

**Lucas County Health Center**  
Chariton, Iowa

**Basic Financial Statements and  
Supplementary Information  
June 30, 2014 and 2013**

**Together with Independent Auditor's Report**

# Lucas County Health Center

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# Lucas County Health Center

Officials  
June 30, 2014

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<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
<b>Board of Trustees:</b>		
Betty Hansen	Chairman	December 2018
Natalie McGee	Vice Chairman	December 2016
Randy Westman	Secretary	December 2014
Sue Frazier	Treasurer	December 2018
Raymond Meyer	Member	December 2016
Mike Miller	Member	December 2018
Denise Storm	Member	December 2014
<b>Health Center Officials:</b>		
Veronica Fuhs	Chief Executive Officer	
Larry Brown	Chief Financial Officer	

## Independent Auditor's Report

To the Board of Trustees  
Lucas County Health Center  
Chariton, Iowa:

### Report on the Financial Statements

We have audited the accompanying financial statements of Lucas County Health Center (Health Center) as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Health Center'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 audit. 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. Those standards require that we plan and perform the audit 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 Health Center as of June 30, 2014, and the respective change in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Emphasis of Matter**

As discussed in Note 1 to the financial statements, in 2014 the Health Center adopted new accounting guidance to reflect the provisions of Statement No. 65 of the Governmental Accounting Standards Board, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

**Other Matters**

The financial statements of the Health Center, as of and for the year ended June 30, 2013, were audited by other auditors whose report dated October 22, 2013 expressed an unmodified opinion of those statements.

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis (pages 4 through 9) and budgetary comparison information (page 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 Health Center'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 (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 (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 16, 2014 on our consideration of the Health Center'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 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 Health Center's internal control over financial reporting and compliance.



Omaha, Nebraska,  
October 16, 2014.

## **Lucas County Health Center**

### **Management's Discussion and Analysis June 30, 2014 and 2013**

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As management of Lucas County Health Center, we offer readers of the financial statements this narrative overview and analysis of the Health Center's financial performance during the fiscal years ended June 30, 2014, 2013 and 2012. Please read it in conjunction with the Health Center's financial statements, which follow this section.

#### **Overview of the Financial Statements**

This annual report includes this management's discussion and analysis, the independent auditor's reports, the basic financial statements of the Health Center, and supplementary information. The financial statements also include notes that explain in more detail some of the information in the financial statements.

#### **Required Financial Statements**

The financial statements of the Health Center report information of the Health Center using accounting methods similar to those used by private sector companies. These statements offer short and long-term financial information about its activities. The statement of net position includes all of the Health Center's assets and liabilities and provides information about the nature and amounts of investments in resources, assets, and the obligations to Health Center's creditors, liabilities. It also provides the basis for evaluating the capital structure of the Health Center and assessing the liquidity and financial flexibility of the Health Center.

All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses, and changes in net position. This statement measures the success of the Health Center operations over the past year and can be used to determine whether the Health Center has successfully recovered all its costs through its patient service revenue and other revenue sources, profitability and credit worthiness.

The final required financial statement is the statement of cash flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, noncapital financing, capital and related financing and investing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

#### **Financial Highlights**

- Total assets increased by \$709,688, or 6.9%, to \$11,021,673
- Noncurrent assets whose use is limited or restricted remained steady over the last 2 years at \$273,820
- Total property and equipment decreased by \$543,118 to \$5,184,324
- Total net position increased by \$288,699 to \$6,454,532
- Net patient service revenue increased by \$1,618,645, or 10.8%, to \$16,633,627
- Total operating expenses increased by \$1,063,229, or 5.9%, to \$19,148,373

#### **Financial Analysis of the Health Center**

The statement of net position and the statement of revenue, expenses, and changes in net position report the net position of the Health Center and the changes in them. The Health Center's net position, the difference between assets and liabilities, are a way to measure financial health or financial position. Over time, sustained increases or decreases in the Health Center's net position are one indicator of whether its financial health is improving or deteriorating. However, other nonfinancial factors such as changes in economic conditions, population growth and new or changed government legislation should also be considered.

**Lucas County Health Center**

**Management's Discussion and Analysis  
June 30, 2014 and 2013**

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A summary of the Health Center's balance sheets is presented in Table 1.

**Table 1: Statements of Net Position**

	<u>2014</u>	<u>2013</u>	<u>2012</u>
<b>Assets:</b>			
Estimated third-party payor settlements	\$ 17,000	12,000	380,000
Other current assets	5,546,529	4,295,230	4,423,670
Assets limited as to use or restricted	273,820	277,313	231,615
Capital assets, net	<u>5,184,324</u>	<u>5,727,442</u>	<u>6,523,544</u>
Total assets	<u>11,021,673</u>	<u>10,311,985</u>	<u>11,558,829</u>
<b>Liabilities:</b>			
Long-term debt	1,123,813	1,297,588	1,418,536
Other current and non-current liabilities	<u>2,269,530</u>	<u>1,663,564</u>	<u>1,848,699</u>
Total liabilities	<u>3,393,343</u>	<u>2,961,152</u>	<u>3,267,235</u>
<b>Deferred Inflows of Resources,</b>			
Unavailable property tax revenue	<u>1,173,798</u>	<u>1,185,000</u>	<u>1,050,000</u>
<b>Net Position:</b>			
Net investment in capital assets	4,060,511	4,429,854	5,105,008
Restricted - expendable for debt service	102,282	102,085	100,464
Unrestricted	<u>2,291,739</u>	<u>1,633,894</u>	<u>2,036,122</u>
Total net position	<u>\$ 6,454,532</u>	<u>6,165,833</u>	<u>7,241,594</u>

As depicted in Table 1, total assets increased in fiscal year 2014 to \$11,021,673. The change in total assets was due to a decrease in total property and equipment as a result of provision for depreciation in excess of additions to property and equipment as well as an increase of over \$600,000 in accounts receivable related to increased revenue and a recent change to Rural Health Clinic status in the hospital's attached clinic.

Total liabilities increased due to the purchase of computer software and hardware in order to meet CMS Meaningful Use requirements. An agreement was reached with the computer system vendor that payment was not required until funds had been received from CMS.

## Lucas County Health Center

### Management's Discussion and Analysis June 30, 2014 and 2013

A summary of the Health Center's historical statements of revenues, expenses, and changes in net position is presented in Table 2.

**Table 2: Operating Results and Changes in Net Position**

	<u>2014</u>	<u>2013</u>	<u>2012</u>
<b>Operating revenue:</b>			
Net patient service revenue	\$ 16,633,627	15,014,982	14,724,177
Other operating revenue	1,413,205	696,878	965,253
Total operating revenue	<u>18,046,832</u>	<u>15,711,860</u>	<u>15,689,430</u>
<b>Operating expenses:</b>			
Salaries and employee benefits	11,561,751	10,956,400	8,347,983
Purchased services and other	6,515,350	6,043,183	8,204,383
Depreciation	1,011,461	1,019,597	1,078,738
Interest	59,811	65,964	70,056
Total expenses	<u>19,148,373</u>	<u>18,085,144</u>	<u>17,701,160</u>
<b>Operating loss</b>	<u>(1,101,541)</u>	<u>(2,373,284)</u>	<u>(2,011,730)</u>
<b>Nonoperating Revenue:</b>			
County taxes	1,187,890	1,056,660	847,752
Investment income	41,084	18,281	37,303
Grants and contributions	161,266	222,582	190,071
Total nonoperating revenue, net	<u>1,390,240</u>	<u>1,297,523</u>	<u>1,075,126</u>
Increase (decrease) in net position	288,699	(1,075,761)	(936,604)
Net position, beginning of year	<u>6,165,833</u>	<u>7,241,594</u>	<u>8,178,198</u>
Net position, end of year	<u>\$ 6,454,532</u>	<u>6,165,833</u>	<u>7,241,594</u>

#### Operating and Financial Performance

The following summarizes the Health Center's statements of revenues, expenses and changes in net position between June 30, 2014 and 2013.

