

Washington State Auditor's Office
Financial Statements Audit Report

**Chelan County Public Hospital District
No. 2
(Lake Chelan Community Hospital)**

Audit Period
January 1, 2012 through December 31, 2012

Report No. 1010958

Issue Date
December 30, 2013



WASHINGTON
TROY KELLEY
STATE AUDITOR



**Washington State Auditor
Troy Kelley**

December 30, 2013

Board of Commissioners
Lake Chelan Community Hospital
Chelan, Washington

Report on Financial Statements

Please find attached our report on the Lake Chelan Community Hospital's financial statements.

We are issuing this report in order to provide information on the District's financial condition.

Sincerely,

TROY KELLEY
STATE AUDITOR

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**Lake Chelan Community Hospital
Chelan County
January 1, 2012 through December 31, 2012**

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Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

**Lake Chelan Community Hospital
Chelan County
January 1, 2012 through December 31, 2012**

Board of Commissioners
Lake Chelan Community Hospital
Chelan, Washington

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the financial statements of the Lake Chelan Community Hospital, Chelan County, Washington, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated November 20, 2013. During the year ended December 31, 2012, the District implemented Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*.

INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audits 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 District'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.

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 the District's 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 District'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 District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose. However, this report is a matter of public record and its distribution is not limited. It also serves to disseminate information to the public as a reporting tool to help citizens assess government operations.



TROY KELLEY
STATE AUDITOR

November 20, 2013

Independent Auditor's Report on Financial Statements

Lake Chelan Community Hospital Chelan County January 1, 2012 through December 31, 2012

Board of Commissioners
Lake Chelan Community Hospital
Chelan, Washington

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Lake Chelan Community Hospital, Chelan County, Washington, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed on page 5.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District'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 District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Lake Chelan Community Hospital, as of December 31, 2012 and 2011, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Matters of Emphasis

As discussed in Note 1 to the financial statements, in 2012, the District adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. Our opinion is not modified with respect to this matter.

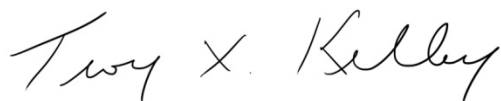
Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 13 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 REPORTING REQUIRED BY GOVERNMENT AUDITING STANDARDS

In accordance with *Government Auditing Standards*, we have also issued our report dated November 20, 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.



TROY KELLEY
STATE AUDITOR

November 20, 2013

Financial Section

**Lake Chelan Community Hospital
Chelan County
January 1, 2012 through December 31, 2012**

REQUIRED SUPPLEMENTARY INFORMATION

Management's Discussion and Analysis – 2012 and 2011

BASIC FINANCIAL STATEMENTS

Balance Sheets – 2012 and 2011

Statements of Revenues, Expenses and Changes in Net Position – 2012 and 2011

Statements of Cash Flows – 2012 and 2011

Notes to Financial Statements – 2012 and 2011

Chelan County Public Hospital District No. 2 d/b/a Lake Chelan Community Hospital

Management's Discussion and Analysis

See Accountant's Compilation Report



LAKE CHELAN COMMUNITY HOSPITAL DISTRICT MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis is intended to provide an interpretive context to enhance the reader's awareness and understanding of some of the issues influencing the organization's financial position for the year ended December 31, 2012. This overview represents management's perspective on these issues and should be viewed as a source of information complimentary to the financial statements themselves.

Chelan County Public Hospital District No. 2 (The District) is a non-profit, municipal corporation, which includes Lake Chelan Community Hospital, Lake Chelan Community Apartments, Home Health, and an Ambulance Company. The District is a Critical Access Hospital (CAH) licensed for 34 beds, but held to 25 in-patient CAH requirements. The District serves a population base of over 10,000. The hospital has operated since 1948 and became a hospital district in 1969. The current facility was constructed in 1972 with a third floor added to the hospital in 1994.

CAH status for the Hospital has a favorable impact on District finances. Medicare and Medicaid reimbursement is cost based and therefore typically higher than what the District would otherwise receive under a fixed, DRG or APC-driven, prospective payment system (PPS). The District receives tax revenue representing approximately 4.6% of 2012's gross patient receipts: \$672,978 hospital levy and \$746,559 EMS levy.

The District is governed by a five member elected board of directors. Day-to-day operations are managed by the Chief Executive Officer. The District employed 182 FTE's on December 31, 2012, and had an annual payroll of \$14.9M including benefits.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Management's Discussion and Analysis

See Accountant's Compilation Report

Issues Facing the District

The challenges facing Lake Chelan Community Hospital District in 2012 are largely similar, although varying in degree of intensity, to those issues facing the health care industry in general and for small, rural hospitals in particular. Where the immediate environment and circumstances uniquely influence the District, these areas are also highlighted in the discussion below:

- **Indigent and Uncompensated Care:** Uncompensated care is a national issue that impacts the District. Health care reform is designed to increase the number of insured under Medicaid and decrease uncompensated care.
- **Health Information Technology:** Centers for Medicare & Medicaid Services (CMS) have issued a mandate with punitive results if health care providers do not fully comply with Electronic Health Record requirements by 2015. The District has a robust health information technology system and has met CMS meaningful use requirements.

In summary, the external environment continues to challenge hospitals and small rural hospitals in particular with uncompensated care and health information technology. At the same time, The District's employees working together continue to find ways to make progress on improving how the District organizes and processes work in such a way that we continue to improve clinical care and service to our patients and community all the while striving to improve our financial positioning and overall performance.

Financial Highlights Executive Overview

The District finished 2012 with a profit of \$509,239.

Lake Chelan Community Hospital made the following capital purchases in 2012: Colonoscope, Arthroscopy tower, Color video printer and Vital signs monitor for the OR for \$132,641; ACLS manual Defibrillator and 2000 Ford Explorer replacement engine for EMS for \$61,364; 14 Stryker beds for the Sanctuary for \$58,266; 6 Wall mounted monitors for patient rooms and Nihon Khoden with two monitors for \$27,593; Chevy Pickup with snow plow, Bio-Med Testing equipment and Tractor with loader and blade for Plant for \$22,999; Barracuda backup server and Nortel phone system upgrade for IT for \$20,404; EDIE interface software with CPSI and Nihon Khoden monitor for the ER for \$16,561; Linear Array Transducer for Anesthesiology for \$8,709; Alarm Pro Lockdown system for the hospital for \$8,056.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Management's Discussion and Analysis

See Accountant's Compilation Report

Comparisons of 2012 Actual to Budget and Prior Year Performance

Net patient service revenue was \$19,109,000 in 2012 which was a 4.2% increase over the prior year and a 1.27% decrease over budget. The net increase is attributed to the changes in total patient services revenue as reflected in the total patient services gross revenue table below. Total operating expenses were under budget by 0.3% and over the prior year by 3.6%.

