

**Lakes Regional Healthcare**  
Spirit Lake, Iowa

**Basic Financial Statements and Supplementary Information**  
**June 30, 2017 and 2016**

**Together with Independent Auditor's Report**

# Lakes Regional Healthcare

## Table of Contents

---

	<u>Page</u>
Board of Trustees and Hospital Officials .....	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, 2017 and 2016 .....	9 – 10
Statements of Revenue, Expenses and Changes in Net Position For the Years Ended June 30, 2017 and 2016 .....	11
Statements of Cash Flows For the Years Ended June 30, 2017 and 2016 .....	12 – 13
Notes to Financial Statements June 30, 2017 and 2016 .....	14 – 28
Required Supplementary Information:	
Budgetary Comparison Schedule of Revenue, Expenses and Changes in Net Position – Budget and Actual (Cash Basis) and Notes to the Schedule.....	29
Schedule of the Hospital's Proportionate Share of the Net Pension Liability.....	30
Schedule of the Hospital's Contributions .....	31
Notes to Required Supplementary Information – Pension Liability.....	32
Other Supplementary Information:	
Exhibit 1 - Net Patient Service Revenue For the Years Ended June 30, 2017 and 2016.....	33
Exhibit 2 - Other Operating Revenue For the Years Ended June 30, 2017 and 2016.....	34
Exhibit 3 - Departmental Expenses For the Years Ended June 30, 2017 and 2016.....	35
Exhibit 4 - Patient Receivables and Allowance for Doubtful Accounts June 30, 2017 and 2016.....	36
Exhibit 5 - Inventories/Prepaid Expenses June 30, 2017 and 2016.....	37
Exhibit 6 - Statistical Information For the Years Ended June 30, 2017 and 2016.....	38
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 <i>Government Auditing Standards</i> .....	39 – 40
Schedule of Findings and Responses .....	41
Summary Schedule of Prior Year Audit Findings .....	42
Audit Staff .....	43

# Lakes Regional Healthcare

## Board of Trustees and Hospital Officials June 30, 2017

---

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
<b>Board of Trustees:</b>		
Denny Perry	Chairman	December 2022
Kris Walker	Vice-Chairman	December 2018
Steve Feld	Secretary/Treasurer	December 2022
Linda Moore		December 2021
Dan Sedlacek		December 2020
Mary Kay Bates		December 2018
Jeremy Bolluyt		December 2020
<b>Hospital Officials:</b>		
Jason Harrington	Chief Executive Officer	Indefinite
Steve Alger	Chief Financial Officer	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 basic financial statements of Lakes Regional Healthcare (Hospital) as of and for the years ended June 30, 2017 and 2016, 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, 2017 and 2016, and changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

## **Other Matters**

### *Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis (pages 4 through 8), budgetary comparison information (page 29), the schedule of the Hospital's proportionate share of the net pension liability (page 30) and the schedule of Hospital contributions (pages 31 through 32), 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 as a whole. The supplementary statements (Exhibits 1-6) are presented for the purposes of additional analysis and are not a required part of the basic financial statements. The supplementary information is the responsibility of management and is 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 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 20, 2017 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.

*Stim Johnson, LLP*

Omaha, Nebraska,  
October 20, 2017.

## Lakes Regional Healthcare

### Management's Discussion and Analysis June 30, 2017 and 2016

---

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, 2017, 2016 and 2015. This discussion and analysis should be read in conjunction with financial statements, which start on page 9.

#### 2017 Financial Highlights

- LRH reported a net position increase in 2017 of \$1,671,260, compared to a net position increase of \$786,562 and \$1,154,505 in 2016 and 2015, respectively.
- LRH reported operating income in 2017 of \$657,382, compared to an operating income of \$251,415 and \$930,937 in 2016 and 2015, respectively.
- LRH reported non-operating activity in 2017 of \$618,378, compared to non-operating activity of \$545,361 and \$226,509 in 2016 and 2015, respectively.
- LRH received a \$400,000 Helmsley Grant in 2017, which will be applied toward the purchase of a new CT scanner in 2018.

#### Using This Annual Report

The annual report consists of a series of financial statements and other information, as follows:

Management's Discussion and Analysis introduces the basic financial statements and provides an analytical overview of LRH's financial activities.

The basic financial statements consist of a statement of net position, a statement of revenue, expenses and changes in net position and a statement of cash flows. These statements provide information about the activities of LRH on a comparative basis, including resources held by LRH but restricted for specific purposes by creditors, contributors, grantors or enabling legislation.

Notes to financial statements provide additional information essential to a full understanding of the data provided in the basic financial statements.

Required supplementary information further explains and supports the financial statements with a comparison of LRH's budget for the year, LRH's proportionate share of the net pension liability and related contributions.

Supplementary information provides detailed information about the operations of LRH.

#### 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 it. 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.

# Lakes Regional Healthcare

## Management's Discussion and Analysis June 30, 2017 and 2016

### 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.

### The Hospital's Net Position

LRH net position is the difference between assets, deferred inflows and outflows of resources, and liabilities reported in the statement of net position on page 9. LRH net position increased this past year by \$1,671,260, as shown in Table 1. This compares to an increase of \$786,562 in 2016 and an increase of \$1,154,505 in 2015.

*Table 1: Condensed Statements of Net Position*

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2017 Change</u>
<b>Assets:</b>				
Current assets	\$ 29,282,957	27,528,088	26,382,793	6.4%
Other non-current assets	1,085,080	1,086,101	1,095,010	-0.1%
Capital assets, net	<u>29,242,186</u>	<u>30,126,839</u>	<u>31,814,747</u>	<u>-2.9%</u>
Total assets	59,610,223	58,741,028	59,292,550	1.5%
<b>Deferred outflows of resources</b>				
Pension related deferred outflows of resources	<u>3,409,976</u>	<u>2,054,039</u>	<u>879,825</u>	<u>133.5%</u>
Total assets and deferred outflows of resources	<u>\$ 63,020,199</u>	<u>60,795,067</u>	<u>60,172,375</u>	<u>3.7%</u>
<b>Liabilities:</b>				
Current Liabilities	\$ 5,675,323	5,402,551	5,196,086	5.0%
Long-term debt outstanding	13,274,575	14,388,716	15,472,857	-7.7%
Net pension liability	<u>9,081,548</u>	<u>7,228,933</u>	<u>5,893,175</u>	<u>22.7%</u>
Total liabilities	<u>28,031,446</u>	<u>27,020,200</u>	<u>26,562,118</u>	<u>3.7%</u>
<b>Deferred inflow of resources:</b>				
Unavailable property tax revenue	700,000	650,000	650,000	7.7%
Pension related deferred inflows of resources	<u>1,300,390</u>	<u>1,807,764</u>	<u>2,429,716</u>	<u>-28.1%</u>
Total deferred inflows of resources	<u>2,000,390</u>	<u>2,457,764</u>	<u>3,079,716</u>	<u>-25.0%</u>
<b>Net position:</b>				
Net investment in capital assets	14,853,470	14,653,982	15,277,749	1.4%
Restricted for debt service	1,115,056	1,374,138	1,372,673	-18.9%
Restricted expendable	460,819	65,319	75,533	605.5%
Restricted nonexpendable	25,000	25,081	25,000	-0.3%
Unrestricted	<u>16,534,018</u>	<u>15,198,583</u>	<u>13,779,586</u>	<u>8.8%</u>
Total net position	<u>32,988,363</u>	<u>31,317,103</u>	<u>30,530,541</u>	<u>5.3%</u>
Total liabilities, deferred inflows of resources and net position	<u>\$ 63,020,199</u>	<u>60,795,067</u>	<u>60,172,375</u>	<u>3.7%</u>

# Lakes Regional Healthcare

## Management's Discussion and Analysis June 30, 2017 and 2016

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

In 2017, LRH net position increased by \$1,671,260 or 5.3%, as shown in Table 2. This increase was a combination of three components. Operating revenue increased by \$1,380,976 or 3.7% in 2017, while operating expenses increased by \$975,009, or 2.6%. Non-operating revenue increased by \$78,731, or 13.4%. Capital grants, contributions and auxiliary activity increased by \$405,714.

