

Lakes Regional Healthcare
Spirit Lake, Iowa

**Basic Financial Statements and
Supplementary Information
June 30, 2015 and 2014**

Together with Independent Auditor's Report

Lakes Regional Healthcare

Table of Contents

	<u>Page</u>
Officials – June 30, 2015	1
Independent Auditor's Report	2 – 3
Required Supplementary Information:	
Management's Discussion and Analysis	4 – 8
Basic Financial Statements:	
Statements of Net Position June 30, 2015 and 2014	9
Statements of Revenue, Expenses and Changes in Net Position For the Years Ended June 30, 2015 and 2014	10
Statements of Cash Flows For the Years Ended June 30, 2015 and 2014	11 – 12
Notes to Financial Statements June 30, 2015 and 2014	13 – 29
Required Supplementary Information:	
Budgetary Comparison Schedule of Revenue, Expenses and Changes in Net Position – Budget and Actual (Cash Basis)	30
Schedule of the Hospital's Proportionate Share of the Net Pension Liability	31
Schedule of the Hospital's Contributions	32
Notes to Required Supplementary Information – Pension Liability	33
Other Supplementary Information:	
Exhibit 1 - Net Patient Service Revenue For the Years Ended June 30, 2015 and 2014	34
Exhibit 2 - Other Operating Revenue For the Years Ended June 30, 2015 and 2014	35
Exhibit 3 - Departmental Expenses For the Years Ended June 30, 2015 and 2014	36
Exhibit 4 - Patient Receivables and Allowance for Doubtful Accounts June 30, 2015 and 2014	37
Exhibit 5 - Inventories/Prepaid Expenses June 30, 2015 and 2014	38
Exhibit 6 - Financial and Statistical Highlights For the Years Ended June 30, 2015 and 2014	39
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	40 – 41
Schedule of Findings and Responses	42 – 43
Audit Staff	44

Lakes Regional Healthcare

Officials
June 30, 2015

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, Secretary/Treasurer	Milford, Iowa	December 2016
Linda Moore	Spirit Lake, Iowa	December 2020
Dan Sedlacek	Spirit Lake, Iowa	December 2020
Mary Kay Bates	Spirit Lake, Iowa	December 2018
Jeremy Bolluyt	Spirit Lake, Iowa	December 2020

Chief Executive Officer

Jason Harrington	Spirit Lake, Iowa	Indefinite
------------------	-------------------	------------

Chief Financial Officer

Steve Alger	Spirit Lake, Iowa	Indefinite
-------------	-------------------	------------

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, 2015 and 2014, 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, 2015 and 2014, 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.

Emphasis of Matter

As discussed in Note 14 to the financial statements, in 2015 the Hospital adopted new accounting guidance of the Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, budgetary comparison information, the schedule of the Hospital's proportionate share of the net pension liability, and the schedule of Hospital contributions on pages 4 through 8 and 30 through 33, 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 other 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 23, 2015 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 23, 2015.

Lakes Regional Healthcare

Management's Discussion and Analysis June 30, 2015 and 2014

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, 2015, 2014 and 2013. This discussion and analysis should be read in conjunction with financial statements, which start on page 9.

Financial Highlights

- LRH implemented Governmental Accounting Standards Board (GASB) Statement No. 68, Accounting and Financial Reporting for Pensions, during fiscal year 2015. Excluding the restatement of the beginning net position as of July 1, 2014, LRH net position increased in 2015 by \$1,154,505 or 3.9%. In 2014, the net position increased by \$629,050 or 1.7%. In 2013, the net position increased by \$1,030,090 or 2.9%.
- LRH reported operating income in 2015 of \$930,937, compared to an operating income of \$326,510 and \$597,000 in 2014 and 2013, respectively.
- LRH reported non-operating activity in 2015 of \$223,568, compared to non-operating activity of \$302,540 and \$433,090 in 2014 and 2013, respectively.

Using This Annual Report

LRH financial statements consist of three statements—a statement of net position; a statement of revenue, 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 Revenue, Expenses, and Changes in Net Position

Analysis of LRH finances starts on page 9. The statement of net position and the statement of revenue, 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, deferred inflows and outflows, and liabilities using the accrual basis of accounting. All the current year's revenue 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 further 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 operating, 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, 2015 and 2014

Table 1: Condensed Statements of Net Position

	<u>2015</u>	<u>(not restated) 2014</u>	<u>(not restated) 2013</u>	<u>2015 Change</u>
Assets:				
Current assets	\$ 26,391,777	23,613,334	33,991,315	11.8%
Other non-current assets	1,086,026	3,763,401	3,772,673	-71.1%
Capital assets, net	<u>31,814,747</u>	<u>34,152,186</u>	<u>23,436,858</u>	<u>-6.8%</u>
Total assets	<u>59,292,550</u>	<u>61,528,921</u>	<u>61,200,846</u>	<u>-3.6%</u>
Deferred outflows of resources				
Pension related deferred outflows	<u>879,825</u>	<u>--</u>	<u>--</u>	<u>100.0%</u>
Total assets and deferred outflows	<u>\$ 60,172,375</u>	<u>61,528,921</u>	<u>61,200,846</u>	<u>-2.2%</u>
Liabilities:				
Current Liabilities	\$ 5,196,086	7,156,470	6,483,981	-27.4%
Long-term debt outstanding	15,472,857	16,536,998	17,585,462	-6.4%
Net pension liability	<u>5,893,175</u>	<u>--</u>	<u>--</u>	<u>100.0%</u>
Total liabilities	<u>26,562,118</u>	<u>23,693,468</u>	<u>24,069,443</u>	<u>12.1%</u>
Deferred inflow of resources:				
Unavailable property tax revenue	650,000	425,000	350,000	52.9%
Pension related deferred inflows	<u>2,429,716</u>	<u>--</u>	<u>--</u>	<u>100.0%</u>
Total deferred inflows of resources	<u>3,079,716</u>	<u>425,000</u>	<u>350,000</u>	<u>624.6%</u>
Net position:				
Net investment in capital assets	15,277,749	16,566,047	13,199,015	-7.8%
Restricted for debt service	1,372,673	1,373,539	1,342,437	-0.1%
Restricted expendable	75,533	78,473	189,832	-3.7%
Restricted nonexpendable	25,000	25,000	25,000	0.0%
Unrestricted	<u>13,779,586</u>	<u>19,367,394</u>	<u>22,025,119</u>	<u>-28.9%</u>
Total net position	<u>30,530,541</u>	<u>37,410,453</u>	<u>36,781,403</u>	<u>-18.4%</u>
Total liabilities, deferred inflows and net position	<u>\$ 60,172,375</u>	<u>61,528,921</u>	<u>61,200,846</u>	<u>-2.2%</u>

Net Operating Results and Changes in the Hospital's Net Position

LRH net position is the difference between assets, deferred inflows and outflows, and liabilities reported in the statement of net position on page 9. LRH net position decreased this past year by \$6,879,912 or 18.4%, as shown in Table 1. This compares to an increase of \$629,050 in 2014 and an increase of \$1,030,090 in 2013.

Governmental Accounting Standards Board (GASB) Statement No. 68, Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27 was implemented during fiscal year 2015. The beginning net position as of July 1, 2014 was restated by \$8,034,417 to retroactively report the net pension liability as of June 30, 2013 and deferred outflows of resources related to contributions made after June 30, 2013 but prior to July 1, 2014. The financial statement amounts for fiscal years 2013 and 2014 for net pension liabilities, pension expense, deferred outflows of resources and deferred inflows of resources were not restated because the information was not available. In the past, pension expense was the amount of the employer contribution. Current reporting provides a more comprehensive measure of pension expense which is more reflective of the amounts employees earned during the year.