	LAKE CHELAN COMMUNITY HOSPITAL		
	<u>Actual</u>	<u>Budget</u>	<u>Variance</u>
Ambulance	\$ 1,887,590	\$ 1,798,376	4.96%
Home Health	451,459	464,653	-2.84%
Med Surg	1,790,641	1,834,772	-2.41%
Surgery	1,047,371	1,131,577	-7.44%
Emergency Room	3,754,159	3,962,212	-5.25%
Anesthesiology	598,558	521,213	14.84%
Labor & Delivery	647,657	634,364	2.10%
Respiratory Therapy	1,116,211	2,116,730	-47.27%
Physical Therapy	915,170	667,752	37.05%
Laboratory	2,604,131	2,450,607	6.26%
Radiology	3,177,673	3,023,277	5.11%
Sanctuary	3,580,931	3,378,218	6.00%
Pharmacy	2,866,161	3,068,749	-6.60%
All Others	6,793,376	6,578,835	3.26%
Totals	<u>\$ 31,231,088</u>	<u>\$ 31,631,335</u>	<u>-1.27%</u>

Overview of the Financial Statements

The District's financial statements consist of three statements: Balance sheet; statement of revenue, expenses, and changes in net position; and a statement of cash flows. These financial statements and related notes provide information about the activities of the District, including resources held by the District but restricted for specific purposes.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Management's Discussion and Analysis

See Accountant's Compilation Report

Required Financial Statements

All of the revenue and expenses for years 2012 and 2011 are accounted for in the statements of revenue, expenses, and changes in net position. The statements can be used to determine whether the District has successfully recovered all of its costs through its patient service revenue and other revenue sources. Revenue and expenses are reported on an accrual basis, which means the related cash could be received or paid in a subsequent period. Over time, increases or decreases in the District's net position are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the Hospital's patient base and measures of quality of service it provides to the community, as well as local economic factors, to assess the overall health of the District.

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

The District's financial statements report information of the District using accounting methods similar to those used by private sector health care organizations. These statements offer short-term and long-term information about its activities. The statements of net position include all of the District's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to District's creditors (liabilities). The statements of net position also provide the basis for evaluating the capital structure of the District's and assessing the liquidity and financial flexibility of the District.

The Balance Sheet and Statement of Revenue, Expenses and Changes in Net Position

One of the most important questions asked about the District's finances is, "Is the District as a whole better or worse off as a result of the year's activities?" The balance sheet and the statement of revenue, expenses and changes in net position report information about the District's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted asset and liabilities using the accrual basis of accounting. All of the current year's revenue and expenses are taken into account regardless of when cash is received or paid.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Management's Discussion and Analysis

See Accountant's Compilation Report

The Balance Sheet and Statement of Revenue, Expenses and Changes in Net Position (Continued)

These two statements report the District's net position and changes. You can think of the District's net position the difference between assets and liabilities as one way to measure the District's financial health, or financial position. Over time, increases or decreases in the District's net position are one indicator of whether its financial health is improving or deteriorating. You will need to consider other non-financial factors, however, such as changes in the District's patient base and measure of the quality of service it provides to the community, and local economic factors to assess the overall health of the District.

The Statement of Cash Flows

The final required statement is the Statement of Cash Flows. Cash Flow Statements report cash receipts, cash payments and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?", "What was cash used for?", and "What was the change in cash balance during the reporting period?"

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Management's Discussion and Analysis

See Accountant's Compilation Report

The Financial Analysis of the District

The following is a presentation of certain financial information derived from the District's Balance Sheet:

The balance sheet shows a decrease of \$498,188 in current assets from 2011 to 2012. The filed Medicare cost report indicates the Medicare and Medicaid settlements to be in the amount of \$250,879 receivable and \$167,769 payable, respectively. Noncurrent assets show an increase of \$982,465 from 2011 to 2012. Long term debt had a decrease of \$327,508 while current liabilities had an increase of \$249,166. Capital lease obligations decreased \$42,369 from 2011 to 2012.

	2012	2011	2010
ASSETS			
Current assets	\$ 4,803,406	\$ 5,301,594	\$ 6,086,859
Noncurrent assets	3,713,490	2,731,025	3,408,764
Capital assets - Net	9,597,120	9,680,112	9,290,806
Other assets	360,257	373,014	334,474
Total assets	<u>\$ 18,474,273</u>	<u>\$ 18,085,745</u>	<u>\$ 19,120,903</u>
LIABILITIES			
Current liabilities	\$ 2,505,412	\$ 2,256,246	\$ 3,932,851
Long term debt less current maturities	7,460,000	7,787,508	8,091,208
Capital lease obligation less current portion	54,912	97,281	137,081
Total liabilities	<u>10,020,324</u>	<u>10,141,035</u>	<u>12,161,140</u>
NET POSITION			
Invested in capital assets, net of related debt	1,751,686	1,514,215	947,064
Restricted	129,933	129,704	129,513
Unrestricted	6,572,330	6,300,791	5,883,186
Total net position	<u>8,453,949</u>	<u>7,944,710</u>	<u>6,959,763</u>
Total liabilities and net position	<u>\$ 18,474,273</u>	<u>\$ 18,085,745</u>	<u>\$ 19,120,903</u>

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Management's Discussion and Analysis

See Accountant's Compilation Report

Operating Results and Changes in the District's Net Position

The following is a presentation of certain financial information derived from the District's statements of revenue, expenses and changes in net position:

Overall, the District had an increase of net position of \$509,239 from 2011 to 2012.

	2012	2011	2010
OPERATING REVENUES			
Net patient service revenue	\$ 19,109,140	\$ 18,330,753	\$ 17,560,207
Other operating revenue	547,783	711,734	281,950
Total operating revenues	19,656,923	19,042,487	17,842,157
OPERATING EXPENSES			
Salaries and benefits	14,906,028	13,833,786	12,529,766
Professional fees	639,337	521,134	569,729
Medical supplies and drugs	1,569,284	1,584,413	1,423,866
Purchased services	733,839	865,951	632,485
Insurance	324,882	328,020	309,837
Other operating expenses	1,602,610	1,805,886	1,500,061
Depreciation and amortization	751,377	701,504	678,375
Total operating expenses	20,527,357	19,640,694	17,644,119
OPERATING INCOME (LOSS)	(870,434)	(598,207)	198,038
NON OPERATING REVENUES - NET	1,343,230	1,583,154	1,446,141
Capital Grants and Contributions	36,443	-	-
CHANGE IN NET POSITION	509,239	984,947	1,644,179
NET POSITION - Beginning of year	7,944,710	6,959,763	5,315,584
NET POSITION - End of year	\$ 8,453,949	\$ 7,944,710	\$ 6,959,763

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Management's Discussion and Analysis

See Accountant's Compilation Report

The District's Statement of Cash Flows

The following is a presentation of certain financial information derived from the District's Statements of Cash Flows:

The District ended the year with an increase in cash flow of \$1,021,619.

	2012	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES			
Net cash provided by (used) in operating activities	\$ 679,633	\$ (1,426,810)	\$ 2,269,351
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Net cash provided by noncapital financing activities	1,493,330	1,673,971	1,469,758
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Net cash used in capital and related financing activities	(1,096,956)	(1,603,685)	(1,217,312)
CASH FLOWS FROM INVESTING ACTIVITIES			
Net cash provided by investing activities	19,126	33,277	44,894
Net increase (decrease) in cash and cash equivalents	1,095,133	(1,323,247)	2,566,691
Cash and cash equivalents - Beginning of year	4,010,001	5,116,198	2,549,507
Cash and cash equivalents - End of year	<u>\$ 4,888,084</u>	<u>\$ 3,792,951</u>	<u>\$ 5,116,198</u>

Contacting the District's Financial Management

This financial report provides our patients, suppliers, taxpayers and creditors with a general overview of Lake Chelan Community Hospital District's finances and shows the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's Administrative Office at Lake Chelan Community Hospital, 503 E. Highland Avenue, Chelan, Washington.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Balance Sheets

