position.

## Lakes Regional Healthcare

### Notes to Financial Statements For the Years Ended June 30, 2013 and 2012

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*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, 2013 and 2012 was \$906,584 and \$865,968, respectively.

*O. Statement of Revenue, Expenses and Changes in Net Position*

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 revenue and 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 revenue. Amounts restricted to capital acquisitions or that are restricted to a specific operating purpose are reported after nonoperating revenue and expenses.

*R. Charity Care*

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

*S. 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 statements of net position in the amount of \$206,141 and \$201,592 at June 30, 2013 and 2012, respectively.

*T. 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.

## Lakes Regional Healthcare

### Notes to Financial Statements For the Years Ended June 30, 2013 and 2012

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#### U. *Change in Accounting Principle*

During 2013, the Hospital has adopted the provisions of GASB Statement No. 63. GASB Statement No. 63 required additional changes such as referring to "Net Assets" as "Net Position" on the statements of net position.

#### V. *Subsequent Events*

The Hospital considered events occurring through October 14, 2013 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, 2013 and 2012 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, 2013 and 2012.

### (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 and swing-bed services rendered to Medicare program beneficiaries are paid based on Medicare defined costs of providing the services pursuant to the terms of the Rural Community Hospital Demonstration Program. 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.

The "Budget Control Act of 2011" requires, among other things, mandatory across-the-board reductions in Federal spending, also known as sequestration. The "American Taxpayer Relief Act of 2012" postponed sequestration for two months. As required by law, President Obama issued a sequestration order on March 1, 2013. In general, Medicare claims with dates of service or dates of discharge on or after April 1, 2013, will incur a two percent reduction in Medicare payment.

## Lakes Regional Healthcare

### Notes to Financial Statements For the Years Ended June 30, 2013 and 2012

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**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 Hospital reports net patient service revenue at estimated net realizable amounts from patients, third-party payers, and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. Net patient service revenue increased \$450,000 and \$55,000 in 2013 and 2012, respectively, due to the removal of allowances previously estimated that are no longer necessary as a result of information obtained from final settlements and years that are no longer subject to audits, reviews, and investigations.

Revenue from the Medicare and Medicaid programs accounted for approximately 49% and 6%, respectively, of the Hospital's net patient service revenue for the year ended June 30, 2013, and 48% and 7%, respectively, for the year ended June 30, 2012. The Hospital grants credit without collateral to their patients, most of who are local residents and are insured under third-party payor agreements. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

#### (4) **Assets Limited as to Use**

##### By Board

Cash deposits and certificates of deposit designated by the Board for endowments as of June 30, 2013 and 2012, are summarized as follows:

	<u>2013</u>	<u>2012</u>
Endowments -		
Cash	\$ 4,393	12,094
Certificates of deposit	2,651,340	2,633,000
Interest receivable	2,852	2,766
Commingled donor funds (see below)	<u>(94,978)</u>	<u>(93,989)</u>
	<u>\$ 2,563,607</u>	<u>2,553,871</u>

##### Under Loan Agreements

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

*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).

In connection with the issuance of Dickinson County General Obligation Urban Renewal Hospital Bonds, Series 2012 and Series 2013, and pursuant to the Loan Agreements between Dickinson County and the Hospital, the Hospital is required to maintain the following funds:

## Lakes Regional Healthcare

### Notes to Financial Statements For the Years Ended June 30, 2013 and 2012

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*Construction Fund* – Consists of unexpended bond proceeds to be used for the construction, furnishing and equipping of the projects specified in the trust indenture agreements.

*Sinking Funds* – 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 2012 and 2013).

*Debt Service Reserve Fund* – Established for the deposit of an amount equal to the maximum annual debt service payable on the Series 2012 and 2013 notes in any future fiscal year.