Lakes Regional Healthcare

Management's Discussion and Analysis June 30, 2015 and 2014

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

	<u>2015</u>	<u>(not restated) 2014</u>	<u>(not restated) 2013</u>	<u>2015 Change</u>
Operating Revenue:				
Net patient service revenue	\$ 36,223,153	34,094,127	34,648,143	6.2%
Provision for bad debt	(1,213,788)	(1,755,229)	(1,842,480)	-30.8%
Other operating revenue, net	1,565,272	1,456,088	1,326,016	7.5%
Net assets released for operations	27,894	93,272	1,969	-70.1%
	<u>36,602,531</u>	<u>33,888,258</u>	<u>34,133,648</u>	<u>8.0%</u>
Operating Expenses:				
Salaries and benefits	13,877,120	14,104,051	14,328,633	-1.6%
Purchased services and other	18,719,142	17,364,531	16,985,189	7.8%
Depreciation and amortization	3,075,332	2,093,166	2,222,826	46.9%
	<u>35,671,594</u>	<u>33,561,748</u>	<u>33,536,648</u>	<u>6.3%</u>
Operating income	<u>930,937</u>	<u>326,510</u>	<u>597,000</u>	<u>185.1%</u>
Non-operating Revenues and Expenses				
Interest expense	(294,896)	(37,661)	(27,493)	683.0%
Investment income	96,405	101,561	120,773	-5.1%
County tax revenue	425,000	350,000	350,000	21.4%
Other non-operating revenue and expenses, net	(2,941)	(111,360)	(10,190)	-97.4%
	<u>223,568</u>	<u>302,540</u>	<u>433,090</u>	<u>-26.1%</u>
Increase in net position	1,154,505	629,050	1,030,090	83.5%
Net position beginning of year, as restated	<u>29,376,036</u>	<u>36,781,403</u>	<u>35,751,313</u>	<u>-20.1%</u>
Net position end of year	<u>\$ 30,530,541</u>	<u>37,410,453</u>	<u>36,781,403</u>	<u>-18.4%</u>

Statement of Revenue, Expenses and Changes in Net Position

In 2015, LRH net position decreased by \$6,879,912 or 18.4%, as shown in Table 2. As stated previously, implementation of GASB Statement No. 68 during the current year resulted in a restatement of the beginning of the year net position of \$8,034,417. After taking into account this restatement, LRH net position for 2015 increased by \$1,154,505 or 3.9%. This increase was a combination of three components. Operating revenue increased by \$2,714,273 or 8.0% in 2015, while operating expenses increased by \$2,109,846 or 6.3%. Non-operating revenue decreased by \$78,972 or 26.1%.

Operating Revenue

The first component of the change in LRH net position is operating revenue. Operating revenue increased \$2,714,273 or 8.0% in 2015. The primary drivers of the change in operating revenue are as follows:

- Net patient service revenue increased \$2,129,026 or 6.2% in 2015, compared to a decrease of \$231,869 or 0.7% in 2014 and an increase of \$7,216,001 or 26.3% in 2013. LRH assumed the operations of the two primary care clinics located on the hospital campus during 2013 of which accounted for an increase to patient service revenue of \$5,010,869 during 2013. LRH received \$1,868,510 in 2015, \$2,136,023 in 2014 and \$2,318,328 in 2013 of supplemental Medicare reimbursements as a member of the Rural Community

Lakes Regional Healthcare

Management's Discussion and Analysis June 30, 2015 and 2014

Hospital Demonstration Program (see Note 3). In addition to the positive effects of the above activity, net patient service revenue in 2015 experienced consistency in patient volumes combined with a higher mix of more profitable orthopedic surgeries. Acute patient days were 2,716 in 2015, compared to 2,732 in 2014 and 3,022 in 2013. Surgical patients were 2,150 in 2015, compared to 2,158 in 2014 and 2,044 in 2013.

- The ability to collect revenue charged to patients affects operating revenue. The provision for bad debt in 2015 was \$1,213,788, a 30.8% decrease from 2014. This decrease is a reflection of a declining self-pay patient population and increased efforts to assist patients with the expanded Medicaid qualification requirements. This has been assisted by increased account collection efforts.
- 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 \$161,279 in 2015 compared to \$353,769 in 2014 and \$290,361 in 2013. 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 13). LRH recognized incentive payments of \$763,554 in 2015 compared to \$436,901 in 2014, and \$731,250 in 2013.

Operating Expenses

The second component of the change in LRH net position is operating expenses. Operating expenses increased \$2,109,846 or 6.3% in 2015. The primary components of the change in operating expenses are:

- As noted above, the hospital assumed the operations of the two primary care clinics located on the hospital campus during 2013. Operating expenses increased \$4,918,279 during 2013 due to the initial year of the clinic operations.
- Salary and benefit costs for employees decreased \$232,564 or 1.6% in 2015, compared to a decrease of \$224,582 or 1.6% in 2014, and an increase of \$544,042 or 3.9% in 2013. The 2015 decrease relates primarily to the favorable impact of implementation of GASB Statement No. 68. Excluding the impact of this implementation, LRH would have seen an increase in salary and benefit costs of approximately 2.1% when compared to 2014.
- Purchased services and other expenses increased \$1,360,244 or 7.8% in 2015, compared to an increase of \$377,841 or 2.2% in 2014, and an increase of \$5,382,565 or 49.5% in 2013. The 2015 increase relates to increases in supplies with the increased orthopedic volumes, increases in information technology spending, increases in physician recruitment costs and leased staff costs from the primary care clinic. The 2013 increase included \$4,924,411 for the primary care clinic.

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 decreased \$78,972 or 26.1% in 2015. The primary components affecting non-operating revenue are:

- Property tax income was \$425,000 in 2015, compared to \$350,000 in 2014, and 2013 respectively. Dickinson County provides property tax revenue to LRH for the ambulance service. The county tax levy was \$0.19269 per \$1,000 of valuation for 2015, \$0.16291 in 2014 and \$0.16999 in 2013.
- Investment income was \$96,405 for 2015, \$101,561 in 2014, and \$120,773 in 2013. Excess cash is maintained in interest bearing checking accounts and short term certificates of deposits. These low risk investments continue to have very low rates of return.
- Interest expense was \$294,896 for 2015, \$37,661 in 2014, and \$27,493 in 2013. Financial reporting requirements allow for interest expense to be capitalized instead of expensed during the construction phase period. The building project was finalized in late 2014 and therefore, an entire year's worth of interest was recorded as expense in 2015.
- Other non-operating revenue (expenses), net were (\$2,941) in 2015, (\$111,360) in 2014, and (\$10,190) in 2013. The majority of this expense has related to the release of restrictions on donations.

Lakes Regional Healthcare

Management's Discussion and Analysis June 30, 2015 and 2014

Cash Flows

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

Capital Asset and Debt Administration

Capital Assets

As of June 30, 2015 LRH had \$31,814,747 invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. At June 30, 2014, LRH had \$34,152,186 invested in capital assets, net of accumulated depreciation. In 2015, LRH purchased new capital assets costing \$1,716,766. Capital spending was \$13,126,041 and \$8,258,475 in 2014 and 2013, respectively. The increased capital spending in 2014 and 2013 was the result of capitalization of 40,000 square feet of space that provided 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 \$15,472,857 in capital loan notes outstanding. The majority of this debt was issued in conjunction with the 2013/2014 construction project.

Other Economic Factors

Reimbursement rates continue to be the main challenge for LRH. Medicare and Medicaid make up 61% of the patient revenue in FY 2015. Special Medicare reimbursement programs have been discontinued in recent years, i.e. the Outpatient Hold Harmless provisions within the OPSS payment system. In addition to this, the government continues to hold in effect a 2% Medicare reimbursement cut that started in 2013 as a result of government sequestration. The effects of these cuts have been somewhat lessened by LRH continued participation in the Rural Community Hospital Demonstration Program. 2015 was the fourth year of participation in this five year program.