December 31, 2012 and 2011

<i>Assets</i>	2012	2011
Current assets:		
Cash and cash equivalents	\$ 1,151,698	\$ 1,039,030
Noncurrent assets required for current liabilities	22,896	22,896
Receivables:		
Patient accounts - Less allowance for uncollectible accounts and contractual adjustments of \$2,308,000 in 2012 and \$2,678,000 in 2011	2,668,113	2,681,266
Taxes	86,740	125,399
Estimated third-party payor settlements	533,486	943,270
Other	1,280	208,649
Inventories	212,228	211,404
Prepaid expenses	126,965	69,680
Total current assets	4,803,406	5,301,594
Assets limited as to use:		
Noncurrent cash and cash equivalents:		
Restricted for capital improvements	129,934	129,704
Internally designated for EMS	154,284	114,305
Internally designated for capital acquisitions	3,452,168	2,509,912
Total assets limited to use	3,736,386	2,753,921
Less - Assets required for current liabilities	22,896	22,896
Net noncurrent assets limited as to use	3,713,490	2,731,025
Capital assets:		
Depreciable capital assets - Net of accumulated depreciation	3,541,243	3,935,714
Nondepreciable capital assets	6,055,877	5,744,398
Total capital assets - Net of accumulated depreciation	9,597,120	9,680,112
Other assets:		
Deferred financing costs	56,509	62,022
Lake Chelan Community Apartment assets	303,748	310,992
Total other assets	360,257	373,014
TOTAL ASSETS	\$ 18,474,273	\$ 18,085,745

The accompanying notes are an integral part of this financial statement.

<i>Liabilities and Net Position</i>	2012	2011
Current liabilities:		
Current maturities - Long-term debt	\$ 327,508	\$ 303,700
Current portion - Capital lease obligations	42,369	41,547
Accounts payable	241,238	268,212
Employee compensation and related liabilities	407,207	433,465
Estimated third-party payor settlements	200,004	-
Accrued vacation	1,071,501	874,566
Accrued interest payable	33,880	35,837
Deferred revenue	181,705	298,919
Total current liabilities	2,505,412	2,256,246
Long-term debt - Less current maturities	7,460,000	7,787,508
Capital lease obligations - Less current portion	54,912	97,281
Total liabilities	10,020,324	10,141,035
Net position:		
Net invested in capital assets	1,751,686	1,514,215
Restricted expendable net position	129,933	129,704
Unrestricted	6,572,330	6,300,791
Total net position	8,453,949	7,944,710

TOTAL LIABILITIES AND NET POSITION	\$ 18,474,273	\$ 18,085,745
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The accompanying notes are an integral part of this financial statement.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Statements of Revenue, Expenses, and Changes in Net Position

Years Ended December 31, 2012 and 2011

	2012	2011
Operating revenue:		
Patient service revenue (net of contractual adjustments and discounts)	\$ 20,218,184	\$ 20,108,072
Provision for bad debt	(1,109,044)	(1,777,319)
Ancillary services, outpatient		
Rental receipts		
Net patient service revenue	19,109,140	18,330,753
Revenue deductions and allowances, including provision for bad debts of \$1,109,044 in 2012 and \$1,777,319 in 2011		
Net patient service revenue	19,109,140	18,330,753
Other operating revenues:		
SWAP	-	-
Other operating revenue	547,783	711,734
Total operating revenue	19,656,923	19,042,487
Operating expenses:		
Salaries and wages	12,144,521	11,351,521
Employee benefits	2,761,507	2,482,265
Professional fees	639,337	521,134
Supplies	1,569,284	1,584,413
Purchased services - Utilities	198,300	195,005
Purchased services - Other	733,839	865,951
Insurance	324,882	328,020
Repairs and maintenance	522,029	568,225
Rent	266,205	288,518
Other	616,076	754,138
Depreciation and amortization	751,377	701,504
Total operating expenses	20,527,357	19,640,694
Loss from operations	(870,434)	(598,207)

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Statements of Revenue, Expenses, and Changes in Net Position

Years Ended December 31, 2012 and 2011

	2012	2011
Loss from operations brought forward	\$ (870,434)	\$ (598,207)
Nonoperating revenues (expenses):		
Interest earnings	8,405	7,275
Interest expense	(148,721)	(166,630)
Noncapital grants and contributions	65,969	227,608
Gain (loss) on disposal of assets	(12,688)	23,617
Other		
Property tax	1,419,544	1,465,282
Lake Chelan Community Apartment assets rental revenue - Net of expenses	10,721	26,002
Nonoperating revenues - Net	1,343,230	1,583,154
Excess of revenue over expenses	472,796	984,947
Capital grants and contributions	36,443	-
Increase in net position	509,239	984,947
Net position - Beginning of year	7,944,710	6,959,763
Net position - End of year	\$ 8,453,949	\$ 7,944,710

The accompanying notes are an integral part of this financial statement.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Statements of Cash Flows

Years Ended December 31, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Receipts from and on behalf of patients	\$ 19,732,081	\$ 16,776,545
Receipts from other operating revenue	547,783	711,734
Payments to employee	(14,735,351)	(13,725,841)
Payments to suppliers, contractors, and others	(4,864,880)	(5,189,248)
Net cash provided by (used in) operating activities	679,633	(1,426,810)
Cash flows from noncapital financing activities:		
Property taxes for operations	1,458,203	1,475,116
Receipts from donations and other nonoperating revenues	65,969	227,608
Other	5,513	5,515
Principal paid on long-term debt	(30,986)	(29,478)
Interest paid on long-term debt	(5,369)	(4,790)
Net cash provided by noncapital financing activities	1,493,330	1,673,971
Cash flows from capital and related financing activities:		
Capital grants and contributions	36,443	-
Principal paid on long-term debt	(272,714)	(291,182)
Principal paid on capital lease obligations	(41,547)	(37,451)
Proceeds from sale of assets	18,419	65,099
Interest paid	(145,309)	(163,804)
Payments for purchase of property, buildings and equipment	(699,492)	(1,132,292)
Payments on escrow accounts related to property held for future expansion	7,244	(44,055)
Net cash used in capital and related financing activities	(1,096,956)	(1,603,685)
Cash flows from investing activities:		
Cash received from Lake Chelan Community Apartment assets - Net	10,721	26,002
Interest received	8,405	7,275
Net cash provided by investing activities	19,126	33,277
Net increase (decrease) in cash and cash equivalents	1,095,133	(1,323,247)
Cash and cash equivalents - Beginning of year	4,010,001	5,116,198
Cash and cash equivalents - End of year	\$ 5,105,134	\$ 3,792,951

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Statements of Cash Flows (Continued)

Years Ended December 31, 2012 and 2011

	2012	2011
Reconciliation of loss from operations to net cash provided by (used in) operating activities:		
Loss from operations	\$ (870,434)	\$ (598,207)
Adjustments to reconcile loss from operations to net cash provided by (used in) operating activities:		
Depreciation and amortization	751,377	701,504
Provision for bad debts	(370,000)	502,997
Change in operating assets and liabilities:		
Receivables:		
Patient accounts	383,153	102,179
Estimated third-party payor settlements	409,784	(374,723)
Other	207,369	(206,857)
Inventories	(824)	656
Prepaid expenses	(57,285)	105,671
Warrants payable	-	(318,674)
Accounts payable	(26,974)	36,441
Employee compensation and related liabilities	(26,258)	32,230
Estimated third-party payor settlements	200,004	(1,784,661)
Accrued vacation	196,935	75,715
Deferred revenue	(117,214)	298,919
Total adjustments	1,550,067	(828,603)
Net cash provided by (used in) operating activities	\$ 679,633	\$ (1,426,810)

The accompanying notes are an integral part of this financial statement.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 1 **Summary of Significant Accounting Policies**

The Entity

Chelan County Public Hospital District No. 2 owns and operates Lake Chelan Community Hospital (the "District"), a licensed 34-bed acute care hospital in Chelan, Washington. The District provides acute care and clinical services to patients in the Chelan market. The services include acute care, hospital inpatient and outpatient surgery, obstetrics, ambulance, emergency room, home health, physician, behavioral health, chemical dependency, and the related ancillary procedures (lab, x-ray, therapy, etc.) associated with those services.