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

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2017 Change</u>
<b>Operating revenue:</b>				
Net patient service revenue	\$ 38,676,364	36,918,455	36,223,153	4.8%
Provision for bad debt	(976,257)	(740,083)	(1,213,788)	31.9%
Other, net	<u>1,035,122</u>	<u>1,175,881</u>	<u>1,593,166</u>	<u>-26.2%</u>
Total operating revenue	<u>38,735,229</u>	<u>37,354,253</u>	<u>36,602,531</u>	<u>3.7%</u>
<b>Operating expenses:</b>				
Salaries and benefits	15,321,454	14,764,035	13,877,120	3.8%
Purchased services and other	20,015,116	19,492,148	18,719,142	2.7%
Depreciation	<u>2,741,277</u>	<u>2,846,655</u>	<u>3,075,332</u>	<u>-3.7%</u>
Total operating expenses	<u>38,077,847</u>	<u>37,102,838</u>	<u>35,671,594</u>	<u>2.6%</u>
<b>Operating income</b>	<u>657,382</u>	<u>251,415</u>	<u>930,937</u>	<u>161.5%</u>
<b>Non-operating revenues and expenses</b>				
Interest expense	(266,296)	(281,269)	(294,896)	-5.3%
Investment income	234,674	176,630	96,405	32.9%
County tax revenue	<u>650,000</u>	<u>650,000</u>	<u>425,000</u>	<u>0.0%</u>
Total non-operating revenue, net	<u>618,378</u>	<u>545,361</u>	<u>226,509</u>	<u>13.4%</u>
Excess revenue over expenses before capital grants, contributions and auxiliary activity, net	1,275,760	796,776	1,157,446	60.1%
Capital grants, contributions, and auxiliary activity, net	<u>395,500</u>	<u>(10,214)</u>	<u>(2,941)</u>	<u>-3972.1%</u>
Increase in net position	1,671,260	786,562	1,154,505	112.5%
<b>Net position beginning of year, as restated</b>	<u>31,317,103</u>	<u>30,530,541</u>	<u>29,376,036</u>	<u>2.6%</u>
<b>Net position end of year</b>	<u>\$ 32,988,363</u>	<u>31,317,103</u>	<u>30,530,541</u>	<u>5.3%</u>

## Lakes Regional Healthcare

### Management's Discussion and Analysis June 30, 2017 and 2016

---

#### Operating Revenue

The first component of the change in LRH net position is operating revenue. Operating revenue increased \$1,380,976 or 3.7% in 2017. The primary drivers of the change in operating revenue are as follows:

- Net patient service revenue increased \$1,757,909 or 4.8% in 2017, compared to an increase of \$695,302 or 1.9% in 2016 and an increase of \$2,129,026 or 6.2% in 2015. Patient volumes for LRH showed continued growth in 2017, fueled by growth in the orthopedic surgery service line. In addition, LRH accrued for inpatient supplemental Medicare reimbursements of approximately \$2 million dollars as a member of the Rural Community Hospital Demonstration Program (see Note 3). 2017 represented the sixth straight year of LRH's participation in this program. The provision for bad debt in 2017 was \$976,257, compared to 740,083 in 2016 and \$1,213,788 in 2015. LRH has experienced a declining private pay payor population that has been driven by the expansion of Medicaid qualification requirements in the state. This expansion has helped to reduce bad debt for the facility. This has been offset by an industry shift in the Commercial plans that have resulted in patients with higher deductibles and out of pocket exposure. The latter has led to the increase in bad debt that LRH has experienced in 2017.
- 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 \$262,503 in 2017 compared to \$76,248 in 2016 and \$158,544 in 2015. 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. LRH recognized incentive payments of \$73,425 in 2017 compared to \$285,425 in 2016, and \$763,554 in 2015.

#### Operating Expenses

The second component of the change in LRH net position is operating expenses. Operating expenses increased \$975,009 or 2.6% in 2017. The primary components of the change in operating expenses are:

- Salary and benefit costs for employees increased \$557,419 or 3.8% in 2017, compared to an increase of \$886,915 or 6.4% in 2016, and a decrease of \$232,564 or 1.6% in 2015. The 2017 increase was primarily due to annual wage increases provided to employees.
- Purchased services and other expenses increased \$522,968 or 2.7% in 2017, compared to an increase of \$773,006 or 4.1% in 2016, and an increase of \$1,360,244 or 7.8% in 2015. The 2017 increase primarily relates to increased implant supply cost to support the noted increase in orthopedic surgeries.

#### Non-Operating Revenue and Expenses

The third and final component of the change in LRH net position is its non-operating revenue. Non-operating revenue increased \$1,013,878 or 89.5% in 2017. The primary components affecting non-operating revenue are:

- Property tax income was \$650,000 in 2017, compared to \$650,000 in 2016 and \$425,000 in 2015 respectively. Dickinson County provides property tax revenue to LRH for the ambulance service. The county tax levy was \$0.27 per \$1,000 of valuation for 2017, \$0.29 in 2016 and \$0.19 in 2015. LRH ranks 36 out of 42 Iowa county hospitals in the amount of tax dollars levied.
- Investment income was \$234,674 for 2017, \$176,630 in 2016, and \$96,405 in 2015. Excess cash is maintained in interest bearing checking accounts and short term certificates of deposits. These low risk investments, while showing improvement, continue to have low rates of return.
- Interest expense was \$266,296 for 2017, \$281,269 in 2016, and \$294,896 in 2015. The declining expense is the result of continued pay down on existing debt balances.

#### Capital Grants, Contributions and Auxiliary Activity, Net

- Capital grants, contributions and auxiliary activity, net were \$395,500 in 2017, (\$10,214) in 2016, and (\$2,941) in 2015. The majority of the increase in 2017 relates to LRH being awarded a Helmsley Grant in 2017 that will be applied toward the purchase of a new CT scanner in 2018.

## Lakes Regional Healthcare

### Management's Discussion and Analysis June 30, 2017 and 2016

---

#### Cash Flows

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

#### Capital Asset and Debt Administration

##### Capital Assets

As of June 30, 2017 LRH had \$29,242,186 invested in capital assets, net of accumulated depreciation, as detailed in Note 6 to the financial statements. At June 30, 2016, LRH had \$30,126,839 invested in capital assets, net of accumulated depreciation. In 2017, LRH purchased new capital assets costing \$1,838,163. These purchases related to new and replacement equipment. Capital spending was \$1,204,207 and \$1,716,766 in 2016 and 2015, respectively.

##### Debt

At June 30, 2017 and 2016, LRH had \$14,280,000 and \$15,345,000, respectively, in capital loan notes outstanding, as detailed in Note 7 to the financial statements. LRH issued no new debt in fiscal years 2017 and 2016. LRH continues to make payments as required on the outstanding debt.