In addition to the regular impact of changes imposed by various payers, it is expected that Medicaid payments will be potentially impacted in FY16 by the state's decision to move its Medicaid program to a "managed care" model effective January 1, 2016. Although final details are pending, it is expected that the model will include some type of capitated payment arrangement with the net effect being an overall decrease in reimbursement at some level. Additionally, LRH has tentatively agreed to participate in a 3-year "Medicare Shared Savings Program" that will include participation in an Accountable Care Organization model consistent with future Medicare "alternative payment" strategies. It is expected that this program will have limited financial impact on LRH. However, there is not sufficient historical experience to provide guidance. It is believed participation in this program will position LRH for more permanent changes in the program in 2018 or 2019.

In addition to the above pressures on hospital revenue, expenses continue to be impacted by higher than average inflation rates 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, 2015 and 2014

	<u>2015</u>	<u>2014</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 16,605,955	15,959,610
Certificates of deposit	2,677,027	--
Assets limited as to use - current portion	378,232	379,200
Receivables -		
Patients, net of allowance for doubtful accounts of \$1,983,813 in 2015 and \$1,686,861 in 2014	3,785,476	4,470,021
Succeeding year property tax	650,000	425,000
Other	1,074,452	1,225,631
Inventories	997,832	938,103
Prepaid expenses	213,819	215,769
Total current assets	<u>26,382,793</u>	<u>23,613,334</u>
Assets limited as to use	1,095,010	3,763,401
Capital assets, net of accumulated depreciation	<u>31,814,747</u>	<u>34,152,186</u>
Total assets	<u>59,292,550</u>	<u>61,528,921</u>
DEFERRED OUTFLOWS OF RESOURCES		
Pension related deferred outflows	<u>879,825</u>	<u>--</u>
Total assets and deferred outflows of resources	<u>\$ 60,172,375</u>	<u>61,528,921</u>
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	\$ 1,064,141	1,049,141
Accounts payable -		
Trade	1,547,434	2,501,594
Construction	44,871	969,426
Salaries, wages and accrued vacation payable	1,464,602	1,460,638
Payroll taxes withheld and accrued	127,798	130,587
Accrued interest payable	25,204	26,340
Other accrued liabilities	577,608	565,020
Estimated third-party payor settlements, net	344,428	453,724
Total current liabilities	<u>5,196,086</u>	<u>7,156,470</u>
Long-term debt, net of current portion	15,472,857	16,536,998
Net pension liability	<u>5,893,175</u>	<u>--</u>
Total liabilities	<u>26,562,118</u>	<u>23,693,468</u>
DEFERRED INFLOW OF RESOURCES		
Unavailable property tax revenue	650,000	425,000
Pension related deferred inflows	<u>2,429,716</u>	<u>--</u>
Total deferred inflows of resources	<u>3,079,716</u>	<u>425,000</u>
NET POSITION		
Net investment in capital assets	15,277,749	16,566,047
Restricted -		
For debt service	1,372,673	1,373,539
Expendable for capital acquisitions and operating activities	75,533	78,473
Nonexpendable	25,000	25,000
Unrestricted	<u>13,779,586</u>	<u>19,367,394</u>
Total net position	<u>30,530,541</u>	<u>37,410,453</u>
Total liabilities, deferred inflows of resources, and net position	<u>\$ 60,172,375</u>	<u>61,528,921</u>

See notes to financial statements

Lakes Regional Healthcare

Statements of Revenue, Expenses and Changes in Net Position For the Years Ended June 30, 2015 and 2014

	<u>2015</u>	<u>(not restated) 2014</u>
OPERATING REVENUE:		
Net patient service revenue before provision for bad debt	\$ 36,223,153	34,094,127
Provision for bad debt	<u>(1,213,788)</u>	<u>(1,755,229)</u>
Net patient service revenue	35,009,365	32,338,898
Other, net	<u>1,593,166</u>	<u>1,549,360</u>
Total operating revenue	<u>36,602,531</u>	<u>33,888,258</u>
OPERATING EXPENSES:		
Salaries	11,235,225	10,853,202
Employee benefits	2,641,895	3,250,849
Purchased services and professional fees	9,532,240	8,954,067
Utilities	539,279	521,209
Supplies and other expenses	8,433,463	7,655,554
Depreciation	3,075,332	2,093,166
Insurance	<u>214,160</u>	<u>233,701</u>
Total operating expenses	<u>35,671,594</u>	<u>33,561,748</u>
OPERATING INCOME	<u>930,937</u>	<u>326,510</u>
NONOPERATING REVENUE (EXPENSE):		
Interest expense	(294,896)	(37,661)
Investment income	96,405	101,561
County tax revenue	<u>425,000</u>	<u>350,000</u>
Total nonoperating revenue, net	<u>226,509</u>	<u>413,900</u>
EXCESS REVENUE OVER EXPENSES BEFORE RESTRICTED AND AUXILIARY ACTIVITY, NET	1,157,446	740,410
RESTRICTED AND AUXILIARY ACTIVITY, NET	<u>(2,941)</u>	<u>(111,360)</u>
INCREASE IN NET POSITION	1,154,505	629,050
NET POSITION, beginning of year, as restated (see note 14)	<u>29,376,036</u>	<u>36,781,403</u>
NET POSITION, end of year	<u>\$ 30,530,541</u>	<u>37,410,453</u>

See notes to financial statements

Lakes Regional Healthcare

Statements of Cash Flows

For the Years Ended June 30, 2015 and 2014

	<u>2015</u>	<u>(not restated) 2014</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third party payors	\$ 35,584,614	33,439,483
Cash paid for employees salaries and benefits	(14,467,296)	(14,113,834)
Cash paid to suppliers and contractors	(19,718,493)	(16,878,193)
Other receipts and payments, net	1,798,570	1,062,654
Net cash provided by operating activities	<u>3,197,395</u>	<u>3,510,110</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES,		
County taxes received	<u>425,000</u>	<u>350,000</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of capital assets, net	(1,716,766)	(13,126,041)
Payments on long-term debt	(1,030,000)	(910,000)
Interest paid on long-term debt	(315,173)	(346,484)
Net cash used in capital and related financing activities	<u>(3,061,939)</u>	<u>(14,382,525)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Withdrawals from assets limited as to use, net	2,666,511	8,230,290
Withdrawals from (deposits to) certificates of deposit, net	(2,677,027)	3,708,547
Investment income	96,405	105,311
Net cash provided by investing activities	<u>85,889</u>	<u>12,044,148</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	646,345	1,521,733
CASH AND CASH EQUIVALENTS, beginning of year	<u>15,959,610</u>	<u>14,437,877</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 16,605,955</u>	<u>15,959,610</u>

See notes to financial statements

Lakes Regional Healthcare

Statements of Cash Flows (Continued) For the Years Ended June 30, 2015 and 2014

	<u>2015</u>	<u>(not restated)</u> <u>2014</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 930,937	326,510
Adjustments to reconcile operating income to net cash provided by operating activities -		
Depreciation and amortization	3,075,332	2,093,166
Loss (gain) on disposal of capital assets	54,317	(9,335)
Decrease in net pension liability	(3,079,947)	--
Decrease in deferred outflows of resources	58,880	--
Increase in deferred inflows of resources	2,429,716	--
(Increase) decrease in current assets -		
Receivables -		
Patients	684,545	197,158
Other	151,179	(71,983)
Inventories	(59,729)	(203,200)
Prepaid expenses	1,950	(34,122)
Estimated third-party payor settlements, net	--	131,874
Increase (decrease) in current liabilities -		
Accounts payable - trade	(954,160)	647,771
Due to restricted funds	(92)	(85,938)
Salaries, wages and accrued vacation payable	3,964	74,621
Payroll taxes withheld and accrued	(2,789)	(84,404)
Other accrued liabilities	12,588	74,268
Estimated third-party payor settlements, net	(109,296)	453,724
Net cash provided by operating activities	\$ <u>3,197,395</u>	<u>3,510,110</u>

See notes to financial statements

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

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

Lakes Regional Healthcare (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.

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*

For financial reporting purposes, the Hospital has included all funds of the Hospital, specifically all assets, deferred inflows and outflows of resources, 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 healthcare 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 healthcare 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 healthcare 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. Several provisions have been implemented while other provisions are 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 June 30, 2015 and 2014

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 revenue 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 loan 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. 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.