The amounts as of June 30, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Bond Fund, Series 2002, cash	\$ 270,303	269,007
Construction Fund, Series 2012 and 2013, cash	8,277,437	--
Sinking Funds, Series 2012 and 2013, cash	77,900	--
Debt Service Reserve Fund, Series 2012 and 2013, cash	<u>994,234</u>	<u>--</u>
	9,619,874	269,007
Less current portion	<u>(8,625,640)</u>	<u>(269,007)</u>
	<u>\$ 994,234</u>	<u>--</u>

#### By Donor

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

The 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, 2013 and 2012 are as follows:

	<u>2013</u>	<u>2012</u>
Mandelbaum Endowment fund		
Certificate of deposit	\$ 25,000	25,000
Hospice and other restricted contributions		
Commingled with board designated endowment funds	94,978	93,989
Hospital auxiliary assets, primarily cash and cash equivalents	<u>94,854</u>	<u>106,034</u>
	<u>\$ 214,832</u>	<u>225,023</u>

# Lakes Regional Healthcare

## Notes to Financial Statements For the Years Ended June 30, 2013 and 2012

### (5) Capital Assets

Capital assets activity for the years ended June 30, 2013 and 2012 were as follows:

	June 30, 2012	Additions	Transfers and Disposals	June 30, 2013
Capital assets, not being depreciated:				
Land	\$ 919,017	--	--	919,017
Construction in progress	762,046	9,720,627	(865,913)	9,616,760
Total capital assets, not being depreciated	1,681,063	9,720,627	(865,913)	10,535,777
Capital assets, being depreciated:				
Land improvements	623,724	7,020	--	630,744
Hospital buildings	16,451,743	8,040	789,039	17,248,822
Medical office building	3,841,875	--	--	3,841,875
Fixed equipment	3,706,988	--	(43,389)	3,663,599
Major moveable equipment	13,465,747	269,451	(111,269)	13,623,929
Total capital assets, being depreciated	38,090,077	284,511	634,381	39,008,969
Less accumulated depreciation:				
Land improvements	390,296	24,651	--	414,947
Hospital buildings	8,352,483	650,640	--	9,003,123
Medical office building	2,357,194	122,949	--	2,480,143
Fixed equipment	2,153,816	348,448	(43,389)	2,458,875
Major moveable equipment	10,785,930	1,076,138	(111,268)	11,750,800
Total accumulated depreciation	24,039,719	2,222,826	(154,657)	26,107,888
Total capital assets, being depreciated, net	14,050,358	(1,938,315)	789,038	12,901,081
Total capital assets, net	\$ 15,731,421	7,782,312	(76,875)	23,436,858
	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

## Lakes Regional Healthcare

### Notes to Financial Statements

#### For the Years Ended June 30, 2013 and 2012

Construction in progress for the Hospital as of June 30, 2013 consists of Phase 2 of a multi-phase master facility plan. Phase 2 consists of the construction and remodeling of approximately 40,000 square feet of space that is providing 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 Spring 2014. The estimated cost of Phase 2 is \$20.6 million and is being financed through a combination of existing funds and two loans from Dickinson County totaling \$15 million.

#### (6) Long-Term Debt

Long-term debt activity of the Hospital as of June 30, 2013 and 2012 consisted of the following:

	<u>June 30,</u> <u>2012</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30,</u> <u>2013</u>	<u>Due Within</u> <u>One Year</u>
Capital loan notes (A)	\$ 3,625,000	--	(295,000)	3,330,000	310,000
Series 2012 loan agreement (B)	--	10,000,000	--	10,000,000	--
Series 2013 loan agreement (C)	--	5,000,000	--	5,000,000	600,000
Unamortized bond premiums (B, C)	--	193,100	(7,820)	185,280	19,818
	<u>\$ 3,625,000</u>	<u>15,193,100</u>	<u>(302,820)</u>	<u>18,515,280</u>	<u>929,818</u>
	<u>June 30,</u> <u>2011</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30,</u> <u>2012</u>	<u>Due Within</u> <u>One Year</u>
Capital loan notes (A)	\$ 3,905,000	--	280,000	3,625,000	295,000

