

Boone County Hospital

Accountants' Report and Financial Statements

June 30, 2004 and 2003



Boone County Hospital
June 30, 2004 and 2003

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Independent Accountants' Report on Financial Statements and Supplementary Information

Board of Trustees
Boone County Hospital
Boone, Iowa

We have audited the accompanying balance sheets of Boone County Hospital as of June 30, 2004 and 2003, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. 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, Chapter 11 of the Code of Iowa and the standards for financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. These 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 Boone County Hospital as of June 30, 2004 and 2003, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 6, 2004 on our consideration of Boone County Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is 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 accompanying management's discussion and analysis is not a required part of the basic financial statements but is 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 measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

/s/ BKD, LLP

Kansas City, Missouri
August 6, 2004

Solutions
for
Success

Boone County Hospital

Management's Discussion and Analysis

Years Ended June 30, 2004 and 2003

Introduction

This management's discussion and analysis of the financial performance of Boone County Hospital provides an overview of the Hospital's financial activities for the years ended June 30, 2004 and 2003. It should be read in conjunction with the accompanying financial statements of the Hospital. Unless otherwise indicated, amounts are rounded to nearest thousands.

Financial Highlights

- Cash, short-term investments and noncurrent cash and deposits increased (decreased) in 2004 and 2003 by \$32,000 and \$(233,000), or 1% and (6)%, respectively.
- The Hospital's net assets increased in each of the past two years with a \$461,000 or 3% increase in 2004 and a \$548,000 or 4% increase in 2003.
- The Hospital reported operating losses of \$254,749 and \$106,396 in 2004 and 2003, respectively.
- The Hospital reported excess of revenues over expenses in both 2004 of \$461,000 and 2003 of \$548,000.
- Net nonoperating revenues increased by \$61,000 over 2003 and were virtually unchanged between 2003 and 2002.

Using This Annual Report

The Hospital's financial statements consist of three statements—a balance sheet; a statement of revenues, expenses and change in net assets; and a statement of cash flows. These statements provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by creditors and contributors. The Hospital is accounted for as a business-type activity and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting.

The Balance Sheet and Statement of Revenues, Expenses and Changes in Net Assets

One of the most important questions asked about any Hospital's finances is "Is the Hospital as a whole better or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Revenues, Expenses and Changes in Net Assets report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting.

Using the accrual basis of accounting means that all of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net assets and changes in them. The Hospital's total net assets—the difference between assets and liabilities—is one measure of the Hospital's financial health or financial position. Over time, increases or decreases in the Hospital's net assets are an indicator of whether its financial health is improving or deteriorating. Other nonfinancial factors, such as changes in the Hospital's patient base, changes in legislation and regulations, measures of the quantity and quality of services provided to its patients and local economic factors should also be considered to assess the overall financial health of the Hospital.

The Statement of Cash Flows

The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash and cash equivalents resulting from four defined types of 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 and cash equivalents during the reporting period.

The Hospital's Net Assets

The Hospital's net assets are the difference between its assets and liabilities reported in the Balance Sheet. The Hospital's net assets increased by \$461,000 (3%) in 2004 over 2003 and \$548,000 (4%) in 2003 over 2002 as shown in Table 1.

Table 1: Assets, Liabilities and Net Assets – Actual Amounts

	2004	2003	2002
Assets			
Patient accounts receivable, net	\$ 4,234,414	\$ 4,419,677	\$ 3,490,076
Other current assets	3,331,872	3,356,977	3,476,514
Capital assets, net	13,678,929	13,341,084	13,278,625
Other noncurrent assets	<u>2,042,375</u>	<u>1,957,046</u>	<u>1,839,751</u>
Total assets	<u>\$ 23,287,590</u>	<u>\$ 23,074,784</u>	<u>\$ 22,084,966</u>
Liabilities			
Long-term debt	\$ 5,407,421	\$ 5,251,804	\$ 5,545,000
Other current and noncurrent liabilities	<u>3,644,259</u>	<u>4,048,178</u>	<u>3,313,312</u>
Total liabilities	<u>9,051,680</u>	<u>9,299,982</u>	<u>8,858,312</u>
Net Assets			
Invested in capital assets, net of related debt	7,637,960	7,648,607	7,359,454
Restricted – expendable	272,482	260,477	248,574
Restricted – nonexpendable	57,440	57,440	57,440
Unrestricted	<u>6,268,028</u>	<u>5,808,278</u>	<u>5,561,186</u>
Total net assets	<u>14,235,910</u>	<u>13,774,802</u>	<u>13,226,654</u>
Total liabilities and net assets	<u>\$ 23,287,590</u>	<u>\$ 23,074,784</u>	<u>\$ 22,084,966</u>