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

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. Other Receivables

Other receivables include physician recruitment advances and income guarantees and other miscellaneous receivables.

J. Inventories

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

K. 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.

L. 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	10 to 50 years
Buildings and building improvements	10 to 50 years
Equipment, computers, and furniture	3 to 25 years

The Hospital'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 such as land, buildings or equipment are reported as unrestricted support and are excluded from the excess of expenses over revenue, unless explicit donor stipulations specify how the donated assets must be used. 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.

M. 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, net of capitalized interest income on unspent borrowed funds.

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

N. Deferred Outflows of Resources

Deferred outflows of resources represent a consumption of net position that applies to a future period(s) and will not be recognized as an outflow of resources (expense) until then. Deferred outflows of resources consist of unrecognized items not yet charged to pension expense and contributions from the employer after the measurement date, but before the end of the employer's reporting period.

O. 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, 2015 and 2014 was \$907,410 and \$929,844, respectively.

P. Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Iowa Public Employees' Retirement System (IPERS) and additions to/deductions from IPERS' fiduciary net position have been determined on the same basis as they are reported by IPERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Q. Deferred Inflows of Resources

Deferred inflows of resources represent an acquisition of net position that applies to a future period(s) and will not be recognized as an inflow of resources (revenue) until that time. Deferred inflows of resources in the statement of net position consists of succeeding year property tax receivable that will not be recognized as revenue until the year for which it is levied and the unamortized portion of the net difference between projected and actual earnings on pension plan investments.

R. 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 healthcare 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.

S. 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.

T. Charity Care

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

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

U. Group Health Insurance Costs

The Hospital is self-insured under its employee group health program 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 \$250,000 and \$245,000 at June 30, 2015 and 2014, respectively.

V. Grants and Contributions

From time to time, the Hospital 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 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.

W. 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.

X. Reclassifications

Certain amounts in the 2014 financial statements have been reclassified to conform to the 2015 reporting format.

Y. Subsequent Events

The Hospital considered events occurring through October 23, 2015 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, 2015 and 2014 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 GASB Codification Section 150 and 155 at June 30, 2015 and 2014.

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

(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, 2013.

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, incur a two percent reduction in Medicare payment.

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.

Commercial. Wellmark Blue Cross and Blue Shield (Wellmark) is the dominant commercial payor in the state of Iowa. The Hospital has a significant portion of its commercial business with this payor. The Hospital is reimbursed for inpatient acute care and swing-bed services at a discount from established charges. Outpatient services are paid based on Enhanced Ambulatory Patient Groups (EAPG). For the majority of the other commercial payors, the basis of payment to the Hospital primarily includes discounts from established charges.

The Hospital 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. Net patient service revenue increased \$289,000 in 2014, 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 47% and 9%, respectively, of the Hospital's net patient service revenue for the year ended June 30, 2015, and 51% and 7%, respectively, for the year ended June 30, 2014. The Hospital grants credit without collateral to their 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.

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

(4) Other Receivables

The composition of other receivables at June 30, 2015 and 2014 is summarized as follows:

	<u>2015</u>	<u>2014</u>
Physician loans and income guarantees, net	\$ 932,367	917,424
Other	142,085	308,207
	<u>\$ 1,074,452</u>	<u>1,225,631</u>

Receivables for physician loans and income guarantees are recorded when paid and subsequently amortized to operating expenses as the physicians fulfill the commitments in the agreements.

(5) Assets Limited as to Use

By Board

Cash deposits and certificates of deposit designated by the Board for endowments as of June 30, 2015 and 2014, are summarized as follows:

	<u>2015</u>	<u>2014</u>
Endowments -		
Cash	\$ --	3,530
Certificates of deposit	--	2,670,000
Interest receivable	--	1,099
Commingled donor funds (see below)	--	(9,040)
	<u>\$ --</u>	<u>2,665,589</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:

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.

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

The amounts as of June 30, 2015 and 2014 represent cash and cash equivalents and are as follows:

	<u>2015</u>	<u>2014</u>
Bond Fund, Series 2002	\$ 275,360	275,485
Sinking Funds, Series 2012 and 2013	102,872	103,715
Debt Service Reserve Fund, Series 2012 and 2013	<u>994,441</u>	<u>994,339</u>
	1,372,673	1,373,539
Less current portion	<u>(378,232)</u>	<u>(379,200)</u>
	<u>\$ 994,441</u>	<u>994,339</u>

By Donor

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

The Hospital Auxiliary conducts various projects to raise funds which are used to satisfy needs of the Hospital as determined by its executive Board and the Hospital Board of Trustees.

The amounts segregated as of June 30, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Mandelbaum Endowment fund		
Certificate of deposit	\$ 25,000	25,000
Hospice and other restricted contributions		
Commingled with short-term investments	8,948	9,040
Hospital auxiliary assets, primarily cash and cash equivalents	<u>66,585</u>	<u>69,433</u>
	<u>\$ 100,533</u>	<u>103,473</u>
Total assets limited as to use, net of current portion	<u>\$ 1,094,974</u>	<u>3,763,401</u>

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

(6) Capital Assets

Capital assets activity for the years ended June 30, 2015 and 2014 were as follows:

	June 30, 2014	Additions	Transfers and Disposals	June 30, 2015
Capital assets, not being depreciated:				
Land	\$ 919,017	--	--	919,017
Capital assets, being depreciated:				
Land improvements	766,699	13,987	--	780,686
Hospital buildings	37,182,121	197,925	(8,226)	37,371,820
Fixed equipment	4,895,977	21,255	(63,668)	4,853,564
Major moveable equipment	15,904,630	559,043	(3,296,682)	13,166,991
Total capital assets, being depreciated	<u>58,749,427</u>	<u>792,210</u>	<u>(3,368,576)</u>	<u>56,173,061</u>
Less accumulated depreciation:				
Land improvements	355,598	39,396	--	394,994
Hospital buildings	10,748,747	1,253,582	(7,188)	11,995,141
Fixed equipment	2,740,396	544,730	(32,773)	3,252,353
Major moveable equipment	11,671,517	1,237,624	(3,274,298)	9,634,843
Total accumulated depreciation	<u>25,516,258</u>	<u>3,075,332</u>	<u>(3,314,259)</u>	<u>25,277,331</u>
Total capital assets, being depreciated, net	<u>33,233,169</u>	<u>(2,283,122)</u>	<u>(54,317)</u>	<u>30,895,730</u>
Total capital assets, net	<u>\$ 34,152,186</u>	<u>(2,283,122)</u>	<u>(54,317)</u>	<u>31,814,747</u>

	June 30, 2013	Additions	Transfers and Disposals	June 30, 2014
Capital assets, not being depreciated:				
Land	\$ 919,017	--	--	919,017
Construction in progress	9,616,760	12,662,392	(22,279,152)	--
Total capital assets, not being depreciated	<u>10,535,777</u>	<u>12,662,392</u>	<u>(22,279,152)</u>	<u>919,017</u>
Capital assets, being depreciated:				
Land improvements	630,744	--	135,955	766,699
Hospital buildings	21,090,697	--	16,091,424	37,182,121
Fixed equipment	3,663,599	--	1,232,378	4,895,977
Major moveable equipment	13,623,929	164,268	2,116,433	15,904,630
Total capital assets, being depreciated	<u>39,008,969</u>	<u>164,268</u>	<u>19,576,190</u>	<u>58,749,427</u>
Less accumulated depreciation:				
Land improvements	414,947	25,866	(85,215)	355,598
Hospital buildings	11,483,266	827,623	(1,562,142)	10,748,747
Fixed equipment	2,458,875	328,666	(47,145)	2,740,396
Major moveable equipment	11,750,800	911,011	(990,294)	11,671,517
Total accumulated depreciation	<u>26,107,888</u>	<u>2,093,166</u>	<u>(2,684,796)</u>	<u>25,516,258</u>
Total capital assets, being depreciated, net	<u>12,901,081</u>	<u>(1,928,898)</u>	<u>22,260,986</u>	<u>33,233,169</u>
Total capital assets, net	<u>\$ 23,436,858</u>	<u>10,733,494</u>	<u>(18,166)</u>	<u>34,152,186</u>