**Net Patient Service Revenue:** Net patient service revenue is a product of volume, price increases and payor mix.

**Volume:** Acute discharges for fiscal year 2014 were 412 compared to 344 in fiscal year 2013. Average length of stay was 3.01 for fiscal year 2014 compared to 3.44 in fiscal year 2013 as acute patient days increased to 1,185 from 1,090 in 2013. Swing bed discharges for fiscal year 2014 were 68 compared to 63 in fiscal year 2013. Swing bed average length of stay increased and patient days increased to 905 from 622 in 2013 while swing bed revenue increased 45.8% to \$1,282,308. Volume on the outpatient side indicated positive growth in 2014. In 2014, gross outpatient charges increased to \$23,298,582 compared to \$21,062,388 in 2013. Laboratory, radiology, and LCHC Medical Clinic reflected the most significant increases in 2014.

**Price Increase:** As is customary annually, the Health Center did review its charge structure and incorporated certain price increases in 2014. Overall, gross patient service revenue increased to \$28,486,146 from \$25,611,527 in 2013.

## Lucas County Health Center

### Management's Discussion and Analysis June 30, 2014 and 2013

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**Payor Mix:** The Health Center is designated a Critical Access Hospital. As a Critical Access Hospital, most services related to Medicare and Medicaid beneficiaries are paid based on a cost reimbursement methodology. Contractual adjustments and bad debts were \$11,852,519 in 2014 compared to \$10,596,545 in 2013, representing 41.3% and 41.4% of gross patient charges, respectively.

A summary of the percentages of gross charges for patient services by payor is presented in Table 3.

**Table 3  
Payor Mix By Percentage**

	Year ended June 30		
	2014	2013	2012
Medicare	44 %	46 %	44 %
Medicaid	16	14	16
Commercial insurance	36	36	36
Patients	4	4	4
	<u>100 %</u>	<u>100 %</u>	<u>100 %</u>

#### Other Revenue

Other revenue increased to \$1,413,205 in 2014 compared to \$696,878 in 2013 due to the accrual of Meaningful Use funds due from Medicare and Medicaid.

#### Expenses

Approximately 47.7% of Health Center's expenses are for salaries. Total salaries increased by 5.6% to \$9,113,114 in 2014 from \$8,627,978 in 2013. The Health Center departments experiencing the most significant increase in 2014 were emergency service and LCHC Medical Clinic.

Approximately 47% of Health Center's expenses are for supplies and expenses. Total supplies and expenses increased by 7.1% to \$8,966,588 in 2014 from \$8,373,451 in 2013. The Health Center departments experiencing the most significant increase in 2013 were laboratory, pharmacy, the medical clinic and maintenance.

Approximately 5.3% of Health Center's expenses relate to provision for depreciation. The provision for depreciation decreased to \$1,011,461 in 2014 from \$1,019,597 in 2013.

#### Nonoperating Gains

Nonoperating gains increased to \$1,390,240 in 2014 from \$1,297,523 in 2013 due primarily to an increase in county taxes.

#### Property and Equipment

At the end of 2014, the Health Center had \$5,184,324 invested in property and equipment, net of accumulated depreciation. The Notes to the Financial Statements provide more detail of changes in property and equipment. In 2014, \$474,826 was spent to acquire new equipment.

## Lucas County Health Center

### Management's Discussion and Analysis June 30, 2014 and 2013

A summary of the Health Center's property and equipment is presented in Table 4.

**Table 4  
Property and Equipment**

	<b>June 30</b>		
	<b>2014</b>	<b>2013</b>	<b>2012</b>
Land	\$ 83,861	\$ 83,861	\$ 83,861
Land improvements	786,692	786,692	786,692
Building and improvements	8,402,479	8,402,479	8,402,479
Major moveable equipment	<u>11,380,428</u>	<u>11,077,641</u>	<u>11,086,994</u>
	20,653,460	20,350,673	20,360,026
Less Accumulated depreciation	<u>(15,469,136)</u>	<u>(14,623,231)</u>	<u>(13,836,482)</u>
Property and equipment, net	<u>\$ 5,184,324</u>	<u>\$ 5,727,442</u>	<u>\$ 6,523,544</u>

#### Debt Administration

At year end, the Health Center had \$1,123,813 in current and long-term debt. This has decreased by \$173,775, which was the required amount of principal payments of \$259,089, net of new debt issued in the amount of \$85,314 during fiscal year 2014. More detailed information about the Health Center's outstanding debt is presented in the Notes to Financial Statements. Note that the total long-term debt represents approximately 33% of the Health Center's total liabilities as of year end.

#### Performance Compared to County Hospital Budget

The Health Center prepares its annual County Hospital budget on the budget basis, which differs from generally accepted accounting principles, GAAP basis. More detailed information as to major differences between County Hospital budget and GAAP bases are presented as Required Supplementary Information on page 26. A comparison of the Health Center's fiscal year 2014 actual budget basis financial information to its County Hospital budget is presented in Table 5.

**Table 5  
Actual vs Budget**

	<b>Actual Budget Basis</b>	<b>County Hospital Budget</b>	<b>Variance</b>
Amount to be raised by taxation	\$ 1,187,890	1,148,689	39,201
Other revenue/receipts	<u>16,999,386</u>	<u>18,032,366</u>	<u>(1,032,980)</u>
	18,187,276	19,181,055	(993,779)
Expenses/expenditures	<u>18,246,201</u>	<u>18,837,625</u>	<u>591,424</u>
Net	<u>\$ (58,925)</u>	<u>343,430</u>	<u>(402,355)</u>

## **Lucas County Health Center**

### **Management's Discussion and Analysis June 30, 2014 and 2013**

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Actual other revenue/receipts results were lower than County Hospital budget due to lower net patient service revenue than expected. Expenses/expenditures were lower than County Hospital budget due to less equipment purchases.

#### **Economic and Other Factors and Next Year's Budget**

The Health Center's board and management considered many factors when setting the fiscal year 2014 budget. Of primary importance are the market forces and environmental factors impacting healthcare such as:

- Medicare and Medicaid reimbursement rates
- Reimbursement rates of other payors
- Cost of supplies
- Facility expansion and growth in demand for services
- Technology advancements

#### **Contacting Health Center's Management**

This financial report is designed to provide users with a general overview of the Health Center's finances and to demonstrate the Health Center's accountability. If you have questions about this report or need additional information, contact Lucas County Health Center at (641) 774-3000 or write care of: Chief Financial Officer, Lucas County Health Center, 1200 N. Seventh Street, Chariton, Iowa 50049.

**Lucas County Health Center**

**Statements of Net Position  
June 30, 2014 and 2013**

	<u>2014</u>	<u>2013</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 307,707	366,632
Assets limited as to use or restricted, current portion	86,632	86,506
Receivables -		
Patient, net of allowance for uncollectible accounts of \$573,000 in 2014 and \$455,000 in 2013	2,671,828	2,060,771
Succeeding year property tax	1,173,798	1,185,000
Other	795,143	66,240
Inventories	176,975	219,895
Prepaid expenses	334,446	310,186
Estimated third-party payor settlements	<u>17,000</u>	<u>12,000</u>
 Total current assets	 5,563,529	 4,307,230
Noncurrent assets:		
Assets limited as to use or restricted, net of current portion	273,820	277,313
Capital assets, net	<u>5,184,324</u>	<u>5,727,442</u>
 Total assets	 <u>11,021,673</u>	 <u>10,311,985</u>
<b>LIABILITIES</b>		
Current liabilities:		
Current portion of long-term debt	153,653	255,834
Accounts payable -		
Trade	901,722	601,134
Capital assets	337,348	--
Accrued expenses -		
Accrued salaries, wages and vacation payable	784,360	805,039
Payroll taxes and withholdings	218,101	226,880
Interest	<u>27,999</u>	<u>30,511</u>
 Total current liabilities	 2,423,183	 1,919,398
Long-term debt, net of current portion	<u>970,160</u>	<u>1,041,754</u>
 Total liabilities	 <u>3,393,343</u>	 <u>2,961,152</u>
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Unavailable property tax revenue	<u>1,173,798</u>	<u>1,185,000</u>
Commitments and contingencies		
<b>NET POSITION</b>		
Net investment in capital assets	4,060,511	4,429,854
Restricted - expendable for debt service	102,282	102,085
Unrestricted	<u>2,291,739</u>	<u>1,633,894</u>
 Total net position	 <u>\$ 6,454,532</u>	 <u>6,165,833</u>

