

**ADAIR COUNTY MEMORIAL HOSPITAL  
d/b/a ADAIR COUNTY HEALTH SYSTEM**

**FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION**

**YEARS ENDED JUNE 30, 2004 AND 2003**

**ADAIR COUNTY HEALTH SYSTEM  
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**ADAIR COUNTY HEALTH SYSTEM  
BOARD OF TRUSTEES AND OFFICIALS  
YEAR ENDED JUNE 30, 2004**

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
BOARD OF TRUSTEES AND OFFICIALS		
Sherri Kramer	Chairperson	2006
Roger Queck	Vice Chairperson	2007
John E. F. Schildberg, III	Secretary	2006
Ron R. Kniep	Treasurer	2004
Marilyn Jacobson	Member	2004
Everett Shepherd	Member	2006
Kara Ladd	Member	2007
HOSPITAL OFFICIALS		
Myrna Erb-Gundel	Administrator	
Lisa Blazek	Chief Financial Officer	

## INDEPENDENT AUDITORS' REPORT

Board of Trustees  
Adair County Health System  
Greenfield, Iowa

We have audited the accompanying balance sheets of Adair County Health System as of June 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets and changes in cash flows for the years then ended. These financial statements are the responsibility of the Health System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards, Chapter 11 of the Code of Iowa 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Adair County Health System as of June 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As described in Note 1 to the financial statements, Adair County Health System adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Government: Omnibus* and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*, as of June 30, 2004. The financial statements as of and for the year ended June 30, 2003 have been reclassified to conform to the current year presentation.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 12, 2004 on our consideration of Adair County Health System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The management's discussion on pages 3 through 8 and analysis and budgetary comparison information on page 25 are not required parts of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentations of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information from pages 26-34 is presented for purpose of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in cursive script that reads "Larson, Allen, Weishair & Co., LLP". The signature is written in black ink and is positioned above the printed name of the firm.

**LARSON, ALLEN, WEISHAIR & CO., LLP**

Austin, Minnesota  
August 12, 2004

**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
YEARS ENDED JUNE 30, 2004 AND 2003**

The Management Discussion and Analysis offers the readers of Adair County Health System's (the Health System) financial statements a narrative overview and analysis of the financial activities of Adair County Health System for the fiscal year ended June 30, 2004. The analysis will focus on the Health System's financial performance as a whole and should be considered in conjunction with the audited financial report.

**Financial Highlights**

- The Health System's total assets increased by \$107,292 or 1.2% in 2004.
- The Health System's patient service revenues increased \$567,838 or 12.0% from 2003 to 2004.
- The accounts receivable decreased from \$229,097 or 17% between 2003 and 2004.

**Required Financial Statements**

The financial statements of the Health System report information about the Health System using Governmental Accounting Standards Board (GASB) accounting principles. These statements combine information on short term, spendable resources with capital assets and long term obligations. The balance sheet includes all of the Health System's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to Hospital creditors (liabilities). It is a statement of financial position and provides the basis for evaluating the capital structure of the Health System and assessing the liquidity and financial flexibility of the Health System. The Statement of Revenue, Expenses, and Changes in Net Assets reflects all of the current and previous year's revenues and expenses. This statement shows the results of the Health System's operations and can be used to determine if Hospital has been able to recover all of its costs through its revenue sources. The final required financial statement is the Statement of Cash Flow. This statement provides information about the movement of money in and out of the Health System. It answers the questions of where did cash come from, what was cash used for, and what was the change in cash balance during the year.

Required Supplementary Information further explains and supports the financial statements with a comparison of the Health System's budget for the year, and Other Supplementary Information provides detailed information about the operations of the Health System. Other supplementary statements that provide supporting information are as follows:

- Schedules of Net Patient Service Revenues
- Schedules of Adjustments to Net Patient Service Revenues and Other Revenue
- Schedules of Operating Expenses
- Schedules of Accounts Receivable from Patients and Allowance for Doubtful Accounts
- Schedules of Inventory and Prepaid Expenses
- Schedules of Home Health

There was one significant change in accounting policies for the year ended June 30, 2004. The amount to qualify for an item as a capital expenditure increased from \$1,500 to \$5,000.

**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
YEARS ENDED JUNE 30, 2004 AND 2003**

**Financial Analysis of the Health System**

The Balance Sheets, Statements of Revenues, Expenses & Changes in Net Assets, and the Statements of Cash Flows have been summarized in the following tables. Tables 1 and 2 report on the net assets of the Health System and the changes in them. Increases or decreases in net assets are one indicator of whether or not the Health System's financial health is improving. Other non-financial factors can also have an effect on the Health System's financial position. These can include such things as changes in Medicare and Medicaid regulations and reimbursement, changes with other third party payers, as well as, changes in the economic environment.

**Table 1: Assets, Liabilities, and Net Assets**

	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>Assets:</b>			
Current Assets	\$ 2,667,636	\$ 2,574,841	\$ 2,018,386
Noncurrent Cash and Investments	200,000	200,000	263,991
Capital Assets, Net	924,455	832,243	554,039
Succeeding Year Property Tax Receivable	796,065	765,898	766,093
Other Assets	59,825	167,707	130,171
<b>Total Assets</b>	<u>\$ 4,647,981</u>	<u>\$ 4,540,689</u>	<u>\$ 3,732,680</u>
<b>Liabilities:</b>			
Total Current Liabilities	\$ 696,756	\$ 800,950	\$ 706,488
Long-Term Debt (Less Current Maturities)	333,778	237,132	101,905
Deferred Revenue from Succeeding Year Property Tax Receivable	796,065	765,898	766,093
<b>Total Liabilities</b>	<u>1,826,599</u>	<u>1,803,980</u>	<u>1,574,486</u>
<b>Total Net Assets</b>	<u>2,821,382</u>	<u>2,736,709</u>	<u>2,158,194</u>
<b>Total Liabilities and Net Assets</b>	<u>\$ 4,647,981</u>	<u>\$ 4,540,689</u>	<u>\$ 3,732,680</u>

The most significant changes are in Other Assets and Long-Term Debt. Other Assets last year included the investment in a Joint Venture with Mercy Medical Center Des Moines for a family practice clinic in Stuart of \$94,839. This joint venture was dissolved as of July 1, 2003 and the clinic was run solely by Adair County Health System for the fiscal year ending June 30, 2004. The final arrangements for dissolution are still being made at this time, but no further gain or loss is expected and the value of the joint venture was absorbed back into the operations of the Health System. Long-term Debt (including the current portion) increased \$121,700 over last year. This is attributed to the purchase of property and a new boiler system.

Table 2 summarizes the information from the Statements of Revenues, Expenses, and Changes in Net Assets. Revenues increased 8% from the prior year. This is due to the addition of new services. This is the first full year for the clinics that were opened in March 2003. We also added MRI mobile services this year. The increase in services is also the reason for the 23% increase in expenses.