In 2004, the principal change in total assets was due to increases in capital assets. The hospital purchased a new CT scanner and ultrasound equipment to improve radiology services at the hospital. A portion of the assets were financed, which resulted in an increase in long-term debt.

In 2003, a significant change in the Hospital's total assets was due to the activity surrounding the start-up of Boone County Family Medicine Clinics in Boone and Ogden. Those Clinics increased patient accounts receivable and the other current assets of the Hospital. Changes in patient accounts receivable was due to increased volume of services at the Hospital. Although cash and related deposits decreased \$233,000, the Hospital was able to invest in the Clinics, as well as start a Bariatric Surgery program during the year.

Operating Results

In 2004, the Hospital's Excess of Revenues Over Expenses was \$461,108, as shown in Table 2. This excess is less than the \$548,148 generated in fiscal year 2003, due to increased operating expenses.

Table 2: Operating Results

	2004	2003	2002
Operating Revenues			
Net patient service revenue	\$ 23,308,709	\$ 22,212,826	\$ 18,015,595
Other operating revenues	<u>1,780,758</u>	<u>1,469,384</u>	<u>1,216,783</u>
Total operating revenues	<u>25,089,467</u>	<u>23,682,210</u>	<u>19,232,378</u>
Operating Expenses			
Salaries and wages and employee benefits	13,386,173	12,681,426	10,032,546
Medical professional fees	3,147,576	2,871,063	2,243,546
Depreciation and amortization	1,282,424	1,176,200	1,162,072
Other operating expenses	<u>7,528,043</u>	<u>7,059,917</u>	<u>5,711,168</u>
Total operating expenses	<u>25,344,216</u>	<u>23,788,606</u>	<u>19,149,332</u>
Operating Income (Loss)	<u>(254,749)</u>	<u>(106,396)</u>	<u>83,046</u>
Nonoperating Revenues (Expenses)			
Non-capital contributions	25,942	—	—
Interest income	80,064	91,357	125,641
Interest expense	(294,360)	(315,610)	(311,667)
County tax revenues	<u>904,211</u>	<u>878,797</u>	<u>840,663</u>
Total nonoperating revenues	<u>715,857</u>	<u>654,544</u>	<u>654,637</u>
Excess of Revenues Over Expenses	<u>\$ 461,108</u>	<u>\$ 548,148</u>	<u>\$ 737,683</u>

Operating Loss

In 2004, the increased operating loss was attributed to increases in supply expense and pharmacy drug costs. Professional Fees also increased as the Hospital had to obtain temporary coverage for radiologist services. The Hospital also experienced a 41% increase in insurance expense during the year. Net Patient Service revenue increased in 2004 in radiology, physical therapy and emergency services. Salaries, wages and employee benefits increased \$704,747 or 5% due to overall increases of 4% and payments to physicians.

In 2003, the Hospital experienced a slight reduction in Operating Income. The Hospital received a one time payment related to settlement of a Medicare reimbursement issue from 1995 in the amount of \$491,303, which was recorded in net patient service revenue. One nonrecurring expense related to bond arbitrage expense of \$104,109, which is a one-time payment related to the revenue bonds, was included in Operating Expenses. The Excess of Revenues Over Expenses was \$189,535 (26%) less than FYE 2002. The Hospital experienced significant changes in revenues and expenses leading to the Operating Loss for Fiscal Year End 2003. Most of the fluctuation was due to the start-up of Boone County Family Medicine Clinics in Boone and Ogden. The Clinics, which were staffed with seven physicians and other support staff, began operations August 1, 2002. Operation of the Clinics generated \$2,722,474 in Net Patient Revenue during Fiscal Year End 2003. The Clinics also generated 60% of the total increase in operating expenses. The operating expense increases related to the Clinic were \$2,005,715 in Salary/Benefits; \$297,624 in Purchased Service; \$495,051 in Other Operating Expenses (rent, supplies, etc).