*See notes to financial statements*

## Lucas County Health Center

### Statements of Revenue, Expenses and Changes in Net Position For the Years Ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
OPERATING REVENUE:		
Net patient service revenue before provision for bad debt	\$ 17,630,550	15,741,586
Provision for bad debt	<u>(996,923)</u>	<u>(726,604)</u>
Net patient service revenue	16,633,627	15,014,982
Other operating revenue	<u>1,413,205</u>	<u>696,878</u>
Total operating revenue	<u>18,046,832</u>	<u>15,711,860</u>
OPERATING EXPENSES:		
Salaries and wages	9,113,114	8,627,978
Employee benefits	2,448,637	2,328,422
Professional fees and purchased services	1,901,176	1,862,736
Supplies and other	4,455,359	4,012,079
Insurance	158,815	168,368
Depreciation	1,011,461	1,019,597
Interest	<u>59,811</u>	<u>65,964</u>
Total operating expenses	<u>19,148,373</u>	<u>18,085,144</u>
OPERATING LOSS	<u>(1,101,541)</u>	<u>(2,373,284)</u>
NONOPERATING REVENUE:		
County taxes	1,187,890	1,056,660
Investment income	41,084	18,281
Noncapital grants and contributions	<u>161,266</u>	<u>222,582</u>
Nonoperating revenue	<u>1,390,240</u>	<u>1,297,523</u>
INCREASE (DECREASE) IN NET POSITION	288,699	(1,075,761)
NET POSITION, Beginning of year	<u>6,165,833</u>	<u>7,241,594</u>
NET POSITION, End of year	<u>\$ 6,454,532</u>	<u>6,165,833</u>

*See notes to financial statements*

**Lucas County Health Center**

**Statements of Cash Flows  
For the Years Ended June 30, 2014 and 2013**

	<u>2014</u>	<u>2013</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Cash received from patients and third-party payors	\$ 16,017,570	15,486,536
Cash paid for employee salaries and benefits	(11,591,209)	(10,946,995)
Cash paid to suppliers and contractors	(6,196,102)	(6,206,240)
Other receipts and payments, net	680,885	791,349
Net cash used in operating activities	<u>(1,088,856)</u>	<u>(875,350)</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>		
Unrestricted contributions	161,266	222,582
Property taxes received	1,187,890	1,056,660
Net cash provided by noncapital financing activities	<u>1,349,156</u>	<u>1,279,242</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
Purchase of capital assets	(137,478)	(260,939)
Proceeds from sale of capital assets	9,900	25,851
Proceeds from issuance of long term debt	85,314	205,843
Payments on long term debt	(259,089)	(326,791)
Interest paid on debt	(62,323)	(68,489)
Net cash used in capital and related financing activities	<u>(363,676)</u>	<u>(424,525)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
(Deposits to) withdrawals from assets limited as to use or restricted, net	3,367	(132,204)
Investment income received	41,084	18,281
Net cash provided by (used in) investing activities	<u>44,451</u>	<u>(113,923)</u>
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(58,925)</b>	<b>(134,556)</b>
<b>CASH AND CASH EQUIVALENTS, Beginning of year</b>	<b>366,632</b>	<b>501,188</b>
<b>CASH AND CASH EQUIVALENTS, End of year</b>	<b>\$ <u>307,707</u></b>	<b><u>366,632</u></b>

*See notes to financial statements*

## Lucas County Health Center

### Statements of Cash Flows (Continued) For the Years Ended June 30, 2014 and 2013

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	<u>2014</u>	<u>2013</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating loss	\$ (1,101,541)	(2,373,284)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	1,011,461	1,019,597
(Gain) loss on disposal of property and equipment	(3,417)	11,593
Interest expense included in operating expenses	59,811	65,964
(Increase) decrease in current assets -		
Receivables -		
Patients	(611,057)	103,554
Other	(728,903)	82,878
Inventories	42,920	599
Prepaid expenses	(24,260)	28,359
Estimated third-party payor settlements	(5,000)	368,000
Increase (decrease) in current liabilities -		
Accounts payable	300,588	(192,015)
Accrued salaries, wages and vacation payable	(20,679)	10,307
Payroll taxes and withholdings	(8,779)	(902)
Net cash used in operating activities	<u>\$ (1,088,856)</u>	<u>(875,350)</u>

*See notes to financial statements*

# Lucas County Health Center

## Notes to the Financial Statements June 30, 2014 and 2013

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

The following is a description of the reporting entity and a summary of significant accounting policies of Lucas County Health Center (Health Center). These policies are in accordance with accounting principles generally accepted in the United States of America.

#### A. *Reporting Entity*

The Health Center is a county public hospital under Chapter 347 of the Code of Iowa and is governed by a seven member Board of Trustees elected for terms of six years. The Health Center is a Critical Access Hospital with 25 acute care beds and primarily earns revenue by providing inpatient, outpatient and emergency care services to patients in Chariton, Iowa and the surrounding area.

For financial reporting purposes, the Health Center has included all the funds of the Health Center, specifically all assets, deferred outflows, liabilities, deferred inflows, revenue and expenses over which the Health Center's governing board exercises oversight responsibility. The Health Center 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 Health Center are such that exclusion would cause the Health Center'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 Health Center 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 Health Center. The Health Center 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 Health Center is in compliance with applicable 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 Health Center'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 statements of net position display the Health Center's assets, deferred inflows, liabilities, and deferred outflows, with the difference reported as net position. Net position is reported in the following categories/components:

## Lucas County Health Center

### Notes to the Financial Statements June 30, 2014 and 2013

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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.

Restricted - expendable – This component of net position results when constraints placed on net use are either externally imposed or are imposed by law through constitutional provisions or enabling legislation. Enabling legislation did not result in any restricted net position.

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 the Health Center has both restricted and unrestricted resources available for use, generally it is the Health Center's policy to use restricted net position first.

#### *D. Measurement Focus and Basis of Accounting*

Measurement focus refers to when revenues 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 Health Center's basic financial statements are presented on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Revenue is recognized when earned, expenses are recognized when 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, deferred outflows, liabilities, and deferred inflows and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

#### *F. Cash and Cash Equivalents*

Cash and cash equivalents include highly liquid investments with an original maturity of three months or less, excluding amounts limited as to use by the Board of Trustees or under debt agreements.

#### *G. Patient Receivables, Net*

Net patient receivables consist of uncollateralized patient and third-party obligations reduced by a valuation allowance for doubtful accounts and contractual adjustments from third-party payors, patients and others. The allowances reflect management's estimate of amounts that will not be collected in the future and are based on reviews of patient balances by payor classes. Percentages are applied to each payor class based on contractual agreements and historical collection and recovery information to determine the net realizable value of the patient receivables. Accounts are considered delinquent based on passage of a specified period of time and consideration of payment history. Accounts deemed uncollectible are written off and charged to the allowance in the year they are deemed uncollectible.

The Health Center also maintains a patient financial assistance policy as described in Note 1(Q).

# Lucas County Health Center

## Notes to the Financial Statements June 30, 2014 and 2013

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### H. *Property Tax Receivable*

Property tax receivable is recognized on the levy or lien date, which is the date that the tax asking is certified by the County Board of Supervisors. The succeeding year property tax receivable represents taxes certified by the Board of Supervisors 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.

### I. *Inventories*

Inventories are stated at the lower of cost, determined by the first-in, first-out method, or market.