**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
YEARS ENDED JUNE 30, 2004 AND 2003**

**Table 2: Statement of Revenues, Expenses & Changes in Net Assets**

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Operating Revenue	\$ 6,394,740	\$ 5,778,631	\$ 5,055,251
Operating Expenses	<u>6,565,546</u>	<u>5,332,321</u>	<u>4,802,382</u>
Operating Income	(170,806)	446,310	252,869
Non-Operating Revenues (Expenses)	<u>198,668</u>	<u>111,556</u>	<u>(63,983)</u>
Excess of Revenues over Expenses before Capital Grants and Contributions	27,862	557,866	188,886
Capital Grants and Contributions	<u>56,811</u>	<u>20,649</u>	<u>124,319</u>
Increase in Net Assets	84,673	578,515	313,205
Net Assets, Beginning of Year	<u>2,736,709</u>	<u>2,158,194</u>	<u>1,844,989</u>
Net Assets, End of Year	<u>\$ 2,821,382</u>	<u>\$ 2,736,709</u>	<u>\$ 2,158,194</u>

**Table 3: Net Patient Service Revenue and Contractual Adjustments**

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Total Patient Service Revenues	\$ 6,568,382	\$ 5,327,302	\$ 4,323,078
Contractual Adjustments and Provisions for Bad Debt			
Medicare	(684,121)	(276,391)	(23,490)
Medicaid	(94,388)	(86,678)	(37,935)
Provision for Bad Debt	(297,708)	(167,985)	(88,049)
Other	<u>(206,942)</u>	<u>(78,864)</u>	<u>(115,478)</u>
Total Contractual Adjustments and Provision for Bad Debt	(1,283,159)	(609,918)	(264,952)
Net Patient Service Revenue	<u>\$ 5,285,223</u>	<u>\$ 4,717,384</u>	<u>\$ 4,058,126</u>

Operating expenses increasing at a larger rate than operating revenues is due to the increase in our contractual adjustments and Provision for Bad Debt. These adjustments are offset directly against our patient services revenue that is a part of operating revenue. Our contractual adjustments grew 168%. There are several issues that influenced this but the addition of physician clinics was the major factor. Physician's fee schedules pay at a discount significantly higher than the discounts taken on our hospital services. Also, the physician clinics are not covered under the Critical Access Hospital program, so they are not reimbursed at cost from Medicare. This decreases the amount of cost the Health System can claim for reimbursement and ultimately increases the contractual adjustment rate for hospital services. We have applied for provider-based Rural Health Clinic status to reverse this drain of expenses from cost based reimbursement. The costs in the clinics will then be allowable to be reimbursed at cost much like the Health System costs. We also saw an increase in our write offs and bad debt. We had some old accounts that we were unable to collect because of our internal systems. These systems were changed and collection of accounts in a timely manner has greatly improved. Bad debts also increased over prior years in accordance with current trends seen throughout health care.

**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
YEARS ENDED JUNE 30, 2004 AND 2003**

**Table 4: Other Revenues**

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Revenues for Expenses of HHC:			
County Taxes	\$ 812,298	\$ 805,388	\$ 769,308
Cafeteria Meals	44,583	33,868	36,234
Grant Revenue	66,418	36,014	115,344
Revenues for Home Health Services	125,053	123,090	108,176
Revenues for Expenses of Ambulance, Adair County	737	12	984
Lifeline	29,055	29,940	23,382
Other	31,373	32,935	22,010
Total Other Revenues	<u>\$ 1,109,517</u>	<u>\$ 1,061,247</u>	<u>\$ 1,075,438</u>

As a result of an increase in cash received from patients and third parties and increase in patient revenues, accounts receivable decreased from 99 to 75 days.

Salary expense increased 14%, total expenses for the Health System increased 23%. The addition of two clinic sites for the first full year attributed to most of the growth.

The Health System had an agreement with Mercy Medical Center – Des Moines (Mercy) to be a joint owner of a clinic, Adair County Medical Associates, L.L.C. (ACMA) in Stuart, Iowa. The Health System and Mercy each owned a 50% share of the joint venture. The arrangement ended June 30, 2003. The Health System had a due to ACMA of \$6,206 for cash collected on behalf of ACMA and \$94,839 investment in the joint venture. The joint venture is currently in the process of dissolving and as of August 12, 2004 there has been no agreement reached. The Health System has evaluated its current investment in ACMA in light of the impending dissolution and as a result the Health System has recognized a loss of \$88,634 for the year ended June 30, 2004.

The Health System's cash flows are consistent with the changes in operating income and financial performance as discussed earlier.

### **Hospital Statistical Data**

Table 5 shows the Health System statistical data.

The admissions and patient days show a slight decrease in comparison with the prior year due to changes in the physician mix. Rate increases and increases in outpatient services allowed for growth in patient revenues in spite of inpatient volume decreases. The Greenfield clinic was operated by the Health System only 3 months last year which explains the dramatic increase in those volumes from the prior year.

**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
YEARS ENDED JUNE 30, 2004 AND 2003**

**Table 5: Statistical Data**

	<u>2004</u>	<u>2003</u>	<u>2002</u>
<b>Admissions</b>			
Acute	326	339	387
ICU	9	18	1
Skilled	44	58	60
Intermediate	0	3	4
Total	<u>379</u>	<u>418</u>	<u>452</u>
<b>Patient Days</b>			
Acute	992	1,185	1,198
ICU	10	26	1
Skilled	329	437	427
Intermediate	0	6	17
Total	<u>1,331</u>	<u>1,654</u>	<u>1,643</u>
ER Visits	1,559	1,631	1,592
OP Surgery	187	189	144
24 Hour Observation	156	201	122
Home Health Visits	8,764	9,141	9,386
Stuart Clinic Visits	1,932	2,775	1,656
Greenfield Clinic Visits	8,543	2,776	0
Fontanelle/Hospital FP Clinic Visits	2,721	3,828	2,392
<b>Average Length of Stay</b>			
Acute	3.00	3.40	3.10
Skilled	7.30	7.60	7.20
Total	3.47	3.98	3.61
Medicare (Acute)	3.40	3.60	3.50
<b>Average Hourly Length of Stay</b>	68.77	79.17	75.14
<b>Average Daily Census</b>	3.64	4.54	4.50

**Capital Assets**

At June 30, 2004 the Health System had \$924,455 invested in capital assets net of accumulated depreciation. In 2004, the Health System purchased capital assets costing \$241,701, which includes \$12,884 acquired under a capital lease agreement and \$80,000 for real property.

**Long Term Debt**

**Table 6: Long Term Debt**

	<u>2004</u>	<u>2003</u>	<u>2002</u>
Note Payable	\$ 379,219	\$ 240,354	\$ 71,991
Capital Lease Obligations	<u>61,913</u>	<u>79,078</u>	<u>53,914</u>
Total Long Term Debt	<u>\$ 441,132</u>	<u>\$ 319,432</u>	<u>\$ 125,905</u>

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**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
YEARS ENDED JUNE 30, 2004 AND 2003**

There are two new notes payable this year. One is a mortgage on the purchase of property this year of a house and land across the street from the Health System to use as office space, storage, and ER physician quarters. The note has monthly payments of \$506 through February 2024. The second is for a new boiler system. It is payable in monthly installments of \$2,440 through September 2008.

The rest of the notes payable are:

A mortgage to finance the purchase and improvement costs of the home health agency building. The mortgage has monthly payments of \$726 through July 2012. The interest is variable and is adjustable in sixty months from July 2002. At June 30, 2004 the interest rate is 3.95 percent. A note payable to finance the purchase of medical and office equipment costs of a family practice clinic. The loan calls for monthly payments of \$2,645 the interest rate is 4.75% and the final payment is due April 2008. Finally there is a note payable to finance the purchase of medical equipment with monthly payments of \$1,457 including interest at 4.75% through July 2005.

The Health System has entered into agreements to acquire a sterilizer, hematology machine, computer equipment, and a time clock system under capital leases. The obligations are due in monthly installments totaling \$3,324, expiring on different dates through March 2009, including interest at rates of 6.58% to 13.84%.