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

(7) Long-Term Debt

Long-term debt activity of the Hospital as of June 30, 2015 and 2014 consisted of the following:

	<u>June 30, 2014</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30, 2015</u>	<u>Due Within One Year</u>
Capital loan notes (A)	\$ 3,020,000	--	(320,000)	2,700,000	335,000
Series 2012 loan agreement (B)	10,000,000	--	--	10,000,000	--
Series 2013 loan agreement (C)	4,400,000	--	(710,000)	3,690,000	710,000
Unamortized bond premiums (B, C)	166,139	--	(19,141)	146,998	19,141
	<u>\$ 17,586,139</u>	<u>--</u>	<u>(1,049,141)</u>	<u>16,536,998</u>	<u>1,064,141</u>

	<u>June 30, 2013</u>	<u>Borrowings</u>	<u>Payments</u>	<u>June 30, 2014</u>	<u>Due Within One Year</u>
Capital loan notes (A)	\$ 3,330,000	--	(310,000)	3,020,000	320,000
Series 2012 loan agreement (B)	10,000,000	--	--	10,000,000	--
Series 2013 loan agreement (C)	5,000,000	--	(600,000)	4,400,000	710,000
Unamortized bond premiums (B, C)	185,280	--	(19,141)	166,139	19,141
	<u>\$ 3,330,000</u>	<u>--</u>	<u>(329,141)</u>	<u>17,586,139</u>	<u>1,049,141</u>

- (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 revenue, 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 were 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 were 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 \$710,000 to \$740,000 from 2016 through 2020 with a final payment of \$70,000 in June 2021.

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

A summary of the Hospital's future principal and interest payments as of June 30, 2015 is as follows:

<u>Year</u>	<u>Interest Rates</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
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	0.99 - 1.50	1,115,000	257,255	1,372,255
2020	0.99 - 1.50	1,140,000	242,535	1,382,535
2021-2025	0.99 - 2.00	4,760,000	956,627	5,716,627
2026-2030	2.00 - 2.38	4,305,000	528,100	4,833,100
2031-2032	2.38 - 2.50	1,865,000	69,100	1,934,100
		<u>16,390,000</u>	<u>2,911,105</u>	<u>19,301,105</u>
Add unamortized bond premium		<u>146,998</u>		
		<u>\$ 16,536,998</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>2015</u>	<u>2014</u>
Interest costs	\$ 314,037	342,262
Amortization of bond premiums	(19,141)	(19,141)
Less interest capitalized with Hospital construction project	--	(285,460)
Interest included in the statements of revenue, expenses and changes in net position	<u>\$ 294,896</u>	<u>37,661</u>

(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.

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, 2015 and 2014, 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.

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

(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 membership is mandatory for employees of the Hospital, except for those covered by another retirement system. IPERS issues a stand-alone financial report which is available to the public by mail at 7401 Register Drive, P.O. Box 9117, Des Moines, Iowa 50360-9117 or at www.ipers.org.

IPERS benefits are established under Iowa Code chapter 97B and the administrative rules thereunder. Chapter 97B and the administrative rules are the official plan documents. The following brief description is provided for general informational purposes only. Refer to the plan documents for more information.

Pension Benefits

A regular member may retire at normal retirement age and receive monthly benefits without an early-retirement reduction. Normal retirement age is age 65, any time after reaching age 62 with 20 or more years of covered employment, or when the member's years of service plus the member's age at the last birthday equals or exceeds 88, whichever comes first. (These qualifications must be met on the member's first month of entitlement to benefits.) Members cannot begin receiving retirement benefits before age 55. The formula used to calculate a Regular member's monthly IPERS benefit includes:

- A multiplier (based on years of service).
- The member's highest five-year average salary. (For members with service before June 30, 2012, the highest three-year average salary as of that date will be used if it is greater than the highest five-year average salary.)

If a member retires before normal retirement age, the member's monthly retirement benefit will be permanently reduced by an early-retirement reduction. The early-retirement reduction is calculated differently for service earned before and after July 1, 2012. For service earned before July 1, 2012, the reduction is 0.25 percent for each month that the member receives benefits before the member's earliest normal retirement age. For service earned starting July 1, 2012, the reduction is 0.50 percent for each month that the member receives benefits before age 65.

Generally, once a member selects a benefit option, a monthly benefit is calculated and remains the same for the rest of the member's lifetime. However, to combat the effects of inflation, retirees who began receiving benefits prior to July 1990 receive a guaranteed dividend with their regular November benefit payments.

Disability and Death Benefits

A vested member who is awarded federal Social Security disability or Railroad Retirement disability benefits is eligible to claim IPERS benefits regardless of age. Disability benefits are not reduced for early retirement. If a member dies before retirement, the member's beneficiary will receive a lifetime annuity or a lump-sum payment equal to the present actuarial value of the member's accrued benefit or calculated with a set formula, whichever is greater. When a member dies after retirement, death benefits depend on the benefit option the member selected at retirement.

Contributions

Effective July 1, 2012, as a result of a 2010 law change, the contribution rates are established by IPERS following the annual actuarial valuation, which applies IPERS' Contribution Rate Funding Policy and Actuarial Amortization Method. Statute limits the amount rates can increase or decrease each year to 1 percentage point. IPERS Contribution Rate Funding Policy requires that the actuarial contribution rate be determined using the "entry age normal" actuarial cost method and the actuarial assumptions and methods approved by the IPERS Investment Board. The actuarial contribution rate covers normal cost plus the unfunded actuarial liability payment based on a 30-year amortization period. The payment to amortize the unfunded actuarial liability is determined as a level percentage of payroll, based on the Actuarial Amortization Method adopted by the Investment Board.

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

In fiscal years 2015 and 2014, pursuant to the required rate, Regular members contributed 5.95 percent of pay and the Hospital contributed 8.93 percent for a total rate of 14.88 percent.

The Hospital's contributions to IPERS for the year ended June 30, 2015 and 2014 were \$957,723 and \$938,705, respectively.

Net Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At June 30, 2015, the Hospital reported a liability of \$5,893,175 for its proportionate share of the net pension liability. The Hospital's net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Hospital's proportion of the net pension liability was based on the Hospital's share of contributions to the pension plan relative to the contributions of all IPERS participating employers. At June 30, 2014, the Hospital's proportion was .1493042 percent, which was a decrease of .0000820 from its proportion measured as of June 30, 2013. For the year ended June 30, 2015, the Hospital recognized pension expense of \$366,372. At June 30, 2015, the Hospital reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 65,407	11,270
Changes of assumptions	265,601	269
Net difference between projected and actual earnings on pension plan investments	--	2,418,177
Changes in proportion and differences between Hospital contributions and proportionate share of contributions	(408,906)	--
Hospital contributions subsequent to the measurement date	<u>957,723</u>	<u>--</u>
Total	<u>\$ 879,825</u>	<u>2,429,716</u>

\$957,723 reported as deferred outflows of resources related to pensions resulting from the Hospital contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

<u>Year Ended June 30,</u>	
2016	\$ (625,441)
2017	(625,441)
2018	(625,441)
2019	(625,441)
2020	<u>(5,850)</u>
	<u>\$ (2,507,614)</u>

There were no non-employer contributing entities at IPERS.

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

Actuarial Assumptions

The total pension liability in the June 30, 2014 actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Rate of Inflation (effective June 30, 2014)	3.00 percent
Salary increases (effective June 30, 2014)	4.00 percent, average, including inflation
Investment rate of return (effective June 30, 1996)	7.50 percent per annum, compounded annually, net of pension plan investment expense, including inflation

The actuarial assumptions used in the June 30, 2014 valuation were based on the results of actuarial experience studies with dates corresponding to those listed above.