Financial Statement Presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) as prescribed by the Government Accounting Standards Board (GASB).

The accounting records of the District are maintained in accordance with methods prescribed by the State Auditor under the authority of Chapter 43.09 RCW and the Department of Health in the *Accounting and Reporting Manual for Hospitals*. The District's statements are reported using the economic resources measurement focus and full-accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred regardless of the timing of the cash flows. Property taxes are recognized as revenue in the year in which they are levied. Grants and similar items are recognized as revenue as soon as eligibility requirements imposed by the provider have been met.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 1 **Summary of Significant Accounting Policies** (Continued)

Cash and Cash Equivalents

All cash receipts are deposited directly into the District's depository bank account. Periodically, such cash is transferred to the Chelan County Treasurer who acts as the District's Treasurer. Warrants are issued by the District against the cash placed with the County Treasurer, and the warrants are redeemed from a commercial bank by the County Treasurer. At the direction of the District, the County Treasurer invests cash in certificates of deposit, money market funds, and other short-term investments until it is necessary to redeem warrants. For purposes of the statements of cash flows, the District considers all cash and cash investments with maturity dates of less than ninety days as cash and cash equivalents.

Patient Accounts Receivable and Credit Policy

Patient accounts receivable are uncollateralized patient obligations that are stated at the amount management expects to collect from outstanding balances. These obligations are primarily from local residents, most of whom are insured under third-party payor agreements. 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 co-pay and deductible amounts that are the patients' responsibility. Payments on patient accounts receivables 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.

Patient accounts receivable are recorded in the accompanying balance sheets net of contractual adjustments and allowance for uncollectable accounts which reflect management's best estimate of the amounts that will not be collected. The carrying amounts of patient accounts receivables 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 accounts receivable. In addition, management provides for probable uncollectible amounts, primarily from uninsured patients and amounts patients are personally responsible for, through a reduction of gross revenue and a credit to the allowance for uncollectable accounts.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 1 **Summary of Significant Accounting Policies** (Continued)

Patient Accounts Receivable and Credit Policy (Continued)

In evaluating the collectability of patient accounts receivable, the District analyzes past results and identifies trends for each of its major payor sources of revenue to estimate the appropriate allowance for uncollectable accounts and provision for bad debts.

Management regularly reviews data from the major payor sources revenue in evaluating the sufficiency of the allowance for uncollectable accounts. Specifically, for receivables associated with services provided to patients who have third-party coverage, the District analyzes contractually due amounts and provides an allowance for uncollectable accounts and a provisions for bad debts for expected uncollectible deductibles and copayments on accounts for which the third-party payor has not yet paid, or for payors who are known to be having financial difficulties that make the realization of amounts due unlikely. For receivables associated with self-pay patients (which includes both patients without insurance and patients with deductible and copayment balances due for which third-party coverage exists for part of the bill), the District records a significant provision for bad debts in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or discounted rates if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is charged off against the allowance for uncollectable accounts.

Property Taxes

The District has the authority to impose taxes on property within the boundaries of the health care district. Taxes are received from Chelan County (the "County"). Ad Valorem taxes and per parcel assessments are levied by the County on the District's behalf on January 1 and are intended to finance the District's activities of the same year. Taxes are payable in two equal installments on April 30 and October 31.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 1 Summary of Significant Accounting Policies (Continued)

Inventories

Inventories of supplies are stated at cost (FIFO), which is considered lower than market value. Inventories consist of pharmaceutical, medical-surgical, and other supplies used in the operation of the District.

Noncurrent Assets Limited as to Use

Noncurrent assets are comprised of certain cash and cash equivalents and other resources set aside for specific purposes due to restrictions placed on them. Board designated assets include assets set aside by the Board of Commissioners for future capital improvements or other designated purposes. Board designated and restricted assets that are required for obligations classified as current liabilities are reported as current assets.

Capital Assets

Capital acquisitions are recorded at cost or, if donated, at fair value at the date of donation. The District capitalizes all assets with a cost of \$5,000 or greater. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included with depreciation expense in the accompanying financial statements.

The estimated useful lives of capital assets are as follows:

Land improvements	3 to 52 years
Buildings and fixed equipment	5 to 40 years
Major moveable equipment	3 to 20 years
Software	3 to 5 years

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 1 **Summary of Significant Accounting Policies** (Continued)

Asset Impairment

Capital assets are reviewed for impairment when events or changes in circumstances suggest that the service utility of the capital asset may have significantly and unexpectedly declined. Capital assets are considered impaired if both the decline in service utility of the capital asset is large in magnitude and the event or change in circumstance is outside the normal life cycle of the capital asset. Such events or changes in circumstances that may be indicative of impairment include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage. The determination of the impairment loss is independent of the event or circumstance in which the impairment occurred. Impairment losses, if any, are recorded in the statements of revenue and expenses and changes in net position. No impairment losses were recorded in 2012 and 2011.

Land Held for Future Expansion

Land held for future expansion is stated at cost. Related replacement reserve and property insurance and tax escrow account balances are included with property held for future expansion.

Deferred Financing Costs

Deferred financing costs are legal, accounting, underwriting fees, printing costs, and other expenses associated with the issuance of the limited tax general obligation bonds. Such costs are amortized over the term of the bonds.

Compensated Absences

The Annual Leave (AL) program at the District provides eligible personnel with appropriate compensation during sick time, holidays and vacation time. The District accrues annual leave for compensated absences as an expense and liability when earned based on the employee's status. The maximum allowable amount of AL time for each employee is twice their annual accrual.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 1 **Summary of Significant Accounting Policies** (Continued)

Compensated Absences (Continued)

AL balances, which have been accrued in a prior calendar year but not used during a subsequent calendar year, will accrue to a two-year maximum. A payout of 80 hours is made only if the employee has used 80 hours in a year. All employees who terminate their employment, with proper notice, will be paid unused AL hours at the regular rate of pay upon completion of three years of employment.

The sick leave program provides employees with appropriate compensation for illnesses for themselves or an eligible family member. The maximum allowable balance of sick leave is 480 hours. The District pays out 25% of the accrued balance (480 maximum) at termination of employment after three years of benefited employment status.

Net Position

Net position of the District is classified into three components. Net investment in capital assets consist of capital assets net of accumulated depreciation 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 creditors, grantors, or contributors external to the District. Unrestricted net position is remaining net position that does not meet the definition above.

Patient Service Revenue

The District recognizes patient service revenue associated with services provided to patients who have third-party payor coverage on the basis of contractual rates for the services rendered. Certain third-party payor reimbursement agreements are subject to audit and retrospective adjustments. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. For uninsured patients that do not qualify for charity care, the District recognizes revenue basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of historical experience, a significant portion of the District's uninsured patients will be unable or unwilling to pay for the services provided. Thus, the District records a significant provision for bad debts related to uninsured patients in the period the services are provided.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 1 **Summary of Significant Accounting Policies** (Continued)

Grants and Contributions

From time to time, the District receives grants from Chelan County and the State of Washington as well as contributions from individuals and private organizations. Revenue from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

Charity Care

The District provides health care services 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 the amounts of charges forgone for services and supplies furnished under the charity care policy. Because the District does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue

SWAP Revenue

The District received Public Hospital Disproportionate Share SWAP funds from the Washington State Department of Social and Health Services (DSHS) to maintain and or expand access to services for low-income and Medicaid eligible patients. The revenue is recorded as a contra contractual adjustment.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 1 **Summary of Significant Accounting Policies** (Continued)

Electronic Health Records Incentive Payments

The American Recovery and Reinvestment Act of 2009 ("ARRA") provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and physician practices that demonstrate meaningful use of certified electronic health record ("EHR") technology. These provisions of ARRA, collectively referred to as the Health Information Technology for Economic and Clinical Health Act (the "HITECH Act"), are intended to promote the adoption and meaningful use of health information technology and qualified EHR technology.