### **Economic Factors**

The Health System improved some aspects of its financial position such as reducing its balance in accounts receivable and increasing its cash and investments. However it did realize losses this year due to the increase in contractual adjustments from governmental payers and the dissolution of a joint venture with Mercy Medical Center-Des Moines. Funds from the county have decreased over the last 3 years. The dollars to home care have been cut as the county and state work to balance their budgets. The county has indicated future cuts may occur.

### **Contacting the Health System**

This financial report is designed to provide our citizens, customers, and creditors with a general overview of the Health System's finances and to demonstrate the Health System's accountability for the money it receives. If you have any questions about this report or need additional information, please contact Hospital administration at Adair County Health System, 609 SE Kent, Greenfield, IA 50849.

**ADAIR COUNTY HEALTH SYSTEM  
BALANCE SHEETS  
JUNE 30, 2004 AND 2003**

<b>ASSETS</b>	2004	2003
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 791,187	\$ 807,984
Certificates of Deposit	545,447	270,499
Patient Receivables, Less Allowance for Uncollectible Accounts (2004 \$139,000; 2003 \$150,000)	1,102,294	1,331,391
Accounts Receivable - Other	16,607	16,786
Third-Party Payor Settlement Payable	57,000	-
Inventories	108,144	105,736
Prepaid Expenses	46,957	42,445
Total Current Assets	2,667,636	2,574,841
<b>NONCURRENT CASH AND INVESTMENTS</b>		
Internally Designated By Board for Capital Expenditures	200,000	200,000
<b>CAPITAL ASSETS, NET</b>		
	924,455	832,243
<b>OTHER ASSETS</b>		
Succeeding Year Property Taxes Receivable	796,065	765,898
Investment in Joint Venture	-	94,839
Other Assets	59,825	72,868
Total Other Assets	855,890	933,605
Total Assets	\$ 4,647,981	\$ 4,540,689

See accompanying Notes to Financial Statements.

<b>LIABILITIES AND NET ASSETS</b>	<u>2004</u>	<u>2003</u>
<b>CURRENT LIABILITIES</b>		
Current Maturities of Long-Term Debt	\$ 107,354	\$ 82,300
Accounts Payable	279,866	367,412
Accrued Employee Compensation	309,536	270,032
Third-Party Payor Settlement Payable	-	75,000
Due to Joint Venture	-	6,206
Total Current Liabilities	<u>696,756</u>	<u>800,950</u>
<b>LONG-TERM DEBT</b> , Less Current Maturities	333,778	237,132
<b>DEFERRED REVENUE</b>		
Succeeding Year Property Taxes	<u>796,065</u>	<u>765,898</u>
Total Liabilities	1,826,599	1,803,980
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>NET ASSETS</b>		
Invested in Capital Assets Net of Related Debt	483,323	512,811
Restricted For Capital Expenditures	20,020	-
Unrestricted	<u>2,318,039</u>	<u>2,223,898</u>
Total Net Assets	<u>2,821,382</u>	<u>2,736,709</u>
Total Liabilities and Net Assets	<u>\$ 4,647,981</u>	<u>\$ 4,540,689</u>

**ADAIR COUNTY HEALTH SYSTEM**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
**YEARS ENDED JUNE 30, 2004 AND 2003**

	2004	2003
<b>OPERATING REVENUES</b>		
Net Patient Service Revenues (net of provision for bad debts of \$297,708 in 2004 and \$167,985 in 2003)	\$ 5,285,223	\$ 4,717,384
Other Revenues	1,109,517	1,061,247
Total Revenues	6,394,740	5,778,631
<b>EXPENSES</b>		
Nursing Service	1,802,114	1,740,364
Other Professional Service	2,555,794	1,789,775
General Service	367,834	378,371
Fiscal, Administrative, and Unassigned Expenses	1,660,804	1,280,350
Depreciation	143,699	124,315
Interest and Amortization	35,301	19,146
Total Expenses	6,565,546	5,332,321
<b>OPERATING INCOME (LOSS)</b>	(170,806)	446,310
<b>NON-OPERATING GAINS (LOSSES)</b>		
Investment Income	29,051	31,298
Unrestricted Contributions	256,401	144,736
Loss on Joint Venture	-	(64,478)
Loss From Disposition of Joint Venture	(88,634)	-
Loss on Disposal of Property	1,850	-
Net Nonoperating Gains	198,668	111,556
<b>EXCESS (DEFECIT) OF REVENUES AND GAINS OVER EXPENSES AND LOSSES</b>	27,862	557,866
Capital Grants and Contributions	56,811	20,649
Increase in Net Assets	84,673	578,515
Net Assets Beginning of Year	2,736,709	2,158,194
Net Assets End of Year	\$ 2,821,382	\$ 2,736,709

See accompanying Notes to Financial Statements.

**ADAIR COUNTY HEALTH SYSTEM  
STATEMENTS OF CASH FLOWS  
YEARS ENDED JUNE 30, 2004 AND 2003**

	2004	2003
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash Received from Patients and Third Parties	5,382,320	4,390,767
Cash Paid to Employees	(2,505,010)	(2,136,916)
Cash Paid to Suppliers	(3,936,319)	(3,012,698)
Other Receipts and Payments, Net	291,013	133,326
Net Cash Used by Operating Activities	(767,996)	(625,521)
<b>CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES</b>		
Tax Appropriations	812,298	805,388
Contributions	313,212	165,385
Net Cash Provided by Non-Capital Financing Activities	1,125,510	970,773
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Purchase of Property and Equipment	(214,970)	(407,351)
Proceeds from Issuance of Long Term Debt	210,000	190,000
Payments on Long Term Debt	(101,186)	(56,857)
Interest Payments on Long-Term Debt	(22,258)	(14,798)
Net Cash Used by Capital and Related Financing Activities	(128,414)	(289,006)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Decrease in Noncurrent Cash and Investments	-	63,991
Interest Income	29,051	31,298
Cash Invested in Joint Venture	-	(41,146)
Purchases of Certificates of Deposit, Net	(274,948)	(153,609)
Net Cash Used by Financing Activities	(245,897)	(99,466)
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(16,797)	(43,220)
Cash and Cash Equivalents - Beginning	807,984	851,204
<b>CASH AND CASH EQUIVALENTS - ENDING</b>	\$ 791,187	\$ 807,984

See accompanying Notes to Financial Statements.

**ADAIR COUNTY HEALTH SYSTEM  
STATEMENTS OF CASH FLOWS (CONTINUED)  
YEARS ENDED JUNE 30, 2004 AND 2003**

<b>RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES</b>	2004	2003
Operating Income (Loss)	\$ (170,806)	\$ 446,310
Adjustments to Reconcile Income from Operations to Net Cash Provided by Operating Activities		
County Taxes	(812,298)	(805,388)
Interest Expense and Amortization Considered Capital Activity	35,301	19,146
Depreciation	143,699	124,315
Decrease (Increase) in -		
Patient Receivables	229,097	(447,020)
Third Party Payor Settlements Receivable	(57,000)	45,403
Other Receivables	179	(2,373)
Inventories	(2,408)	(35,274)
Prepaid Expenses	(4,512)	(6,802)
Increase (Decrease) in -		
Accounts Payable	(87,546)	47,150
Accrued Salaries, Wages, Benefits and Other	39,504	36,545
Third Party Payor Settlements Payable	(75,000)	75,000
Due to Related Organization	(6,206)	(122,533)
Net Cash Used by Operating Activities	\$ (767,996)	\$ (625,521)
 <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Noncash Investing and Financing Activities		
Equipment Acquired Under Capital Leases	\$ 12,886	\$ 60,384

See accompanying Notes to Financial Statements.

