



Report of Independent Auditors
and Financial Statements
(with supplementary information) for

Lake Health District
dba Lake District Hospital

June 30, 2013 and 2012

MOSS-ADAMS LLP

Certified Public Accountants | Business Consultants

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DISTRICT OFFICIALS
June 30, 2013

BOARD OF DIRECTORS

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Lakeview, OR 97630

Don Liddycoat, CPA, Secretary
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ADMINISTRATOR

Charles Tveit
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DISTRICT OFFICE

Lake District Hospital
700 South J Street
Lakeview, OR 97630

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Lake Health District dba Lake District Hospital

Report on the Financial Statements

We have audited the accompanying financial statements of Lake Health District dba Lake District Hospital (the District), which comprise the balance sheet as of June 30, 2013, and the related statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements. The financial statements of the District as of June 30, 2012 were audited by other auditors whose report dated January 15, 2013 expressed an unmodified opinion on those statements.

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 opinions 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 Lake Health District dba Lake Health Hospital as of June 30, 2013, and the results of its operations and its cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

REPORT OF INDEPENDENT AUDITORS (continued)

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 11 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.

Other Supplementary Information

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of adopted appropriations and expenditures, original and final budget and actual is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the 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 December 31, 2013 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Report on Other Legal and Regulatory Requirements

In accordance with the Minimum Standards for Audits of Oregon Municipal Corporations, we have issued our report dated December 31, 2013, on our consideration of the District's compliance with certain provisions of laws and regulations, including the provisions of Oregon Revised Statutes as specified in Oregon Administrative Rules. The purpose of that report is to describe the scope of our testing of compliance and the results of that testing and not to provide an opinion on compliance.



for Moss Adams LLP
Portland, Oregon
December 31, 2013

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

Our discussion and analysis of Lake Health District, dba Lake District Hospital (the District) financial performance provides an overview of the District's financial activities for the fiscal year ended June 30, 2013. Please read it in conjunction with the District's financial statements that follow this analysis.

The District is a governmental entity, a political subdivision of the State of Oregon. The State of Oregon has provided counties authority to create independent health districts rendering hospital and other health care services for the residents of the District. The District was created by public vote on July 18, 1967 and the current District facility opened its doors in 1971. The District operates a 24-bed acute care hospital, an attached 47-bed skilled long term care facility, outpatient medical services, and home health and hospice services. The District's services include the acute care hospital, obstetrical services, surgery, emergency department and related ancillary services (lab, x-ray, etc.). Outpatient clinic services are provided through leased physician clinic facilities, where the District provides buildings to support those operations.

A five-member board of directors governs the District. The members of the board are elected for a term of four years. Elections are staggered so no more than one third of the board is up for election at one time. The board is required to elect a chairman, secretary, and treasurer. One of their duties is to appoint an Administrator / Chief Executive Officer (CEO). The board delegates the day-to-day operations of the District to the CEO.

As a municipal government entity, the District levies and the county collects property taxes from property owners within the District. These tax revenues are used to support the purpose of the District, which is to provide health care to its members. Tax support has increased due to the construction of the replacement hospital as well recently due to a gas pipe line development. Tax receipts in 2013 and 2012 represented approximately 11% and 7% of District receipts, respectively.

The Government Accounting Standards Board prescribes the financial reporting of the District. This is the format followed by the District. The State of Oregon's Auditors Office maintains copies of audited financial statements.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Issues Facing the District

There are issues facing the District that could result in material changes in its financial position in the long term. Among those issues are:

- Risks related to Medicare and Medicaid reimbursement due to state and national healthcare reform and budget shortfalls
- Labor shortages for healthcare professionals including physicians, registered nurses, and other healthcare related fields
- Increasing employee and employee benefit costs
- Increasing numbers of uninsured and underinsured patients
- High liability and malpractice insurance premiums for the hospital and physician practices
- Concern about retaining and recruiting primary care physicians
- Difficulty recruiting and maintaining specialty physician services in the community

The District's hospital is certified as a provider under both the Medicare program, which provides certain healthcare benefits to beneficiaries who are over 65 years of age or disabled, and the Medicaid program, funded jointly by the federal government and the states, which provides medical assistance to certain needy individuals and families. Approximately 45% of the gross patient revenue for fiscal year ending June 30, 2013 was derived from Medicare, 19% was derived from Medicaid, 29% from other insurance, and 7% from private pay or uninsured.

Designated as a Critical Access Hospital since December 2001, the District's hospital services for Medicare and Medicaid beneficiaries are paid on a cost basis. Interim payments are computed on a percentage of charges, derived from the most recently filed Medicare Statement of Reimbursable Cost.

Medicare compensates the District on fixed rates for different classifications of skilled nursing, home health services, hospice services, and physician services. When the reimbursement is fixed, the District is at risk to lose money on any service where expenses exceed the reimbursement.

Under Medicaid, the federal government provides grants to states that have programs meeting certain federal guidelines. These funds or programs continue to be reduced as Oregon's state government has attempted to balance its budget.

In recent years, both the state and federal governments have increased enforcement of laws designed to combat health care fraud, and additional anti-fraud legislation has been adopted at both the federal and state levels. There are high penalties for organizations caught breaking these laws. There are a number of examples in the west, where hospitals have been audited and the justice department is looking to recover millions of dollars in what they allege to be improper payments. The fees and fines for a hospital caught in violation of these laws can be substantial. Failure of the District to be in compliance with these laws can result in the exclusion of Medicare and Medicaid funds along with fines and criminal penalties.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Healthcare Reform Bill – HR 3962 (Affordable Care Act)

Healthcare Reform Bill 3962, signed into law March 23, 2010, is a sweeping overhaul of the nation's healthcare system. Part of the plan's mandate is to reduce healthcare costs. Implementation of this law will take place over a number of years and is in process. Currently, Oregon Medicaid is moving toward replacing cost based and fee for service reimbursement to a capitation payment methodology. How this change and how the mandates will affect reimbursement and operating expenditures is still unknown. However, at this point Critical Access Hospitals in frontier communities are not expected to be affected by the changes until 2014.

Risks Related to HIPAA

Under the Health Insurance Portability and Accountability Act (HIPAA), health plans, healthcare clearinghouses, and healthcare providers, including hospitals and their business partners, must maintain reasonable and appropriate administrative, technical, and physical safeguards to ensure the integrity and confidentiality of electronic healthcare information. The District must also protect against reasonable foreseeable threats to the security or integrity of the information and protect against unauthorized use or disclosure. Penalties are high and may include the loss of Medicare and Medicaid funds, fines, and criminal sanctions. The implementation of an electronic medical records system and upgrades to the District's information system in 2011 helped to strengthen security related to HIPAA. The expanding use of smart phones and other portable computers is adding additional risk to potential security breaches.

General Risks Affecting Health Care Facilities

Technology and Services

Scientific and technological advances, new procedures, drugs and appliances, preventive medicine, occupational health and safety programs and outpatient healthcare delivery may reduce utilization and revenues for the District in the future. Technological advances continue to accelerate the trend toward the use of sophisticated equipment and services for diagnosis and treatment of healthcare illnesses and diseases.

Employment and Labor Issues

The District is a major employer within the community and has a complex mix of professional, technical, clerical, maintenance, dietary, housekeeping, union and non-union workers. Potential risks include contract disputes, discrimination claims, personal tort actions, and claims for work-related injuries and exposures to hazardous materials. A shortage of nursing staff and other medical professional/technical employees is contributing to higher salaries and increased utilization of agency staff at a premium wage rate.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

General Risks Affecting Health Care Facilities (continued)

Competition

Even in a rather isolated geographic location, competition from other hospitals and healthcare providers is a risk to the District's revenue. Tertiary care facilities and others offering specialty care often promote competitive profitable services to those provided locally. All too frequently, others try to carve out profitable segments of the District's business leaving the hospital with product lines or services that are losing money.