The District recognizes revenue for EHR incentive payments when there is reasonable assurance that the District will meet the conditions of the program. For Medicaid purposes, the District may request and receive the first incentive payments as they adopt, implement, upgrade, and demonstrate meaningful use of certified EHR technology. In order to claim the first Medicare payment, the District must actually demonstrate meaningful use of certified EHR technology for the applicable period. The demonstration of meaningful use is based on meeting a series of objectives. Meeting the series of objectives in order to demonstrate meaningful use becomes progressively more stringent as its implementation is phased in through stages as outlined by the Centers for Medicare and Medicaid Services (CMS).

Amounts recognized under the Medicare and Medicaid EHR incentive programs are based on management's best estimates, which are based in part on cost report data that is subject to audit by fiscal intermediaries; accordingly, amounts recognized are subject to change. In addition, the District's attestation of its compliance with the meaningful use criteria is subject to audit by the federal government or its designee.

The District incurs both capital expenditures and operating expenses in connection with the implementation of its EHR initiative. The amount and timing of these expenditures does not directly correlate with the timing of the District's receipt or recognition of the EHR incentive payments.

The District has deferred a portion of the payment received under the Medicare EHR program. The deferred revenue is being amortized and recognized as revenue over four years, which is the period the software would have been depreciated and cost reimbursed through the cost report.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 1 **Summary of Significant Accounting Policies** (Continued)

Operating Revenue and Expenses

The District's statements of revenue, expenses, and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenue result from exchange transactions associated with providing health care services, the District's primary business. Non-exchange revenue, including taxes, and grants and contributions received for purposes other than capital assets acquisition are reported as non-operating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expense totaled \$40,653 and \$43,219 in 2012 and 2011, respectively.

Tax Status

The District operates under the laws of the state of Washington for Washington municipal corporations. As organized, the District is exempt from payment of federal income tax on operations or activities under Section 115 of the Internal Revenue Code. All District assets, liabilities, and financial transactions are included in these financial statements.

New Accounting Pronouncements

In June 2011, the Government Accounting Standards Board (GASB) issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, to 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. The District has adopted this guidance as December 31, 2012. The adoption of this policy had no impact on the recording of changes in net position.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 1 **Summary of Significant Accounting Policies** (Continued)

Reclassifications

Certain reclassifications of 2011 amounts have been made in the accompanying financial statements to conform to 2012 presentation.

Subsequent Events

Subsequent events have been evaluated through the date of the opinion, which is the date the financial statements were available to be issued. During this period, there were no subsequent events requiring recognition in the financial statements, however, there was an event which requires additional disclosure. See Note 17 for additional information on the subsequent event.

Note 2 **Compliance**

Management believes the District is in substantial compliance with current laws and regulation through year ended December 31, 2012.

Note 3 **Cash and Cash Equivalents**

The District maintains depository relationships with area financial institutions that are Federal Depositary Insurance Corporation (FDIC) insured institutions. On November 9, 2010, the FDIC issued a final rule implementing Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which provides for unlimited insurance coverage of non-interest-bearing transaction accounts through December 31, 2012. In addition, the District maintains cash in interest-bearing accounts at these institutions. The accounts are insured by the FDIC up to \$250,000. Beginning January 1, 2013, non-interest bearing transaction accounts will be included with depositor's other accounts at the applicable financial institution, with the aggregate balance insured up to \$250,000. At December 31, 2012, the District did exceed the insured limits in 2012.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 3 Cash and Cash Equivalents (Continued)

The Revised Code of Washington, Chapter 39, authorizes municipal governments to invest their funds in a variety of investments including federal, state, and local government certificates, notes, or bonds; the Washington State Local Government Investment Pool (PDPC); savings accounts in qualified public depositories; and certain other investments.

Custodial credit risk – Custodial credit risk is the risk that, in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a deposit policy for custodial credit risk. The District's deposits and certificates of deposit are covered by federal depository insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the PDPC.

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). The District does not have a policy limiting the amount it may invest in any one issuer or multiple issuers.

At December 31, the District's had bank balances as follows:

	2012	2011
Insured (FDIC)(PDPC)	\$ 4,807,809	\$ 4,009,276
Uncollateralized	223,811	725
Totals	\$ 5,031,620	\$ 4,010,001
Carrying value	\$ 5,031,620	\$ 4,010,001

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 3 Cash and Cash Equivalents (Continued)

The carrying amounts of deposits shown above are included in the District's balance sheets as follows at December 31:

	2012	2011
Included in the following balance sheet captions:		
Cash and cash equivalents	\$ 1,151,698	\$ 1,039,030
Assets limited as to use:	3,736,386	2,753,921
Carrying value	\$ 4,888,084	\$ 3,792,951

Note 4 Patient Accounts Receivable

The mix of patient accounts receivable at December 31 is as follows:

	2012	2011
Receivables from patients and their insurance carriers	\$ 3,447,701	\$ 3,667,408
Receivables from Medicare	1,283,203	1,283,789
Receivables from Medicaid	245,209	408,069
Total patient accounts receivable	4,976,113	5,359,266
Less:		
Contractual adjustments	498,000	584,000
Allowance for uncollectible accounts	1,810,000	2,094,000
Patient accounts receivable - Net	\$ 2,668,113	\$ 2,681,266

The District's allowance for uncollectable accounts for self-pay patients remained consistent at 87% of self pay accounts receivable at December 31, 2012 and 2011. In addition, the District's self-pay write-offs decreased \$668,275 from \$1,777,319 for year 2011 to \$1,109,044 for year 2012. The District has not changed its charity care or uninsured discount policies during years 2011 or 2012. The District does not maintain a material allowance for uncollectable accounts from third-party payors, nor did the District have significant write-offs from third-party payors.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 5 Property Taxes

The District received approximately 4.50% and 4.68% of total revenue from property taxes in 2012 and 2011, respectively. These funds were used as follows:

	2012	2011
Levied to support operations	\$ 1,419,544	\$ 1,465,282

The District is permitted by law to levy up to \$0.75 per \$1,000 of assessed valuation for general district purposes. Washington State Constitution and Washington State Law, RCW 84.55.010, limit the rate. The District may also levy taxes at a lower rate. Further, amounts of tax need to be authorized by the vote of the people.

Note 5 Property Taxes (Continued)

For 2012, the District's general tax levy was \$.2682856731 per \$1,000 on a total assessed valuation of \$2,405,451,184 for a total general levy of \$645,348. Additionally, the District's EMS tax levy was \$.310000 per \$1,000 on a total assessed valuation of \$2,405,451,184 for a total EMS levy of \$745,690.

For 2011, the District's general tax levy was \$.2453413 per \$1,000 on a total assessed valuation of \$2,582,524,615 for a total general levy of \$633,600. Additionally, the District's EMS tax levy was \$.310000 per \$1,000 on a total assessed valuation of \$2,582,524,615 for a total EMS levy of \$800,583.