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2004 AND 2003**

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES**

Adair County Health System (the Health System) is a county public hospital, organized under Chapter 347, Code of Iowa, not subject to taxes on income or property, and receives tax support from Adair County. Services are provided to residents of Adair and surrounding counties in southwestern Iowa.

**A. Reporting Entity**

For financial reporting purposes, Adair County Health System has included all funds, organizations, account groups, agencies, boards, commissions, and authorities that are not legally separate. The Health System has also considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Health System are such that exclusion would cause the Health System's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Health System to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Health System. These criteria also include organizations that are fiscally dependent on the Health System. The Health System has no component units, which meet the Governmental Accounting Standards Board criteria.

**B. Use of Estimates**

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

**C. Basis of Accounting**

The Health System has adopted the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis for State and Local Governments*; Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus* and Statement No. 38, *Certain Financial Statement Disclosures* in these financial statements effective July 1, 2003. These financial statements as of and for the year ended June 30, 2003 have been reclassified to conform to the current year's presentation. The GASB pronouncements established financial reporting standards for state and local government entities. The impact of this accounting change primarily relates to the format of the financial statements, presentations of net assets, and the inclusion of management's discussion and analysis.

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2004 AND 2003**

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

The accompanying financial statements have been prepared on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles. Revenues are recognized when earned and expenses are recorded when the liability is incurred.

In reporting the financial activity of its proprietary funds, the Health System applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures.

**D. Assets, Liabilities, and Net Assets**

The following accounting policies are followed in preparing the balance sheets:

*Cash and Cash Equivalents* – For purposes of the statement of cash flows, the Health System considers savings accounts and all other highly liquid investments (including restricted assets) with an original maturity of three months or less to be cash equivalents.

*Patient Receivables* – The Health System provides an allowance for uncollectible accounts based on the allowance method using management's judgment. Patients are not required to provide collateral for services rendered. Payment for services is required within 30 days of receipt of invoice or claim submitted. Accounts past due more than 90 days are turned over to collection agents. In addition, an allowance is estimated for other accounts based on historical experience in the Health System. At June 30, 2004 and 2003, the allowance for uncollectible accounts was \$139,000 and \$150,000, respectively. Accounts receivable are shown at the amount expected to be collected after determining the allowance for doubtful accounts.

*Inventory* – Inventory is valued at cost using the first-in, first-out method.

*Noncurrent Cash and Investments* – Noncurrent cash and investments include assets which have been internally designated by the Health System's Board of Trustees, assets which are restricted by debt agreements and assets which have been restricted by contributors or grantors. Board designated assets remain under the control of the Board of Trustees, which may at its discretion later use the funds for other purposes. Restricted funds are used to differentiate funds which are limited by the donor to specific uses from funds on which the donor places no restriction or which arise as a result of the operation of the Health System for its stated purposes. Resources set aside for Board-designated purposes are not considered to be restricted. Resources restricted by donors or grantors for specific operating purposes are reported in non-operating income to the extent expended within the period.

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2004 AND 2003**

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*Capital Assets* – Capital assets are reported at historical cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. The Health System computes depreciation on buildings and equipment using the straight-line method. Lives for the building and land improvements are fifteen to forty years, while equipment lives range from three to twenty years. Capital expenditures of \$5,000 or greater are capitalized and depreciated over the life of the assets. Capital expenditures less than \$5,000 are expensed when incurred.

*Property Tax Receivable* – Property tax receivable is recognized on the levy or lien date, which is the date that the tax asking is certified by the County Board of Supervisors. The succeeding year property tax receivable represents taxes certified by the Board of Supervisors to be collected in the next fiscal year for the purposes set out in the budget for the next fiscal year. By statute, the Board of Supervisors is required to certify the budget in March of each year for the subsequent fiscal year. However, by statute, the tax asking and budget certification for the following fiscal year becomes effective on the first day of that year. Although the succeeding year property tax receivable has been recorded, the related revenue is deferred and will not be recognized as revenue until the year for which it is levied.

*Investments* – Investments are valued at purchase cost, or fair market value at date of acquisition if donated. Investments consist of certificates of deposit with maturities greater than three months.

*Deferred Revenue* – Although certain revenues are measurable, they are not available. Available means collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period. Deferred revenue represents the amount of assets that have been recognized, but the related revenue has not been recognized since the assets are not collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period. Deferred revenue consists of succeeding year property tax receivable.

*Net Assets* – Net assets of the Health System are classified into three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors or contributors external to the Health System. Unrestricted net assets are remaining net assets that do not meet the definition of invested capital assets net of related debt or restricted. Restricted net assets of \$20,020 consisted of funds received for the purchase of equipment. There were no restricted net assets at June 30, 2003.

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2004 AND 2003**

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**E. Contributions**

From time to time the Health System receives contributions from individuals and private organizations. Revenues from contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. 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.

**F. Restricted Resources**

When the Health System has both restricted and unrestricted resources available to finance a particular program, it is the Health System's policy to use restricted resources before unrestricted resources.

**G. Operating Revenues and Expenses**

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

**H. Net Patient Service Revenue**

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are provided and adjusted in future periods, as final settlements are determined.

**I. Charity Care**

The Health System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Health System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Total charity care provided amounted to \$22,018 and \$3,703 for the years ended June 30, 2004 and 2003, respectively.

**J. County Tax Revenue**

Taxes levied to finance the current year are included in other operating revenue.

**K. Other Assets**

Other assets consist of costs related to the purchase of medical records. Medical records are being amortized over five years using the straight-line method. Accumulated amortization was \$17,391 and \$4,348 at June 30, 2004 and 2003, respectively.

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2004 AND 2003**

**NOTE 2 DESIGNATED NET ASSETS**

Of the \$2,318,039 and \$2,223,898 of unrestricted net assets at June 30, 2004 and 2003, respectively, \$200,000 have been designated by the Health System's Board of Trustees for capital acquisitions. Designated funds remain under the control of the Board of Trustees, which may at its discretion later use the funds for other purposes.

**NOTE 3 NET PATIENT SERVICE REVENUE**

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

**Medicare**

The Health System has received certification as a Critical Access Hospital (CAH) and receives reimbursement for services provided to Medicare beneficiaries based on the cost of providing those services. Interim payment rates are established for inpatient and outpatient services, with settlement for over or under payments determined based on year-end cost reports. The Health System's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Health System. The Health System's Medicare cost reports have been finalized by the Medicare intermediary through June 30, 2001.

**Medicaid**

The Health System has received certification as a Critical Access Health System (CAH) and receives reimbursement for services provided to Medicaid beneficiaries based on the cost of providing those services. Interim payment rates are established for inpatient and outpatient services, with settlement for over or under payments determined based on year-end cost reports. The Health System's Medicaid cost reports have been finalized by the Medicaid intermediary through June 30, 2001.

**Other**

The Health System has also entered into payment agreements with Blue Cross and other commercial insurance carriers. The basis for reimbursement under these agreements includes discounts from established charges and prospectively determined rates.