Mortality rates were based on the RP-2000 Mortality Table for Males or Females, as appropriate, with adjustments for mortality improvements based on Scale AA.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Asset Allocation</u>	<u>Long-Term Expected Real Rate of Return</u>
US Equity	23%	6.31
Non US Equity	15	6.76
Private Equity	13	11.34
Real Estate	8	3.52
Core Plus Fixed Income	28	2.06
Credit Opportunities	5	3.67
TIPS	5	1.92
Other Real Assets	2	6.27
Cash	1	(0.69)
Total	<u>100%</u>	

Discount Rate

The discount rate used to measure the total pension liability was 7.5 percent. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the contractually required rate and that contributions from the Hospital will be made at contractually required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

Sensitivity of the Hospital's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents the Hospital's proportionate share of the net pension liability calculated using the discount rate of 7.5 percent, as well as what the Hospital's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.5 percent) or 1-percentage-point higher (8.5 percent) than the current rate.

	<u>1% Decrease (6.5%)</u>	<u>Discount Rate (7.5%)</u>	<u>1% Increase (8.5%)</u>
Hospital's proportionate share of the net pension liability	\$ 11,585,386	5,893,175	1,089,160

Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in the separately issued IPERS financial report which is available on IPERS' website at www.ipers.org.

Payables to the Pension Plan

At June 30, 2015, the Hospital reported payables to the defined benefit pension plan of \$201,803 for legally required employer contributions and \$49,516 for legally required employee contributions which had been withheld from employee wages but not yet remitted to IPERS.

(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:

2016	\$ 67,860
2017	67,860
2018	67,860
2019	67,860
2020	67,860
2021	33,930

(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.

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

(12) Concentrations of Credit Risk

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

	<u>2015</u>	<u>2014</u>
Medicare	35.7%	38.4%
Medicaid	10.1	8.9
Blue Cross	22.7	23.0
Private pay	13.0	11.8
Other third-party payors	18.5	17.9
	<u>100.0%</u>	<u>100.0%</u>

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

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

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

The Hospital accounts for meaningful use incentive payments under the grant accounting model, cliff recognition. Medicare EHR incentive payments are recognized as revenue when eligible providers demonstrate meaningful use of certified EHR technology and data is available to estimate the incentive payments for each period (a 365 day period after the initial 90 day attestation period). Medicaid EHR incentive payments are recognized as revenue when an eligible provider demonstrates meaningful use of certified EHR technology for each period. For fiscal years 2015 and 2014, the Hospital recognized \$763,554 and \$349,401, respectively, of Medicare meaningful use grant revenue. For fiscal years 2015 and 2014 the Hospital recognized \$-0- and \$87,500, respectively, of Medicaid meaningful use grant revenue in other revenue in its statement of revenue, expenses, and changes in net position. 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 from the initial payments under the program.

(14) Change in Accounting Principle

Governmental Accounting Standards Board Statement No. 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB No. 27* was implemented during fiscal year 2015. The revised requirements establish new financial reporting requirements for state and local governments which provide their employees with pension benefits, including additional note disclosures and required supplementary information. In addition, GASB No. 68 requires a state or local government employer to recognize a net pension liability and changes in the net pension liability, deferred outflows of resources and deferred inflows of resources which arise from other types of events related to pensions. During the transition year, as

Lakes Regional Healthcare

Notes to Financial Statements June 30, 2015 and 2014

permitted beginning balances for deferred outflows of resources and deferred inflows of resources will not be reported, except for deferred outflows of resources related to contributions made after the measurement date of the beginning net pension liability which is required to be reported by Governmental Accounting Standards Board Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. Beginning net position was restated to retroactively report the beginning net pension liability and deferred outflows of resources related to contributions made after the measurement date, as follows:

	<u>Net Position</u>
Net position June 30, 2014, as previously reported	\$ 37,410,453
Net pension liability at June 30, 2014	(8,973,122)
Deferred outflows of resources related to contributions made after the July 30, 2013 measurement date	<u>938,705</u>
Net position July 1, 2014, as restated	<u>\$ 29,376,036</u>

Lakes Regional Healthcare

Budgetary Comparison Schedule of Revenue, Expenses and Changes in Net Position – Budget and Actual (Cash Basis) Required Supplementary Information June 30, 2015

This budgetary comparison is presented as Required Supplementary Information in accordance with GASB 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, 2015, the Hospital's expenditures exceeded amounts budgeted.

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

	Actual Accrual Basis	Accrual Adjustments	Actual Cash Basis	Budgeted Amounts	Variance Favorable (Unfavorable)
Estimated amount to be raised by taxation	\$ 425,000	--	425,000	419,781	5,219
Estimated other revenues / receipts	<u>36,695,995</u>	<u>780,894</u>	<u>37,476,889</u>	<u>34,723,130</u>	<u>2,753,759</u>
	37,120,995	780,894	37,901,889	35,142,911	2,758,978
Expenses and disbursements	<u>35,966,490</u>	<u>1,280,287</u>	<u>37,246,777</u>	<u>36,232,816</u>	<u>(1,013,961)</u>
Net	1,154,505	(499,393)	655,112	\$ <u>(1,089,905)</u>	<u>1,745,017</u>
Balance beginning of year	<u>29,376,036</u>	<u>(9,274,924)</u>	<u>20,101,112</u>		
Balance end of year	\$ <u>30,530,541</u>	<u>(9,774,317)</u>	<u>20,756,224</u>		

See accompanying independent auditor's report

Lakes Regional Healthcare

Schedule of the Hospital's Proportionate Share of the Net Pension Liability Required Supplementary Information June 30, 2015

Iowa Public Employee's Retirement System Last Fiscal Year* (In Thousands)		<u>2015</u>
Hospital's proportion of net pension liability		0.1493042%
Hospital's proportionate share of the net pension liability	\$	5,893
Hospital's covered-employee payroll	\$	10,515
Hospital's proportionate share of the net pension liability as a percentage of its covered-employee payroll		56.04%
Plan fiduciary net position as a percentage of the total pension liability		87.61%

* The amounts presented for each fiscal year were determined as of June 30.

See accompanying independent auditor's report

Note: GASB Statement No. 68 requires ten years of information to be presented in this table. However, until a full 10-year trend is compiled, the Hospital will present information for those years for which information is available.

Lakes Regional Healthcare

**Schedule of the Hospital's Contributions
Required Supplementary Information
June 30, 2015**

Iowa Public Employee's Retirement System
Last 10 Fiscal Years
(In Thousands)

	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Statutorily required contribution	\$ 958	939	949	846	711	659	615	556	492	463
Contributions in relation to the statutorily required contribution	<u>(958)</u>	<u>(939)</u>	<u>(949)</u>	<u>(846)</u>	<u>(711)</u>	<u>(659)</u>	<u>(615)</u>	<u>(556)</u>	<u>(492)</u>	<u>(463)</u>
Contribution deficiency (excess)	\$ <u> --</u>	<u> --</u>								
Hospital's covered-employee payroll	\$ 10,728	10,515	10,933	10,470	10,245	9,925	9,685	9,175	8,586	8,052
Contributions as a percentage of covered-employee payroll	8.93%	8.93%	8.68%	8.08%	6.94%	6.64%	6.35%	6.06%	5.73%	5.75%

See accompanying independent auditor's report

Lakes Regional Healthcare

Notes to Required Supplementary Information – Pension Liability June 30, 2015

Changes of Benefit Terms

Legislation passed in 2010 modified benefit terms for current Regular members. The definition of final average salary changed from the highest three to the highest five years of covered wages. The vesting requirement changed from four years of service to seven years. The early retirement reduction increased from 3 percent per year measured from the member's first unreduced retirement age to a 6 percent reduction for each year of retirement before age 65.

In 2008, legislative action transferred four groups – emergency medical service providers, county jailers, county attorney investigators, and National Guard installation security officers – from Regular membership to the protection occupation group for future service only.