Property taxes are recorded as receivables when levied. Since State law allows for the sale of property for failure to pay taxes, no estimate of uncollectible taxes is made.

Note 6 Reimbursement Arrangements With Third-Party Payors

The District provides services to patients under contractual agreements with the Medicare and Medicaid programs. Differences between gross revenue charged and reimbursement under each of the various programs are included in contractual adjustments. A summary of the basis of reimbursement with major third-party payors follows: Gross revenue billed under the programs totaled \$15,653,938 and \$15,745,716 for 2012 and 2011, respectively.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 6 Reimbursement Arrangements With Third-Party Payors (Continued)

Medicare and Medicaid – The District's hospital is designated as a CAH. As such, all inpatient, swing bed, and outpatient hospital services are paid based on a cost reimbursement method, with the exception of certain types of laboratory and therapy services, which are reimbursed on a prospectively determined fee schedule. Professional services provided by physicians and other clinicians continue to be reimbursed on prospectively determined fee schedules.

Others – 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.

Accounting for Medicare and Medicaid Contractual Arrangements – The District is reimbursed for cost-reimbursable items at interim rates, with final settlements determined after audit of the related annual cost reports by the respective Medicare and Medicaid fiscal intermediaries. Estimated provisions to approximate the final expected settlements after review by the intermediaries are included in the accompanying financial statements. The District's Medicare and Medicaid cost reports have been audited and tentatively settled through 2009.

Electronic Health Record Incentive Funding

For the year ended December 31, 2011, the District received \$416,133 in EHR incentive payments from the Medicare program. In 2011, and 2012, the District recognized \$117,214 each year of deferred revenue from the Medicare EHR incentive program. This amount is included in other operating revenue in the accompanying 2012 and 2011 statements of revenue, expenses, and changes in net position. As of December 31, 2012, deferred revenue from the Medicare EHR incentive payment totaled \$181,705.

As of December 31, 2012 and 2011 the District received Medicaid EHR incentive payments totaling \$248,446 and \$397,513, respectively. The Medicaid EHR incentive payment is recognized as other operating revenue the year it is received

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 6 Reimbursement Arrangements With Third-Party Payors (Continued)

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 substantial compliance with applicable current laws and regulations.

The Centers for Medicare and Medicaid Services (CMS) uses recovery audit contractors (RACs) to search for potentially inaccurate Medicare payments that may have been made to health care providers and 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. As of December 31, 2012, the District has not been notified by the RAC of any potential significant reimbursement adjustments.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 7 Capital Assets

Capital asset additions, retirements, and balances for the following at December 31:

	Balance January 1, 2012	Additions/ Transfers	Retirements	Balance December 31, 2012
Nondepreciable capital assets:				
Land	\$ 34,785	\$ -	\$ -	\$ 34,785
Land held for future expansion	4,133,845	-	-	4,133,845
Construction in progress	1,575,768	311,479	-	1,887,247
Total nondepreciable capital assets	5,744,398	311,479	-	6,055,877
Depreciable capital assets:				
Land improvements	461,334	-	-	461,334
Buildings	5,149,510	-	-	5,149,510
Building service and fixed equipment	916,701	-	441	916,260
Equipment	4,367,354	388,013	116,513	4,638,854
Software	758,365	-	-	758,365
Total depreciable capital assets	11,653,264	388,013	116,954	11,924,323
Total capital assets before depreciation	17,397,662	699,492	116,954	17,980,200
Less accumulated depreciation for:				
Land improvements	316,793	12,861	-	329,654
Buildings	3,158,752	178,531	-	3,337,283
Building service and fixed equipment	755,950	12,800	-	768,750
Equipment	3,098,979	396,082	85,848	3,409,213
Software	387,076	151,104	-	538,180
Total accumulated depreciation	7,717,550	751,378	85,848	8,383,080
Total capital assets - Net	\$ 9,680,112	\$ (51,886)	\$ 31,106	\$ 9,597,120

At December 31, 2012, construction in progress consisted of new planning costs related to a replacement hospital. The District estimates the costs of building a replacement hospital to total \$30 million. The District is committed to the project and plans to fund the project by issuing revenue bonds. The replacement hospital is estimated to be completed in 2015.

Chelan County Public Hospital District No. 2

d/b/a Lake Chelan Community Hospital

Notes to Financial Statements

See Accountant's Compilation Report

Note 7 Capital Assets (Continued)

Capital asset additions, retirements, and balances for the year ended December 31, 2011, are as follows:

	Balance January 1, 2011	Additions/ Transfers	Retirements	Balance December 31, 2011
Nondepreciable capital assets:				
Land	\$ 34,785	\$ -	\$ -	\$ 34,785
Land held for future expansion	4,133,845	-	-	4,133,845
Construction in progress	1,245,141	366,987	36,360	1,575,768
Total nondepreciable capital assets	5,413,771	366,987	36,360	5,744,398
Depreciable capital assets:				
Land improvements	461,334	-	-	461,334
Buildings	5,121,782	27,728	-	5,149,510
Building service and fixed equipment	1,097,767	(181,066)	-	916,701
Equipment	3,914,860	591,097	138,603	4,367,354
Software	430,819	327,546	-	758,365
Total depreciable capital assets	11,026,562	765,305	138,603	11,653,264
Total capital assets before depreciation	16,440,333	1,132,292	174,963	17,397,662
Less accumulated depreciation for:				
Land improvements	290,751	26,042	-	316,793
Buildings	2,976,220	182,532	-	3,158,752
Building service and fixed equipment	760,164	(4,214)	-	755,950
Equipment	2,853,954	378,506	133,481	3,098,979
Software	268,438	118,638	-	387,076
Total accumulated depreciation	7,149,527	701,504	133,481	7,717,550
Total capital assets - Net	\$ 9,290,806	\$ 430,788	\$ 41,482	\$ 9,680,112

Chelan County Public Hospital District No. 2

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Notes to Financial Statements

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Note 8 Long-Term Debt and Capital Lease Obligations

A schedule of changes in the District's long-term debt and capital lease obligations at December 31 is as follows:

	Balance January			Balance	Amounts Due
	1, 2012	Additions	Reductions	December 31, 2012	Within One Year
Bonds and notes payable:					
1998 LTGO Bonds	\$ 215,000	\$ -	\$ 105,000	\$ 110,000	\$ 110,000
2001 LTGO Bonds	480,000	-	45,000	435,000	45,000
2006 LTGO Bonds	2,040,000	-	100,000	1,940,000	100,000
2009 LTGO Bonds	5,230,000	-	-	5,230,000	-
LCCH Apartment mortgage	62,069	-	22,714	39,355	39,355
Promissory note	64,139	-	30,986	33,153	33,153
Total long-term debt	8,091,208	-	303,700	7,787,508	327,508
Capital lease obligations:					
Horiba Financial Services	20,648	-	10,726	9,922	9,922
Philips Medical Cap	118,180	-	30,821	87,359	32,447
Total capital lease obligations	138,828	-	41,547	97,281	42,369
Total long-debt and capital lease obligations	\$ 8,230,036	\$ -	\$ 345,247	\$ 7,884,789	\$ 369,877

Chelan County Public Hospital District No. 2

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Notes to Financial Statements

See Accountant's Compilation Report

Note 8 Long-Term Debt and Capital Lease Obligations (Continued)