A summary of patient service revenue and contractual adjustments is as follows:

	2004	2003
Total Patient Service Revenue	\$ 6,568,382	\$ 5,327,302
Contractual Adjustments:		
Medicare	(684,121)	(276,391)
Medicaid	(94,388)	(86,678)
Provision for Bad Debt	(297,708)	(167,985)
Other	(206,942)	(78,864)
Total Contractual Adjustments and Bad Debts	(1,283,159)	(609,918)
Net Patient Service Revenue	\$ 5,285,223	\$ 4,717,384

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2004 AND 2003**

**NOTE 4 PATIENT RECEIVABLES**

Patient receivables reported as current assets by the Health System at June 30, 2004 and 2003 consisted of the following:

	<u>2004</u>	<u>2003</u>
Receivable from Patients and Their Insurance Carriers	\$ 725,506	\$ 691,679
Receivable from Medicare	426,621	713,816
Receivable from Medicaid	89,167	75,896
Total Patient Receivables	<u>1,241,294</u>	<u>1,481,391</u>
Less Allowance for Doubtful Accounts	<u>(139,000)</u>	<u>(150,000)</u>
Patient Receivables, Net	<u>\$ 1,102,294</u>	<u>\$ 1,331,391</u>

**NOTE 5 DEPOSITS AND INVESTMENTS**

The Health System's deposits in banks at June 30, 2004 are covered by federal depository insurance or the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This Chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Health System is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

The Health System's investments are categorized to give an indication of the level of risk assumed by the Health System at year end. The Health System's investments are all Category 1 which means that the investments are insured or registered or the securities are held by the Health System or its agent in the Health System's name.

At June 30, 2004 and 2003, the Health System had bank balances as follows:

	<u>2004</u>	<u>2003</u>
Insured or Collateralized by Iowa Insurance Trust	<u>\$ 1,725,854</u>	<u>\$ 1,293,062</u>
Carrying Amount	<u>\$ 1,536,634</u>	<u>\$ 1,278,483</u>

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2004 AND 2003**

**NOTE 5 DEPOSITS AND INVESTMENTS (CONTINUED)**

The carrying amount of deposits shown above is included in the Health System's balance sheets as follows:

	2004	2003
Deposits	\$ 1,536,634	\$ 1,278,483
Included in the following balance sheet captions		
Cash and Cash Equivalents	\$ 791,187	\$ 807,984
Certificates of Deposit	545,447	270,499
Noncurrent Cash and Investments Internally Internally Designated By Board for Capital Expenditures	200,000	200,000
	\$ 1,536,634	\$ 1,278,483

**NOTE 6 CAPITAL ASSETS**

<b>Capital Assets</b>	July 1, 2003	Additions	(Retirements)	June 30, 2004
Land Improvements	\$ 176,523	\$ 14,025	\$ -	\$ 190,548
Building	812,654	71,390	-	884,044
Fixed Equipment	473,869	126,439	(14,027)	586,281
Movable Equipment	730,541	16,963	(4,040)	743,464
Leased Equipment	450,556	12,884	-	463,440
Construction in Progress	26,486	125,643	(131,432)	20,697
Totals	2,670,629	\$ 367,344	\$ (149,499)	2,888,474
<b>Accumulated Depreciation</b>				
Land Improvements	53,794	11,830	-	65,624
Building	568,721	26,188	-	594,909
Fixed Equipment	384,811	17,246	(14,082)	387,975
Movable Equipment	502,309	38,875	(3,984)	537,200
Leased Equipment	328,751	49,560	-	378,311
Totals	1,838,386	\$ 143,699	\$ (18,066)	1,964,019
	\$ 832,243			\$ 924,455

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2004 AND 2003**

**NOTE 6 CAPITAL ASSETS (CONTINUED)**

Summaries of capital assets for the years ended June 30, 2004 and 2003 are as follows:

<b>Capital Assets</b>	July 1, 2002	Additions	(Retirements)	June 30, 2003
Land Improvements	\$ 86,782	\$ 89,741	\$ -	\$ 176,523
Building	796,054	16,600	-	812,654
Fixed Equipment	452,103	24,080	(2,314)	473,869
Movable Equipment	574,219	264,605	(108,283)	730,541
Leased Equipment	455,141	93,384	(97,969)	450,556
Construction in Progress	21,741	26,486	(21,741)	26,486
Totals	<u>2,386,040</u>	<u>\$ 514,896</u>	<u>\$ (230,307)</u>	<u>2,670,629</u>
<b>Accumulated Depreciation</b>				
Land Improvements	43,818	9,976	-	53,794
Building	543,605	25,116	-	568,721
Fixed Equipment	374,264	12,861	(2,314)	384,811
Movable Equipment	495,564	24,392	(17,647)	502,309
Leased Equipment	374,750	51,970	(97,969)	328,751
Totals	<u>1,832,001</u>	<u>\$ 124,315</u>	<u>\$ (117,930)</u>	<u>1,838,386</u>
	<u>\$ 554,039</u>			<u>\$ 832,243</u>

**NOTE 7 INVESTMENT IN JOINT VENTURE**

The Health System has entered into an agreement with Mercy Medical Center – Des Moines to be a joint owner of a clinic, Adair County Medical Associates, L.L.C. (ACMA) in Stuart, Iowa. The Health System owns a 50% share of the joint venture. This investment is being accounted for using the equity method of accounting. The Health System contributed \$41,146 during the year ended June 30, 2003, to the joint venture through the payment of expenses on behalf of ACMA. The Health System's share of ACMA loss for the year ended June 30, 2003, respectively was \$64,478 and is included in non-operating gains (losses). As of June 30, 2003, the Health System had a due to ACMA of \$6,206 for cash collected on behalf of ACMA. The joint venture is currently in the process of dissolving and as of August 12, 2004 there has been no agreement reached. The Health System has evaluated its current investment in ACMA in light of the impending dissolution and as a result has the Health System has recognized a loss of \$88,634 for the year ended June 30, 2004. Clinic revenues and expenses were included with the Health System operations for fiscal 2004.

**NOTE 8 OTHER ASSETS**

The Health System purchased a physician practice in Adair County during the year ended June 30, 2003. As part of the clinic purchase, the Health System acquired the medical records of the clinic, which are included in other assets. The Health System is amortizing the value of the medical records over a five year period. The cost of the medical records was \$65,216. Accumulated amortization is \$17,391 and \$4,348 at June 30, 2004 and 2003, respectively.

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2004 AND 2003**

**NOTE 9 LONG-TERM DEBT**

A schedule of changes in the Health System's long-term debt for 2004 and 2003 is as follows:

	Balance July 1, 2003	Additions	(Payments)	Balance June 30, 2004	Amounts Due Within One Year
Notes Payable	\$ 235,963	\$ 210,000	\$ (66,744)	\$ 379,219	\$ 77,600
Obligations Under Capital Lease	83,469	12,886	(34,442)	61,913	29,754
<b>Total Long-Term Debt</b>	<b>\$ 319,432</b>	<b>\$ 222,886</b>	<b>\$ (101,186)</b>	<b>\$ 441,132</b>	<b>\$ 107,354</b>

  

	Balance July 1, 2002	Additions	(Payments)	Balance June 30, 2003	Amounts Due Within One Year
Notes Payable	\$ 77,103	\$ 190,000	\$ (26,749)	\$ 240,354	\$ 48,262
Obligations Under Capital Lease	48,802	60,384	(30,108)	79,078	34,038
<b>Total Long-Term Debt</b>	<b>\$ 125,905</b>	<b>\$ 250,384</b>	<b>\$ (56,857)</b>	<b>\$ 319,432</b>	<b>\$ 82,300</b>

**Notes Payable**

The Health System has entered into notes payable as follows:

- Mortgage to finance the purchase and improvement costs of its home health agency building. The mortgage calls for monthly payments of \$726 including interest through July 2012. The interest is variable and is adjustable every sixty months beginning July 8, 2002. At June 30, 2004 the interest rate is 3.95%.
- Note payable to finance the purchase of medical and office equipment costs of its clinic. The loan calls for monthly payments of \$2,645 including interest. The interest rate is 4.75% and the final payment is due April 2008.
- Note payable to finance the purchase of medical equipment. The loan calls for monthly payments of \$1,457 including interest at 4.75% through July 2005.
- Note payable for the purchase of a house and land adjacent to the Health System building to be used for office space. The note is payable in monthly installments of \$506, including principal and interest at 4.5% through February 2024.
- Note payable for a boiler system payable in monthly installments of \$2,440 including interest at 4.75% through September 2008.