### J. *Assets Limited as to Use or Restricted*

Assets limited as to use or restricted include the following:

By Board of Trustees - Periodically, the Health Center's Board of Trustees has set aside assets for future capital improvements. The Board retains control over these assets and may, at its discretion, subsequently use them for other purposes.

By Debt Agreements – These funds are reserve funds held as security for the Series 1991B Hospital Revenue Note and the Series 1994A USDA Mortgage Note. These funds are used for the payment of principal and interest on the revenue note.

Amounts required to meet current obligations of the Health Center have been included as current assets in the statements of net position at June 30, 2014 and 2013.

### K. *Capital Assets, Net*

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	5 to 30 years
Buildings and building improvements	5 to 40 years
Equipment, computers and furniture	3 to 20 years

The Health Center's capital assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected cash flows is less than the carrying amount of the asset, a loss is recognized.

Gifts of capital assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire capital assets are reported as restricted support. Absent explicit donor stipulations about how long those capital assets must be maintained, expirations of donor restrictions are reported when the donated or acquired capital assets are placed into service.

## Lucas County Health Center

### Notes to the Financial Statements June 30, 2014 and 2013

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*L. Compensated Absences*

Health Center policies permit most employees to accumulate paid time off benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Paid Time Off (PTO) accumulates and may be carried forward by an employee in an amount not to exceed 360 hours. PTO expense is accrued as an expense and a liability as it is earned. PTO expenditures are recognized to the extent it is paid during the year and the earned amount is recorded as a current liability. Accrued PTO liability at June 30, 2014 and 2013 was \$388,952 and \$445,130, respectively.

*M. Deferred Inflows of Resources*

Deferred inflows of resources in the statements of net position consist of succeeding year property taxes receivable which will not be recognized as revenue until the year for which it is levied.

*N. 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 as nonoperating revenues and peripheral or incidental transactions are reported as nonoperating revenues and expenses.

*O. Net Patient Service Revenue*

The Health Center has agreements with third-party payors that provide for payments to the Health Center at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs and discounted charges. 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.

*P. Grants and Contributions*

From time to time, the Health Center receives grants and contributions from individuals and private organizations. Revenue 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 or restricted for a specific operating purpose are reported as nonoperating revenue. Amounts restricted to capital acquisitions are reported after nonoperating revenue and expenses.

*Q. Charity Care*

The Health Center 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 Health Center 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. Charges excluded from patient service revenue under the Health Center's charity care policy were \$129,955 and \$128,743, for 2014 and 2013, respectively.

## Lucas County Health Center

### Notes to the Financial Statements June 30, 2014 and 2013

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*R. Fair Value of Financial Instruments*

The carrying value of all financial instruments approximates estimated fair value. Cash and cash equivalents, assets limited as to use or restricted, receivables, and current liabilities approximate fair value due to the relatively short period of time between their origination and expected realization. The carrying value of long-term debt approximates fair value since the interest rates closely reflect market rates.

*S. Risk Management*

The Health Center 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.

*T. Change in Accounting Principle*

During 2014, the Health Center adopted the provisions of GASB Statement No. 65, which requires reclassification of certain items previously reported as assets and liabilities as deferred outflows of resources or deferred inflows of resources on the statement of net position. GASB 65 also requires recognition of certain items previously reported as assets and liabilities as outflows of resources or inflows of resources on the statement of revenue, expenses and changes in net position. The requirements of this statement improve financial reporting by clarifying the appropriate use of the financial statement elements deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting.

*U. Reclassification*

Certain amounts in the 2013 financial statements have been reclassified to conform to the 2014 reporting format.

*V. Subsequent Events*

The Health Center considered events occurring through October 16, 2014 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) Deposits and Assets Limited as to Use or Restricted**

The Health Center's deposits in banks at June 30, 2014 and 2013 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 Health Center 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; certain joint investment trusts, and warrants or improvement certificates of a drainage district.

# Lucas County Health Center

## Notes to the Financial Statements June 30, 2014 and 2013

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The Health Center manages the following risks in accordance with their formal investment policy:

*Interest Rate Risk:* The Health Center's investment policy limits the investment of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) to instruments that mature within 397 days. Funds not identified as operating funds may be invested in investments with maturities longer than 397 days, but the maturities shall be consistent with the needs and use of the Health Center.

*Custodial credit risk:* Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The Health Center's investment policy requires the fund to be deposited into banking institutions that have the ability to collateralize any deposits made in excess of the Federal Deposit Insurance Corporation's insurance limits.

The composition of assets limited as to use or restricted as of June 30, 2014 and 2013 is as follows:

	<u>2014</u>	<u>2013</u>
Assets Limited as to Use or Restricted:		
By the Board of Trustees for capital improvements:		
Money market funds	\$ 171,538	175,228
By Debt Agreements – Reserve and Sinking Fund Accounts:		
Cash and cash equivalents	86,632	86,506
Money market funds	102,282	102,085
	<u>188,914</u>	<u>188,591</u>
Total assets limited as to use or restricted	360,452	363,819
Less amounts required to meet current obligations	<u>86,632</u>	<u>86,506</u>
Long-term portion	<u>\$ 273,820</u>	<u>277,313</u>

### (3) Net Patient Service Revenue

The Health Center has agreements with third-party payors that provide for payments to the Health Center at amounts different from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

**Medicare.** Inpatient acute care services rendered to Medicare program beneficiaries in a Critical Access Hospital are paid based on Medicare defined costs of providing the services. Inpatient nonacute, certain outpatient and rural health clinic services related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Health Center is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Health Center and audit thereof by the Medicare Administrative Contractor. The Health Center's Medicare cost reports have been audited by the Medicare Administrative Contractor through June 30, 2012.

The "Budget Control Act of 2011" requires, among other things, mandatory across-the-board reductions in Federal spending, also known as sequestration. 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.

## Lucas County Health Center

### Notes to the Financial Statements June 30, 2014 and 2013

**Medicaid.** Inpatient acute services and outpatient services rendered to Medicaid program beneficiaries in a Critical Access Hospital are paid based on Medicaid defined costs of providing the services. The Health Center is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Health Center.

**Commercial.** The Health Center has also entered into payment agreements with certain commercial insurance carriers. This basis for payment to the Health Center under these agreements includes discounts from established charges and prospectively determined rates.

The following illustrates the Health Center's gross patient service revenue at its established rates and revenue deductions by major third-party payors:

	<u>2014</u>	<u>2013</u>
Gross patient service revenue:		
Inpatient services and swing bed	\$ 5,187,564	4,549,139
Outpatient	19,629,178	18,337,962
Clinics	<u>3,669,404</u>	<u>2,724,426</u>
Total gross patient service revenue	<u>28,486,146</u>	<u>25,611,527</u>
Deductions from patient service revenue:		
Medicare	4,779,762	5,120,637
Medicaid	2,112,318	1,318,388
Other payors	3,833,561	3,302,173
Charity care	<u>129,955</u>	<u>128,743</u>
Total deductions from patient service revenue	<u>10,855,596</u>	<u>9,869,941</u>
Net patient service revenue before provision for bad debt	<u>\$ 17,630,550</u>	<u>15,741,586</u>

The Health Center reports net patient service revenue at estimated net realizable amounts from patients, third-party payors, 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.

