

LAKE HEALTH DISTRICT
dba
Lake District Hospital & Long Term Care Facility
aka
Lakeview Home Health & Hospice
Lake District Medical Office
Lake District Health Center

Management's Discussion and Analysis

Our discussion and analysis of Lake Health District, dba Lake District Hospital & Long Term Care Facility's (District) financial performance provides an overview of the District Hospital's financial activities for the fiscal year ended on June 30, 2005. Please read it in conjunction with the Hospital's financial statements that follow this analysis.

The District Hospital is a governmental entity and a political subdivision of the State of Oregon. It was created by the Oregon legislature to provide hospital services 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 Hospital facility opened its doors in 1971. The District operates a 21-bed acute care hospital, an attached 47-bed skilled long term care facility, a home health and hospice service, outpatient clinic services, provides through leases physician clinic facilities, and buildings to support those operations. The District services include the acute care hospital, obstetrical services, surgery, emergency room, and related ancillary services (lab, x-ray, etc.) associated with these services.

A 5-member board of directors governs the District. The members of the board are elected for a term of 4 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 and secretary. 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.

The District is a municipal government entity. As such, the District levies and the county collects property taxes from property owners within Lake Health District. These tax revenues are used to support the purpose of the District, which is to provide health care to its members. However, tax support is minimal representing approximately five percent of hospital receipts.

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

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Issues Facing the Health 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
- Labor shortages for healthcare professionals in nursing and other healthcare related fields
- Increasing employee benefit costs, especially health insurance
- Increasing numbers of uninsured and underinsured patients
- High liability and malpractice insurance premiums
- Concern about access to affordable capital for future facility development or renovation
- Concern about retaining and recruiting primary care physicians
- High liability and malpractice costs affecting primary care physician practices
- Difficulty recruiting and maintaining specialty physician services in the community

The 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 48.6 percent of the gross patient revenue for FY ending June 30, 2005 was derived from Medicare and 18.9 percent were derived from Medicaid.

As a Critical Access Facility since December 2001, payments for Medicare and Medicaid hospital services have been paid on a cost basis. Actual interim payment is computed on a percentage of charges, derived from the most recent filed Medicare Statement of Reimbursable Cost.

Medicare compensates the District on fixed rates for different classifications of Skilled Nursing and Home Health Services. Also, Hospice services and physician services are paid at fixed rates or fee schedules. When the reimbursement is fixed, the hospital lost money on any cases that the 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 their 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 from each one 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 meet these laws can result in the exclusion of Medicare and Medicaid funds along with fines and criminal penalties.

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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 hospital must also protect against reasonable foreseeable threats to the security or integrity of the information and protect against unauthorized use or disclosure. Again, penalties are high with the loss of Medicare and Medicaid funds, fines and criminal sanctions.

General Risks Affecting Healthcare 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 Hospital 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 Hospital is a major employer within the community, employing a complex mix of professional, technical, clerical, maintenance, dietary, housekeeping, union and non-union workers. Risks include contract disputes, discrimination claims, personal tort actions, work-related injuries and exposure to hazardous materials to name a few of the potential issues. A nursing shortage, as well as other medical professional/technical employees, is another issue that is causing higher salaries, requiring the usage of agency staff at a premium wage rate.

Competition

Even in a rather isolated geographic location, competition from other hospitals and healthcare providers are a risk to the hospital'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 hospital's business leaving hospital with product lines or services that are losing money.

Insurance

Malpractice costs for hospitals and physicians have increased significantly over the last 6 years. These increases have caused providers to leave certain geographic areas and certain specialties. In Oregon, with no

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cap on malpractice damages, the exposure is high for healthcare providers resulting in substantially higher premiums.

Financial Highlights

The Hospital's overall business remained stable with gross patient revenue at \$12.8 million. The net patient revenue increased \$0.5 million or 5.1%. Non-patient revenues increased \$148,199 or 23.4%. Revenue deductions, allowances and bad debts have reduced gross patient revenue by \$ 2.7 million or 21.0% of gross patient revenue. These reductions are largely the result of contractual adjustment and allowances with Medicare \$ 1.4 million and Medicaid \$ 0.8 million, comprising 80.9% of total revenue deductions.

In total, including non-patient activities, the Hospital's expenses increased by \$0.6 million or 5.8%. Salary and wages increased \$ 243 thousand or 5.6%. Employees benefit expense increased by \$210 thousand or 16.9%. This increase was predominantly due to increases of health insurance costs.