#### Other Economic Factors

Reimbursement rates continue to be the main challenge for LRH. Medicare and Medicaid programs made up 61% of the gross patient revenue in FY 2017. Special Medicare reimbursement programs have been discontinued in recent years. 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.

LRH is currently participating in a 3-year Medicare Shared Savings Program (MSSP) Accountable Care Organization (ACO). Under the MSSP, the ACO that LRH is a member of is eligible to share cost savings with Medicare related to the Medicare population that is attributed to it. This program is the predecessor to more risk-based payment models that are being aggressively rolled out over the next several years. This will mark a significant change in the way that care is delivered and all healthcare organizations will be required to position themselves to accept more risk and better manage the care of the populations assigned to it.

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, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 8,364,834	13,195,899
Certificates of deposit	13,642,074	8,119,377
Assets limited as to use or restricted - current portion	115,795	378,437
Receivables -		
Patients, net of allowance for doubtful accounts of \$2,381,766 in 2017 and \$2,054,800 in 2016	3,848,054	3,760,477
Succeeding year property tax	700,000	650,000
Other	204,978	358,582
Inventories	893,069	867,250
Prepaid expenses	213,705	198,066
Estimated third-party payor settlements, net	<u>1,300,448</u>	<u>--</u>
Total current assets	29,282,957	27,528,088
Noncurrent assets:		
Assets limited as to use or restricted	1,085,080	1,086,101
Capital assets, net of accumulated depreciation	<u>29,242,186</u>	<u>30,126,839</u>
Total assets	59,610,223	58,741,028
<b>DEFERRED OUTFLOWS OF RESOURCES</b>		
Pension related deferred outflows	<u>3,409,976</u>	<u>2,054,039</u>
Total assets and deferred outflows of resources	<u>\$ 63,020,199</u>	<u>60,795,067</u>

*See notes to financial statements*

## Lakes Regional Healthcare

### Statements of Net Position (continued) June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
<b>LIABILITIES</b>		
Current liabilities:		
Current portion of long-term debt	\$ 1,114,141	1,084,141
Accounts payable -		
Trade	1,939,161	1,770,913
Construction	33,724	--
Salaries, wages and accrued vacation payable	1,668,248	1,561,850
Payroll taxes withheld and accrued	145,406	130,663
Accrued interest payable	24,546	25,204
Other accrued liabilities	750,097	679,780
Estimated third-party payor settlements - Medicare	--	150,000
	<u>5,675,323</u>	<u>5,402,551</u>
Total current liabilities		
Long-term liabilities:		
Long-term debt, net of current portion	13,274,575	14,388,716
Net pension liability	9,081,548	7,228,933
	<u>28,031,446</u>	<u>27,020,200</u>
Total liabilities		
<b>DEFERRED INFLOWS OF RESOURCES</b>		
Unavailable property tax revenue	700,000	650,000
Pension related deferred inflows	1,300,390	1,807,764
	<u>2,000,390</u>	<u>2,457,764</u>
Total deferred inflows of resources		
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>NET POSITION</b>		
Net investment in capital assets	14,853,470	14,653,982
Restricted -		
For debt service	1,115,056	1,374,138
Expendable for capital acquisitions and operating activities	460,819	65,319
Nonexpendable	25,000	25,081
Unrestricted	16,534,018	15,198,583
	<u>32,988,363</u>	<u>31,317,103</u>
Total net position		
Total liabilities, deferred inflows of resources, and net position	\$ <u><u>63,020,199</u></u>	<u><u>60,795,067</u></u>

See notes to financial statements

## Lakes Regional Healthcare

### Statements of Revenue, Expenses and Changes in Net Position For the Years Ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
OPERATING REVENUE:		
Net patient service revenue before provision for bad debt	\$ 38,676,364	36,918,455
Provision for bad debt	(976,257)	(740,083)
Net patient service revenue	37,700,107	36,178,372
Other operating revenue, net	1,035,122	1,175,881
Total operating revenue	<u>38,735,229</u>	<u>37,354,253</u>
OPERATING EXPENSES:		
Salaries	11,587,008	11,441,060
Employee benefits	3,734,446	3,322,975
Purchased services and professional fees	10,327,875	10,148,521
Utilities	492,623	528,715
Supplies and other expenses	8,968,303	8,590,055
Depreciation	2,741,277	2,846,655
Insurance	226,315	224,857
Total operating expenses	<u>38,077,847</u>	<u>37,102,838</u>
OPERATING INCOME	<u>657,382</u>	<u>251,415</u>
NONOPERATING REVENUE (EXPENSE):		
Interest and amortization expense	(266,296)	(281,269)
Investment income	234,674	176,630
County tax revenue	650,000	650,000
Total nonoperating revenue, net	<u>618,378</u>	<u>545,361</u>
EXCESS REVENUE OVER EXPENSES BEFORE CAPITAL GRANTS, CONTRIBUTIONS AND AUXILIARY ACTIVITY, NET	1,275,760	796,776
CAPITAL GRANTS, CONTRIBUTIONS AND AUXILIARY ACTIVITY, NET	<u>395,500</u>	<u>(10,214)</u>
INCREASE IN NET POSITION	1,671,260	786,562
NET POSITION, beginning of year	<u>31,317,103</u>	<u>30,530,541</u>
NET POSITION, end of year	<u>\$ 32,988,363</u>	<u>31,317,103</u>

See notes to financial statements

## Lakes Regional Healthcare

### Statements of Cash Flows

For the Years Ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third party payors	\$ 36,162,082	36,060,225
Cash paid for employees salaries and benefits	(15,211,009)	(15,124,330)
Cash paid to suppliers and contractors	(19,818,008)	(19,020,162)
Other receipts and payments, net	1,134,683	1,821,827
	<u>2,267,748</u>	<u>3,737,560</u>
Net cash provided by operating activities		
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES,		
County taxes received	<u>650,000</u>	<u>650,000</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of capital assets, net	(1,838,163)	(1,204,207)
Proceeds from the sale of capital assets	69,305	10,283
Payments on long-term debt	(1,065,000)	(1,045,000)
Interest paid on long-term debt	(286,095)	(300,410)
	<u>(3,119,953)</u>	<u>(2,539,334)</u>
Net cash used in capital and related financing activities		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital grant received	400,000	--
Withdrawals from assets limited as to use or restricted, net	259,163	7,438
Deposits to certificates of deposit, net	(5,522,697)	(5,442,350)
Investment income	234,674	176,630
	<u>(4,628,860)</u>	<u>(5,258,282)</u>
Net cash used in investing activities		
NET DECREASE IN CASH AND CASH EQUIVALENTS	(4,831,065)	(3,410,056)
CASH AND CASH EQUIVALENTS, beginning of year	<u>13,195,899</u>	<u>16,605,955</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 8,364,834</u>	<u>13,195,899</u>

*See notes to financial statements*

## Lakes Regional Healthcare

### Statements of Cash Flows (continued) For the Years Ended June 30, 2017 and 2016

	<u>2017</u>	<u>2016</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 657,382	251,415
Adjustments to reconcile operating income to net cash provided by operating activities -		
Depreciation	2,741,277	2,846,655
Gain on disposal of capital assets	(54,042)	(9,694)
Increase in net pension liability	1,852,615	1,335,758
Decrease in deferred outflows of resources	(1,355,937)	(1,174,214)
Decrease in deferred inflows of resources	(507,374)	(621,952)
(Increase) decrease in current assets -		
Receivables -		
Patients	(87,577)	24,999
Other	153,604	715,870
Inventories	(25,819)	130,582
Prepaid expenses	(15,639)	15,753
Estimated third-party payor settlements, net	(1,300,448)	--
Increase (decrease) in current liabilities -		
Accounts payable - trade	168,248	223,479
Due to restricted funds	--	(8,948)
Salaries, wages and accrued vacation payable	106,398	97,248
Payroll taxes withheld and accrued	14,743	2,865
Other accrued liabilities	70,317	102,172
Estimated third-party payor settlements - Medicare	(150,000)	(194,428)
Net cash provided by operating activities	\$ <u>2,267,748</u>	<u>3,737,560</u>

*See notes to financial statements*

# Lakes Regional Healthcare

## Notes to Financial Statements June 30, 2017 and 2016

---

### (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 as prescribed by the Governmental Accounting Standards Board (GASB).