	Balance January 1, 2011	Additions	Reductions	Balance December 31, 2011	Amounts Due Within One Year
Bonds and notes payable:					
1998 LTGO Bonds	\$ 315,000	\$ -	\$ 100,000	\$ 215,000	\$ 105,000
2001 LTGO Bonds	550,000	-	70,000	480,000	45,000
2006 LTGO Bonds	2,140,000	-	100,000	2,040,000	100,000
2009 LTGO Bonds	5,230,000	-	-	5,230,000	-
LCCH Apartment mortgage	83,251	-	21,182	62,069	22,714
Promissory note	93,617	-	29,478	64,139	30,986
Total long-term debt	8,411,868	-	320,660	8,091,208	303,700
Capital lease obligations:					
Horiba Financial Services	28,963	-	8,315	20,648	9,922
Philips Medical Cap	147,316	-	29,136	118,180	31,625
Total capital lease obligations	176,279	-	37,451	138,828	41,547
Total long-debt and capital lease obligations	\$ 8,588,147	\$ -	\$ 358,111	\$ 8,230,036	\$ 345,247

Chelan County Public Hospital District No. 2

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Notes to Financial Statements

See Accountant's Compilation Report

Note 8 Long-Term Debt and Capital Lease Obligations (Continued)

The terms and due dates of the District's long-term debt, including capital lease obligations, at December 31, 2012 and 2011, follows:

Long-Term Debt

Limited Tax General Obligation Refunding Bonds, dated December 1, 1998 due in annual principal installments of \$110,000 in 2013, plus interest at varying rates from 4.85% to 5.25%, payable June 1 and December 1 each year; bonds are subject to redemption prior to their stated dates of maturities beginning December 1, 2009.

Limited Tax General Obligation Bonds, dated March 15, 2001, due in varying annual principal installments of \$45,000 in 2013 to \$50,000 in 2021, plus interest at varying rates from 4.25% to 5.25%, payable June 1 and December 1 each year; bonds maturing on or after December 1, 2012, are subject to optional redemption prior to their stated maturity dates on or after December 1, 2011 at par plus accrued interest to the date of such redemption.

Limited Tax General Obligation Bonds, dated July 10, 2006, due in varying annual principal installments of \$100,000 in 2013 to \$185,000 in 2026, plus interest at varying rates from 3.9% to 4.75%, payable June 1 and December 1 each year; bonds maturing on or after December 1, 2011, are subject to optional redemption prior to their stated maturity dates on or after June 1, 2011, at par plus accrued interest to the date of such redemption.

Limited Tax General Obligation Bonds, dated October 1, 2009, due in varying annual principal installments of \$70,000 beginning in 2016 to \$570,000 in 2034, plus interest at varying rates from 4.15% to 4.75%, payable June 1 and December 1 each year; bonds maturing on or after December 1, 2011, are subject to optional redemption prior to their stated maturity dates on or after June 1, 2011 at par plus accrued interest to the date of such redemption.

LCCH Apartment mortgage payable to Housing and Urban Development, due in monthly installments of \$2,195, including interest at 7.0% with a balloon payment due August 1, 2013.

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Notes to Financial Statements

See Accountant's Compilation Report

Note 8 Long-Term Debt and Capital Lease Obligations (Continued)

Long-Term Debt (Continued)

Promissory note payable related to settled lawsuit, due in annual installments of \$34,268 beginning in May 2004 through May 2013, including interest at 5%.

Capital Lease Obligations

Lease obligation to Philips Medial Capital due in monthly installments of \$4,297 in 2013 through July 2015, including interest at 5.15% collateralized by equipment at a cost of \$199,934, with accumulated depreciation of \$40,096

Lease obligation to Horiba Financial Services due in monthly installments of \$827 in 2013 through November 2013, collateralized by equipment at a cost of \$30,292, with accumulated depreciation of \$6,075.

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

Years Ending December 31,	Bonds and Notes Payable			Capital Lease Obligation		
	Principal	Interest	Total	Principal	Interest	Total
2013	\$ 327,508	\$ 397,051	\$ 724,559	\$ 42,369	\$ 3,743	\$ 46,112
2014	150,000	381,784	531,784	34,159	2,030	36,189
2015	155,000	375,190	530,190	20,753	358	21,111
2016	235,000	368,278	603,278	-	-	-
2017	245,000	357,805	602,805	-	-	-
2018-2022	1,425,000	1,596,887	3,021,887	-	-	-
2023-2027	1,810,000	1,204,572	3,014,572	-	-	-
2028-2032	2,330,000	685,298	3,015,298	-	-	-
2033-2037	1,110,000	90,303	1,200,303	-	-	-
Total	\$ 7,787,508	\$ 5,457,168	\$ 13,244,676	\$ 97,281	\$ 6,131	\$ 103,412

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Notes to Financial Statements

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Note 9 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 December 31, 2012 and 2011 amounted to \$91,989 and \$123,931, respectively.

Note 10 Risk Management

The District is one of a number of Washington hospitals who are members of the Washington Casualty Company (WCC). WCC is a wholly owned subsidiary of Coverys, a nonprofit mutual insurance corporation used for payment of liability claims.

The WCC policy provides protection on a "claims-made" basis whereby only malpractice claims reported to the insurance carriers in the current year are covered by the current policy. Although there exists the possibility of claims arising from services provided to patients through December 31, 2012, which have not yet been asserted, the District is unable to determine the ultimate cost if any, of such possible claims and, accordingly, no provision has been made. If there are unreported incidents which result in a malpractice claim in the current year, such claims will be covered in the year the claim is reported to the insurance carriers only if the District purchases claims-made insurance in that year or the District purchases "tail" insurance to cover claims incurred before but reported to the insurance carrier after cancellation or expiration of a claims-made policy.

The policy's limits provide \$1,000,000 per claim of primary coverage with a \$5,000,000 annual aggregate limit. WCC also provides excess coverage of \$4,000,000 per claim with \$4,000,000 annual aggregate. There are no significant deductible or coinsurance clauses for this policy.

The District is also exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees; and natural disasters. The District carries commercial insurance for these risks of loss. Settled claims resulting from these risks have not exceeded the commercial insurance coverage in any of the past three years.

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Notes to Financial Statements

See Accountant's Compilation Report

Note 10 **Risk Management** (Continued)

Workers' Compensation

The District participates in the self-insured Public Hospital District Workers' Compensation Trust, which is administered by the Washington State Hospital Association. The District pays its share of actual injury claims, maintenance of reserves, administrative expenses, and reinsurance premiums. Amounts paid by the District for workers' compensation expense were \$143,666 and \$121,919 for 2012 and 2011, respectively.

Unemployment

The District participates in the self-insured Public Hospital District Unemployment Compensation Fund, which is administered by the Washington State Hospital Association. The District pays its share of actual unemployment claims, maintenance of reserves, and administrative expenses.

Payments by the District charged to unemployment expense were \$45,216 and \$61,410 for 2012 and 2011, respectively.

Dental Plan

Effective January 1, 2004, the District has a self-insured dental plan for its employees, which is administered by the Guardian Life Insurance Company. The District pays its share of actual dental claims, maintenance of reserves, and administrative expenses. Payments by the District charged to dental expenses were \$79,300 and \$35,667 in 2012 and 2011, respectively.

Note 11 **Charity Care**

The District provides health care services and other financial support through various programs that are designed, among other matters, to enhance the health of the community including the health of low-income patients. Consistent with the mission of the District, health care is provided to patients regardless of their ability to pay, including providing services to those persons who cannot afford health insurance because of inadequate resources.

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Notes to Financial Statements

See Accountant's Compilation Report

Note 11 **Charity Care** (Continued)

Patients who meet certain criteria for charity care, generally based on federal poverty guidelines, are provided care based on criteria defined in the District's charity care policy. The District maintains records to identify and monitor the level of charity care it provides. The amount of charges foregone for services and supplies furnished under the District's charity care policy aggregated \$360,577 and \$364,208 for the years ended December 31, 2012 and 2011, respectively.