- (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, 2017 at the rate equal to the five-year United States Treasury Note Index plus .25%.
- (B) On August 22, 2012, Dickinson County, Iowa issued \$10,000,000 of General Obligation Urban Renewal Hospital Bonds Series 2012. Proceeds from the issuance were loaned to the Hospital under a loan agreement between the Hospital and Dickinson County, Iowa. Proceeds from the Series 2012 are being used to provide funds for the construction of additions to and remodeling of the existing Hospital facilities. The interest rate on the bonds varies between 2.00% and 2.50%. Annual principal payments range in amounts from \$680,000 to \$945,000 and are due beginning in 2021 through June 2032.
- (C) On February 21, 2013, Dickinson County, Iowa issued \$5,000,000 of General Obligation Urban Renewal Hospital Bonds Series 2013. Proceeds from the issuance were loaned to the Hospital under a loan agreement between the Hospital and Dickinson County, Iowa. Proceeds from the Series 2013 are being used to provide funds for the construction of additions to and remodeling of the existing Hospital facilities. The interest rate on the bonds is 1.50%. Annual principal payments range in amounts from \$600,000 to \$740,000 and are due beginning in 2014 through 2020 with a final payment of \$70,000 in June 2021.

## Lakes Regional Healthcare

### Notes to Financial Statements For the Years Ended June 30, 2013 and 2012

A summary of the Hospital's future principal and interest payments as of June 30, 2013 is as follows:

<u>Year</u>	<u>Interest Rates</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2014	0.99 - 1.50	\$ 910,000	346,484	1,256,484
2015	0.99 - 1.50	1,030,000	313,616	1,343,616
2016	0.99 - 1.50	1,045,000	299,833	1,344,833
2017	0.99 - 1.50	1,065,000	285,903	1,350,903
2018	0.99 - 1.50	1,095,000	271,752	1,366,752
2019-2023	0.99 - 2.00	5,410,000	1,125,217	6,535,217
2024-2028	2.13	4,130,000	704,700	4,834,700
2029-2032	2.50	3,645,000	223,700	3,868,700
		18,330,000	<u>3,571,205</u>	<u>21,901,205</u>
Add unamortized bond premium		<u>185,280</u>		
		<u>\$ 18,515,280</u>		

Under the terms of the Series 2012 and 2013 loan agreements, the Hospital is required to maintain certain deposits, which are included with assets limited as to use, satisfy certain measures of financial performance as long as the loans are outstanding and comply with other covenants.

The following interest costs are associated with the Hospital's long-term debt:

	<u>2013</u>	<u>2012</u>
Interest costs	\$ 232,405	177,825
Amortization of bond premiums	(7,820)	--
Less interest capitalized with Hospital construction project	<u>(197,092)</u>	<u>--</u>
Interest included in the statements of revenue, expenses and changes in net position	<u>\$ 27,493</u>	<u>177,825</u>

#### (7) Designated Net Position

Of the \$22,266,302 and \$23,163,369 of unrestricted net position reported in 2013 and 2012, respectively \$2,563,607 and \$2,553,871 has been designated by the Hospital's Board of Trustees for endowments. Designated funds remain under control of the Board of Trustees, which may as its discretion later use the funds for other purposes.

#### (8) 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.

## Lakes Regional Healthcare

### Notes to Financial Statements For the Years Ended June 30, 2013 and 2012

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Accounting principles generally accepted in the United States of America require a healthcare provider to recognize the ultimate costs of malpractice claims or similar contingent liabilities, which include costs associated with litigating or settling claims, when the incidents that give rise to the claims occur. The Hospital does evaluate all incidents and claims along with prior claim experienced to determine if a liability is to be recognized. For the years ending June 30, 2013 and 2012, management determined no liability should be recognized for asserted or unasserted claims. Management is not aware of any such claim that would have a material adverse impact on the accompanying financial statements.

#### (9) 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 5.78% and 5.38% of their annual salary and the Hospital is required to contribute an additional 8.67% and 8.07% of annual covered payroll for 2013 and 2012, respectively. Contribution requirements are established by State statute. The Hospital's contribution to IPERS for the years ended June 30, 2013, 2012 and 2011 were \$949,393, \$846,471 and \$710,995, respectively, which equaled the required contributions for each year.