The Hospital had net (loss) of (\$101,183) in 2004 and a gain of \$245,881 in 2005.

Net accounts receivable decreased slightly from \$1.46 million in 2004 to \$1.41 million. The District continues to maintain an effective accounts receivable, collection and processing system.

Lake District spent \$391,426 in capital expenditures in 2005, an increase of \$215,806 or 123% from 2004. Capital Expenditures included the purchase of a 1600 square foot building totaling \$102,841. Additional Expenditures included a Video Processor, Electric Beds, Cardiac Monitor Defibrillator, new Chemistry Analyzer, Lab Information System, an Injector System, Anesthesia Unit, Data Processing Software and a Hospital Vehicle. With the exception of the building, these expenditures were for routine equipment replacement and/or upgrades and investments in new equipment to help keep the hospital functioning at a high level. The Building was purchased for expansion needs of the District. The District has been fortunate to receive grant funds from a local foundation. Collins McDonald provided \$120,000 for capital needs. Additional proceeds were received from state and federal grants.

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Condensed financial information for the years ended June 30, 2005 June 30, 2004 & June 30, 2003 are as follows:

Table 1: Assets, Liabilities, and Net Assets

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Assets:			
Current assets	\$ 4,128,044	\$ 4,180,065	\$ 3,732,603
Capital assets, net	2,590,764	2,718,110	3,047,441
Other non-current assets	<u>2,600,481</u>	<u>2,549,819</u>	<u>2,510,232</u>
Total assets	<u>\$ 9,319,289</u>	<u>\$ 9,447,994</u>	<u>\$ 9,290,276</u>
Liabilities:			
Long-term debt outstanding	\$ 124,984	\$ 270,987	\$ 419,373
Other current and non-current liabilities	<u>1,048,653</u>	<u>1,278,548</u>	<u>895,225</u>
Total liabilities	<u>\$ 1,173,637</u>	<u>\$ 1,549,535</u>	<u>\$ 1,314,598</u>
Net assets:			
Unrestricted	\$ 5,235,096	\$ 4,988,417	\$ 4,892,674
Capital assets, net of related debt	2,319,798	2,308,200	2,505,123
Temporarily restricted	204,588	215,672	191,711
Permanently restricted	<u>386,170</u>	<u>386,170</u>	<u>386,170</u>
Total net assets	<u>\$ 8,145,652</u>	<u>\$ 7,898,459</u>	<u>\$ 7,975,678</u>

Table 2: Operating Results and Changes in Net Assets

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Operating Revenues:			
Net patient service revenues	\$ 10,098,768	\$ 9,318,520	\$ 8,611,569
Other operating revenues	<u>60,202</u>	<u>56,799</u>	<u>460,588</u>
Total operating revenues	<u>10,158,970</u>	<u>9,375,319</u>	<u>9,072,157</u>
Operating Expenses:			
Salaries and benefits	6,043,336	5,590,476	5,499,765
Depreciation and amortization	510,504	504,652	545,231
Supplies	1,114,457	1,011,266	861,113
Other operating expenses	<u>3,025,220</u>	<u>3,002,345</u>	<u>2,382,932</u>
Total operating expenses	<u>10,693,517</u>	<u>10,108,739</u>	<u>9,289,041</u>
Loss from Operations	<u>(534,547)</u>	<u>(733,420)</u>	<u>(216,884)</u>
Non-operating Revenues (Expenses)			
Taxation	575,764	557,988	563,105
Lease income	43,779	47,372	49,380
Contributions	116,547	9,127	9,255
Other non operating gains/<Losses>	<u>44,338</u>	<u>17,750</u>	<u>22,936</u>
Total non-operating gains, net	<u>780,428</u>	<u>632,237</u>	<u>644,676</u>
Increase (Decrease) in net assets	\$ 245,881	\$ (105,631)	\$ 427,792
Net assets, beginning of year	7,898,459	7,975,678	7,421,414
Restricted Contributions, Net of Disbursements	794	20,946	122,610
Interest Earned on Restricted Net Assets	<u>518</u>	<u>3,018</u>	<u>3,862</u>
Net assets, end of year	<u>\$ 8,145,652</u>	<u>\$ 7,898,459</u>	<u>\$ 7,975,678</u>

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