Revenue from the Medicare and Medicaid programs accounts for approximately 34% and 11%, respectively, of the Health Center's net patient revenue for the year ended June 30, 2014 compared to 34% for Medicare and 13% for Medicaid in 2013. The Health Center grants credit without collateral to its patients, most of whom 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) Patient Receivables, Net

Patient receivables, net as of June 30, 2014 and 2013 consist of the following:

	<u>2014</u>	<u>2013</u>
Patient receivables	\$ 4,506,828	3,487,771
Less estimated third-party contractual adjustments	(1,262,000)	(972,000)
Less allowance for uncollectible accounts	<u>(573,000)</u>	<u>(455,000)</u>
	<u>\$ 2,671,828</u>	<u>2,060,771</u>

## Lucas County Health Center

### Notes to the Financial Statements June 30, 2014 and 2013

The Health Center is located in Chariton, Iowa. The Health Center 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>2014</u>	<u>2013</u>
Medicare	27%	27%
Medicaid	16	10
Other third-party payors	32	34
Private pay	<u>25</u>	<u>29</u>
	<u>100%</u>	<u>100%</u>

#### (5) Capital Assets

Capital assets activity for the years ended June 30, 2014 and 2013 were as follows:

	<u>June 30, 2013</u>	<u>Additions</u>	<u>Transfers and Disposals</u>	<u>June 30, 2014</u>
Capital assets, not being depreciated:				
Land	\$ 83,861	--	--	83,861
Construction in progress	241,835	58,430	(268,785)	31,480
Total capital assets, not being depreciated	<u>325,696</u>	<u>58,430</u>	<u>(268,785)</u>	<u>115,341</u>
Capital assets, being depreciated:				
Land improvements	786,692	--	--	786,692
Building and leasehold improvements	8,402,479	--	--	8,402,479
Fixed equipment	4,455,500	--	241,835	4,697,335
Major movable equipment	6,380,306	416,396	(145,089)	6,651,613
Total capital assets, being depreciated	<u>20,024,977</u>	<u>416,396</u>	<u>96,746</u>	<u>20,538,119</u>
Less accumulated depreciation:				
Land improvements	446,387	37,574	--	483,961
Building and leasehold improvements	5,106,289	324,348	--	5,430,637
Fixed equipment	4,007,583	99,740	--	4,107,323
Major movable equipment	5,062,972	549,799	(165,556)	5,447,215
Total accumulated depreciation	<u>14,623,231</u>	<u>1,011,461</u>	<u>(165,556)</u>	<u>15,469,136</u>
Total capital assets, being depreciated, net	<u>5,401,746</u>	<u>(595,065)</u>	<u>262,302</u>	<u>5,068,983</u>
Total capital assets, net	<u>\$ 5,727,442</u>	<u>(536,635)</u>	<u>(6,483)</u>	<u>5,184,324</u>

# Lucas County Health Center

## Notes to the Financial Statements June 30, 2014 and 2013

	June 30, 2012	Additions	Transfers and Disposals	June 30, 2013
Capital assets, not being depreciated:				
Land	\$ 83,861	--	--	83,861
Construction in progress	222,345	19,490	--	241,835
Total capital assets, not being depreciated	<u>306,206</u>	<u>19,490</u>	<u>--</u>	<u>325,696</u>
Capital assets, being depreciated:				
Land improvements	786,692	--	--	786,692
Building and leasehold improvements	8,402,479	--	--	8,402,479
Fixed equipment	4,455,500	--	--	4,455,500
Major movable equipment	6,409,149	241,449	(270,292)	6,380,306
Total capital assets, being depreciated	<u>20,053,820</u>	<u>241,449</u>	<u>(270,292)</u>	<u>20,024,977</u>
Less accumulated depreciation:				
Land improvements	408,813	37,574	--	446,387
Building and leasehold improvements	4,777,107	329,182	--	5,106,289
Fixed equipment	3,916,782	90,801	--	4,007,583
Major movable equipment	4,733,780	562,040	(232,848)	5,062,972
Total accumulated depreciation	<u>13,836,482</u>	<u>1,019,597</u>	<u>(232,848)</u>	<u>14,623,231</u>
Total capital assets, being depreciated, net	<u>6,217,338</u>	<u>(778,148)</u>	<u>(37,444)</u>	<u>5,401,746</u>
Total capital assets, net	<u>\$ 6,523,544</u>	<u>(758,658)</u>	<u>(37,444)</u>	<u>5,727,442</u>

Depreciation expense for the years ending June 30, 2014 and 2013 amounted to \$1,011,461 and \$1,019,597, respectively

### (6) Long-Term Debt

Long-term debt activity of the Health Center as of June 30, 2014 and 2013 consisted of the following:

	June 30, 2013	Borrowings	Payments	June 30, 2014	Due Within One Year
Hospital Revenue Note, Series 1991B (A)	\$ 224,406	--	40,677	183,729	42,712
USDA Mortgage Note, Series 1994A (B)	698,234	--	17,954	680,280	18,761
Notes Payable, equipment (C)	374,948	85,314	200,458	259,804	92,180
	<u>1,297,588</u>	<u>85,314</u>	<u>259,089</u>	<u>1,123,813</u>	<u>153,653</u>
	June 30, 2012	Borrowings	Payments	June 30, 2013	Due Within One Year
Hospital Revenue Note, Series 1991B (A)	\$ 263,147	--	38,741	224,406	40,667
USDA Mortgage Note, Series 1994A (B)	715,414	--	17,180	698,234	17,947
Notes Payable, equipment (C)	439,975	205,843	270,870	374,948	197,220
	<u>1,418,536</u>	<u>205,843</u>	<u>326,791</u>	<u>1,297,588</u>	<u>255,834</u>

(A) The Health Center issued a Hospital Revenue Note, Series 1991B (Note) in the original amount of \$700,000 to finance capital improvements of the Health Center. The Note is payable solely from future revenues of the Health Center and is due in equal annual installments of \$51,898, including interest at 5%, payable each July through 2017.

## Lucas County Health Center

### Notes to the Financial Statements June 30, 2014 and 2013

- (B) The Health Center entered into a USDA Rural Economic and Community Development Mortgage Note, Series 1994A (Note) in the original amount of \$900,000 to finance the construction of a medical office building adjacent to the Health Center. The Note is secured by a mortgage and is due in equal annual installments of \$49,374, including interest at 4.5%, payable each November through 2035.
- (C) The Health Center has entered into various notes payable with local banks to finance the purchase of certain medical equipment. The notes require monthly payments ranging from \$523 to \$11,979, including interest with rates ranging from 2.78% to 5.99%, with various maturity dates through May 2019.

A summary of the Health Center's annual debt service requirements are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 153,653	49,500	203,153
2016	123,041	43,583	166,624
2017	128,909	37,715	166,624
2018	102,480	31,910	134,390
2019	37,986	27,551	65,537
2020 – 2024	127,906	118,964	246,870
2025 – 2029	159,394	87,476	246,870
2030 – 2034	198,634	48,236	246,870
2035 – 2038	91,810	6,218	98,028
	<u>\$ 1,123,813</u>	<u>451,153</u>	<u>1,574,966</u>

Under the terms of the Hospital Revenue Note and USDA Mortgage Note, the Health Center is required to maintain certain funds which are included in assets limited as to use or restricted in the accompanying financial statements. The Hospital Revenue Note and USDA Mortgage Note also contain certain financial covenants related to the operations of the Health Center, of which the Health Center is in substantial compliance with those covenants.

#### (7) Line of Credit

The Health Center has a bank revolving line of credit that provides for maximum borrowings of \$500,000 with a variable interest rate and matures March 15, 2015. The agreement is secured by substantially all assets of the Health Center. There were no amounts withdrawn on the line of credit at June 30, 2014 and 2013.

#### (8) Other Operating Revenue

Other operating revenue for the years ended June 30, 2014 and 2013 consisted of the following:

	<u>2014</u>	<u>2013</u>
Electronic health records incentive payments	\$ 723,819	--
Day care	340,754	376,545
Rental income	180,524	178,159
Cafeteria	91,925	84,794
Lifeline	36,949	39,287
Medical records	4,690	2,437
Gain (loss) on disposal of capital assets	3,417	(11,593)
Miscellaneous	31,127	27,249
	<u>\$ 1,413,205</u>	<u>696,878</u>

## Lucas County Health Center

### Notes to the Financial Statements June 30, 2014 and 2013

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The Electronic Health Records Incentive Program, enacted as part of the *American Recovery and Reinvestment Act of 2009*, provides for one-time incentive payments under both the Medicare and Medicaid programs to eligible hospitals that demonstrate meaningful use of certified electronic health records technology (EHR). Critical access hospitals (CAHs) are eligible to receive incentive payments in the cost reporting period beginning in the federal fiscal year in which meaningful use criteria have been met. The Medicare incentive payment is for qualifying costs of the purchase of certified EHR technology multiplied by the hospital's Medicare share fraction, which includes a 20% incentive. If meaningful use criteria are not met in future periods, the Health Center is subject to penalties that would reduce future payments for services. Payments under the Medicaid program are generally made for up to four years based upon a statutory formula, as determined by the state, which is approved by the Centers for Medicare and Medicaid Services (CMS). The final amount for any payment year under both programs is determined based upon an audit by the Medicare Administrative Contractor. Events could occur that would cause the final amounts to differ materially from the initial payments under the program.