Insurance

Malpractice costs for hospitals and physicians have increased significantly over the last six years. These increases have caused providers to leave certain geographic areas and certain specialties. In Oregon, with no cap on malpractice damages, the exposure is high for healthcare providers, resulting in substantially higher premiums.

Cost Based Reimbursement

Critical access hospitals are paid on cost based reimbursement from Medicare and Medicaid. Gains and losses are limited on services performed for those hospital patients. The larger gains and losses come from private insurance and self-pay, consisting of 36% of the District's hospital patient revenue. Long term care and home health and hospice are not paid on cost based reimbursement.

Financial Discussion

The downward trend in inpatient census, which has pressured financial results over the past four years, continued as inpatient census decreased 16%. However, a portion of this decrease is offset with a greater clinical focus on outpatient visits in observation and emergency room which both increased over 7%. Enhanced details on financial highlights are explained below:

1. **Data System:** The District's new data system went live on January 1, 2011. The system is a fully integrated tool designed to provide better information in a digital format also called an Electronic Health Record. In September 2011, the District met the clinical quality measures designated by the Center's for Medicare & Medicaid Systems. By meeting these measures, the District qualified for financial incentive reimbursements. A Medicare financial incentive reimbursement of \$660,556 was received in the current fiscal year end for meeting meaningful use of electronic health records.
2. **Building Remodel:** During the fiscal year ended June 30, 2012 the District completed a remodel on the existing facility. The remodel and previously completed 37,000 square foot expansion completed a \$22 million project to address limitations in space, service, and expansion which have limited patient service and have been a hindrance to economic growth.
3. **Surgery Service:** The District had been seeking to expand its surgical services for a number of years. In May 2012, a general surgeon was hired as a permanent solution to allow for more local surgical procedures, thus reducing travel for many patients living in or near the District.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Discussion (continued)

4. **Long Term Care:** The District's long term care census decreased by 4% in 2013 over 2012, which follows a similar trend the last few years. The trend of decreasing census has been due in large part to the State of Oregon's focus on keeping residents in foster care or staying at home rather than entering long term care facilities. While other critical access hospitals across the State have closed or disposed of their Long Term Care facilities, the Board has seen fit to subsidize the District facility because of community needs. Long term care continues to be an economic challenge. Management believes that an increased aging population, continuing demand for long term care, and added focus on high quality care will contribute to future increases in census.

5. **Recessionary Issues:** The past four years of the national economic downturn has affected hospitals across the country and the District has also been impacted. During the new fiscal year beginning July 2013, recessionary factors in Lake County continue to be a challenge.

2013 Financial Highlights

The District's overall business increased with gross patient revenue at \$22.1 million or a 10% increase from the prior year. Net patient revenues increased \$604,000 or 3.5% due to increased Medicare reimbursements.

Revenue deductions, allowances, charity, and bad debts reduced gross patient revenue by \$4.3 million, or 19% of gross patient revenue primarily due to increased contractual adjustments and bad debt.

In total, including non-patient activities, the District's expenses increased by \$815,000 or 4.5%. Salary and wages increased \$47,000, or 0.6%. Full time equivalents (FTE) decreased by 3 to 187. These positions related to a combination of the expanded facility and implementation of the new data system. Employees benefit expense decreased by \$144,000 or 5.0%.

Nonoperating revenues totaled \$1,585,334, an increase of \$1,217,987 or 332% from 2012.

The District had net income of \$1,903,065 in 2013 compared to a net loss of \$159,487 in 2012.

Net accounts receivable increased from \$2.8 million in 2012 to \$2.9 million in 2013 proportional to the increased in net patient revenue from 2012 to 2013.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

2013 Financial Highlights (continued)

Capital Assets

Lake District spent \$671,659 and \$2,521,681 in capital expenditures in 2013 and 2012, respectively. The majority of the expenditures in 2012 related to final expenditures related to the remodel of the existing building. Current year expenditures were primarily related to the purchase of a building and an ultrasound machine.

Long term Debt

In 2011, the remodel and previously completed 37,000 square foot expansion, completed a \$22 million project. These amounts are financed by a combination of community support in the passing of an \$8 million general obligation bond, bank loans from South Valley Bank in the amount of \$10.5 million, and State loans in the amount of \$2.95 million. The USDA purchased the \$8 million bond and a \$550,000 revenue bond issued by the District. The new and remodeled facilities will help solve problems related to space, quality of care, and privacy.

**LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS**

2013 Financial Highlights (continued)

Condensed financial information for the years ended June 30, 2013, 2012, and 2011 are as follows:

	June 30,		
	2013	2012	2011
ASSETS			
Current assets	\$ 5,751,349	\$ 7,284,740	\$ 4,654,477
Capital assets, net	22,755,935	24,030,732	23,347,374
Noncurrent assets	6,017,493	2,475,492	5,397,828
Total assets	<u>\$ 34,524,777</u>	<u>\$ 33,790,964</u>	<u>\$ 33,399,679</u>
LIABILITIES			
Long-term debt outstanding	\$ 21,310,723	\$ 21,934,261	\$ 21,968,478
Other current and noncurrent liabilities	2,171,565	2,144,797	2,132,290
Deferred revenue	-	572,482	-
Total liabilities	<u>23,482,288</u>	<u>24,651,540</u>	<u>24,100,768</u>
NET POSITION			
Unrestricted	9,645,016	7,149,931	4,973,936
Net investment in capital assets	837,945	1,430,219	876,134
Construction	-	-	2,940,851
Restricted - expendable	273,358	273,104	221,820
Restricted - nonexpendable	286,170	286,170	286,170
Total net position	<u>11,042,489</u>	<u>9,139,424</u>	<u>9,298,911</u>
Total liabilities and net position	<u>\$ 34,524,777</u>	<u>\$ 33,790,964</u>	<u>\$ 33,399,679</u>

**LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS**

2013 Financial Highlights (continued)

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

	Years Ended June 30,		
	2013	2012	2011
OPERATING REVENUES			
Net patient service revenues	\$ 17,970,176	\$ 17,365,872	\$ 14,992,913
Other operating revenues	1,171,855	116,995	79,924
Total operating revenues	<u>19,142,031</u>	<u>17,482,867</u>	<u>15,072,837</u>
OPERATING EXPENSES			
Salaries and benefits	10,878,107	10,975,122	9,594,755
Depreciation and amortization	1,946,456	1,838,323	874,290
Supplies	1,655,998	1,424,058	1,404,381
Other operating expenses	4,343,739	3,772,198	4,047,055
Total operating expenses	<u>18,824,300</u>	<u>18,009,701</u>	<u>15,920,481</u>
OPERATING INCOME (LOSS)	317,731	(526,834)	(847,644)
NONOPERATING REVENUES (EXPENSES)			
Property taxes	2,107,290	1,291,506	704,639
Lease income	52,209	48,789	45,224
Noncapital grants and donations, net	364,590	141,445	16,827
Interest expense	(962,287)	(1,121,452)	(247,793)
Other nonoperating expenses	23,532	7,059	98,068
Net nonoperating revenue	1,585,334	367,347	616,965
CHANGE IN NET POSITION	1,903,065	(159,487)	(230,679)
NET POSITION, beginning of year	9,139,424	9,298,911	9,529,590
NET POSITION, end of year	<u>\$ 11,042,489</u>	<u>\$ 9,139,424</u>	<u>\$ 9,298,911</u>