#### 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 GASB 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 GASB 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.

#### 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.

*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.

# Lakes Regional Healthcare

## Notes to Financial Statements June 30, 2017 and 2016

---

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, deferred inflows and outflows of resources, 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*

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payors, patients and others. The Hospital provides an allowance for doubtful self-pay and miscellaneous commercial insurance accounts based on the allowance method. Patients are not required to provide collateral for services rendered. The allowance is estimated based on past experience and on analysis of current accounts receivable collectability. Accounts are considered delinquent based on passage of a specified period of time and consideration of payment history. Accounts deemed uncollectible are written off and charged to the allowance in the year they are deemed uncollectible.

The Hospital also maintains a charity care policy as described in Note 1(T).

*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 taxes 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 that fiscal year. By statute, the Board of Supervisors is required to certify the budget in March of each year for the subsequent fiscal year. However, by statute, the tax asking and budget certification for the following fiscal year becomes effective on the first day of that year. Although the succeeding year property taxes 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.

# Lakes Regional Healthcare

## Notes to Financial Statements June 30, 2017 and 2016

---

### J. *Inventories*

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

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

Assets limited as to use or restricted primarily include assets held by trustees under loan agreements and contributions restricted by donors. Amounts required to meet current liabilities of the Hospital have been included in current assets in the statements of net position at June 30, 2017 and 2016.

### 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. *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.

### N. *Compensated Absences*

Hospital policies permit most employees to accumulate paid time off benefits that may be realized as paid time off or, in limited circumstances, as a cash payment. Expense and the related liability are recognized as benefits are earned whether the employee is expected to realize the benefit as time off or in cash. Compensated absence liabilities are computed using the regular pay and termination pay rates in effect at the balance sheet date plus an additional amount for compensation-related payments such as social security and Medicare taxes computed using rates in effect at that date.

## Lakes Regional Healthcare

### Notes to Financial Statements June 30, 2017 and 2016

---

*O. 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.

*P. 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 IPERS' investments.

*Q. Income Taxes*

As an essential government function of the County, the Hospital is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law.

*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*

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs and discounted charges. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

*T. Financial Assistance Policy / Charity Care*

The Hospital provides care to patients who meet certain criteria under its financial assistance policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

The Hospital is dedicated to providing comprehensive healthcare services to all segments of society, including the aged and otherwise economically disadvantaged. In addition, the Hospital provides a variety of community health services at or below cost.

## Lakes Regional Healthcare

### Notes to Financial Statements June 30, 2017 and 2016

---

#### 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 \$424,558 and \$368,704 at June 30, 2017 and 2016, 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. *Reclassification*

Certain amounts in the 2016 financial statements have been reclassified to conform to the 2017 reporting format.

#### Y. *Subsequent Events*

The Hospital considered events occurring through October 20, 2017 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, Deposits and Assets Limited as to Use or Restricted**

The Hospital's deposits in banks at June 30, 2017 and 2016 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 uses the fair value hierarchy established by generally accepted accounting principles based on the value inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets. Level 2 inputs are significant other observable inputs. Level 3 inputs are significant unobservable inputs.

The Hospital has no investments meeting the disclosure requirements of Governmental Accounting Standard Board Statement No. 72.

## Lakes Regional Healthcare

### Notes to Financial Statements June 30, 2017 and 2016

---

#### (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 Administrative Contractor through June 30, 2015.

The "Budget Control Act of 2011" requires, among other things, mandatory across-the-board reductions in Federal spending, also known as sequestration. In general, Medicare claims with dates of service or dates of discharge on or after April 1, 2013, incur a 2% 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. On April 1, 2016 most existing Iowa Medicaid members were enrolled in IA Health Link. IA Health Link brings together physical, behavioral and long-term care under one program across Iowa which is covered by managed care organizations. The Hospital is reimbursed by these managed care organizations under contracted rates.

**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 \$87,000 and \$116,000 in 2017 and 2016, respectively, due to the removal of allowances previously estimated that are no longer necessary as a result of information obtained from final settlements and years that are no longer subject to audits, reviews, and investigations.

Revenue from the Medicare and Medicaid programs accounted for approximately 41% and 6%, respectively, of the Hospital's net patient service revenue for the year ended June 30, 2017, and 39% and 7%, respectively, for the year ended June 30, 2016. 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, 2017 and 2016

#### (4) Other Receivables

The composition of other receivables at June 30, 2017 and 2016 is summarized as follows:

	<u>2017</u>	<u>2016</u>
Physician loans and income guarantees, net	\$ 195,759	369,371
Other	9,219	40,493
	<u>\$ 204,978</u>	<u>409,864</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 or Restricted

##### 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.

The amounts as of June 30, 2017 and 2016 represent cash and cash equivalents and are as follows:

	<u>2017</u>	<u>2016</u>
Bond Fund, Series 2002	\$ 34,376	275,241
Sinking Funds, Series 2012 and 2013	81,419	103,196
Debt Service Reserve Fund, Series 2012 and 2013	999,261	995,701
	1,115,056	1,374,138
Less current portion	<u>(115,795)</u>	<u>(378,437)</u>
	<u>\$ 999,261</u>	<u>995,701</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.

# Lakes Regional Healthcare

## Notes to Financial Statements June 30, 2017 and 2016

The amounts segregated as of June 30, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
Mandelbaum Endowment fund		
Certificate of deposit	\$ 25,000	25,081
Hospital auxiliary assets, primarily cash and cash equivalents	<u>60,819</u>	<u>65,319</u>
	\$ <u>85,819</u>	<u>90,400</u>
Total assets limited as to use or restricted, net of current portion	<u>\$ 1,085,080</u>	<u>1,086,101</u>

### (6) Capital Assets

Capital assets activity for the years ended June 30, 2017 and 2016 were as follows:

	<u>June 30, 2016</u>	<u>Additions</u>	<u>Transfers and Disposals</u>	<u>June 30, 2017</u>
Capital assets, not being depreciated:				
Land	\$ 919,017	--	--	919,017
Construction in progress	<u>--</u>	<u>64,875</u>	<u>--</u>	<u>64,875</u>
Total capital assets, not being depreciated	<u>919,017</u>	<u>64,875</u>	<u>--</u>	<u>983,892</u>
Capital assets, being depreciated:				
Land improvements	776,037	16,724	--	792,761
Hospital buildings	37,336,232	207,854	--	37,544,086
Fixed equipment	4,882,327	81,370	--	4,963,697
Major moveable equipment	<u>12,787,747</u>	<u>1,507,342</u>	<u>(184,985)</u>	<u>14,110,104</u>
Total capital assets, being depreciated	<u>55,782,343</u>	<u>1,813,290</u>	<u>(184,985)</u>	<u>57,410,648</u>
Less accumulated depreciation:				
Land improvements	419,089	36,610	--	455,699
Hospital buildings	13,029,691	1,099,491	--	14,129,182
Fixed equipment	3,748,595	330,359	--	4,078,954
Major moveable equipment	<u>9,377,146</u>	<u>1,274,817</u>	<u>(163,444)</u>	<u>10,488,519</u>
Total accumulated depreciation	<u>26,574,521</u>	<u>2,741,277</u>	<u>(163,444)</u>	<u>29,152,354</u>
Total capital assets, being depreciated, net	<u>29,207,822</u>	<u>(927,987)</u>	<u>(21,541)</u>	<u>28,258,294</u>
Total capital assets, net	<u>\$ 30,126,839</u>	<u>(863,112)</u>	<u>(21,541)</u>	<u>29,242,186</u>
	<u>June 30, 2015</u>	<u>Additions</u>	<u>Transfers and Disposals</u>	<u>June 30, 2016</u>
Capital assets, not being depreciated:				
Land	\$ 919,017	--	--	919,017
Capital assets, being depreciated:				
Land improvements	780,686	8,920	(13,569)	776,037
Hospital buildings	37,371,820	54,493	(90,081)	37,336,232
Fixed equipment	4,853,564	78,240	(49,477)	4,882,327
Major moveable equipment	<u>13,166,991</u>	<u>1,017,683</u>	<u>(1,396,927)</u>	<u>12,787,747</u>
Total capital assets, being depreciated	<u>56,173,061</u>	<u>1,159,336</u>	<u>(1,550,054)</u>	<u>55,782,343</u>
Less accumulated depreciation:				
Land improvements	394,994	37,664	(13,569)	419,089
Hospital buildings	11,995,141	1,124,631	(90,081)	13,029,691
Fixed equipment	3,252,353	545,719	(49,477)	3,748,595
Major moveable equipment	<u>9,634,843</u>	<u>1,138,641</u>	<u>(1,396,338)</u>	<u>9,377,146</u>
Total accumulated depreciation	<u>25,277,331</u>	<u>2,846,655</u>	<u>(1,549,465)</u>	<u>26,574,521</u>
Total capital assets, being depreciated, net	<u>30,895,730</u>	<u>(1,687,319)</u>	<u>(589)</u>	<u>29,207,822</u>
Total capital assets, net	<u>\$ 31,814,747</u>	<u>(1,687,319)</u>	<u>(589)</u>	<u>30,126,839</u>

## Lakes Regional Healthcare

### Notes to Financial Statements June 30, 2017 and 2016

#### (7) Long-Term Debt

Long-term debt activity of the Hospital as of June 30, 2017 and 2016 consisted of the following:

	June 30, 2016	Borrowings	Payments	June 30, 2017	Due Within One Year
Capital loan notes (A)	\$ 2,365,000	--	(350,000)	2,015,000	370,000
Series 2012 loan agreement (B)	10,000,000	--	--	10,000,000	--
Series 2013 loan agreement (C)	2,980,000	--	(715,000)	2,265,000	725,000
Unamortized bond premiums (B, C)	127,857	--	(19,141)	108,716	19,141
	<u>\$ 15,472,857</u>	<u>--</u>	<u>(1,084,141)</u>	<u>14,388,716</u>	<u>1,114,141</u>
	June 30, 2015	Borrowings	Payments	June 30, 2016	Due Within One Year
Capital loan notes (A)	\$ 2,700,000	--	(335,000)	2,365,000	350,000
Series 2012 loan agreement (B)	10,000,000	--	--	10,000,000	--
Series 2013 loan agreement (C)	3,690,000	--	(710,000)	2,980,000	715,000
Unamortized bond premiums (B, C)	146,998	--	(19,141)	127,857	19,141
	<u>\$ 16,536,998</u>	<u>--</u>	<u>(1,064,141)</u>	<u>15,472,857</u>	<u>1,084,141</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 2.11% and was reset on June 1, 2017 at the rate equal to the five-year United States Treasury Note Index plus .25%. The previous interest rate was 0.975%. Annual principal payments range in amounts from \$370,000 to \$400,000 through 2022.
- (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 \$725,000 to \$740,000 from 2017 through 2020 with a final payment of \$70,000 in June 2021.

## Lakes Regional Healthcare

### Notes to Financial Statements June 30, 2017 and 2016

A summary of the Hospital's future principal and interest payments as of June 30, 2017 is as follows:

Year	Interest Rates	Principal	Interest	Total
2018	1.50 - 2.11	\$ 1,095,000	271,752	1,366,752
2019	1.50 - 2.11	1,115,000	257,255	1,372,255
2020	1.50 - 2.11	1,140,000	242,535	1,382,535
2021	2.00 - 2.11	1,170,000	227,246	1,397,246
2022	2.00 - 2.11	1,205,000	208,758	1,413,758
2023-2027	2.00 - 2.13	4,050,000	786,750	4,836,750
2028-2032	2.25 - 2.50	4,505,000	277,250	4,782,250
		14,280,000	<u>2,271,546</u>	<u>16,551,546</u>
Add unamortized bond premium		<u>108,716</u>		
		<u>\$ 14,388,716</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:

	2017	2016
Interest costs	\$ 285,437	300,410
Amortization of bond premiums	<u>(19,141)</u>	<u>(19,141)</u>
Interest included in the statements of revenue, expenses and changes in net position	<u>\$ 266,296</u>	<u>281,269</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, 2017 and 2016, 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, 2017 and 2016

---

#### (9) Pension Plan

##### Plan Description

IPERS membership is mandatory for employees of the Hospital, except for those covered by another retirement system. Employees of the Hospital are provided with pensions through a cost-sharing multiple employer defined benefit pension plan administered by the Iowa Public Employees' Retirement System (IPERS). IPERS issues a stand-alone financial report which is available to the public by mail at 7401 Register Drive, PO Box 9117, Des Moines, Iowa, 50306-9117 or at [www.ipers.org](http://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 except for members with service before June 30, 2012 which will use the highest three-year average salary as of that date if it is greater than the highest five-year average salary.

Protection occupation members may retire at normal retirement age, which is generally at age 55. The formula used to calculate a protection occupation member's monthly IPERS benefit includes:

- 60% of average salary after completion of 22 years of service, plus an additional 1.5% of average salary for years of service greater than 22 but not more than 30 years of service.
- The member's highest three-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% 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% 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.

# Lakes Regional Healthcare

## Notes to Financial Statements June 30, 2017 and 2016

---

### Contributions

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.

In fiscal year 2017, pursuant to the required rate, Regular members contributed 5.95% of covered payroll and the Hospital contributed 8.93% of covered payroll for a total rate of 14.88%. Protective occupation members contributed 6.56% of covered payroll and the Hospital contributed 9.84% of covered payroll, for a total rate of 16.40%.

The Hospital's contributions to IPERS for the year ended June 30, 2017 and 2016 were \$991,952 and \$981,014, respectively.

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

At June 30, 2017, the Hospital reported a liability of \$9,081,548 for its proportionate share of the net pension liability. The Hospital's net pension liability was measured as of June 30, 2016, 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, 2016, the Hospital's proportion was .144305%, which was a decrease of .002016% from its proportion measured as of June 30, 2015.