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2004 AND 2003**

**NOTE 9 LONG-TERM DEBT (CONTINUED)**

**Obligations Under Capital Lease**

The Health System has entered into agreements to acquire medical, computer, and telephone equipment under capital leases. The obligations are due in monthly installments totaling \$3,324, expiring on different dates through March 2009, including interest at rates of 6.58% to 13.84%.

Aggregate future payments of principal and interest on the long-term debt obligations are as follows:

Years Ending June 30:	Notes Payable		Capital Lease Obligations	
	Principal	Interest	Principal	Interest
2005	\$ 77,600	\$ 15,687	\$ 29,754	\$ 5,434
2006	65,204	12,291	17,764	2,733
2007	66,540	9,264	8,777	1,089
2008	61,722	14,082	3,032	632
2009	17,818	4,221	2,586	795
2010-2014	42,830	15,846	-	-
2015-2019	22,000	8,354	-	-
2020-2024	25,505	2,825	-	-
	<u>\$ 379,219</u>	<u>\$ 82,570</u>	<u>\$ 61,913</u>	<u>\$ 10,683</u>

The following is the leased equipment by major class at June 30, 2004 and 2003:

	2004	2003
Equipment	\$ 463,440	\$ 450,556
Less Accumulated Depreciation	<u>(378,311)</u>	<u>(328,751)</u>
Net Property Under Capital Lease	<u>\$ 85,129</u>	<u>\$ 121,805</u>

**NOTE 10 DEFINED BENEFIT PENSION PLAN**

The Health System contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits, which are established by State statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, Iowa 50306-9117.

Plan members are required to contribute 3.70% of their annual salary and the Health System is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Health System's contributions to IPERS for the years ended June 30, 2004, 2003, and 2002 were \$143,698, \$124,500, and \$119,238, respectively, equal to the required contributions for each year.

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2004 AND 2003**

**NOTE 11 RELATED ORGANIZATION**

**Management Services**

The Health System has a contractual arrangement with Mercy Medical Center – Des Moines, under which Mercy Medical Center – Des Moines provides an administrator, management consultation, and other services to Adair County Health System. The arrangement does not alter the authority or responsibility of the Board of Trustees of Adair County Health System. Expenses for the administrative and management services received were approximately \$141,957 and \$115,771 for the years ended June 30, 2004 and 2003, respectively.

**Clinic Acquisition**

Effective March 17, 2003, the Health System entered into a purchase agreement with a local clinic in Greenfield, Iowa, for the acquisition of its assets. In conjunction with this agreement, the Health System purchased the supplies, inventory, furniture, fixtures and equipment, and medical records of the clinic for a total purchase price of \$206,216. The provision of professional medical services in Greenfield is included under the Professional Agreement with Mercy Medical Center – North Iowa.

**NOTE 12 COMMITMENTS AND CONTINGENCIES**

**Health System Risk Management**

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

**Litigation**

The Health System is involved in litigation arising in the normal course of business. In consultation with legal counsel, management estimates that these matters will be resolved without material adverse effect on the Health System's financial position or results of operations.

**Rental Agreements**

The Health System has entered into a rental agreement effective March 2003 and ending March 2008. The rental agreement is for the clinic building in Greenfield, which is in conjunction with the clinic acquisition discussed above. The following schedule represents the commitment for future rent payments:

Year Ended June 30,			
2005		\$	60,000
2006			60,000
2007			60,000
2008			45,000
Total Rental Payments		\$	225,000

Rent expense of \$60,000 and \$22,500 on the rental agreement is included in the clinic's expenses for the years ended June 30, 2004 and 2003, respectively.

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## REQUIRED SUPPLEMENTARY INFORMATION

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**ADAIR COUNTY HEALTH SYSTEM  
BUDGETARY COMPARISON SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET  
ASSETS  
YEAR ENDED JUNE 30, 2004**

The Board of Trustees annually prepares and adopts a budget designating the amount necessary for the improvement and maintenance of the Health System on the cash basis following required public notice and hearing in accordance with Chapters 24 and 347 of the Code of Iowa. The Board of Trustees certifies the approved budget to the appropriate county auditors. The budget may be amended during the year utilizing similar statutorily prescribed procedures. Formal and legal budgetary control is based on total expenditures.

	Actual Accrual Basis	Accrual Adjustments	Cash Basis	Budget
Estimated Amount to be Raised by Taxation	\$ 812,298	\$ -	\$ 812,298	\$ 765,898
Estimated Other Revenues/Receipts	<u>5,837,921</u> 6,650,219	<u>(164,588)</u> (164,588)	<u>5,673,333</u> 6,485,631	<u>6,876,272</u> 7,642,170
Expenses/Disbursements Net	<u>6,565,546</u> 84,673	<u>(2,734)</u> (161,854)	<u>6,562,812</u> (77,181)	<u>7,643,975</u> (1,805)
Balance Beginning of Year	<u>2,736,709</u>	<u>(1,668,341)</u>	<u>1,068,368</u>	<u>1,200,273</u>
Balance End of Year	<u><u>\$ 2,821,382</u></u>	<u><u>\$ (1,830,195)</u></u>	<u><u>\$ 991,187</u></u>	<u><u>\$ 1,198,468</u></u>

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## OTHER SUPPLEMENTARY INFORMATION

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF NET PATIENT SERVICE REVENUES  
YEARS ENDED JUNE 30, 2004 AND 2003**

	TOTAL	
	2004	2003
<b>PATIENT CARE SERVICES</b>		
Medical and Surgical	\$ 430,385	\$ 504,720
Swing Bed	80,490	106,830
Intermediate Nursing Care	-	1,710
Total	<u>510,875</u>	<u>613,260</u>
<b>OTHER PROFESSIONAL SERVICES</b>		
Operating Room	288,322	287,721
Recovery Room	32,292	30,475
Anesthesiology	78,002	84,428
Radiology	1,074,863	839,092
Blood Service	13,860	29,400
Laboratory	983,941	740,306
Intravenous Therapy	52,169	46,739
Respiratory Therapy	135,253	135,209
Physical Therapy	300,773	282,726
Occupational Therapy	49,069	18,669
Speech Therapy	10,514	1,308
Electrocardiology	188,363	178,812
Home Health Services	449,385	468,902
Ambulance	245,557	256,359
Medical and Surgical Supplies	140,694	162,686
Pharmacy	402,649	344,068
Emergency	418,740	280,257
Observation Room	118,764	132,601
Clinic	1,096,315	397,987
Total	<u>6,079,525</u>	<u>4,717,745</u>
Total Patient Service Revenues	6,590,400	5,331,005
Charity Care	<u>(22,018)</u>	<u>(3,703)</u>
Total Gross Patient Service Revenue	6,568,382	5,327,302
Adjustments to Patient Service Revenues	<u>(1,283,159)</u>	<u>(609,918)</u>
Net Patient Service Revenues	<u>\$ 5,285,223</u>	<u>\$ 4,717,384</u>