The estimated cost of providing care to patients under the District's charity care policy aggregated \$200,722 and \$247,226 in 2012 and 2011, respectively. The cost was calculated by multiplying the ratio of cost to gross charges for the District times the gross uncompensated charges associated with providing the charity care.

Note 12 **Pension Plan**

The District has a voluntary contributory money-purchase pension plan that is available to all employees that contribute three percent of their salary to the District's 403(b) plan. The plan is administered by CPI Qualified Plan Consultants, Inc. Any changes to the plan provisions must be both documented in the board minutes and authorized with a signature from one of the plan representatives. The plan is funded solely by employer contributions in which the District will contribute five percent of the employees' salary only if certain eligibility criteria are met by the employees, including the contribution to the 403(b) plan.

Employees are vested upon deposit. Pension costs include only current service costs, which are accrued and funded on a current basis. Pension plan expense was \$360,577 and \$336,099 for the years ended December 31, 2012 and 2011, respectively.

The District also has a voluntary retirement plan which was established by the District under section 403(b) of the Internal Revenue Code. The plan is funded solely by employee contributions, which are deposited in employee controlled accounts established with American Mutual Funds.

The District also has a deferred compensation plan created in accordance with Internal Revenue Code Section 457 available to employees who have exceeded the maximum level of contributions to their 403(b) plan. The plan is administered by CPI Qualified Plan Consultants, Inc. and is funded solely by employee contributions with the fees paid for by the District.

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Notes to Financial Statements

See Accountant's Compilation Report

Note 12 Pension Plan (Continued)

The District also has a supplemental defined benefit pension plan, which covers employees of the District at January 1, 1976, who have ten or more years of service and attain age sixty-five prior to December 31, 1991. The District uses the actuarial method of accounting and reporting for the plan's liability. Under this method, the liability is the present value of future payments, based on acceptable life expectancy tables. Pension plan benefits paid to retired employees was \$0 and \$3,219 for the years ended December 31, 2012 and 2011, respectively.

Note 13 Net Patient Service Revenue

Net patient service revenue consisted of the following:

	2012	2011
Gross patient service revenue:		
Inpatient services	\$ 3,394,753	\$ 3,233,437
Outpatient services	27,836,335	26,102,886
Total gross patient revenue	31,231,088	29,336,323
Revenue deductions:		
Medicare contractual adjustments	(5,070,864)	(4,171,286)
Medicaid contractual adjustments	(1,039,345)	(904,601)
Other	(4,902,695)	(4,152,364)
Patient service revenue (net of contractual adjustments and discounts)	\$ 20,218,184	\$ 20,108,072

Chelan County Public Hospital District No. 2

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Notes to Financial Statements

See Accountant's Compilation Report

Note 13 Net Patient Service Revenue (Continued)

Patient service revenue, net of contractual adjustments and discounts (but before provision for bad debts), recognized in the period from these major payor sources, and was as follows for the years ended December 31:

	2012	2011
Third party payors	\$ 9,543,729	\$ 10,669,829
Self pay and other payors	10,674,455	9,438,243
Totals	\$ 20,218,184	\$ 20,108,072

Medicare and Medicaid revenue as a percent of gross patient service revenue approximated 50% for the years ended December 31, 2012 and 2011, respectively.

Note 14 Functional Expenses

The District provides general health care services to residents within its geographical area. Expenses related to providing these services consisted of the following:

	2012	2011
Health care services	\$ 4,163,566	\$ 4,207,379
General and administrative	16,512,512	15,599,945
Total expenses	\$ 20,676,078	\$ 19,807,324

Chelan County Public Hospital District No. 2

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Notes to Financial Statements

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Note 15 Related Organization

Foundation

Lake Chelan Community Hospital Foundation (the "Foundation"), formed in 1981, is a separate tax-exempt Washington corporation. The Foundation is not considered a component unit that must be combined with the District for financial statement purposes. The Foundation has assets and net assets of approximately \$2,424,570 and \$2,192,486 at December 31, 2012 and 2011, respectively, according to unaudited financial statements. Donations of \$35,997 and \$79,037 were contributed to the District by the Foundation for the years ended December 31, 2012 and 2011, respectively.

Lake Chelan Community Apartments

Lake Chelan Community Apartments (LCCA) is owned by Lake Chelan Community Hospital. Lake Chelan Community Hospital has contracted with the Housing Authority of Chelan County and the City of Wenatchee to manage LCCA. The 28-unit apartment is located in Chelan, Washington. LCCA was financed under Section 221 (d) (3) of the National Housing Act. Under this program, LCCA provided housing to tenants subject to regulation by the Department of Housing and Urban Development (HUD) and receives a rent subsidy. During the 2012 and 2011, rental subsidy from HUD totaled \$65,272 and \$67,634, 41 and 52 percent of total revenue, respectively.

The District assumed the existing Housing and Urban Development (HUD) loan on the LCCH Apartments in 2005. The District operates the property to serve the low income households for a period of time in order to meet the existing loan requirements.

The LCCH Apartments began being operated as a department of the Hospital. At December 31, 2012 and December 31, 2011, all assets and liabilities of the rental property are included within the balance sheet of the District. At December 31, 2012 and 2011, rental income, net of expenses, is reported as nonoperating revenues on the statement of revenue and expenses and changes in net position.

Chelan County Public Hospital District No. 2

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Notes to Financial Statements

See Accountant's Compilation Report

Note 16 Nonoperating Revenues Net

Total nonoperating revenues (expenses) for the years ended December 31, were as follows:

	2012	2011
Interest earnings	\$ 8,405	\$ 7,275
Interest expense	(148,721)	(166,630)
Non-capital grants and contributions	65,969	227,608
Gains on disposal of assets	(12,687)	23,617
Property tax	1,419,543	1,465,282
Lake Chelan Community Apartment assets revenue -		
Net of expenses	10,721	26,002
Total nonoperating revenues	\$ 1,343,230	\$ 1,583,154

Note 17 Subsequent Event

During 2013 the District refinanced Limited Tax General Obligation Refunding Bonds, dated December 1, 1998, Limited Tax General Obligation Bonds, dated March 15, 2001, and Limited Tax General Obligation Bonds, dated October 1, 2009 in order to reduce interest expense paid on the outstanding debts. The new debt is called Limited Tax General Obligation Bonds, dated 2013, due in varying annual principal installments of \$145,000 in 2013 to 540,000 in 2034, plus interest varying rates from 2% to 4.5%, payable December 1 each year, the bond is subject to redemption prior to their stated dates of maturity beginning June 1, 2023. The new debt includes an additional \$300,000 in debt due to financing fees.



ABOUT THE STATE AUDITOR'S OFFICE

The State Auditor's Office is established in the state's Constitution and is part of the executive branch of state government. The State Auditor is elected by the citizens of Washington and serves four-year terms.

We work with our audit clients and citizens as an advocate for government accountability. As an elected agency, the State Auditor's Office has the independence necessary to objectively perform audits and investigations. Our audits are designed to comply with professional standards as well as to satisfy the requirements of federal, state, and local laws.

The State Auditor's Office employees are located around the state to deliver services effectively and efficiently.

Our audits look at financial information and compliance with state, federal and local laws on the part of all local governments, including schools, and all state agencies, including institutions of higher education. In addition, we conduct performance audits of state agencies and local governments and fraud, whistleblower and citizen hotline investigations.

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