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LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
BALANCE SHEETS

ASSETS

	June 30,	
	<u>2013</u>	<u>2012</u>
CURRENT ASSETS		
Cash and cash equivalents	\$ 1,929,862	\$ 2,870,167
Receivables		
Patient accounts, less allowance for uncollectible accounts and contractual adjustments	2,857,030	2,778,287
Taxes	165,339	128,633
Other	160,075	278,189
Third-party settlements	497,706	1,128,057
Inventories	78,489	61,906
Prepaid expenses	<u>62,848</u>	<u>39,501</u>
Total current assets	<u>5,751,349</u>	<u>7,284,740</u>
ASSETS LIMITED AS TO USE	<u>6,017,493</u>	<u>2,475,492</u>
CAPITAL ASSETS		
Land	183,735	139,985
Depreciable capital assets, net of accumulated depreciation	<u>22,572,200</u>	<u>23,890,747</u>
Total capital assets, net	<u>22,755,935</u>	<u>24,030,732</u>
Total assets	<u><u>\$ 34,524,777</u></u>	<u><u>\$ 33,790,964</u></u>

**LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
BALANCE SHEETS**

LIABILITIES AND NET POSITION

	June 30,	
	2013	2012
CURRENT LIABILITIES		
Accounts payable	\$ 576,582	\$ 423,775
Accrued compensation and related liabilities	330,948	399,508
Accrued vacation	471,802	470,625
Accrued interest	184,966	184,637
Current maturities of long-term debt and capital leases payable	607,267	666,252
Total current liabilities	2,171,565	2,144,797
LONG-TERM DEBT AND CAPITAL LEASES PAYABLE, LESS CURRENT MATURITIES	21,310,723	21,934,261
OTHER LIABILITIES		
Deferred revenue	-	572,482
Total liabilities	23,482,288	24,651,540
NET POSITION		
Net investment in capital assets	837,945	1,430,219
Restricted - expendable		
For debt service	51,538	51,284
For specific operating activities	221,820	221,820
Restricted nonexpendable		
Nonexpendable permanent endowments	286,170	286,170
Unrestricted	9,645,016	7,149,931
Total net position	11,042,489	9,139,424
Total liabilities and net position	\$ 34,524,777	\$ 33,790,964

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

	Years Ended June 30,	
	2013	2012
OPERATING REVENUES		
Net patient and resident service revenues (net of provisions for bad debts of \$619,645 and \$625,343 in 2013 and 2012, respectively)	\$ 17,970,176	\$ 17,365,872
Other operating revenues	1,171,855	116,995
Total operating revenues	<u>19,142,031</u>	<u>17,482,867</u>
OPERATING EXPENSES		
Salaries and wages	8,149,070	8,102,256
Employee benefits	2,729,037	2,872,866
Professional fees	2,154,990	1,874,944
Depreciation and amortization	1,946,456	1,838,323
Supplies	1,655,998	1,424,058
Other operating expenses	786,035	532,074
Purchased services - utilities	540,780	538,235
Maintenance	379,583	328,463
Rents and leases	264,372	263,464
Purchased services - other	123,523	97,785
Insurance	94,456	137,233
Total operating expenses	<u>18,824,300</u>	<u>18,009,701</u>
OPERATING INCOME (LOSS)	317,731	(526,834)
NONOPERATING REVENUES (EXPENSES)		
Property taxes	2,107,290	1,291,506
Investment income	23,532	7,059
Interest expense	(962,287)	(1,121,452)
Noncapital grants and donations, net	364,590	141,445
Lease income	52,209	48,789
Net nonoperating revenue	<u>1,585,334</u>	<u>367,347</u>
CHANGE IN NET POSITION	1,903,065	(159,487)
NET POSITION, beginning of year	<u>9,139,424</u>	<u>9,298,911</u>
NET POSITION, end of year	<u><u>\$ 11,042,489</u></u>	<u><u>\$ 9,139,424</u></u>

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
STATEMENTS OF CASH FLOWS

	Years Ended June 30,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from patients services	\$ 17,949,302	\$ 17,095,193
Cash received from other operating revenue	1,171,855	116,995
Cash paid for salaries and benefits	(10,945,490)	(10,926,308)
Cash paid for supplies, professional fees, and other operating expenses	(5,768,746)	(5,179,945)
Net cash from operating activities	<u>2,406,921</u>	<u>1,105,935</u>
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Property taxes	2,070,584	1,252,959
Cash received from donations	74,590	141,445
Net cash from noncapital financing activities	<u>2,145,174</u>	<u>1,394,404</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal payments on long-term debt and capital leases	(682,523)	(18,920,727)
Proceeds from long-term debt	-	19,050,000
Interest paid on General Obligation bond debt	(961,958)	(1,101,737)
Purchase of capital assets	(381,659)	(2,762,156)
Net cash used in capital and related financing activities	<u>(2,026,140)</u>	<u>(3,734,620)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	23,532	7,059
Cash received from lease income	52,209	48,789
Net cash from investing activities	<u>75,741</u>	<u>55,848</u>
Net change in cash and cash equivalents	2,601,696	(1,178,433)
CASH AND CASH EQUIVALENTS, beginning of year	<u>5,345,659</u>	<u>6,524,092</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 7,947,355</u>	<u>\$ 5,345,659</u>
Reconciliation of cash and cash equivalents to the balance sheet:		
Cash and cash equivalents in current assets	\$ 1,929,862	\$ 2,870,167
Assets whose use is limited	6,017,493	2,475,492
Total cash and cash equivalents	<u>\$ 7,947,355</u>	<u>\$ 5,345,659</u>
SUPPLEMENTAL DISCLOSURE OF NON-CASH INFORMATION		
Capital assets acquired through donations	<u>\$ 290,000</u>	<u>\$ -</u>

See accompanying notes.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
STATEMENTS OF CASH FLOWS

	Years Ended June 30,	
	<u>2013</u>	<u>2012</u>
Reconciliation of operating income (loss) to net cash from operating activities:		
Operating income (loss)	\$ 317,731	\$ (526,834)
Adjustments to reconcile loss from operations to net cash from operating activities:		
Depreciation and amortization	1,946,456	1,838,323
Provision for bad debts	619,645	625,343
Changes in operating assets and liabilities:		
Patient accounts receivable, net	(698,388)	(491,998)
Other receivables	118,114	43,425
Third-party settlements receivables	630,351	(447,449)
Inventories	(16,583)	(925)
Prepaid expenses	(23,347)	(4,473)
Accounts payable	152,807	21,709
Accrued compensation and related liabilities	(68,560)	64,456
Accrued vacation	1,177	(15,642)
Deferred revenue	(572,482)	-
Total adjustments	<u>2,089,190</u>	<u>1,632,769</u>
Net cash from operating activities	<u>\$ 2,406,921</u>	<u>\$ 1,105,935</u>

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL

NOTES TO THE FINANCIAL STATEMENTS

Note 1 – Description of Reporting Entity and Summary of Significant Accounting Policies

Reporting entity – Lake Health District dba Lake District Hospital (the District), a municipal corporation, owns and operates a 24-bed acute care hospital, a 47-bed skilled nursing facility, home health and hospice services in Lakeview, Oregon. The District provides healthcare services to patients in the south central Oregon market. The services provided include acute care hospital, long term nursing care, emergency room, home health and hospice, and the related ancillary procedures (lab, x-ray, etc.) associated with those services.