INPATIENTS		OUTPATIENTS	
2004	2003	2004	2003
\$ 430,385	\$ 504,720	\$ -	\$ -
80,490	106,830	-	-
-	1,710	-	-
<u>510,875</u>	<u>613,260</u>	<u>-</u>	<u>-</u>
19,468	22,105	268,854	265,616
1,416	2,355	30,876	28,120
4,527	5,907	73,475	78,521
152,144	111,410	922,719	727,682
13,860	18,900	-	10,500
177,883	194,212	806,058	546,094
10,678	10,258	41,491	36,481
126,284	124,180	8,969	11,029
23,060	27,199	277,713	255,527
7,755	1,583	41,314	17,086
2,796	132	7,718	1,176
42,571	33,707	145,792	145,105
-	-	449,385	468,902
2,244	-	243,313	256,359
48,639	65,562	92,055	97,124
179,096	193,639	223,553	150,429
560	10,002	418,180	270,255
1,399	3,018	117,365	129,583
-	-	1,096,315	397,987
<u>814,380</u>	<u>824,169</u>	<u>5,265,145</u>	<u>3,893,576</u>
<u>\$ 1,325,255</u>	<u>\$ 1,437,429</u>	<u>\$ 5,265,145</u>	<u>\$ 3,893,576</u>

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF ADJUSTMENTS TO NET PATIENT SERVICE REVENUES  
AND OTHER REVENUES  
YEARS ENDED JUNE 30, 2004 AND 2003**

	2004	2003
<b>ADJUSTMENTS TO PATIENT SERVICE REVENUES</b>		
Contractual Adjustments - Medicare	\$ 684,121	\$ 276,391
Contractual Adjustments - Medicaid	94,388	86,678
Provision for Bad Debt	297,708	167,985
Other Allowances and Adjustments	206,942	78,864
 Total Adjustments	 \$ 1,283,159	 \$ 609,918
<b>OTHER REVENUES</b>		
County Taxes	\$ 812,298	\$ 805,388
Cafeteria Meals	44,583	33,868
Grant Revenue	66,418	36,014
Revenues for Expenses of Home Health Services	125,053	123,090
Revenues for Expenses of Ambulance, Adair County	737	12
Lifeline	29,055	29,940
Other	31,373	32,935
 Total Other Revenues	 \$ 1,109,517	 \$ 1,061,247

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF OPERATING EXPENSES  
YEARS ENDED JUNE 30, 2004 AND 2003**

	2004	2003
<b>NURSING SERVICE EXPENSES</b>		
<b>NURSING ADMINISTRATION</b>		
Salaries	\$ 51,384	\$ 45,009
Supplies and Expenses	784	547
	52,168	45,556
<b>MEDICAL AND SURGICAL</b>		
Salaries	535,593	551,369
Supplies and Expenses	281,878	182,893
	817,471	734,262
<b>OBSERVATION</b>		
Salaries	9,337	14,512
	9,337	14,512
<b>OPERATING ROOM</b>		
Salaries	33,044	37,234
Supplies and Expenses	22,197	31,099
	55,241	68,333
<b>INTRAVENOUS THERAPY</b>		
Supplies and Expenses	4,263	6,568
<b>EMERGENCY SERVICE</b>		
Salaries	53,961	50,114
Professional Fees	124,569	146,080
Supplies and Expenses	6,033	3,343
	184,563	199,537
<b>HOME HEALTH</b>		
Salaries	420,058	441,450
Professional Fees	17,376	19,511
Supplies and Expenses	69,887	49,371
	507,321	510,332
<b>AMBULANCE</b>		
Salaries	154,367	139,261
Supplies and Expenses	17,383	22,003
	171,750	161,264
<b>TOTAL NURSING SERVICE EXPENSES</b>	<b>\$ 1,802,114</b>	<b>\$ 1,740,364</b>
<b>OTHER PROFESSIONAL SERVICE EXPENSES</b>		
<b>LABORATORY</b>		
Salaries	\$ 121,285	\$ 118,903
Professional Fees	101,419	48,967
Supplies and Expenses	115,919	97,231
	338,623	265,101
<b>BLOOD SERVICE</b>		
Supplies and Expenses	7,028	13,780

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF OPERATING EXPENSES  
YEARS ENDED JUNE 30, 2004 AND 2003**

	2004	2003
<b>OTHER PROFESSIONAL SERVICE EXPENSES (CONTINUED)</b>		
<b>ELECTROCARDIOLOGY</b>		
Salaries	\$ 4,973	\$ -
Professional Fees	68,529	56,597
	73,502	56,597
<b>RADIOLOGY</b>		
Salaries	144,547	134,094
Professional Fees	91,253	85,547
Supplies and Expenses	286,637	261,517
	522,437	481,158
<b>CT SCANS</b>		
Professional Fees	43,510	33,820
Purchased Services	38,034	41,068
	81,544	74,888
<b>PHARMACY</b>		
Professional Fees	24,000	18,000
Drugs	155,977	116,274
Supplies and Expenses	846	945
	180,823	135,219
<b>ANESTHESIOLOGY</b>		
Professional Fees	48,210	50,560
Supplies and Expenses	13,476	12,353
	61,686	62,913
<b>INHALATION THERAPY</b>		
Supplies and Expenses	16,037	15,341
<b>PHYSICAL THERAPY</b>		
Professional Fees	164,256	161,682
Supplies and Expenses	3,150	3,937
	167,406	165,619
<b>OCCUPATIONAL THERAPY</b>		
Professional Fees	29,760	8,571
<b>SPEECH THERAPY</b>		
Professional Fees	5,755	517
<b>MEDICAL RECORDS</b>		
Salaries	54,229	59,324
Supplies and Expenses	20,456	16,304
	74,685	75,628
<b>CLINICS</b>		
Salaries	402,196	136,011
Supplies and Expenses	594,312	298,432
	996,508	434,443
<b>TOTAL OTHER PROFESSIONAL SERVICE EXPENSES</b>	\$ 2,555,794	\$ 1,789,775

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF OPERATING EXPENSES  
YEARS ENDED JUNE 30, 2004 AND 2003**