For the years ended June 30, 2017 and 2016, the Hospital recognized pension expense of \$986,065 and \$520,606, respectively. At June 30, 2017, 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	\$ 79,974	118,974
Changes of assumptions	138,057	143
Net difference between projected and actual earnings on pension plan investments	2,547,323	1,181,273
Changes in proportion and differences between Hospital contributions and proportionate share of contributions	(347,330)	--
Hospital contributions subsequent to the measurement date	991,952	--
	<hr/>	<hr/>
Total	\$ <u>3,409,976</u>	<u>1,300,390</u>

## Lakes Regional Healthcare

### Notes to Financial Statements June 30, 2017 and 2016

Deferred outflows of resources related to pensions included \$991,952 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, 2018. 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>		
2018	\$	45,288
2019		45,288
2020		652,323
2021		377,717
2022		<u>(2,982)</u>
	\$	<u>1,117,634</u>

There were no non-employer contributing entities at IPERS.

#### Actuarial Assumptions

The total pension liability in the June 30, 2016 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% per annum
Rates of salary increases (effective June 30, 2010)	4.00 to 17.00% average, including inflation. Rates vary by membership group
Long-term investment rate of return (effective June 30, 1996)	7.50%, compounded annually, net of Investment expense, including inflation
Wage growth (effective June 30, 1990)	4.00% per annum based on 3.00% inflation and 1.00% real wage inflation

The actuarial assumptions used in the June 30, 2016 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>
Core Plus Fixed Income	28%	1.90%
Domestic Equity	24	5.85
International Equity	16	6.32
Private Equity/Debt	11	10.31
Real Estate	8	3.87
Credit Opportunities	5	4.48
U.S. TIPS	5	1.36
Other Real Assets	2	6.42
Cash	1	(0.26)
Total	<u>100%</u>	

# Lakes Regional Healthcare

## Notes to Financial Statements June 30, 2017 and 2016

---

### Discount Rate

The discount rate used to measure the total pension liability was 7.5%. 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, IPERS' 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 IPERS' investments was applied to all periods of projected benefit payments to determine the total pension liability.

### 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%, 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%) or 1-percentage-point higher (8.5%) 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	\$ 14,960,170	9,081,548	4,120,260

### IPERS' 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](http://www.ipers.org).

### Payables to IPERS

At June 30, 2017, the Hospital reported payables to the defined benefit pension plan of \$223,079 for legally required employer contributions and \$53,607 for legally required employee contributions which had been withheld from employee wages but not yet remitted to IPERS.

## (10) Commitments and Contingencies

### Rental Income

The Hospital is the lessor of certain office space leased under various noncancelable operating leases through 2021. Rental income is recorded monthly as earned in other operating revenue. The future minimum rentals under these leases are as follows:

2018	\$ 101,937
2019	73,205
2020	69,564
2021	34,782

### 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, 2017 and 2016

---

#### (11) Concentrations of Credit Risk

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

	<u>2017</u>	<u>2016</u>
Medicare	43%	37%
Medicaid	11	12
Blue Cross	18	20
Private pay	15	14
Other third-party payors	<u>13</u>	<u>17</u>
	<u>100%</u>	<u>100%</u>

## Lakes Regional Healthcare

### Budgetary Comparison Schedule of Revenue, Expenses and Changes in Net Position – Budget and Actual (Cash Basis) and Notes to the Schedule Required Supplementary Information June 30, 2017

	Actual	Accrual	Actual	Budgeted Amounts		Variance
	Accrual Basis	Adjustments	Cash Basis	Original	Amended	Favorable (Unfavorable)
Estimated amount to be raised by taxation	\$ 650,000	--	650,000	642,138	642,138	7,862
Estimated other revenues / receipts	<u>39,365,403</u>	<u>(1,433,964)</u>	<u>37,931,439</u>	<u>35,667,362</u>	<u>35,667,362</u>	<u>2,264,077</u>
	40,015,403	(1,433,964)	38,581,439	36,309,500	36,309,500	2,271,939
Expenses and disbursements	<u>38,344,143</u>	<u>(190,673)</u>	<u>38,153,470</u>	<u>38,214,403</u>	<u>38,802,500</u>	<u>649,030</u>
Net	1,671,260	(1,243,291)	427,969	\$ <u>(1,904,903)</u>	\$ <u>(2,493,000)</u>	<u>2,920,969</u>
Balance beginning of year	<u>31,317,103</u>	<u>(8,537,289)</u>	<u>22,779,814</u>			
Balance end of year	\$ <u><u>32,988,363</u></u>	<u><u>(9,780,580)</u></u>	<u><u>23,207,783</u></u>			

*See accompanying independent auditor's report*

#### Notes to the Schedule:

This budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary prospective differences.

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, 2017, the Hospital's expenditures did not exceed amounts budgeted.

## Lakes Regional Healthcare

### Schedule of the Hospital's Proportionate Share of the Net Pension Liability Required Supplementary Information June 30, 2017

---

	Iowa Public Employees' Retirement System Last Two Fiscal Years* (In Thousands)		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Hospital's proportion of net pension liability	0.144305%	0.146320%	0.148596%
Hospital's proportionate share of the net pension liability	\$ 9,082	7,229	5,893
Hospital's covered-employee payroll	\$ 10,985	10,728	10,515
Hospital's proportionate share of the net pension liability as a percentage of its covered-employee payroll	82.67%	67.39%	56.04%
Plan fiduciary net position as a percentage of the total pension liability	81.82%	85.19%	87.61%

\* In accordance with GASB Statement No. 68, the amounts presented for each fiscal year were determined as of June 30 of the preceeding year.

*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, 2017**

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

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Statutorily required contribution	\$ 991	981	958	939	949	846	711	659	615	556
Contributions in relation to the statutorily required contribution	<u>(991)</u>	<u>(981)</u>	<u>(958)</u>	<u>(939)</u>	<u>(949)</u>	<u>(846)</u>	<u>(711)</u>	<u>(659)</u>	<u>(615)</u>	<u>(556)</u>
Contribution deficiency (excess)	\$ <u>    --</u>	<u>    --</u>								
Hospital's covered-employee payroll	\$ 11,097	10,985	10,728	10,515	10,933	10,470	10,245	9,925	9,685	9,175
Contributions as a percentage of covered-employee payroll	8.93%	8.93%	8.93%	8.93%	8.68%	8.08%	6.94%	6.64%	6.35%	6.06%

*See accompanying independent auditor's report*

## Lakes Regional Healthcare

### Notes to Required Supplementary Information – Pension Liability June 30, 2017

---

#### 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% per year measured from the member's first unreduced retirement age to a 6% reduction for each year of retirement before age 65.

Legislative action in 2008 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.

#### 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% to 3.00%.
- Decreased the assumed rate of interest on member accounts from 4.00% to 3.75% 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 unfunded actuarial liability (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.