#### (10) Rental Income

The Hospital is the lessor of certain office space leased under various noncancelable operating leases through 2022. Rental income is recorded monthly as earned in other operating revenue. The future minimum rentals under these leases are as follows:

2014	\$	72,032
2015		64,125
2016		64,125
2017		64,125
2018		64,125
2019 – 2022		160,313

#### (11) Contingencies

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

#### (12) Group Health Insurance Costs

The Hospital is self-insured under its employee group health program, up to certain limits. Included in the accompanying statements of revenue, expenses, and changes in net position 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.

## Lakes Regional Healthcare

### Notes to Financial Statements

For the Years Ended June 30, 2013 and 2012

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#### (13) Concentrations of Credit Risk

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

	<u>2013</u>	<u>2012</u>
Medicare	33.7%	33.3%
Medicaid	3.0	5.2
Blue Cross	14.7	21.3
Private pay	34.2	28.4
Other third-party payors	<u>14.4</u>	<u>11.8</u>
	<u>100.0%</u>	<u>100.0%</u>

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

#### (14) 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 years 2013 and 2012, the Hospital recognized \$731,250 and \$1,339,600, respectively, of Medicare meaningful use grant revenue. For fiscal years 2013 and 2012 the Hospital recognized \$-0- and \$175,000, respectively, of Medicaid meaningful use grant revenue in other revenue in its statement of revenue, expenses, and changes in net position.

## Lakes Regional Healthcare

### Budgetary Comparison Schedule of Revenues, Expenses and Changes in Net Position – Budget and Actual (Cash Basis) June 30, 2013 and 2012

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, 2013, 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		Actual Cash Basis	Budgeted Amounts		Variance Favorable (Unfavorable)
	Accrual Basis	Accrual Adjustments		Original	Amended	
Estimated amount to be raised by taxation	\$ 350,000	--	350,000	345,160	345,160	4,840
Estimated other revenues / receipts	<u>34,244,231</u>	<u>13,574,862</u>	<u>47,819,093</u>	<u>28,174,040</u>	<u>28,174,040</u>	<u>19,645,053</u>
	34,594,231	13,574,862	48,169,093	28,519,200	28,519,200	19,649,893
Expenses / Disbursements	<u>33,335,465</u>	<u>5,606,979</u>	<u>38,942,444</u>	<u>27,215,600</u>	<u>42,638,600</u>	<u>3,696,156</u>
Net	1,258,766	7,967,883	9,226,649	\$ <u>1,303,600</u>	<u>(14,119,400)</u>	<u>23,346,049</u>
Balance beginning of year	<u>35,763,820</u>	<u>(14,452,002)</u>	<u>21,311,818</u>			
Balance end of year	\$ <u>37,022,586</u>	<u>(6,484,119)</u>	<u>30,538,467</u>			