Lake Health District operates under the laws of the State of Oregon for Oregon municipal corporations. The District is also a 501(c)(3) and is exempt from payment of federal income tax. All District assets, liabilities, and financial transactions are included in these financial statements.

Basis of accounting and financial statement presentation – The District uses enterprise fund accounting. Revenues and expenses are recognized on an accrual basis using the economic resources measurement focus. The District has adopted Government Accounting Standards Board (GASB) No. 62, Codification of Accounting and Financial Reporting guidance contained in pre-November 30, 1989 Financial Accounting Standards Board (FASB) and American Institute of Certified Professional Accountants (AICPA) Pronouncements, which identifies and codifies most pre-November 30, 1989 FASB and AICPA pronouncements that are relevant to governments and do not conflict with or contradict GASB pronouncements.

GASB is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The following is a summary of the most significant policies.

Budgetary information – ORS 440.403 establishes standard procedures relating to the preparation, adoption, and execution of the annual budget. Budgetary comparisons for enterprise funds are not required by accounting principles generally accepted in the United States of America (GAAP). Accordingly, such comparisons of approved budgeted amounts with actual results of operations for individual funds prepared on a basis other than GAAP are set forth as supplementary information as listed in the table of contents.

Use of estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL

NOTES TO THE FINANCIAL STATEMENTS

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

Cash and cash equivalents – Cash and cash equivalents include certain highly liquid investments with original maturities of three months or less. Cash and cash equivalents are carried at cost, which approximates market value.

Patient accounts receivable and credit policy – Accounts receivable are uncollateralized patient obligations, most of whom are local residents insured under third party payor agreements, and are stated at the amount management expects to collect from outstanding balances. The District bills third party payors on the patients' behalf, or if a patient is uninsured, the patient is billed directly.

Once claims are settled with the primary payor, any secondary insurance is billed, and patients are billed for copay and deductible amounts that are the patients' responsibility. Payments on accounts receivable are applied to the specific claim identified on the remittance advice or statement. The District does not have a policy to charge interest on past due accounts.

The carrying amounts of accounts receivable are reduced by allowances that reflect management's best estimate of the amounts that will not be collected. Management provides for contractual adjustments under terms of third-party reimbursement agreements through a reduction of gross revenue and a credit to patient receivables. In addition, management provides for probable uncollectible amounts, primarily uninsured patients, and amounts patients are personally responsible for, through a charge to operations and a credit to a valuation allowance based on its assessment of historical collection likelihood and the current status of individual accounts. Balances that are still outstanding after management has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable.

Accounts receivable are recorded in the accompanying balance sheets net of contractual adjustments and allowance for doubtful accounts.

Property taxes – The District received approximately 10% and 7% for the years ended June 30, 2013 and 2012, respectively, of its financial support from property taxes. These funds were used to support general operations. Property taxes are levied by the County on the District's behalf once per year and intended to finance the District's activities of the same calendar year. Taxes are billed and collected by Lake County and remittance to the District is made at periodic intervals. Any property tax balances due to the County after May 15th are considered delinquent. Property tax revenues are recognized when levied. No allowance for doubtful taxes receivable is considered necessary.

Inventories – Inventories are stated at lower of cost (first in, first out) or market, and consist of pharmaceutical, medical-surgical, and other supplies used in the operation of the District.

Assets limited as to use – Such assets include certain cash and other assets whose use is limited under debt indentures, trust agreements, and by the Board of Directors for future bond principal and interest payments and future acquisition and replacement of property, buildings, equipment, and other purposes, plus unrestricted earnings on those funds.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
NOTES TO THE FINANCIAL STATEMENTS

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

Donor-restricted investments – The District has donor-restricted investments. The investments represent temporarily and permanently restricted endowment funds restricted for the purchase of hospital and nursing home equipment, the support of hospital and nursing home operations and nursing education. These investments are recorded at cost which approximates market value.

Capital assets – The District’s capital assets are reported at historical cost. Donated capital assets are reported at their estimated fair value at the time of their donation. Expenditures for maintenance and repairs are charged to operations as incurred. Betterments and major renewals with an estimated useful life of one year or greater and with a cost of over \$5,000 are capitalized. Generally, assets with useful lives of less than three years are expensed in the year of purchase.

When capitalized assets are disposed of, the related costs and accumulated depreciation and amortization are removed from the accounts and the resulting gain or loss is classified in nonoperating gains and losses.

The District evaluates prominent events or changes in circumstances affecting the capital assets to determine whether impairment of a capital asset has occurred. Impairment losses on capital assets are measured using the method that best reflects the diminished

All capital assets other than land are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using these asset lives:

Land improvements	15-20 years
Buildings and building improvements	5-40 years
Equipment, computers, and furniture	3-15 years

Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or estimated useful life of the equipment.

Accrued vacation – The District’s employees accumulate paid time off (PTO) days composed of vacation, holiday, personal days, and sick days at varying rates depending on years of service. PTO starts to accumulate from an employee’s most recent date of hire. New employees are eligible to take PTO only after 500 hours of employment. Should a newly hired employee terminate employment before his or her 500 hours are completed, the employee will not be eligible to receive payment for any accumulated PTO. Employees may carry over a maximum of two years accumulated PTO from one year to the next year. Employees with PTO in excess of the combined two-year accrual may, with the approval of management, receive cash payment for excess hours of PTO. On termination of employment, employee shall be paid all accrued, but unused vacation hours provided they have given the notice required by personnel policies and the employee has not been terminated for cause.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL

NOTES TO THE FINANCIAL STATEMENTS

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

Net position – Net position of the District is classified in four components. *Net position, net investment in capital assets* consists of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted expendable net position* is noncapital net position that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the District. *Unrestricted net position* is remaining net position that does not meet the definition of *net investment in capital assets*. *Restricted nonexpendable net position* equals the principal portion of permanent endowments of the District.

Operating revenues and expenses – The District’s statement of revenues and expenses and changes in net position distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the District’s principal activity. Nonexchange revenues, including grants and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Net patient and resident service revenues – Revenues from patient and resident services are reported on the accrual basis in the period in which services are provided at established rates whether or not collection in full is anticipated. Contractual adjustments, the results of arrangements to provide services for other than established rates, are reported as revenue deductions and allowances. Contractual allowances include differences between established rates and amounts estimated by management as reimbursable under various reimbursement programs in effect. Normal estimation differences between final settlements and amounts accrued in previous years are reported as adjustments of the current year's contractual allowances.

The following are the components of net patient service revenue at June 30:

	2013	2012
Gross patient and resident service revenue:		
Daily hospital care	\$ 7,221,408	\$ 2,777,460
Nursing home	2,117,181	1,992,901
Ancillary services	12,881,659	15,361,059
Total gross patient and resident service revenue	22,220,248	20,131,420
Less:		
Charity care	418,564	297,828
Contractual adjustments	3,211,863	1,842,377
Provision for bad debts	619,645	625,343
Total adjustments	4,250,072	2,765,548
Net patient and resident service revenue	\$ 17,970,176	\$ 17,365,872

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL NOTES TO THE FINANCIAL STATEMENTS

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

Charity care – The District provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. The District maintains records to identify and monitor the level of charity care provided. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. Charges associated with charity care were \$418,564 and \$297,828 for the years ended June 30, 2013 and 2012, respectively.