**Net Patient Service Revenue**  
**For the Years Ended June 30, 2017 and 2016**

	2017			2016		
	Inpatient	Outpatient	Total	Inpatient	Outpatient	Total
<b>NURSING SERVICES:</b>						
Medical, surgical and obstetrics	\$ 3,138,599	--	3,138,599	2,905,689	--	2,905,689
Observation	--	1,357,439	1,357,439	--	1,102,621	1,102,621
Coronary care	546,639	--	546,639	504,225	--	504,225
Nursery	281,706	1,242	282,948	288,355	845	289,200
Swing bed	108,150	--	108,150	146,392	--	146,392
	<u>4,075,094</u>	<u>1,358,681</u>	<u>5,433,775</u>	<u>3,844,661</u>	<u>1,103,466</u>	<u>4,948,127</u>
<b>OTHER PROFESSIONAL SERVICES:</b>						
Operating and recovery rooms	2,372,089	8,276,925	10,649,014	1,763,354	8,142,687	9,906,041
Primary care clinics	13,739	9,632,647	9,646,386	16,250	9,512,784	9,529,034
Pharmacy	2,536,935	5,912,101	8,449,036	2,148,722	5,342,181	7,490,903
Central services and supply	4,526,894	3,674,211	8,201,105	2,806,840	2,676,992	5,483,832
Laboratory	1,169,665	6,287,291	7,456,956	1,047,410	6,111,586	7,158,996
Emergency and outpatient service	519,276	5,096,122	5,615,398	486,838	5,047,902	5,534,740
CT scanner	376,238	3,822,713	4,198,951	270,437	3,158,952	3,429,389
MRI	31,785	2,472,421	2,504,206	49,657	2,399,258	2,448,915
Radiology	210,309	1,731,274	1,941,583	179,591	1,789,040	1,968,631
Ambulance	249,497	1,480,143	1,729,640	187,220	1,424,402	1,611,622
Physical therapy	188,758	1,386,221	1,574,979	173,436	1,299,771	1,473,207
Ultrasound	82,983	1,369,420	1,452,403	89,350	1,329,966	1,419,316
Anesthesiology	312,218	986,870	1,299,088	227,768	829,280	1,057,048
Respiratory therapy	228,374	899,273	1,127,647	616,105	709,267	1,325,372
Home health	--	985,605	985,605	--	850,917	850,917
Outpatient clinic	17,002	914,126	931,128	13,872	775,316	789,188
Hospice	681,178	--	681,178	723,927	--	723,927
Delivery and labor room	420,796	184,096	604,892	441,937	155,430	597,367
Sleep studies	--	571,245	571,245	--	536,837	536,837
Mammogram	--	492,030	492,030	--	463,999	463,999
Occupational therapy	90,233	221,700	311,933	66,815	217,124	283,939
Cardiac rehab	--	274,217	274,217	--	228,555	228,555
Enterostomal therapy	812	230,120	230,932	1,708	188,308	190,016
Nuclear medicine	2,161	208,107	210,268	7,086	154,043	161,129
Blood	30,872	66,765	97,637	34,563	124,101	158,664
Speech therapy	14,840	48,183	63,023	18,589	47,941	66,530
	<u>14,077,879</u>	<u>57,223,826</u>	<u>71,301,705</u>	<u>11,371,641</u>	<u>53,516,639</u>	<u>64,888,280</u>
<b>GROSS PATIENT SERVICE REVENUE</b>	<b>\$ 18,152,973</b>	<b>58,582,507</b>	<b>76,735,480</b>	<b>15,216,302</b>	<b>54,620,105</b>	<b>69,836,407</b>
<b>LESS:</b>						
Contractual allowances and other deductions, primarily Medicare and Medicaid			(37,584,219)			(32,700,411)
Charity care services and other discounts, based on charges forgone			(474,897)			(217,541)
<b>NET PATIENT SERVICE REVENUE BEFORE PROVISION FOR BAD DEBT</b>			<b>38,676,364</b>			<b>36,918,455</b>
<b>PROVISION FOR BAD DEBT</b>			<b>(976,257)</b>			<b>(740,083)</b>
<b>NET PATIENT SERVICE REVENUE</b>			<b>37,700,107</b>			<b>36,178,372</b>

See accompanying independent auditor's report

**Other Operating Revenue**  
**For the Years Ended June 30, 2017 and 2016**

---

	<u>2017</u>	<u>2016</u>
Public Health grants	\$ 391,569	409,319
Meals sold	167,064	166,655
Rental income	151,274	167,406
Other	146,308	70,412
Grants	56,923	21,560
Gain (loss) on disposal of capital assets	54,042	9,694
Net position released for operations	30,279	24,242
Meals on wheels	21,150	21,168
Electronic health records incentive payments- Centers for Medicare and Medicaid Services	<u>16,513</u>	<u>285,425</u>
	<u>\$ 1,035,122</u>	<u>1,175,881</u>

*See accompanying independent auditor's report*

Lakes Regional Healthcare

Exhibit 3

Departmental Expenses  
For the Years Ended June 30, 2017 and 2016

	2017			2016		
	Salaries and Wages	Supplies and Other	Total	Salaries and Wages	Supplies and Other	Total
<b>NURSING SERVICES:</b>						
Medical and surgical	\$ 1,699,730	104,644	1,804,374	1,669,079	103,012	1,772,091
Obstetrics	245,056	31,760	276,816	241,670	30,444	272,114
Coronary care	213,810	55,162	268,972	228,297	57,391	285,688
Administration	225,040	1,334	226,374	191,772	443	192,215
Nursery	105,755	6,095	111,850	103,318	3,554	106,872
	<u>2,489,391</u>	<u>198,995</u>	<u>2,688,386</u>	<u>2,434,136</u>	<u>194,844</u>	<u>2,628,980</u>
<b>OTHER PROFESSIONAL SERVICES:</b>						
Primary care clinics	182,879	6,021,515	6,204,394	202,588	6,441,611	6,644,199
Pharmacy	275,094	2,480,236	2,755,330	295,415	2,273,769	2,569,184
Emergency room	850,710	1,864,513	2,715,223	1,022,350	1,668,061	2,690,411
Central services and supply	78,196	1,986,785	2,064,981	86,313	1,392,300	1,478,613
Operating and recovery room	813,228	643,606	1,456,834	703,640	603,475	1,307,115
Laboratory	650,517	676,716	1,327,233	631,167	646,643	1,277,810
Physical therapy	145,896	683,059	828,955	139,412	692,399	831,811
Ambulance	575,587	117,227	692,814	569,111	91,624	660,735
Radiology	382,887	245,504	628,391	379,073	261,039	640,112
Home health	450,233	138,929	589,162	423,771	94,785	518,556
Anesthesiology	265,793	160,958	426,751	170,651	141,889	312,540
Outpatient clinic	366,051	43,048	409,099	365,089	62,135	427,224
Respiratory therapy	165,444	195,152	360,596	149,850	169,100	318,950
Medical records	236,941	88,505	325,446	255,507	120,805	376,312
Same day surgery	269,170	49,066	318,237	276,787	55,058	331,845
Hospice	126,348	174,173	300,521	146,208	194,103	340,311
Public health	247,109	23,422	270,531	260,908	38,197	299,105
Ultrasound	165,999	13,577	179,576	169,428	28,959	198,387
MRI	38,052	131,135	169,187	35,460	131,517	166,977
CT scanner	62,674	87,660	150,334	58,405	177,549	235,954
Sleep studies	--	101,833	101,833	--	70,964	70,964
Electrocardiology	88,455	6,727	95,182	92,396	8,076	100,472
Delivery and labor room	80,374	8,780	89,154	78,522	7,939	86,461
Blood bank	--	86,824	86,824	--	103,647	103,647
Social services	37,100	42,210	79,310	36,602	15,455	52,057
Nuclear medicine	--	77,590	77,590	--	59,369	59,369
Quality assurance	62,516	5,033	67,549	69,482	4,708	74,190
Enterostomal therapy	--	66,533	66,533	--	61,437	61,437
Speech therapy	--	43,075	43,075	--	47,780	47,780
	<u>6,617,253</u>	<u>16,263,391</u>	<u>22,880,645</u>	<u>6,618,135</u>	<u>15,664,393</u>	<u>22,282,528</u>
<b>GENERAL SERVICES:</b>						
Plant operation and maintenance	425,418	865,113	1,290,531	400,327	815,860	1,216,187
Dietary	288,589	283,095	571,684	271,016	275,773	546,789
Housekeeping	157,498	71,763	229,261	162,438	69,610	232,048
Laundry and linen	25,006	78,856	103,862	25,944	73,560	99,504
	<u>896,511</u>	<u>1,298,827</u>	<u>2,195,338</u>	<u>859,725</u>	<u>1,234,803</u>	<u>2,094,528</u>
<b>ADMINISTRATIVE SERVICES</b>						
	<u>1,583,853</u>	<u>2,027,587</u>	<u>3,611,440</u>	<u>1,529,064</u>	<u>2,173,251</u>	<u>3,702,315</u>
<b>NONDEPARTMENTAL:</b>						
Employee benefits	--	3,734,446	3,734,446	--	3,322,975	3,322,975
Depreciation	--	2,741,277	2,741,277	--	2,846,655	2,846,655
Insurance	--	226,315	226,315	--	224,857	224,857
	<u>--</u>	<u>6,702,038</u>	<u>6,702,038</u>	<u>--</u>	<u>6,394,487</u>	<u>6,394,487</u>
<b>TOTAL EXPENSES</b>	<b>\$ 11,587,008</b>	<b>26,490,838</b>	<b>38,077,847</b>	<b>11,441,060</b>	<b>25,661,778</b>	<b>37,102,838</b>