The Hospital's Cash Flows

The Hospital's Cash increased slightly in 2004 due to decreases in patient accounts receivable. Cash was expended for capital equipment during the year which reduced the overall increase. The increase in cash in 2004 was approximately \$109,000.

The Hospital's Cash From Operating Activities has decreased in 2003 by approximately \$1.1 million over the prior year. Approximately \$929,000 of this decrease was attributed to the increase in accounts receivable. Total decrease in cash in 2003 was approximately \$240,000.

Capital Asset and Debt Administration

Capital Assets

At the end of 2004 and 2003, the Hospital had \$13,678,929 and \$13,341,084, respectively, invested in capital assets, net of accumulated depreciation, as detailed in Note 5 to the financial statements. In 2004, the Hospital added \$1,600,000 in new capital assets. Nearly \$894,000 of the addition was for a new CT scanner and Ultrasound machine, which were financed over five years.

In 2003, the Hospital purchased new capital assets costing \$1,240,833. Of this amount, \$205,062 was acquired through incursion of capital lease obligations.

Debt

At June 30, 2004 and 2003, the Hospital had \$6,087,618 and \$5,735,141, respectively, in revenue bonds and capital lease obligations outstanding. In 2004, the Hospital financed \$894,000 in equipment with a five year note. Except for capital leases of \$205,062 initiated in 2003, the Hospital issued no new debt in 2003.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. Questions about this report and requests for additional financial information should be directed to the Hospital Administration by telephoning (515) 433-8461.

Boone County Hospital

Balance Sheets

June 30, 2004 and 2003

Assets

	<u>2004</u>	<u>2003</u>
Current Assets		
Cash	\$ 1,474,432	\$ 1,401,292
Short-term deposits	25,000	100,000
Assets held under indenture agreement – Bond Fund	294,008	283,707
Patient accounts receivable, net of allowance; 2004 – \$1,249,655, 2003 – \$1,197,214	4,234,414	4,419,677
Property tax receivable	799,372	904,000
Supplies	707,275	642,685
Prepaid expenses	<u>31,785</u>	<u>25,293</u>
 Total current assets	 <u>7,566,286</u>	 <u>7,776,654</u>
Noncurrent Cash and Deposits		
Internally designated		
Edward H. Peterson Endowment Fund	241,859	237,282
Capital and other expenditures	1,422,884	1,393,756
Education Fund	6,900	6,832
Externally restricted by donors		
Albert C. Linn Endowment Fund	<u>57,440</u>	<u>57,440</u>
	<u>1,729,083</u>	<u>1,695,310</u>
Capital Assets, net of accumulated depreciation	<u>13,678,929</u>	<u>13,341,084</u>
Other Assets		
Deferred financing costs (net of amortization of \$117,028 in 2004 and \$102,396 in 2003)	66,927	81,559
Investment	30,788	13,657
Receivables	163,077	99,020
Other	<u>52,500</u>	<u>67,500</u>
	<u>313,292</u>	<u>261,736</u>
Total Assets	<u>\$ 23,287,590</u>	<u>\$ 23,074,784</u>

Liabilities and Net Assets

	<u>2004</u>	<u>2003</u>
Current Liabilities		
Current maturities of long-term debt	\$ 680,197	\$ 483,337
Accounts payable	671,445	729,067
Accrued expenses		
Payroll and related deductions	971,969	1,237,243
Health insurance	169,122	280,000
Interest	21,526	23,231
Estimated amounts due to third party payers	342,000	391,300
Deferred revenue for property taxes	<u>788,000</u>	<u>904,000</u>
Total current liabilities	3,644,259	4,048,178
Long-term Debt	<u>5,407,421</u>	<u>5,251,804</u>
Total liabilities	<u>9,051,680</u>	<u>9,299,982</u>
Net Assets		
Invested in capital assets, net of related debt	7,637,960	7,648,607
Restricted – expendable for debt service payments	272,482	260,477
Restricted – nonexpendable endowment	57,440	57,440
Unrestricted	<u>6,268,028</u>	<u>5,808,278</u>
Total net assets	<u>14,235,910</u>	<u>13,774,802</u>
Total Liabilities and Net Assets	<u>\$ 23,287,590</u>	<u>\$ 23,074,784</u>