During 2014 the Health Center qualified for Medicare and Medicaid incentive payments by attesting it met specific criteria set by CMS. An incentive receivable of \$723,819 has been recognized in other receivables in the statement of net position as of June 30, 2014. The Health Center elected to record the entire amount of the incentive payment of \$723,819 as other operating revenue in the period earned.

#### **(9) Professional Liability Insurance**

The Health Center 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 Health Center carries an umbrella policy which also provides \$5,000,000 per occurrence and \$5,000,000 aggregate coverage. These policies provide coverage on a claims-made basis covering only those claims which have occurred and are reported to the insurance company while the coverage is in force. In the event the Health Center should elect not to purchase insurance from the present carrier or the carrier should elect not to renew the policy, any unreported claims which occurred during the policy year may not be recoverable from the carrier.

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 Health Center 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, 2014 and 2013, 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.

#### **(10) Pension and Retirement Benefits**

The Health Center 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 50306-9117.

Plan members are required to contribute 5.95% and 5.78% of their annual salary and the Health Center is required to contribute 8.93% and 8.67% of annual covered salary for the years ended June 30, 2014 and 2013, respectively. Contribution requirements are established by State statute. The Health Center's contribution to IPERS for the years ended June 30, 2014, 2013, and 2012 were \$778,039, \$718,905 and \$680,125 respectively, equal to the required contributions for each year.

## Lucas County Health Center

### Notes to the Financial Statements June 30, 2014 and 2013

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**(11) Other Postemployment Benefits (OPEB)**

The Health Center operates a single-employer retiree benefit plan which provides medical benefits/prescription drug benefits for retirees and their spouses. The Health Center applies GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. An actuarial valuation of the Plan has been performed and the other postemployment benefits have been determined by management to be immaterial to the Health Center and therefore are not included in the financial statements of the Health Center.

**(12) Commitments and Contingencies**

The Health Center is involved in litigation arising in the normal course of business. After consultation with legal counsel, management estimates these matters will be resolved without material adverse affect on the Health Center's future financial position or results from operations.

## Lucas County Health Center

### Budgetary Comparison Schedule of Revenue, Expenses and Changes in Net Position – Budget and Actual (Cash Basis) June 30, 2014

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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 Lucas County Health Center 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 Health Center on the accrual 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, 2014, the Health Center's expenditures did not exceed the amounts budgeted.

	<b>Actual Accrual Basis</b>	<b>Accrual Adjustments</b>	<b>Cash Basis</b>	<b>Budget</b>	<b>Variance Favorable (Unfavorable)</b>
Amount raised by taxation	\$ 1,187,890	--	1,187,890	1,148,689	39,201
Add: Other revenues / receipts	18,249,182	(1,249,796)	16,999,386	18,032,366	(1,032,980)
Less: Expenses / disbursements	<u>19,148,373</u>	<u>(902,172)</u>	<u>18,246,201</u>	<u>18,837,625</u>	<u>591,424</u>
Net	288,699	(347,624)	(58,925)	343,430	<u>(402,355)</u>
Balance beginning of year	<u>6,165,833</u>	<u>(5,799,201)</u>	<u>366,632</u>	<u>2,042,115</u>	
Balance end of year	<u>\$ 6,454,532</u>	<u>(6,146,825)</u>	<u>307,707</u>	<u>2,385,545</u>	

*See accompanying independent auditor's report*

**Net Patient Service Revenue  
For the Years Ended June 30, 2014 and 2013**

	2014			2013		
	Inpatient	Outpatient	Total	Inpatient	Outpatient	Total
<b>NURSING SERVICES:</b>						
Acute care patients	\$ 1,514,850	--	1,514,850	1,435,620	--	1,435,620
Swing bed	625,470	--	625,470	410,520	--	410,520
Observation	--	276,301	276,301	--	276,464	276,464
Nursery	86,427	--	86,427	100,266	--	100,266
	<u>2,226,747</u>	<u>276,301</u>	<u>2,503,048</u>	<u>1,946,406</u>	<u>276,464</u>	<u>2,222,870</u>
<b>OTHER PROFESSIONAL SERVICES:</b>						
Radiology	431,495	5,824,906	6,256,401	360,313	5,103,234	5,463,547
LCHC Medical Clinic	--	3,674,417	3,674,417	--	2,736,447	2,736,447
Laboratory	429,863	2,997,063	3,426,926	383,520	2,706,690	3,090,210
Emergency	48,211	2,426,462	2,474,673	17,955	2,462,308	2,480,263
Pharmacy	772,385	1,695,912	2,468,297	726,357	1,641,835	2,368,192
Operating room	333,602	1,733,847	2,067,449	323,621	1,737,240	2,060,861
Psychiatric and behavioral health services	28,889	1,221,637	1,250,526	18,816	1,155,341	1,174,157
Physical therapy	139,594	746,637	886,231	102,580	639,075	741,655
Anesthesiology	184,030	697,895	881,925	188,644	597,692	786,336
Ambulance	--	880,500	880,500	--	852,995	852,995
Respiratory therapy	370,791	248,551	619,342	266,805	199,966	466,771
Cardiology	2,549	231,459	234,008	1,428	202,123	203,551
Delivery and labor room	126,177	41,062	167,239	152,400	49,776	202,176
Humeston Clinic	--	144,219	144,219	--	179,869	179,869
Electrocardiology	15,399	122,092	137,491	23,408	134,513	157,921
Infusion therapy	--	128,430	128,430	--	112,627	112,627
Occupational therapy	46,102	79,544	125,646	29,454	101,711	131,165
Wound treatment	--	103,619	103,619	--	164,812	164,812
Speech therapy	31,730	23,939	55,669	7,432	7,488	14,920
Diabetic education	--	90	90	--	182	182
	<u>2,960,817</u>	<u>23,022,281</u>	<u>25,983,098</u>	<u>2,602,733</u>	<u>20,785,924</u>	<u>23,388,657</u>
<b>GROSS PATIENT SERVICE REVENUE</b>	<b>\$ 5,187,564</b>	<b>23,298,582</b>	<b>28,486,146</b>	<b>4,549,139</b>	<b>21,062,388</b>	<b>25,611,527</b>
<b>DEDUCTIONS FROM GROSS PATIENT SERVICE REVENUE:</b>						
Contractual allowances and other deductions, primarily Medicare and Medicaid			(10,615,169)			(9,590,875)
Charity care services and other discounts, based on charges forgone			(240,427)			(279,066)
<b>NET PATIENT SERVICE REVENUE BEFORE PROVISION FOR BAD DEBT</b>			<b>17,630,550</b>			<b>15,741,586</b>
Provision for bad debt			(996,923)			(726,604)
<b>NET PATIENT SERVICE REVENUE</b>			<b>\$ 16,633,627</b>			<b>\$ 15,014,982</b>

See accompanying independent auditor's report

**Other Operating Revenue  
For the Years Ended June 30, 2014 and 2013**

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	<u>2014</u>	<u>2013</u>
Electronic health records incentive payments	\$ 723,819	--
Day care	340,754	376,545
Rental income	180,524	178,159
Cafeteria	91,925	84,794
Lifeline	36,949	39,287
Medical records	4,690	2,437
Gain (loss) on disposal of property and equipment	3,417	(11,593)
Miscellaneous	31,127	27,249
	<u>\$ 1,413,205</u>	<u>696,878</u>