*See accompanying independent auditor's report*

**Patient Service Revenue**  
**For the Years Ended June 30, 2013 and 2012**

	2013				2012			
	Inpatient	Outpatient	Swing Bed	Total	Inpatient	Outpatient	Swing Bed	Total
<b>NURSING SERVICES:</b>								
Medical, surgical and obstetrics	\$ 2,815,768	30,690	--	2,846,458	2,417,768	22,320	--	2,440,088
Observation	149,788	577,711	--	727,499	88,638	479,521	--	568,159
Swing bed	--	--	293,321	293,321	--	--	184,794	184,794
Coronary care	249,147	--	--	249,147	180,310	1,396	--	181,706
Nursery	151,420	--	--	151,420	202,884	--	--	202,884
	<u>3,366,123</u>	<u>608,401</u>	<u>293,321</u>	<u>4,267,845</u>	<u>2,889,600</u>	<u>503,237</u>	<u>184,794</u>	<u>3,577,631</u>
<b>OTHER PROFESSIONAL SERVICES:</b>								
Operating and recovery rooms	1,349,202	6,905,551	15,456	8,270,209	1,483,244	6,550,726	3,022	8,036,992
Pharmacy	1,201,837	5,336,764	158,190	6,696,791	1,019,043	4,732,900	147,710	5,899,653
Primary care clinics	--	6,381,135	--	6,381,135	--	--	--	--
Emergency and outpatient service	537,591	4,874,856	2,469	5,414,916	489,603	4,484,838	449	4,974,890
Laboratory	755,756	4,245,230	80,836	5,081,822	627,576	3,345,619	48,027	4,021,222
Central services and supply	2,506,276	1,986,486	10,869	4,503,631	1,896,654	1,470,532	5,974	3,373,160
CT scanner	148,987	2,148,462	3,250	2,300,699	158,540	1,782,483	1,330	1,942,353
Radiology	171,128	1,511,998	25,031	1,708,157	117,538	1,534,508	8,185	1,660,231
Ambulance	237,355	1,422,909	2,206	1,662,470	157,524	1,235,885	3,580	1,396,989
MRI	33,047	1,592,114	15,135	1,640,296	42,624	1,401,922	2,762	1,447,308
Ultrasound	85,368	1,101,551	16,778	1,203,697	44,011	929,072	3,012	976,095
Physical therapy	163,678	879,765	74,350	1,117,793	137,854	829,785	52,908	1,020,547
Intravenous therapy	235,564	849,604	8,974	1,094,142	211,824	697,306	5,180	914,310
Anesthesiology	212,144	871,409	2,556	1,086,109	248,418	761,458	270	1,010,146
Outpatient clinic	10,356	1,014,611	--	1,024,967	8,683	836,372	--	845,055
Home health	--	917,664	--	917,664	--	936,430	--	936,430
Respiratory therapy	490,901	173,387	80,546	744,834	401,656	98,135	53,150	552,941
Electrocardiology	89,472	449,386	6,912	545,770	65,318	345,084	1,521	411,923
Mammogram	--	349,611	--	349,611	--	302,404	--	302,404
Electroencephalography	--	343,561	--	343,561	418	232,770	--	233,188
Hospice	341,353	--	--	341,353	659,988	--	--	659,988
Public health	--	322,478	--	322,478	--	316,465	--	316,465
Occupational therapy	75,794	181,935	47,691	305,420	48,475	187,460	30,110	266,045
Delivery and labor room	211,351	88,622	--	299,973	171,219	60,539	--	231,758
Nuclear medicine	4,722	219,102	3,189	227,013	2,685	181,419	--	184,104
Blood	73,789	60,014	3,614	137,417	79,696	98,814	4,770	183,280
Enterostomal therapy	1,177	131,211	--	132,388	4,420	95,724	1,720	101,864
Cardiac rehab	--	119,052	--	119,052	113	130,097	--	130,210
Stress testing	279	90,529	--	90,808	--	81,672	--	81,672
Speech therapy	19,786	15,440	2,539	37,765	13,293	65,077	2,661	81,031
	<u>8,937,127</u>	<u>44,568,997</u>	<u>558,052</u>	<u>54,101,941</u>	<u>8,090,417</u>	<u>33,725,496</u>	<u>376,341</u>	<u>42,192,254</u>
<b>GROSS PATIENT SERVICE REVENUE</b>	<b>\$ 12,303,250</b>	<b>45,177,398</b>	<b>851,373</b>	<b>58,369,786</b>	<b>10,980,017</b>	<b>34,228,733</b>	<b>561,135</b>	<b>45,769,885</b>
<b>LESS:</b>								
Contractual allowances and other deductions, primarily Medicare and Medicaid				(23,208,817)				(17,817,990)
Charity care services and other discounts, based on charges forgone				(512,826)				(519,754)
<b>NET PATIENT SERVICE REVENUE BEFORE PROVISION FOR BAD DEBT</b>				<b>\$ 34,648,143</b>				<b>\$ 27,432,141</b>
<b>PROVISION FOR BAD DEBT</b>				<b>(1,842,480)</b>				<b>(1,144,815)</b>
<b>NET PATIENT SERVICE REVENUE</b>				<b>\$ 32,805,663</b>				<b>\$ 26,287,326</b>