Gifts, contributions, grants, and bequests – Gifts, contributions, grants, and bequests that are not restricted by the donor are included in nonoperating gains in the statement of revenues, expenses and changes in net position. Gifts, contributions, grants, and bequests restricted by donors for specific purposes are recorded in the donor-restricted fund and transferred to the general fund when restricted amounts are expended for their restricted purpose. When restricted funds are used for operations, these amounts are reflected in the statement of revenues, expenses, and changes in net position as other operating revenues. When restricted funds are used for the acquisition of property, buildings, and equipment these funds are reflected in the general fund as a fund balance transfer.

Income taxes – The District is a municipal corporation under Oregon state law and is not subject to Federal income taxes.

Subsequent events – Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. The District recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the financial statements. The District's financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before the financial statements are issued.

The District has evaluated subsequent events through December 31, 2013, which is the date the financial statements are issued.

Reclassifications – Certain reclassifications have been made to prior year amounts to conform to the current year presentation. These reclassifications had no impact on total net position or the change in net position.

Recent accounting pronouncements – The GASB issued GASB Statement No. 61, The Financial Reporting Entity: Omnibus (GASB No. 61), which is effective for financial statements for periods beginning after June 15, 2012. GASB No. 61 modifies certain requirements for inclusion of component units in the financial reporting entity and amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. It also clarifies the reporting of equity interests in legally separate organizations. It requires a primary government to report its equity interest in a component unit as an asset. The District has adopted the accounting pronouncement for the fiscal year ending June 30, 2013. There was no significant impact to the District's financial statements.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL

NOTES TO THE FINANCIAL STATEMENTS

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

The GASB issued GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position (GASB No. 63), which is effective for financial statements for periods beginning after December 15, 2011. The requirements of GASB No. 63 will improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed. Amounts that are required to be reported as deferred outflows of resources should be reported in a statement of financial position in a separate section following assets. Similarly, amounts that are required to be reported as deferred inflows of resources should be reported in a separate section following liabilities. The statement of net position should report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. Net position represents the difference between all other elements in a statement of financial position and should be displayed in three components – net investment in capital assets; restricted (distinguishing between major categories of restrictions); and unrestricted. The District is currently evaluating the impact of the adoption of GASB No. 63 for the fiscal year ending June 30, 2014.

The GASB also issued GASB Statement No. 65, Items Previously Reported as Assets and Liabilities ("GASB No. 65"), which is effective for financial statements for periods beginning after December 15, 2012. GASB No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. It also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations. The District is currently evaluating the impact of the adoption of GASB No. 65 for the fiscal year ending June 30, 2014.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
NOTES TO THE FINANCIAL STATEMENTS

Note 2 – Cash and Assets Limited as to Use

Oregon Revised Statutes, Chapter 294, authorizes the District to invest in obligations of the U.S. Treasury, U.S. Government agencies and instrumentalities, bankers’ acceptances guaranteed by a qualified financial institution, commercial paper, corporate bonds, repurchase agreements, State of Oregon Local Government Investment Pool, and various interest-bearing bonds of Oregon and other municipalities. The District had the following cash and equivalents at June 30:

	2013	2012
Demand deposits	\$ 2,154,204	\$ 4,428,169
Petty cash	340	340
Certificates of deposit	76,099	76,074
Local Government Investment Pool	5,716,712	841,076
Total cash and cash equivalents	\$ 7,947,355	\$ 5,345,659

The District maintains their investments in the State of Oregon Local Government Investment Pool (LGIP), which is an alternate investment vehicle offered to participants that by law are made the custodian of, or have control of, any public funds. The investments are booked at fair value and are the same as the value of the pool shares. The LGIP investments are governed by a written investment policy that is reviewed annually by the Oregon Short-Term Fund Board. The Oregon Short-Term Fund Board is comprised of members of local government and private investment professionals, who are appointed by the Governor of the State of Oregon. The LGIP is not rated by any national rating service. The District considers all investments to be cash and cash equivalents.

All final decisions regarding the purchase and sale of investment securities remain with the District Board. The District maintains an investment policy designed to maximize return and limit the following types of risks:

Credit risk – The risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is typically measured by the assignment of a rating by a nationally recognized statistical rating organization.

Concentration of credit risk – The inability to recover the value of deposits, investments, or collateral securities in the possession of an outside party caused by a lack of diversification (investments acquired from a single issuer).

Interest rate risk – The possibility that an interest rate change could adversely affect an investment’s fair value.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL

NOTES TO THE FINANCIAL STATEMENTS

Note 2 – Cash and Investments (continued)

The carrying amounts of cash and cash equivalents are included in the District's balance sheets as follows at June:

	<u>2013</u>	<u>2012</u>
Cash and cash equivalents		
Current assets	\$ 1,929,862	\$ 2,870,167
Noncurrent assets (Note 4)	<u>6,017,493</u>	<u>2,475,492</u>
Total cash and cash equivalents	<u>\$ 7,947,355</u>	<u>\$ 5,345,659</u>

Note 3 – Reimbursement Arrangements with Third-Party Payors

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

Medicare – As a certified critical access hospital (CAH), the District is reimbursed for Medicare inpatient and outpatient services at the cost of providing the service plus 1% rather than on a fee schedule or the inpatient DRG and outpatient APC prospective payment system. Medicare swing-bed services are also reimbursed at cost for a CAH. The Hospital is paid at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

The District's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2012.

Net revenue billed under the Medicare program totaled approximately \$5,799,438 and \$4,665,810 for the years ended June 30, 2013 and 2012, respectively.

Medicaid – Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under cost reimbursement methodology. The District is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the District and audits thereof by the Medicaid fiscal intermediary. The District's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through June 30, 2011. Net revenue billed under the Medicaid program totaled approximately \$2,842,303 and \$2,202,413 for the years ended June 30, 2013 and 2012, respectively.

The District has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the District under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
NOTES TO THE FINANCIAL STATEMENTS

Note 3 – Reimbursement Arrangements with Third-Party Payors (continued)

Bad debt expense included in revenue deductions and allowances totaled \$619,645 and \$625,343 for 2013 and 2012, respectively.

Note 4 – Assets Limited as to Use

Noncurrent cash and cash equivalents were held for the following purposes as of June 30 (Note 2):

	2013	2012
Assets limited as to use		
Internally designated for:		
Capital acquisitions	\$ 1,248	\$ 1,356,015
Pharmacy inventory replacement	76,099	76,074
Operational reserves	5,380,618	484,129
Restricted by debt instruments, USDA reserve funds	51,538	51,284
Restricted by endowment provisions	507,990	507,990
Total assets limited as to use	\$ 6,017,493	\$ 2,475,492

Note 5 – Property Taxes Receivable

For the fiscal year June 30, 2013, the District levied their property taxes at the rate of \$2.0311 per \$1,000 of assessed property value. This levy was expected to raise \$2,087,267 in property tax revenues. Property tax revenues are recognized when levied, and are used to support general operations.