*See accompanying independent auditor's report*

**Departmental Expenses  
For the Years Ended June 30, 2014 and 2013**

	2014			2013		
	Salaries and Wages	Other	Total	Salaries and Wages	Other	Total
<b>NURSING SERVICES:</b>						
Medical and surgical	\$ 1,012,257	161,464	1,173,721	976,969	136,979	1,113,948
Nursing administration	108,615	3,879	112,494	103,689	3,777	107,466
Nursery	20,151	5,050	25,201	24,532	6,544	31,076
	<u>1,141,023</u>	<u>170,393</u>	<u>1,311,416</u>	<u>1,105,190</u>	<u>147,300</u>	<u>1,252,490</u>
<b>OTHER PROFESSIONAL SERVICES:</b>						
LCHC Medical Clinic	2,151,752	445,767	2,597,519	1,871,579	403,762	2,275,341
Emergency service	1,235,382	419,151	1,654,533	1,108,578	529,423	1,638,001
Pharmacy	243,958	832,991	1,076,949	228,269	695,589	923,858
Radiology	263,676	713,155	976,831	268,989	705,398	974,387
Laboratory	286,422	482,000	768,422	280,458	408,833	689,291
Operating room	234,201	323,689	557,890	251,299	306,360	557,659
Psychiatric and behavioral health services	443,090	87,989	531,079	452,921	68,867	521,788
Anesthesiology	--	435,161	435,161	--	445,418	445,418
Kids life	349,558	52,625	402,183	356,640	46,291	402,931
Physical therapy	253,197	28,924	282,121	194,137	38,944	233,081
Ambulance	176,514	41,541	218,055	132,852	34,971	167,823
Humeston Clinic	159,034	49,397	208,431	208,177	61,781	269,958
Medical records	143,486	56,048	199,534	145,287	57,267	202,554
Delivery room	131,832	54,696	186,528	188,083	61,326	249,409
Vreedenburg Center	8,552	159,912	168,464	12,716	134,406	147,122
Infusion therapy	60,042	4,661	64,703	65,340	3,919	69,259
Respiratory therapy	73,603	51,859	125,462	85,652	38,274	123,926
Cardiology	69,395	8,097	77,492	64,065	8,784	72,849
Speech therapy	--	62,399	62,399	--	42,068	42,068
Electrocardiology	12,273	56	12,329	9,803	444	10,247
Specialty clinics	10,474	456	10,930	13,462	1,154	14,616
Wound treatment	63,093	7,917	71,010	80,328	10,991	91,319
	<u>6,369,534</u>	<u>4,318,491</u>	<u>10,688,025</u>	<u>6,018,635</u>	<u>4,104,270</u>	<u>10,122,905</u>
<b>GENERAL SERVICES:</b>						
Plant operation and maintenance	199,179	673,532	872,711	204,071	549,386	753,457
Dietary	168,498	133,694	302,192	163,533	118,188	281,721
Housekeeping	211,075	36,098	247,173	204,854	37,478	242,332
Laundry	21,881	4,456	26,337	20,892	8,873	29,765
	<u>600,633</u>	<u>847,780</u>	<u>1,448,413</u>	<u>593,350</u>	<u>713,925</u>	<u>1,307,275</u>
<b>ADMINISTRATIVE SERVICES</b>						
	<u>1,001,924</u>	<u>1,178,686</u>	<u>2,180,610</u>	<u>910,803</u>	<u>1,077,688</u>	<u>1,988,491</u>
<b>NONDEPARTMENTAL:</b>						
Employee benefits	--	2,448,637	2,448,637	--	2,328,422	2,328,422
Depreciation	--	1,011,461	1,011,461	--	1,019,597	1,019,597
Interest	--	59,811	59,811	--	65,964	65,964
	<u>--</u>	<u>3,519,909</u>	<u>3,519,909</u>	<u>--</u>	<u>3,413,983</u>	<u>3,413,983</u>
<b>TOTAL EXPENSES</b>						
	<u>\$ 9,113,114</u>	<u>10,035,259</u>	<u>19,148,373</u>	<u>8,627,978</u>	<u>9,457,166</u>	<u>18,085,144</u>

See accompanying independent auditor's report

**Patient Receivables and Allowance for Uncollectible Accounts  
For the Years Ended June 30, 2014 and 2013**

ANALYSIS OF AGING:

Days Since Discharge	2014		2013	
	Amount	Percent of Total	Amount	Percent of Total
0 - 30	\$ 2,258,016	50 %	1,598,231	46 %
31 - 60	691,064	15	581,460	17
61 - 90	405,214	9	340,572	10
91 - 120	268,789	6	252,215	7
121 and over	883,745	20	715,293	20
	<u>4,506,828</u>	<u>100 %</u>	<u>3,487,771</u>	<u>100 %</u>
Less:				
Allowance for uncollectible accounts	(573,000)		(455,000)	
Allowance for contractual adjustments	<u>(1,262,000)</u>		<u>(972,000)</u>	
	<u>\$ 2,671,828</u>		<u>2,060,771</u>	

	2014	2013
ALLOWANCE FOR UNCOLLECTIBLE ACCOUNTS:		
Balance, beginning of year	\$ 455,000	468,000
Provision of uncollectible accounts	996,923	726,604
Recoveries of accounts previously written off	215,445	178,219
Accounts written off	<u>(1,094,368)</u>	<u>(917,823)</u>
Balance, end of year	<u>\$ 573,000</u>	<u>455,000</u>

*See accompanying independent auditor's report*

**Inventory/Prepaid Expenses  
June 30, 2014 and 2013**

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	<u>2014</u>	<u>2013</u>
INVENTORY:		
Pharmacy	\$ 60,704	85,495
Central store	45,726	46,420
Plant operation and maintenance	33,699	35,109
Gift shop	15,017	30,747
General office	7,777	8,208
Dietary	7,716	6,804
Laboratory	4,875	4,459
Laundry	1,461	2,210
Radiology	--	443
	<u>\$ 176,975</u>	<u>219,895</u>
	<u>2014</u>	<u>2013</u>
PREPAID EXPENSES:		
Insurance	\$ 146,154	140,402
Maintenance contracts	106,984	102,041
Other	81,308	67,743
	<u>\$ 334,446</u>	<u>310,186</u>

*See accompanying independent auditor's report*

**Financial and Statistical Highlights  
For the Years Ended June 30, 2014 and 2013**

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	<u>2014</u>	<u>2013</u>
Patient days:		
Adult and pediatric –		
Medicare	781	656
All other	424	529
Swing bed	905	622
Nursery	<u>95</u>	<u>119</u>
Total	<u><u>2,205</u></u>	<u><u>1,926</u></u>
Patient discharges:		
Adult and pediatric –		
Medicare	217	163
All other	195	181
Swing bed	68	63
Nursery	<u>47</u>	<u>59</u>
Total	<u><u>527</u></u>	<u><u>466</u></u>
Average length of stay (based on discharge days):		
Adult and pediatric –		
Medicare	3.60 days	4.02 days
All other	2.17 days	2.92 days
Swing bed	13.31 days	9.87 days
Nursery	2.02 days	2.02 days
Observation equivalent days	200	220
Surgical procedures	693	642
Emergency room visits	2,795	3,110
Number of employees - full-time equivalents	187.53	184.00

*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  
Lucas County Health Center  
Chariton, Iowa:

We have audited, in accordance with the 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 Lucas County Health Center (Health Center) as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Health Center's basic financial statements, and have issued our report thereon dated October 16, 2014.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Health Center's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Health Center's internal control. Accordingly, we do not express an opinion on the effectiveness of the Health Center'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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Health Center'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 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 that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Health Center's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance 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 noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Comments involving statutory and other legal matters about the Health Center's operations for the year ended June 30, 2014 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Health Center. 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 this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*SEEM JOHNSON, LLP*

Omaha, Nebraska,  
October 16, 2014.