	2004	2003
<b>GENERAL SERVICE EXPENSES</b>		
<b>DIETARY</b>		
Salaries	\$ 95,418	\$ 92,359
Food	24,737	23,597
Supplies and Expenses	7,449	7,982
	127,604	123,938
<b>PLANT OPERATION AND MAINTENANCE</b>		
Salaries	42,142	47,255
Utilities	46,827	44,491
Supplies and Expenses	53,545	72,881
	142,514	164,627
<b>HOUSEKEEPING</b>		
Salaries	51,580	39,166
Supplies and Expenses	11,225	14,758
	62,805	53,924
<b>LAUNDRY AND LINEN</b>		
Salaries	30,076	31,282
Supplies and Expenses	4,835	4,600
	34,911	35,882
<b>TOTAL GENERAL SERVICE EXPENSES</b>	<b>\$ 367,834</b>	<b>\$ 378,371</b>
<b>FISCAL, ADMINISTRATIVE AND UNASSIGNED EXPENSES</b>		
<b>FISCAL AND ADMINISTRATIVE SERVICES</b>		
Salaries	\$ 345,275	\$ 232,973
Crisis Child Care Salaries	-	2,388
Crisis Child Care Supplies and Other	-	468
Management Service	141,957	115,771
Supplies and Purchased Services	212,330	127,202
Telephone	26,799	30,474
Professional Fees	30,059	24,693
Collection Fees	15,100	4,497
Physician Recruitment Expenses	55,722	17,350
Lifeline Salaries	22	757
Lifeline Expense	16,193	18,628
Foundation Expense	22,303	18,134
	865,760	593,335
<b>UNASSIGNED EXPENSES</b>		
Insurance	45,998	49,329
Employee Benefits	749,046	637,686
	795,044	687,015
<b>TOTAL FISCAL, ADMINISTRATIVE AND UNASSIGNED EXPENSES</b>	<b>\$ 1,660,804</b>	<b>\$ 1,280,350</b>

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF ANALYSIS OF ACCOUNTS RECEIVABLE FROM PATIENTS  
AND ALLOWANCE FOR DOUBTFUL ACCOUNTS  
YEARS ENDED JUNE 30, 2004 AND 2003**

**Analysis of Aging**

Age of Accounts (by Date of Discharge)	2004		2003	
	Amount	Percent	Amount	Percent
1-30 days (Includes Patients in Hospital June 30)	\$ 617,924	44.26 %	\$ 659,659	38.52 %
31-60 Days	272,048	19.49 %	321,143	18.75 %
61-90 Days	126,625	9.06 %	190,990	11.15 %
91 Days and Over	379,573	27.19 %	540,895	31.58 %
Total Accounts Receivable	<u>1,396,170</u>	<u>100.00 %</u>	<u>1,712,687</u>	<u>100.00 %</u>

**ALLOWANCES**

Contractual - Medicare Medicaid and Other	(154,518)	(231,296)
Doubtful Accounts	(139,358)	(150,000)
Net Accounts Receivable	<u>\$ 1,102,294</u>	<u>\$ 1,331,391</u>

Net Patient Service Revenue per Calendar Day	<u>\$ 15,296</u>	<u>\$ 13,385</u>
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Days of Net Patient Service Revenue in Accounts Receivable at Year End	<u>72</u>	<u>99</u>
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**Analysis of Allowance for Doubtful Accounts**

	2004		2003	
	Amount	Percent of Net Patient Service Revenue	Amount	Percent of Net Patient Service Revenue
Beginning Balance	\$ 150,000		\$ 140,000	
Add:				
Provision for Doubtful Accounts	297,708	7.18 %	167,985	5.42 %
Recoveries Previously Written Off	35,870	0.86 %	28,768	0.93 %
	<u>483,578</u>		<u>336,753</u>	
Deduct:				
Accounts Written Off	(344,220)	(8.30)%	(186,753)	(6.02)%
Ending Balance	<u>\$ 139,358</u>		<u>\$ 150,000</u>	

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF INVENTORIES AND PREPAID EXPENSES  
YEARS ENDED JUNE 30, 2004 AND 2003**

	June 30,	
	2004	2003
<b>INVENTORIES</b>		
Pharmacy	\$ 34,162	\$ 26,624
Medical Surgical	35,769	45,235
Lab	14,102	14,300
Home Care	2,242	3,713
Clinics	3,889	-
Administrative/Office	17,980	15,864
	<u>\$ 108,144</u>	<u>\$ 105,736</u>
Total Inventories		
 <b>PREPAID EXPENSES</b>		
Insurance	\$ 33,206	\$ 29,150
Dues	2,422	2,143
Maintenance	11,329	11,152
	<u>\$ 46,957</u>	<u>\$ 42,445</u>
Total Prepaid Expenses		

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF HOME HEALTH AND CRISIS CHILD CARE REVENUES AND EXPENSES  
YEARS ENDED JUNE 30, 2004 AND 2003**

	2004	2003
<b>REVENUES</b>		
Net Patient Service Revenue	\$ 383,260	\$ 402,622
Other Revenues and Support	191,471	159,104
Total Revenues	574,731	561,726
<b>EXPENSES</b>		
Salaries	420,058	443,838
Employee Benefits	98,222	94,165
Professional Fees	17,376	19,755
Contracted Services	1,400	2,448
Supplies	41,968	16,824
Other	54,061	51,157
Total Expenses	633,085	628,187
Net Income (Loss)	\$ (58,354)	\$ (66,461)

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN  
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE  
WITH GOVERNMENTAL AUDITING STANDARDS**

Board of Trustees  
Adair County Health System  
Greenfield, Iowa

We have audited the financial statements of Adair County Health System as of and for the year ended June 30, 2004, and have issued our report thereon dated August 12, 2004. We conducted our audit in accordance with U.S. generally accepted auditing standards, Chapter 11 of the Code of Iowa, and the standards applicable to financial audits contained in *U.S. Governmental Auditing Standards*, issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether Adair County Health System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 that are required to be reported under *U.S. Government Auditing Standards*.

Comments involving statutory and other legal matters about the Health System's operations for the year ended June 30, 2004 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Health System. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered Adair County Health System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be a material weakness.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control over financial reporting and its operations that we consider to be material weaknesses.

This report, a public record by law, is intended solely for the information and use of the Board of Trustees, management, employees, and citizens of Adair County and other parties to whom the Health System may report. This report is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in cursive script that reads "Larson, Allen, Weishair & Co., LLP".

**LARSON, ALLEN, WEISHAIR & CO., LLP**

Austin, Minnesota  
August 12, 2004

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULE OF FINDINGS  
YEAR ENDED JUNE 30, 2004**

**04-II-1 OFFICIAL DEPOSITORIES**

A resolution naming official depositories has been adopted by the Board of Trustees. The maximum deposit amounts stated in the resolution were not exceeded during the year ended June 30, 2004.

**04-II-2 CERTIFIED BUDGET**

Health System cash basis expenditures during the year ended June 30, 2004, did not exceed budgeted amounts.

**04-II-3 QUESTIONABLE EXPENDITURES**

We noted no expenditures that we believe may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

**04-II-4 TRAVEL EXPENSES**

No expenditures of Health System money for travel expenses of spouses of Health System officials and/or employees were noted.

**04-II-5 BUSINESS TRANSACTIONS**

Ron R. Kneip, Health System Treasurer, is President of Union State Bank, an official depository of the Health System. The Health System also has two outstanding loans with Union State Bank.

John Schildberg is the owner of Schildberg, Inc., which provided maintenance services on the Health System's ambulance.

**04-II-6 BOARD MINUTES**

Board minutes were examined and appeared to give a condensed accurate account of business transacted by the Board.

**04-II-7 DEPOSITS AND INVESTMENTS**

We noted no instances of noncompliance with the deposit and investment provisions of Chapter 12B and 12C of the Code of Iowa and the Health System's investment policy

**04-II-8 PUBLICATION OF BILLS ALLOWED AND SALARIES**

Chapter 374.13(15) of the Code of Iowa states "There shall be published quarterly in each of the official newspapers of the country as selected by the Board of Supervisors pursuant to Section 349.1 the schedule of bills allowed and there shall be published annually in such newspapers the schedule of salaries paid by job classification and category..." The Health System did publish schedules of bills allowed and a schedule of salaries paid as required by the Code.