Fiscal Year	Receivable June 30, 2012	2012-2013 Net Levy	Collections	Interest Received	Discounts Allowed	Adjustments Applied	Receivable June 30, 2013
2012-2013	\$ -	\$ 2,087,267	\$ (1,939,127)	\$ 1,033	\$ (54,501)	\$ (796)	\$ 93,876
2011-2012	67,853	-	(35,904)	3,067	9	(864)	34,161
2010-2011	31,629	-	(14,485)	2,855	3	(454)	19,548
2009-2010	19,515	-	(11,429)	3,662	3	(487)	11,264
2008-2009	6,704	-	(4,339)	1,649	3	(468)	3,549
2007-2008	1,166	-	(294)	224	3	(443)	656
Prior Years	1,766	-	3	56	-	460	2,285
	\$ 128,633	\$ 2,087,267	\$ (2,005,575)	\$ 12,546	\$ (54,480)	\$ (3,052)	\$ 165,339

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL

NOTES TO THE FINANCIAL STATEMENTS

Note 6 – Capital Assets

The following is a summary of changes in capital assets during the fiscal year:

	Balance June 30, 2012	Additions/ Transfers	Retirements	Balance June 30, 2013
Capital assets at cost:				
Land	\$ 139,985	\$ 43,750	\$ -	\$ 183,735
Land improvements	1,026,581	-	-	1,026,581
Buildings and improvements	28,170,854	298,500	-	28,469,354
Moveable equipment	5,362,164	314,809	-	5,676,973
Software	718,300	14,600	-	732,900
Total capital assets at cost	35,417,884	671,659	-	36,089,543
Less accumulated depreciation and amortization for:				
Land improvements	451,665	76,863	-	528,528
Buildings and improvements	6,822,678	1,338,415	-	8,161,093
Moveable equipment	3,915,484	296,256	-	4,211,740
Software	197,325	234,922	-	432,247
Total accumulated depreciation	11,387,152	1,946,456	-	13,333,608
Capital assets, net	\$ 24,030,732	\$ (1,274,797)	\$ -	\$ 22,755,935
	Balance June 30, 2011	Additions/ Transfers	Retirements	Balance June 30, 2012
Capital assets at cost:				
Land	\$ 139,985	\$ -	\$ -	\$ 139,985
Construction	2,073,621	(2,073,621)	-	-
Land improvements	1,026,581	-	-	1,026,581
Buildings and improvements	24,870,538	3,300,316	-	28,170,854
Moveable equipment	4,628,442	733,722	-	5,362,164
Software	157,036	561,264	-	718,300
Total capital assets at cost	32,896,203	2,521,681	-	35,417,884
Less accumulated depreciation and amortization for:				
Land improvements	374,765	76,900	-	451,665
Buildings and improvements	5,660,442	1,162,236	-	6,822,678
Moveable equipment	3,469,403	446,081	-	3,915,484
Software	44,219	153,106	-	197,325
Total accumulated depreciation	9,548,829	1,838,323	-	11,387,152
Capital assets, net	\$ 23,347,374	\$ 683,358	\$ -	\$ 24,030,732

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
NOTES TO THE FINANCIAL STATEMENTS

Note 6 – Capital Assets (continued)

Construction in progress was related to the construction of an addition to and the remodel of the hospital building, which was completed during the year ended June 30, 2012. Depreciation and amortization expense for the years ended June 30, 2013 and 2012 was \$1,946,456 and \$1,838,323, respectively. Total cost of equipment under capital leases was \$1,164,998 and \$1,144,398 for the years ended June 30, 2013 and 2012, respectively. For the years ended June 30, 2013 and 2012, amortization expense of equipment under capital leases was \$234,922 and \$242,961 and accumulated amortization was \$521,478 and \$286,556, respectively.

Note 7 – Long-term Debt and Other Noncurrent Liabilities

The schedule of changes in the District's noncurrent liabilities for 2013 is as follows:

	Balance at June 30, 2012	Additions	Reductions	Balance at June 30, 2013	Due Within One Year
Notes payable:					
Sterling Bank - CT & ultrasound	\$ 84,842	\$ -	\$ (84,842)	\$ -	\$ -
State of Oregon - construction loan	2,860,647	-	(95,582)	2,765,065	100,150
Washington Federal - loan A	9,405,828	-	(165,889)	9,239,939	158,648
Washington Federal - loan B	1,045,350	-	(15,425)	1,029,925	14,333
USDA - general obligation bond	8,000,000	-	(148,720)	7,851,280	154,298
USDA - revenue bond	550,000	-	(6,138)	543,862	6,368
Total notes payable	21,946,667	-	(516,596)	21,430,071	433,797
Capitalized leases payable	653,846	-	(165,927)	487,919	173,470
Total long-term debt and noncurrent liabilities	<u>\$ 22,600,513</u>	<u>\$ -</u>	<u>\$ (682,523)</u>	<u>\$ 21,917,990</u>	<u>\$ 607,267</u>

The schedule of changes in the Hospital's noncurrent liabilities for 2012 follows:

	Balance at June 30, 2011	Additions	Reductions	Balance at June 30, 2012	Due Within One Year
Notes payable:					
Sterling Bank - CT & ultrasound	\$ 209,309	\$ -	\$ 124,467	\$ 84,842	\$ 84,842
Washington Federal - construction loan	10,500,000	-	10,500,000	-	-
State of Oregon - construction loan	2,950,000	-	89,353	2,860,647	95,581
US Bank - general obligation	8,000,000	-	8,000,000	-	-
Washington Federal - loan A	-	9,450,000	44,172	9,405,828	151,523
Washington Federal - loan B	-	1,050,000	4,650	1,045,350	13,522
USDA - general obligation bond	-	8,000,000	-	8,000,000	148,720
USDA - revenue bond	-	550,000	-	550,000	6,138
Total notes payable	21,659,309	19,050,000	18,762,642	21,946,667	500,326
Capitalized leases payable	811,931	-	158,085	653,846	165,926
Total long-term debt and noncurrent liabilities	<u>\$ 22,471,240</u>	<u>\$ 19,050,000</u>	<u>\$ 18,920,727</u>	<u>\$ 22,600,513</u>	<u>\$ 666,252</u>

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL

NOTES TO THE FINANCIAL STATEMENTS

Note 7 – Long-term Debt and Other Noncurrent Liabilities (continued)

The terms and due dates of the District's long-term debt, including capital lease obligations for the years ended June 30, 2013 and 2012 are as follows:

Sterling Bank note payable, due in monthly installments of \$10,833, including interest at 3.59% through March 2013; collateralized by equipment; paid off during the year ended June 30, 2013.

Washington Federal construction loan, due in monthly installments of interest only, including variable interest at a rate of 5.25% through February 1, 2012, collateralized by property. The variable interest rate is based on Prime plus two percent, with a floor of 5.00%. At June 30, 2011, the balance due on the South Valley Bank loan consisted of amounts that were drawn down for payment of construction in progress. The total funding available to the District under terms of the Note was \$10,500,000. On April 5, 2012, the District refinanced the construction loan through South Valley Bank (now Washington Federal). The loan was refinanced into two components in the amounts of \$9,450,000 and \$1,050,000. The terms of both loans are 30 years. The \$9,450,000 component is due in monthly installments of \$48,456, consisting of principal and interest at a rate initially set at 4.54%. On January 1, 2027, the interest rate will reset to 0.75% over the Farmer Mac 15-Year Reset Cost of Funds Index Net Yield, and will reset every 15 years thereafter.

The \$1,050,000 component is due in monthly installments of \$6,180, consisting of principal and interest at a variable rate initially set at 5.75%. The variable interest rate is set at Prime plus 2.5%, with a floor of 5.75% and a ceiling of the lesser of 9.75% or the maximum rate allowed by applicable law. The interest rate was 5.75% at each of the years ended June 30, 2013 and 2012.

State of Oregon, construction loan, due in annual installments estimated at \$232,320, including interest at 4.78% through December 1, 2030, collateralized by the full faith and credit and taxing power of the District, specifically revenue after the payment of expenses. The debt service payment is approximately based on 1.4% of total revenues and 1.3% of total expenses.