**Lucas County Health Center**

**Schedule of Findings and Responses  
For the Year Ended June 30, 2014**

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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 identified by the audit of the financial statement.
- (c) The audit did not disclose any non-compliance which is material to the financial statements.

**Part II: Findings Related to the Financial Statements**

***Internal Control Deficiencies:***

No matters were reported.

***Instances of Non-Compliance:***

No matters were reported.

**Part III: Other Findings Related to Required Statutory Reporting**

**III-A-14** Certified Budget: Health Center disbursements during the year ended June 30, 2014 did not exceed amounts budgeted.

**III-B-14** 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-14** Travel Expense: No expenditures of Health Center money for travel expenses of spouses of Health Center officials and/or employees were noted.

**III-D-14** Business Transactions: No business transactions between the Health Center and Health Center officials and/or employees were noted to violate Chapter 347.9A(2)(a) 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 Health Center to \$1,500 without publicly invited and opened written competitive bids.

**III-E-14** Board Minutes: No transactions were found that we believe should have been approved in the Board minutes but were not.

**III-F-14** Deposits and Investments: We noted no instances of noncompliance with the deposit and investments provisions of Chapter 12B and Chapter 12C of the Code of Iowa and the Health Center's investment policy.

**III-G-14** 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 Health Center publishes a list of expenditures quarterly which are summarized by major classification and vendor. They also publish a schedule of salaries annually by category.

**Lucas County Health Center**

**Audit Staff  
For the Year Ended June 30, 2014**

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**This audit was performed by:**

Roger E. Thompson, FHFMA, CPA, Partner

Darren R. Osten, FHFMA, CPA, Partner

Nicole R. McDonald, Manager

Brad D. Pieper, Staff Auditor

October 16, 2014

To the Board of Trustees  
Lucas County Health Center  
Chariton, Iowa:

In planning and performing our audit of the financial statements of Lucas County Health Center (the Health Center), as of and for the year ended June 30, 2014, in accordance with auditing standards generally accepted in the United States of America, we considered the Health Center's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Health Center's internal control. Accordingly, we do not express an opinion on the effectiveness of the Health Center'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 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. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be deficiencies, 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 weaknesses may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we did not consider to be material weaknesses.

The following is a description of an identified control deficiencies that we determined did not constitute a significant deficiency or material weakness:

### **Segregation of Duties**

One important aspect of internal control over financial reporting is segregation of duties among employees to prevent an individual employee the ability to circumvent the system of internal control. In reviewing the financial reporting preparation process and controls, due to a limited number of administrative personnel, a lack of segregation of duties exists. Proper segregation of duties ensures an adequate internal control structure and, without this segregation, a greater risk of fraud and defalcation may exist. While we realize that it is not always economically feasible to employ additional personnel for the purposes of greater segregation of duties, we recommend the Hospital continue to review internal control policies and procedures and job assignments to ensure an adequate control structure.

Management is aware of this deficiency in internal control and believes it is economically not feasible for the Health Center to employ additional personnel for the purpose of greater segregation of duties. The Health Center will continue to maintain and improve its segregation of duties.

### **Management Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimations and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements. As part of the audit, we reviewed the following significant estimates made by management:

- Allowance for third-party payor adjustments
- Estimated third-party payor settlements
- Allowance for doubtful accounts

Management performed an analysis of the estimated collectability of accounts receivable based upon historical collection rates as well as an analysis of the estimated third-party settlements based upon reimbursement and settlements received from third-party payors during the year. As part of our audit procedures, additional tests of the allowance for doubtful accounts of clinic accounts receivable was performed which resulted in an audit adjustment. We recommend management monitor and review its estimation process to enhance the process to compute appropriate estimates for allowance for doubtful accounts.

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The following are offered as constructive suggestions to be considered part of the ongoing process of modifying and improving the Hospital's policies and procedures:

**GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities***

GASB Concepts Statement No. 4, *Elements of Financial Statements*, introduced and defined the elements included in the financial statements (i.e., assets, deferred outflows of resources, liabilities, deferred inflows of resources, etc.). Concepts Statement No. 4 also indicated that recognition of deferred outflows of resources and deferred inflows of resources should be limited to those instances specifically identified in subsequent authoritative pronouncements.

GASB Statement 65 amends the recognition of certain items currently reported as assets and liabilities as inflows and outflows of resources. This impacted the presentation of the succeeding year tax revenue on the Statements of Net Position.

**GASB Statement No. 68, *Accounting and Financial Reporting for Pensions***

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, issued June 2012, will be effective for the Hospital beginning with its year ending June 30, 2015. This Statement replaces requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, and GASB Statement No. 50, *Pension Disclosures*, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangement that meet certain criteria. This Statement requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and enhances accountability and transparency through revised and new note disclosures and required supplementary information.

**Critical Access Hospital Status**

The Office of Inspector General (OIG) recently released a study regarding original regulatory requirements for obtaining critical access hospital (CAH) status primarily related to distance and location requirements. The study found that nearly two-thirds of CAHs would not meet the distance requirement if they were required to re-enroll. The study also noted that if CMS had decertified CAHs that were 15 miles or fewer from the nearest hospitals in 2011, the Medicare program would have saved \$449 million.

The OIG also has on its workplan to review swing-bed reimbursement in CAHs compared to amounts reimbursed to traditional skilled nursing facilities. CAHs are paid on a cost reimbursement methodology while skilled nursing facilities are paid on a prospective payment methodology that generally is less reimbursement than what would be received by a CAH for similar services.

If CMS were to act on the OIG study to re-enroll CAHs or make adjustments to CAH swing-bed reimbursement, there would be significant financial implications for the CAH program and the Health Center.

**340B Drug Discount Program**

The 340B program is a Federal drug discount program that was established in 1992 and was eligible to certain qualifying providers. The *Patient Protection and Affordable Care Act* and the *Health Care and Education Reconciliation Act of 2010* updated the qualifying criteria resulting in automatic eligibility of all critical access hospitals. The program allows the Health Center to buy outpatient drugs at reduced prices and benefit from the cost savings. The program allows outpatient drugs to be sold by the Health Center and allows the Health Center to contract with local pharmacies to act as its agent. Under the second arrangement, the Health Center is required to purchase the pharmaceuticals and the vendor provides all pharmacy services.

Under the program, the Health Center would be required to:

- Maintain separate records for inpatient and outpatient drugs,
- Sell covered outpatient drugs to qualifying patients only,
- Ensure covered outpatient drug costs are not subsequently reimbursed by Medicare and Medicaid.

The Health Resources and Services Administration (HRSA) reserves the right to conduct audits of entities participating in the 340B program. As the program expands, HRSA expects to expand audits from 51 in the prior year to 200 to 400 annually. Noncompliance was found in approximately half of the prior year audits, which can result in corrective actions, sanctions, and possibly termination from the program. We recommend that management review the provisions of the 340B drug discount program to ensure compliance, and continue to monitor the program.

### **Medicare Advantage Payments**

Medicare Advantage plans reimburse facilities based on the Medicare interim payment rates in place at the date of service. Fluctuations in facility volumes can significantly change the actual cost of providing services which may exceed interim payment rates. Unlike traditional Medicare, Medicare Advantage plans typically do not provide for a settlement based on actual costs versus interim rates. Due to this, it is important that the Health Center periodically evaluates the appropriateness of interim rates.

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This communication is intended solely for the information and use of the Board of Trustees, management, others within the organization and is not intended to be and should not be used by anyone other than these specified parties. We would be pleased to answer any questions you may have regarding the comments and suggestions contained in the preceding paragraphs.

Sincerely,

SEIM JOHNSON, LLP

A handwritten signature in black ink, appearing to read "Darren R. Osten". The signature is fluid and cursive, with the first name "Darren" and last name "Osten" clearly legible.

Darren R. Osten