See accompanying independent auditor's report

**Other Operating Revenue**  
**For the Years Ended June 30, 2013 and 2012**

	<u>2013</u>	<u>2012</u>
Medicare EHR incentive	\$ 731,250	1,339,600
Rental income	212,321	352,278
Meals sold	149,543	144,560
Lifeline	69,512	64,899
Grants	56,955	14,590
Other	56,740	17,401
Meals on wheels	27,014	18,627
Gain (loss) on disposal of capital assets	17,684	(40,701)
Medical record fees	4,425	4,674
Net position released for operations	1,969	119,940
Dietary instruction	572	5,683
Medicaid EHR incentive	--	175,000
	<u>\$ 1,327,985</u>	<u>2,216,551</u>

*See accompanying independent auditor's report*

**Departmental Expenses  
For the Years Ended June 30, 2013 and 2012**

	2013				2012			
	Salaries and Wages	Professional Fees and Purchased Services	Supplies and Other	Total	Salaries and Wages	Professional Fees and Purchased Services	Supplies and Other	Total
<b>NURSING SERVICES:</b>								
Medical and surgical	\$ 1,860,480	--	100,286	1,960,766	1,761,804	26,170	93,017	1,880,991
Administration	147,602	--	987	148,589	116,530	--	2,004	118,534
Coronary care	175,483	39,100	15,448	230,031	120,180	44,400	4,980	169,560
Obstetrics	153,605	2,748	20,484	176,837	162,233	17,270	19,492	198,995
Nursery	66,579	--	3,772	70,351	72,373	--	7,330	79,703
	<u>2,403,749</u>	<u>41,848</u>	<u>140,977</u>	<u>2,586,574</u>	<u>2,233,120</u>	<u>87,840</u>	<u>126,823</u>	<u>2,447,783</u>
<b>OTHER PROFESSIONAL SERVICES:</b>								
Primary care clinics	130,922	4,282,456	504,901	4,918,279	--	--	--	--
Pharmacy	271,684	--	2,541,822	2,813,506	277,016	--	2,291,640	2,568,656
Emergency room	767,497	1,335,245	174,740	2,277,482	702,421	1,460,880	180,134	2,343,435
Central services and supply	59,285	--	1,757,451	1,816,736	60,256	--	1,177,118	1,237,374
Operating and recovery room	654,670	124,300	301,265	1,080,235	646,574	129,096	283,041	1,058,711
Laboratory	522,319	206,225	256,768	985,312	496,333	146,245	281,599	924,177
Physical therapy	180,004	495,716	61,487	737,207	163,896	499,871	72,689	736,456
Home health	613,440	60,749	53,299	727,488	663,216	79,649	58,675	801,540
Ambulance	515,219	--	116,379	631,598	506,698	75	84,876	591,649
Radiology	345,814	75,968	123,637	545,419	322,715	53,516	92,817	469,048
Medical records	314,093	8	47,531	361,632	343,159	600	65,310	409,069
Outpatient clinic	278,792	--	54,613	333,405	216,943	4,657	76,644	298,244
Hospice	149,340	130,340	46,215	325,895	152,259	234,735	56,122	443,116
Anesthesiology	160,454	52,637	64,990	278,081	--	--	192,768	250,401
Same day surgery	239,146	--	23,555	262,701	235,812	8,462	21,721	265,995
Public health	236,632	4,492	21,228	262,352	230,048	2,581	18,267	250,896
CT scanner	43,453	8,440	155,103	206,996	45,875	1,903	153,076	200,854
Electrocardiology	99,846	97,682	8,296	205,824	110,566	71,808	9,447	191,821
Respiratory therapy	139,543	--	41,702	181,245	--	--	39,073	176,461
Ultrasound	117,505	10,627	32,003	160,135	134,464	3,365	35,386	173,215
MRI	27,767	--	119,443	147,210	31,393	9,195	8,791	49,379
Blood bank	--	99,577	--	99,577	--	109,532	--	109,532
Nuclear medicine	--	92,770	--	92,770	--	86,274	--	86,274
Quality assurance	70,864	--	5,529	76,393	62,639	--	6,772	69,411
Delivery and labor room	52,284	--	6,735	59,019	56,834	--	6,251	63,085
Electroencephalography	--	58,088	80	58,168	--	75,185	--	75,185
Enterostomal therapy	--	44,070	2,732	46,802	--	34,340	1,681	36,021
Speech therapy	--	19,845	6	19,851	--	33,154	265	33,419
Social services	16,509	--	56	16,565	17,263	--	3	17,266
Stress testing	4,412	--	--	4,412	4,264	--	--	4,264
	<u>6,011,494</u>	<u>7,199,235</u>	<u>6,521,566</u>	<u>19,732,295</u>	<u>5,618,032</u>	<u>3,237,891</u>	<u>5,079,031</u>	<u>13,934,954</u>
<b>GENERAL SERVICES:</b>								
Plant operation and maintenance	379,952	105,846	585,043	1,070,841	382,565	80,564	589,795	1,052,924
Dietary	294,803	10,132	265,738	570,673	295,324	1,038	285,140	581,502
Housekeeping	163,990	1,790	51,429	217,209	149,983	10,920	60,352	221,255
Laundry and linen	27,537	63,669	5,670	96,876	25,775	60,265	11,189	97,229
	<u>866,282</u>	<u>181,437</u>	<u>907,880</u>	<u>1,955,599</u>	<u>853,647</u>	<u>152,787</u>	<u>946,476</u>	<u>1,952,910</u>
<b>ADMINISTRATIVE SERVICES</b>	<u>1,848,426</u>	<u>476,912</u>	<u>1,053,638</u>	<u>3,378,976</u>	<u>1,822,374</u>	<u>555,157</u>	<u>980,972</u>	<u>3,358,503</u>
<b>NONDEPARTMENTAL:</b>								
Employee benefits	--	--	3,198,682	3,198,682	--	--	3,257,418	3,257,418
Depreciation and amortization	--	--	2,234,493	2,234,493	--	--	2,254,755	2,254,755
Insurance	--	--	221,353	221,353	--	--	195,304	195,304
Interest	--	--	27,493	27,493	--	--	177,825	177,825
	<u>--</u>	<u>--</u>	<u>5,682,021</u>	<u>5,682,021</u>	<u>--</u>	<u>--</u>	<u>5,885,302</u>	<u>5,885,302</u>
<b>TOTAL EXPENSES</b>	<u>\$ 11,129,951</u>	<u>7,899,432</u>	<u>14,306,082</u>	<u>33,335,465</u>	<u>10,527,173</u>	<u>4,033,675</u>	<u>13,018,604</u>	<u>27,579,452</u>