US Bank, Bond Anticipation Note (BAN), due in a lump sum on October 1, 2011 - extended to April 1, 2012 (Note 1) - with monthly interest payments at 2.65% that began on April 1, 2010, collateralized by General Obligation Bonds (G.O. bonds). In March of 2012, this loan was refinanced into permanent financing through the USDA by the issuance of general obligation bonds.

USDA general obligation bonds, dated March 13, 2012, in the amount of \$8,000,000 for the purpose of providing permanent financing for the funds initially borrowed through the US Bank Bond Anticipation Note (BAN). The bonds have a 30 year term and are due in annual installments of \$448,720, including principal and interest at 3.75% beginning March 13, 2013. The bonds are collateralized by the full faith and credit of the district and have a reserve account requirement of \$44,872 per year until \$448,720 has been accumulated. The District has accumulated \$51,538 in the reserve account as of June 30, 2013. Proceeds from the bonds were used to finance the District's building addition and remodel, which was completed during the year ended June 30, 2012 (Note 5).

**LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
NOTES TO THE FINANCIAL STATEMENTS**

Note 7 – Long-term Debt and Other Noncurrent Liabilities (continued)

US Bank capital lease comprised of two components, dated April 1, 2011 and July 1, 2011, respectively. The first component is due March 1, 2016 with monthly principal payments in varying amounts of \$11,176 in August 2011 to \$13,580 in March 2016 plus interest of 4.26%. The second component is due June 1, 2016 with monthly principal payments in varying amounts of \$1,782 in August 2011 to \$2,340 in June 2016 plus interest of 5.65%. The total net book value of assets secured by the capital lease obligation was \$643,520 and \$857,842 as of June 30, 2013 and 2012, respectively.

Scheduled principal and interest repayments on long-term debt and capital lease obligations are as follows:

Year	State of Oregon E.D. Project Loan		Capital Leases US Bank EMR		Washington Federal 2012 Loan A		Washington Federal 2012 Loan B	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2014	\$ 100,149	\$ 132,171	\$ 173,470	\$ 18,290	\$ 158,648	\$ 422,819	\$ 14,333	\$ 59,823
2015	104,937	127,383	181,361	10,400	166,107	415,360	15,191	58,965
2016	109,953	122,367	133,088	2,437	172,785	408,682	15,939	58,217
2017	115,209	117,111	-	-	182,039	399,428	17,055	57,101
2018	120,716	111,604	-	-	190,598	390,869	18,076	56,079
2019-2023	695,851	465,750	-	-	1,094,943	1,812,393	107,794	262,983
2024-2028	878,837	282,764	-	-	1,377,010	1,530,325	144,065	226,713
2029-2033	639,413	62,299	-	-	1,733,848	1,173,487	192,872	177,906
2034-2038	-	-	-	-	2,181,788	725,548	257,990	112,787
2039-2043	-	-	-	-	1,982,173	181,656	246,610	28,891
2044-2048	-	-	-	-	-	-	-	-
2049-2052	-	-	-	-	-	-	-	-
	<u>\$2,765,065</u>	<u>\$1,421,449</u>	<u>\$ 487,919</u>	<u>\$ 31,127</u>	<u>\$ 9,239,939</u>	<u>\$ 7,460,567</u>	<u>\$1,029,925</u>	<u>\$1,099,465</u>
	USDA General Obligation Bond		USDA Revenue Bond		Long-Term Debt Total			
	Principal	Interest	Principal	Interest	Principal	Interest		
2014	\$ 154,296	\$ 294,423	\$ 6,371	\$ 20,395	\$ 607,267	\$ 947,921		
2015	160,084	288,637	6,066	20,156	633,746	920,901		
2016	166,087	282,634	6,855	19,908	604,707	894,245		
2017	172,315	276,405	7,112	19,651	493,730	869,696		
2018	178,777	269,944	7,379	19,384	515,546	847,880		
2019-2023	999,619	1,243,985	41,260	92,559	2,939,467	3,877,670		
2024-2028	1,201,641	1,041,963	49,598	84,218	3,651,151	3,165,983		
2029-2033	1,444,491	799,110	59,622	74,196	4,070,246	2,286,998		
2034-2038	1,736,423	507,178	71,672	62,147	4,247,873	1,407,660		
2039-2043	1,637,547	156,288	86,156	47,662	3,952,486	414,497		
2044-2048	-	-	103,568	30,249	103,568	30,249		
2049-2052	-	-	98,203	9,320	98,203	9,320		
	<u>\$7,851,280</u>	<u>\$5,160,567</u>	<u>\$ 543,862</u>	<u>\$ 499,845</u>	<u>\$21,917,990</u>	<u>\$15,673,020</u>		

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL

NOTES TO THE FINANCIAL STATEMENTS

Note 8 – Related Party

Related party – Goose Lake Medical Services, Inc. (the Corporation) is a legally separate, tax-exempt corporation. The Corporation provides healthcare services to patients in the southern Oregon and northern California areas. The District and the Corporation have shared board members and officers. The District provided \$59,362 and \$88,987 in services and supplies to the Corporation during the years ended June 30, 2013 and 2012, respectively.

The District Board authorized an increase in the line of credit available to the Corporation from \$300,000 to \$550,000 in March 2013. Outstanding receivables from the Corporation are \$433,038 and \$179,038 at June 30, 2013 and 2012, respectively, and are included in other receivables on the balance sheet. At June 30, 2013, the District recorded an allowance in the full amount of the receivable outstanding. The interest rate is 4% and the note balance is payable on demand.

Note 9 – Contingent Liabilities

General and professional liability – The District maintains primary and umbrella general and professional liability insurance coverage “claims-made” type policies. Current coverage is for \$1,000,000 per claim with a \$5,000,000 annual aggregate limit, plus \$1,000,000 annual excess coverage per claim with a \$1,000,000 annual aggregate. There are no significant deductibles or coinsurance clauses.

Accounting principles generally accepted in the United States of America require that a health care facility disclose the estimated costs of malpractice claims in the period of the incident of malpractice if it is reasonably possible that liabilities may be incurred and losses can be reasonably estimated. Management is not aware of any potential liabilities that would exceed its coverage at June 30, 2013.

Laws and regulations – The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and billing regulations. Government activity with respect to investigations and allegations concerning possible violations of such regulations by health care providers has increased. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayment for patient services previously billed. Management believes that the District is in compliance with applicable government laws and regulations.

While no significant regulatory inquiries have been made of the District, 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.

**LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
NOTES TO THE FINANCIAL STATEMENTS**

Note 9 – Contingent Liabilities (continued)

The Centers for Medicare and Medicaid Services (CMS) has implemented a project using recovery audit contractors (RAC) as part of CMS’s further efforts to ensure accurate payments. RACs search for potentially inaccurate Medicare payments that might have been made to health care providers and that were not detected through existing CMS program integrity efforts. Once a RAC identifies a claim it believes is inaccurate, the RAC makes a deduction from or addition to the provider’s Medicare reimbursement in an amount estimated to equal the overpayment or underpayment. The District may either accept or appeal the RAC’s findings. RAC reviews of the District’s Medicare claims are anticipated; however, the outcomes of such reviews are unknown, and any financial impact cannot be reasonably estimated at June 30, 2013.

Risk management – The District is also exposed to various risks of loss from torts, theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; and natural disasters; medical malpractice; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Note 10 – Patient Accounts Receivable

The District grants credit without collateral to its patients, most of who are local residents and insured under third-party payor agreements. The majority of these patients are geographically concentrated in and around Lake County. No single patient comprises more than five percent of the total receivable at year end.