Benefit provisions for sheriffs and deputies were changed in the 2004 legislative session. The eligibility for unreduced retirement benefits was lowered from age 55 by one year each July 1 (beginning in 2004) until it reached age 50 on July 1, 2008. The years of service requirement remained at 22 or more. Their contribution rates were also changed to be shared 50-50 by the employee and employer, instead of the previous 40-60 split.

Changes of Assumptions

The 2014 valuation implemented the following refinements as a result of a quadrennial experience study:

- Decreased the inflation assumption from 3.25 percent to 3.00 percent.
- Decreased the assumed rate of interest on member accounts from 4.00 percent to 3.75 percent per year.
- Adjusted male mortality rates for retirees in the Regular membership group.
- Reduced retirement rates for sheriffs and deputies between the ages of 55 and 64.
- Moved from an open 30 year amortization period to a closed 30 year amortization period for the UAL beginning June 30, 2014. Each year thereafter, changes in the UAL from plan experience will be amortized on a separate closed 20 year period.

The 2010 valuation implemented the following refinements as a result of a quadrennial experience study:

- Adjusted retiree mortality assumptions.
- Modified retirement rates to reflect fewer retirements. Lowered disability rates at most ages.
- Lowered employment termination rates.
- Generally increased the probability of terminating members receiving a deferred retirement benefit.
- Modified salary increase assumptions based on various service duration.

The 2007 valuation adjusted the application of the entry age normal cost method to better match projected contributions to the projected salary stream in the future years. It also included in the calculation of the UAL amortization payments the one-year lag between the valuation date and the effective date of the annual actuarial contribution rate.

The 2006 valuation implemented the following refinements as a result of a quadrennial experience study:

- Adjusted salary increase assumptions to service based assumptions.
- Decreased the assumed interest rate credited on employee contributions from 4.25 percent to 4.00 percent.
- Lowered the inflation assumption from 3.50 percent to 3.25 percent.
- Lowered disability rates for sheriffs and deputies and protection occupation members.

**Net Patient Service Revenue
For the Years Ended June 30, 2015 and 2014**

	2015			2014 (not restated)		
	Inpatient	Outpatient	Total	Inpatient	Outpatient	Total
NURSING SERVICES:						
Medical, surgical and obstetrics	\$ 3,022,410	(75)	3,022,335	2,626,107	(943)	2,625,164
Observation	--	1,082,430	1,082,430	--	753,082	753,082
Coronary care	302,720	--	302,720	281,520	--	281,520
Nursery	285,238	260	285,498	200,371	--	200,371
Swing bed	151,266	--	151,266	154,613	--	154,613
	<u>3,761,634</u>	<u>1,082,615</u>	<u>4,844,249</u>	<u>3,262,611</u>	<u>752,139</u>	<u>4,014,750</u>
OTHER PROFESSIONAL SERVICES:						
Operating and recovery rooms	2,087,031	7,760,748	9,847,779	1,270,774	7,712,430	8,983,204
Primary care clinics	13,931	8,591,291	8,605,222	1,612	7,768,585	7,770,197
Pharmacy	2,150,872	5,661,846	7,812,718	1,561,327	5,576,796	7,138,123
Laboratory	1,036,673	5,804,221	6,840,894	802,832	5,108,852	5,911,684
Emergency and outpatient service	466,406	5,273,399	5,739,805	483,007	4,742,571	5,225,578
Central services and supply	3,053,622	2,686,763	5,740,385	2,323,562	2,479,788	4,803,350
CT scanner	334,122	2,785,658	3,119,780	222,821	2,518,268	2,741,089
MRI	50,769	2,003,208	2,053,977	35,601	1,868,660	1,904,261
Radiology	192,143	1,784,828	1,976,971	150,220	1,545,510	1,695,730
Ambulance	207,699	1,387,008	1,594,707	200,658	1,405,362	1,606,020
Physical therapy	174,669	1,194,398	1,369,067	199,703	1,097,734	1,297,437
Ultrasound	74,606	1,204,380	1,278,986	66,553	1,179,853	1,246,406
Anesthesiology	300,756	883,240	1,183,996	186,089	933,050	1,119,139
Respiratory therapy	589,720	627,293	1,217,013	562,108	537,500	1,099,608
Outpatient clinic	23,881	973,574	997,455	9,453	970,092	979,545
Home health	--	681,273	681,273	--	778,061	778,061
Hospice	613,660	--	613,660	530,093	--	530,093
Delivery and labor room	390,228	106,346	496,574	325,766	105,315	431,081
Mammogram	--	475,063	475,063	--	383,525	383,525
Occupational therapy	80,059	186,831	266,890	100,807	178,257	279,064
Sleep studies	--	430,032	430,032	--	273,555	273,555
Enterostomal therapy	808	191,180	191,988	2,933	223,486	226,419
Cardiac rehab	--	177,717	177,717	--	182,467	182,467
Blood	60,049	105,044	165,093	83,524	80,012	163,536
Nuclear medicine	5,072	163,959	169,031	3,982	138,079	142,061
Speech therapy	20,867	32,168	53,035	16,358	30,413	46,771
	<u>11,927,643</u>	<u>51,171,468</u>	<u>63,099,111</u>	<u>9,139,783</u>	<u>47,818,221</u>	<u>56,958,004</u>
GROSS PATIENT SERVICE REVENUE	\$ <u>15,689,277</u>	<u>52,254,083</u>	<u>67,943,360</u>	<u>12,402,394</u>	<u>48,570,360</u>	<u>60,972,754</u>
LESS:						
Contractual allowances and other deductions, primarily Medicare and Medicaid			(31,363,133)			(26,219,067)
Charity care services and other discounts, based on charges forgone			(357,074)			(659,560)
NET PATIENT SERVICE REVENUE BEFORE PROVISION FOR BAD DEBT			36,223,153			34,094,127
PROVISION FOR BAD DEBT			(1,213,788)			(1,755,229)
NET PATIENT SERVICE REVENUE			\$ <u>35,009,365</u>			<u>32,338,898</u>

See accompanying independent auditor's report

Other Operating Revenue
For the Years Ended June 30, 2015 and 2014

	<u>2015</u>	<u>(not restated)</u> <u>2014</u>
Electronic health records incentive payments-		
Centers for Medicare and Medicaid Services	\$ 763,554	349,401
Iowa Department of Health and Human Services	--	87,500
Public Health grants	404,540	317,829
Rental income	126,795	200,788
Meals sold	140,122	157,667
Grants	67,801	137,177
Other	77,860	114,828
Net position released for operations	27,894	93,272
Lifeline	24,024	59,928
Meals on wheels	14,893	21,635
Gain (loss) on disposal of capital assets	<u>(54,317)</u>	<u>9,335</u>
	<u>\$ 1,593,166</u>	<u>1,549,360</u>