See accompanying independent auditor's report

**Patient Receivables and Allowance for Doubtful Accounts  
June 30, 2013 and 2012**

## ANALYSIS OF AGING:

Days Since Discharge	2013		2012	
	Amount	Percent of Total	Amount	Percent of Total
0 - 60	\$ 6,089,421	66.5 %	5,773,234	75.4 %
61 - 90	661,242	7.2	392,157	5.1
91 - 180	1,177,941	12.9	819,643	10.7
181 - 364	677,329	7.4	416,363	5.4
> 1 year	553,528	6.0	260,470	3.4
	<u>9,159,461</u>	100.0 %	<u>7,661,867</u>	100.0 %
Less:				
Allowance for doubtful accounts	(1,895,793)		(1,402,198)	
Allowance for contractual adjustments	<u>(2,596,489)</u>		<u>(2,437,447)</u>	
	<u>\$ 4,667,179</u>		<u>\$ 3,822,222</u>	

	2013	2012
NET DAYS REVENUE IN PATIENT ACCOUNTS RECEIVABLE	49.3 days	50.9 days
ALLOWANCE FOR DOUBTFUL ACCOUNTS:		
Balance, beginning of year	\$ 1,402,198	1,402,759
Provision of uncollectible accounts	1,842,480	1,144,815
Recoveries of accounts previously written off	308,400	266,671
Accounts written off	<u>(1,657,285)</u>	<u>(1,412,047)</u>
Balance, end of year	<u>\$ 1,895,793</u>	<u>1,402,198</u>