See accompanying independent auditor's report

**Patient Receivables and Allowance for Doubtful Accounts  
June 30, 2017 and 2016**

ANALYSIS OF AGING:

Days Since Discharge	2017		2016	
	Amount	Percent of Total	Amount	Percent of Total
0 - 60	\$ 8,416,809	76.0 %	7,989,812	80.5 %
61 - 90	615,468	5.6	761,633	7.7
91 - 180	888,155	8.0	793,002	8.0
> 180 days	1,154,453	10.4	381,869	3.8
	<u>11,074,885</u>	<u>100.0 %</u>	<u>9,926,316</u>	<u>100.0 %</u>

Less:

Allowance for doubtful accounts	(2,381,766)	(2,054,800)
Allowance for contractual adjustments	<u>(4,845,065)</u>	<u>(4,111,039)</u>
	<u>\$ 3,848,054</u>	<u>\$ 3,760,477</u>

	2017	2016
ALLOWANCE FOR DOUBTFUL ACCOUNTS:		
Balance, beginning of year	\$ 2,054,800	1,983,813
Provision of uncollectible accounts	976,257	740,083
Recoveries of accounts previously written off	530,393	541,888
Accounts written off	<u>(1,179,684)</u>	<u>(1,210,984)</u>
Balance, end of year	<u>\$ 2,381,766</u>	<u>2,054,800</u>

See accompanying independent auditor's report

**Inventories / Prepaid Expenses**  
**June 30, 2017 and 2016**

	<u>2017</u>	<u>2016</u>
INVENTORIES:		
Surgical services	\$ 418,360	375,097
Pharmacy	218,822	219,116
Central storeroom	128,575	122,796
Primary care clinics	48,319	61,591
Fuel oil	20,796	28,824
Radiology	6,021	5,380
Laboratory	22,435	24,380
Gift shop	11,775	12,232
Dietary	<u>17,966</u>	<u>17,834</u>
	<u>\$ 893,069</u>	<u>867,250</u>
PREPAID EXPENSES:		
Insurance	\$ 104,812	109,314
Maintenance contracts	45,227	38,874
Other	<u>63,666</u>	<u>49,878</u>
	<u>\$ 213,705</u>	<u>198,066</u>

*See accompanying independent auditor's report*

**Statistical Information  
For the Years Ended June 30, 2017 and 2016**

	<u>2017</u>	<u>2016</u>
Patient days:		
Adult and pediatric-		
Medicare	1,747	1,345
Other	<u>914</u>	<u>1,246</u>
	2,661	2,591
Swing bed - skilled	256	298
Newborn	<u>297</u>	<u>320</u>
Total	<u><u>3,214</u></u>	<u><u>3,209</u></u>
Patient discharges:		
Adult and pediatric-		
Medicare	432	412
Other	<u>318</u>	<u>299</u>
	750	711
Swing bed - skilled	27	37
Newborn	<u>125</u>	<u>140</u>
Total	<u><u>902</u></u>	<u><u>888</u></u>
Average length of stay:		
Adult and pediatric-		
Medicare	4.04 days	3.26 days
Other	2.89 days	4.17 days
Swing bed - skilled	6.92 days	8.05 days
Newborn	2.38 days	2.29 days
Surgical cases	2,132	2,062
Emergency room visits	6,674	6,830
Number of employees - full-time equivalents	208	208

**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, 2017, 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 20, 2017.

**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, 2017 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.

**Hospital's Responses to the Findings**

The Hospital's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The Hospital's responses were not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on them.

**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 20, 2017.

# Lakes Regional Healthcare

## Schedule of Findings and Responses For the Year Ended June 30, 2017

---

### 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 matters were reported.*

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

**III-A-17**      Official Depositories: A resolution naming official depositories has been adopted by the Board. However, maximum deposit amounts were not identified in the resolution for the year ended June 30, 2017.

Recommendation – The Hospital should identify maximum deposit amounts in their official depository resolution.

Response – This was a clerical oversight, and future maximum deposit amounts will be identified in the official depository resolutions.

Conclusion – Response accepted.

**III-B-17**      Certified Budget: Hospital disbursements during the year ended June 30, 2017 did not exceed amounts budgeted.

**III-C-17**      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-D-17**      Travel Expense: No expenditures of Hospital money for travel expenses of spouses of Hospital officials and/or employees were noted.

**III-E-17**      Business Transactions: No business transactions between the Hospital and Hospital officials and/or employees were noted to violate Chapter 347.15 of the Code of Iowa which limits a trustee's pecuniary interest in the purchase or sale of any commodities or supplies procured for or disposed of by said hospital to \$1,500 without publicly invited and opened written competitive bids.

**III-F-17**      Board Minutes: No transactions were found that we believe should have been approved in the Board minutes but were not.

**III-G-17**      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-H-17**      Publication of Bills Allowed and Salaries: Chapter 347.13(11) of the Code of Iowa states in part, "There shall be published quarterly in each of the official newspapers of the county as selected by the board of supervisors pursuant to Section 349.1 the schedule of bills allowed and there shall be published annually in such newspaper the schedule of salaries paid by job classification and category..." We noted no instances of noncompliance with the publication of bills allowed and salaries. The Hospital publishes a list of expenditures timely after the completion of each quarter. The Hospital also publishes a schedule of salaries annually by category.

## Lakes Regional Healthcare

### Summary Schedule of Prior Audit Findings For the Year Ended June 30, 2017

---

<b>Finding</b>	<b>Finding title</b>	<b>Status</b>	<b>If not corrected, corrective action plan or other explanation</b>
III-A-16	Official Depositories	Not corrected.	This was a clerical oversight, and future maximum deposit amounts will be identified in the official depository resolutions.

## **Lakes Regional Healthcare**

### **Audit Staff**

**For the Year Ended June 30, 2017**

---

This audit was performed by:

- Roger E. Thompson, FHFMA, CPA, Partner
- Joseph L. Harnisch, CPA, Senior Manager
- Alyson M. Howard, Staff Auditor
- Lindsay A. Beller, Staff Auditor