Patient accounts receivable reported as current assets by the District at June 30, 2013 and 2012 consisted of these amounts:

	<u>2013</u>		<u>2012</u>	
Medicare	\$ 1,173,279	30%	\$ 958,949	27%
Medicaid	371,901	9%	668,979	18%
Other third-party payors	1,703,044	44%	1,278,308	35%
Self-pay	<u>669,918</u>	<u>17%</u>	<u>711,115</u>	<u>20%</u>
	3,918,142	100%	3,617,351	100%
Less:				
Allowance for contractual adjustments	(807,739)		(550,200)	
Allowance for bad debt	<u>(253,373)</u>		<u>(288,864)</u>	
Patient accounts receivable - net	<u>\$ 2,857,030</u>		<u>\$ 2,778,287</u>	

LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL

NOTES TO THE FINANCIAL STATEMENTS

Note 11 – Retirement Plans

Defined contribution plan – The District provides pension benefits for all of its part-time and full-time employees who have worked at least one year through a defined contribution plan. In a defined contribution plan, benefits depend solely on amounts contributed by the District to the plan plus investment earnings. Some employees are eligible to participate only if they agree to contribute to the deferred compensation plan. Each pay period, the District contributes six percent of the employee’s compensation. The contributions are vested at 20% after two years of service with graduated increases until vesting reaches 100% after six years of service. Unvested portions of District contributions and interest forfeited by employees who leave employment before six years of service are used to reduce the District’s current period contribution requirement. The District made the required contributions of \$335,442 and \$353,495 for the years ended June 30, 2013 and 2012, respectively.

Deferred compensation plan – In addition to the defined contribution plan described above, the District provides a deferred compensation plan to substantially all employees under section 403(b) of the Internal Revenue Code. The deferred compensation plan is funded solely from employee contributions, which are deposited with an insurance company. These assets may only be used for the payment of plan liabilities. Funds deposited with the insurance company by the individual employees were \$103,755 and \$174,372, for the years ended June 30, 2013 and 2012, respectively.

Note 12 – Leases

The District is committed under various leases for equipment. These leases are considered operating leases for accounting purposes. Lease expenses for the years ended June 30, 2013 and 2012 amounted to \$264,372 and \$263,464, respectively. Future minimum payments under non-cancellable operating leases with initial or remaining terms in excess of one year are as follows:

Years ending June 30,	2014	\$	43,696
	2015		24,940
	2016		24,940
	2017		10,540
			<hr/>
		\$	104,116
			<hr/> <hr/>

Note 13 – Health Care Reform

As a result of enacted federal and state health care reform legislation, substantial changes are anticipated in the United States health care system. Such legislation includes numerous provisions affecting the delivery of health care services, the financing of health care costs, reimbursement of health care providers and the legal obligations of health insurers, providers and employers. These provisions are slated to take effect at specified times over approximately the next decade. This federal health care reform legislation did not significantly affect the 2013 financial statements.

SUPPLEMENTARY INFORMATION

**LAKE HEALTH DISTRICT dba LAKE DISTRICT HOSPITAL
SCHEDULE OF ADOPTED APPROPRIATIONS AND EXPENDITURES
ORIGINAL AND FINAL BUDGET AND ACTUAL
YEAR ENDED JUNE 30, 2013**

	Actual	Budgetary Amendment	Budgetary Basis	Original/Final Budget	Variance
Revenues					
Total revenues except property taxes	\$ 19,582,362	\$ -	\$ 19,582,362	\$ 23,867,511	\$ 4,285,149
Property tax revenue	2,107,290	-	2,107,290	1,978,810	(128,480)
Total revenues	<u>21,689,652</u>	<u>-</u>	<u>21,689,652</u>	<u>25,846,321</u>	<u>4,156,669</u>
Expenditures					
Personal services	10,878,107	-	10,878,107	11,478,491	600,384
Materials and services	5,999,737	-	5,999,737	7,255,361	1,255,624
Capital only	1,946,456	(1,274,797)	671,659	550,000	(121,659)
Debt service	962,287	682,523	1,644,810	715,058	(929,752)
Total expenditures	<u>19,786,587</u>	<u>(592,274)</u>	<u>19,194,313</u>	<u>19,998,910</u>	<u>804,597</u>
Excess of expenditures over resources	1,903,065	592,274	2,495,339	5,847,411	3,352,072
Other financing sources (uses)					
Other financing sources (uses)	-	-	-	(1,090,849)	(1,090,849)
Total other financing sources (uses)	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,090,849)</u>	<u>(1,090,849)</u>
Excess of revenues over expenditures (expenditures over revenues) and other financing sources (uses)	<u>\$ 1,903,065</u>	<u>\$ 592,274</u>	2,495,339	4,756,562	2,261,223
FUND BALANCE, beginning of year			9,139,424	-	9,139,424
FUND BALANCE, end of year			<u>\$ 11,634,763</u>	<u>\$ 4,756,562</u>	<u>\$ 11,400,647</u>

INDEPENDENT AUDITOR'S COMMENTS

To the Board of Directors
Lake Health District

We have audited the accompanying financial statements of Lake Health District dba Lake District Hospital (the District) as of June 30, 2013, and for the year then ended and have issued our report thereon dated December 31, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, and the provisions of the Minimum Standards for Audits of Oregon Municipal Corporations, prescribed by the Secretary of State. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance

Compliance with laws, regulations, contracts, and grants applicable to the District is the responsibility of the District's management. As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, including provisions of Oregon Revised Statutes (ORS) as specified in Oregon Administrative Rules OAR 162-10-000 to 162-10-330, as set forth below, noncompliance with which could have a direct and material effect on the determination of financial statement amounts:

- The accounting systems and related internal control structure.
- The amount and adequacy of collateral pledged by depositories to secure the deposit of public funds.
- The requirements relating to debt, if any, and the limitation on the debt amount, liquidation of debt within the prescribed period of time, and provisions of indentures or agreements, including restrictions on the use of monies available to retire the indebtedness.
- The requirements relating to the preparation, adoption and execution of the annual budget for the current fiscal year and the preparation and adoption of the budget for the next succeeding fiscal year.
- The requirements relating to insurance and fidelity bond coverage.
- The appropriate laws, rules, and regulations pertaining to programs funded wholly or partially by other governmental agencies.
- The statutory requirements pertaining to the investment of public funds.
- The requirements pertaining to the awarding of public contracts and the construction of public improvements.

INDEPENDENT AUDITOR'S COMMENTS (continued)

However, providing an opinion on compliance with those provisions was not an objective of our audit. Accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Minimum Standards for Audits for Oregon Municipal Corporations, prescribed by the Secretary of State, except as noted below.

Accounting Records and Internal Control (OAR 162-010-0230)

A summary of recommendations made to improve or strengthen the accounting records and internal control has been made by management letter to the District's Board of Directors.

This report is intended solely for the information and use of management, the Board of Directors and the Secretary of State, Division of Audits of the State of Oregon and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in blue ink that reads "Tony Andrews". The signature is written in a cursive style with a long horizontal stroke at the beginning.

for Moss Adams LLP
Portland, Oregon
December 31, 2013

**REPORT OF INDEPENDENT AUDITORS 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 Directors of
Lake Health District

Report on the Financial Statements

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Lake Health District (the District) which are comprised of the balance sheet as of June 30, 2013, and the related statements of revenues, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the financial statements and have issued our report thereon dated December 31, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District'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 that a material misstatement of the entity'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. 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.

**REPORT OF INDEPENDENT AUDITORS 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 (continued)**

Compliance and Other Matters

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

Purpose of this Report

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



for Moss Adams LLP
Portland, Oregon
December 31, 2013