See accompanying independent auditor's report

**Departmental Expenses
For the Years Ended June 30, 2015 and 2014**

	2015			2014 (not restated)		
	Salaries and Wages	Supplies and Other	Total	Salaries and Wages	Supplies and Other	Total
NURSING SERVICES:						
Medical and surgical	\$ 1,732,070	101,435	1,833,505	1,692,717	77,493	1,770,210
Coronary care	191,839	50,733	242,572	204,744	48,483	253,227
Obstetrics	209,792	37,766	247,558	179,979	26,740	206,719
Administration	218,455	420	218,875	135,556	1,986	137,542
Nursery	83,738	4,526	88,264	79,692	4,597	84,289
	<u>2,435,894</u>	<u>194,880</u>	<u>2,630,774</u>	<u>2,292,688</u>	<u>159,299</u>	<u>2,451,987</u>
OTHER PROFESSIONAL SERVICES:						
Primary care clinics	185,568	5,819,298	6,004,866	117,583	5,707,049	5,824,632
Pharmacy	276,782	2,341,444	2,618,226	282,664	2,196,560	2,479,224
Emergency room	1,069,756	1,470,941	2,540,697	937,814	1,423,498	2,361,312
Central services and supply	67,088	1,328,298	1,395,386	60,987	1,309,028	1,370,015
Operating and recovery room	679,180	602,595	1,281,775	651,177	482,904	1,134,081
Laboratory	595,849	576,270	1,172,119	524,585	451,863	976,448
Physical therapy	152,397	705,054	857,451	162,456	619,030	781,486
Ambulance	549,288	115,916	665,204	537,045	101,309	638,354
Home health	445,537	85,760	531,297	485,455	100,421	585,876
Radiology	344,459	265,836	610,295	356,431	226,357	582,788
Outpatient clinic	375,082	57,001	432,083	349,585	46,170	395,755
Hospice	148,846	110,607	259,453	147,873	245,878	393,751
Medical records	294,392	128,704	423,096	339,903	48,235	388,138
Anesthesiology	166,454	172,224	338,678	160,454	125,873	286,327
Same day surgery	244,376	79,974	324,350	242,795	31,635	274,430
Public health	257,187	37,596	294,783	226,391	34,965	261,356
Respiratory therapy	150,651	127,779	278,430	132,225	117,189	249,414
CT scanner	53,515	135,570	189,085	53,505	149,167	202,672
MRI	33,236	134,832	168,068	34,036	128,692	162,728
Ultrasound	146,743	25,131	171,874	128,206	21,150	149,356
Blood bank	--	112,214	112,214	--	108,494	108,494
Electrocardiology	84,802	7,184	91,986	101,342	5,887	107,229
Quality assurance	68,378	9,179	77,557	69,646	4,370	74,016
Delivery and labor room	64,977	8,557	73,534	62,582	6,904	69,486
Enterostomal therapy	--	46,388	46,388	--	64,308	64,308
Nuclear medicine	--	63,258	63,258	--	58,787	58,787
Sleep studies	--	69,985	69,985	--	36,159	36,159
Speech therapy	--	22,754	22,754	--	23,593	23,593
Social services	31,702	36	31,738	23,139	64	23,203
	<u>6,486,245</u>	<u>14,660,385</u>	<u>21,146,630</u>	<u>6,187,879</u>	<u>13,875,539</u>	<u>20,063,418</u>
GENERAL SERVICES:						
Plant operation and maintenance	394,522	799,191	1,193,713	399,037	771,947	1,170,984
Dietary	264,043	278,770	542,813	281,179	266,841	548,020
Housekeeping	146,042	83,811	229,853	149,853	48,182	198,035
Laundry and linen	24,401	74,780	99,181	25,111	76,214	101,325
	<u>829,008</u>	<u>1,236,552</u>	<u>2,065,560</u>	<u>855,180</u>	<u>1,163,184</u>	<u>2,018,364</u>
ADMINISTRATIVE SERVICES	1,484,078	2,413,165	3,897,243	1,517,455	1,932,808	3,450,263
NONDEPARTMENTAL:						
Employee benefits	--	2,641,895	2,641,895	--	3,250,849	3,250,849
Depreciation	--	3,075,332	3,075,332	--	2,093,166	2,093,166
Insurance	--	214,160	214,160	--	233,701	233,701
	<u>--</u>	<u>5,931,387</u>	<u>5,931,387</u>	<u>--</u>	<u>5,577,716</u>	<u>5,577,716</u>
TOTAL EXPENSES	\$ 11,235,225	24,436,369	35,671,594	10,853,202	22,708,546	33,561,748

See accompanying independent auditor's report

**Patient Receivables and Allowance for Doubtful Accounts
June 30, 2015 and 2014**

ANALYSIS OF AGING:

Days Since Discharge	2015		2014	
	Amount	Percent of Total	Amount	Percent of Total
0 - 60	\$ 7,748,076	79.7 %	8,293,036	83.7 %
61 - 90	681,394	7.0	466,973	4.7
91 - 180	727,505	7.5	696,570	7.0
> 180 days	565,410	5.8	452,835	4.6
	<u>9,722,385</u>	<u>100.0 %</u>	<u>9,909,414</u>	<u>100.0 %</u>
Less:				
Allowance for doubtful accounts	(1,983,813)		(1,686,861)	
Allowance for contractual adjustments	<u>(3,953,096)</u>		<u>(3,752,532)</u>	
	<u>\$ 3,785,476</u>		<u>\$ 4,470,021</u>	

	2015	2014
NET DAYS REVENUE IN PATIENT ACCOUNTS RECEIVABLE	38.1 days	47.4 days
ALLOWANCE FOR DOUBTFUL ACCOUNTS:		
Balance, beginning of year	\$ 1,686,861	1,895,793
Provision of uncollectible accounts	1,213,788	1,755,229
Recoveries of accounts previously written off	705,123	328,224
Accounts written off	<u>(1,621,959)</u>	<u>(2,292,385)</u>
Balance, end of year	<u>\$ 1,983,813</u>	<u>1,686,861</u>

See accompanying independent auditor's report

Inventories / Prepaid Expenses
June 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
INVENTORIES:		
Surgical services	\$ 443,597	378,644
Pharmacy	245,374	241,913
Central storeroom	123,198	128,634
Primary care clinics	82,486	80,324
Fuel oil	34,344	28,225
Radiology	10,000	23,470
Laboratory	25,405	20,584
Gift shop	17,142	20,163
Dietary	<u>16,286</u>	<u>16,146</u>
	<u>\$ 997,832</u>	<u>938,103</u>
 PREPAID EXPENSES:		
Insurance	\$ 114,748	105,507
Maintenance contracts	57,372	77,127
Other	<u>41,699</u>	<u>33,135</u>
	<u>\$ 213,819</u>	<u>215,769</u>

See accompanying independent auditor's report

**Financial and Statistical Highlights
For the Years Ended June 30, 2015 and 2014**

	<u>2015</u>	<u>2014</u>
Patient days:		
Adult and pediatric-		
Medicare	1,598	1,752
Other	<u>1118</u>	<u>980</u>
	2,716	2,732
Swing bed - skilled	387	345
Newborn	<u>333</u>	<u>274</u>
Total	<u><u>3,436</u></u>	<u><u>3,351</u></u>
Patient discharges:		
Adult and pediatric-		
Medicare	415	450
Other	<u>355</u>	<u>313</u>
	770	763
Swing bed - skilled	51	61
Newborn	<u>140</u>	<u>124</u>
Total	<u><u>961</u></u>	<u><u>948</u></u>
Average length of stay:		
Adult and pediatric-		
Medicare	3.88 days	3.89 days
Other	3.14 days	3.13 days
Swing bed - skilled	7.57 days	5.66 days
Newborn	2.38 days	2.21 days
Surgical procedures	3,911	3,639
Emergency room visits	7,389	6,774
Number of employees - full-time equivalents	207	204

**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, 2015, 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 23, 2015.

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 appropriate in the circumstances 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 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 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 noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance or other matters which are described in Part III of the accompanying schedule of findings and responses.

Comments involving statutory and other legal matters about the Hospital's operations for the year ended June 30, 2015 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 23, 2015.

Lakes Regional Healthcare

Schedule of Findings and Responses For the Year Ended June 30, 2015

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-15

Certified Budget: Hospital disbursements during the year ended June 30, 2015 exceeded amounts budgeted.

Recommendation: Management should periodically review its budget estimates to actual activity and make appropriate revisions when necessary.

Response: Actual disbursements exceeded the reported budget for fiscal year ending June 30, 2015 by \$1,013,961. Management has identified the reporting difference and will make appropriate adjustments to the reported budget for fiscal year ending June 30, 2016 if necessary.

Conclusion: Response accepted.

III-B-15

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-15

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

III-D-15

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.

Lakes Regional Healthcare

Schedule of Findings and Responses For the Year Ended June 30, 2015

III-E-15

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

III-F-15

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.

III-G-15

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

Audit Staff For the Year Ended June 30, 2015

This audit was performed by:

- Roger E. Thompson, FHFMA, CPA, Partner
- Joseph L. Harnisch, CPA, Senior Manager
- Blake L. Berke, CPA, Staff Auditor
- McKayla I. Anderson, Staff Auditor