See accompanying independent auditor's report

**Inventories / Prepaid Expenses**  
**June 30, 2013 and 2012**


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	<u>2013</u>	<u>2012</u>
INVENTORIES:		
Surgical services	\$ 305,567	342,278
Pharmacy	222,062	203,142
Central storeroom	98,261	104,316
Primary care clinics	55,065	--
Laboratory	19,713	34,324
Radiology	18,395	11,671
Dietary	10,073	10,905
Respiratory therapy/stress testing	3,904	4,307
Fuel oil	<u>1,863</u>	<u>25,454</u>
	<u>\$ 734,903</u>	<u>736,397</u>
PREPAID EXPENSES:		
Insurance	\$ 52,413	67,921
Maintenance contracts	106,426	82,490
Other	<u>22,808</u>	<u>16,639</u>
	<u>\$ 181,647</u>	<u>167,050</u>

*See accompanying independent auditor's report*

**Financial and Statistical Highlights  
For the Years Ended June 30, 2013 and 2012**

	<u>2013</u>	<u>2012</u>
Patient days:		
Adult and pediatric-		
Medicare	2,067	1,913
Other	<u>955</u>	<u>958</u>
	3,022	2,871
Swing bed - skilled	602	401
Newborn	<u>229</u>	<u>318</u>
Total	<u><u>3,853</u></u>	<u><u>3,590</u></u>
Patient discharges:		
Adult and pediatric-		
Medicare	501	468
Other	<u>333</u>	<u>357</u>
	834	825
Swing bed - skilled	94	68
Newborn	<u>97</u>	<u>143</u>
Total	<u><u>1,025</u></u>	<u><u>1,036</u></u>
Average length of stay:		
Adult and pediatric-		
Medicare	4.13 days	4.09 days
Other	2.87 days	2.68 days
Swing bed - skilled	6.40 days	5.90 days
Newborn	2.36 days	2.22 days
Surgical procedures	3,655	3,445
Emergency room visits	7,089	6,906
Number of employees - full-time equivalents	214	209

*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 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, the financial statements of Lakes Regional Healthcare (Hospital) as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Hospital's basic financial statements, and have issued our report thereon dated October 14, 2013.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Hospital's internal control over financial reporting (internal control) to determine the auditing procedures for the purpose of expressing our opinion of the financial statements but not for the purpose of expressing our opinion on the effectiveness of the Hospital's internal control. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control.

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. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of the internal control 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weakness may exist that have not been identified.

**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 or other matters 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, 2013 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.

**Purpose of the Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Hospital's internal control or on compliance. This report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the Hospital's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Spim Johnson, LLP*

Omaha, Nebraska,  
October 14, 2013.

# Lakes Regional Healthcare

## Schedule of Findings and Responses For the Year Ended June 30, 2013

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### Part I: Summary of the Independent Auditor's Results

- a. An unmodified 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-13**

*Certified Budget:* Hospital disbursements during the year ended June 30, 2013 did not exceed amounts budgeted.

#### **III-B-13**

*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-13**

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

#### **III-D-13**

*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-13**

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

#### **III-F-13**

*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 Responses For the Year Ended June 30, 2013

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#### **III-G-13**

*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 no instances of noncompliance with the publication of bills allowed and salaries. The Hospital publishes a list of expenditures timely after the completion of each quarter. The Hospital also publishes a schedule of salaries annually by category.

## Lakes Regional Healthcare

### Summary Schedule of Prior Year Audit Findings For the Year Ended June 30, 2013

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<u>Finding</u>	<u>Finding title</u>	<u>Status</u>	<u>If not corrected, corrective action plan or other explanation</u>
II-G-12	Publication of bills allowed and salaries	Corrected	

## Lakes Regional Healthcare

### Audit Staff For the Year Ended June 30, 2013

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This audit was performed by:

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