Boone County Hospital
Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Operating Revenues		
Net patient service revenue before provision for uncollectible accounts	\$ 24,462,527	\$ 23,335,633
Provision for uncollectible accounts	<u>(1,153,818)</u>	<u>(1,122,807)</u>
Net patient service revenue	23,308,709	22,212,826
Other	<u>1,780,758</u>	<u>1,469,384</u>
	<u>25,089,467</u>	<u>23,682,210</u>
Operating Expenses		
Salaries and wages	10,687,106	9,990,911
Employee benefits	2,699,067	2,690,515
Medical professional fees	3,147,576	2,871,063
Supplies and other	4,604,215	4,161,566
General services	971,939	993,420
Administrative services	1,705,189	1,730,172
Insurance	246,700	174,759
Depreciation and amortization	<u>1,282,424</u>	<u>1,176,200</u>
	<u>25,344,216</u>	<u>23,788,606</u>
Operating Loss	<u>(254,749)</u>	<u>(106,396)</u>
Nonoperating Revenues (Expenses)		
Non-capital contributions	25,942	—
Interest income	80,064	91,357
Interest expense	(294,360)	(315,610)
Property tax revenue	<u>904,211</u>	<u>878,797</u>
	<u>715,857</u>	<u>654,544</u>
Increase in Net Assets	461,108	548,148
Net Assets, Beginning of the Year	<u>13,774,802</u>	<u>13,226,654</u>
Net Assets, End of the Year	<u>\$ 14,235,910</u>	<u>\$ 13,774,802</u>

Boone County Hospital
Statements of Cash Flows
Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Operating Activities		
Receipts from and on behalf of patients	\$ 23,444,672	\$ 21,505,181
Payments to suppliers	(10,877,101)	(10,011,650)
Payments to employees	(13,653,152)	(12,524,553)
Other receipts and payments, net	<u>1,592,114</u>	<u>1,631,377</u>
Net cash provided by operating activities	<u>506,533</u>	<u>600,355</u>
Noncapital Financing Activities		
Property taxes supporting operations	904,211	878,797
Gifts and grants for other than capital purchases	<u>25,942</u>	<u>—</u>
Net cash provided by noncapital financing activities	<u>930,153</u>	<u>878,797</u>
Capital and Related Financing Activities		
Purchase of capital assets	(649,512)	(996,875)
Proceeds from sale of capital assets	2,800	7,000
Principal payments on long-term debt	(541,408)	(486,493)
Interest paid on long-term debt	<u>(294,360)</u>	<u>(315,610)</u>
Net cash used in capital and related financing activities	<u>(1,482,480)</u>	<u>(1,791,978)</u>
Investing Activities		
Purchase of certificates of deposit	(1,148,560)	(1,575,300)
Proceeds from sale of certificates of deposit	1,223,560	1,556,560
Income received on deposits	<u>79,460</u>	<u>91,357</u>
Net cash provided by investing activities	<u>154,460</u>	<u>72,617</u>
Increase (Decrease) in Cash	108,666	(240,209)
Cash, Beginning of Year	<u>1,839,443</u>	<u>2,079,652</u>
Cash, End of Year	<u>\$ 1,948,109</u>	<u>\$ 1,839,443</u>
Reconciliation of Cash to the Balance Sheets		
Cash	\$ 1,474,432	\$ 1,401,292
Cash in assets held under indenture agreement – Bond Fund	294,008	283,707
Cash and noncurrent cash and deposits		
Internally designated		
Edward H. Peterson Endowment Fund	25,120	20,187
Capital and other expenditures	147,649	127,425
Education Fund	<u>6,900</u>	<u>6,832</u>
	<u>\$ 1,948,109</u>	<u>\$ 1,839,443</u>

Boone County Hospital
Statements of Cash Flows (Continued)
Years Ended June 30, 2004 and 2003

	2004	2003
Reconciliation of Operating Income (Loss) to Net Cash		
Provided by Operating Activities		
Operating loss	\$ (254,749)	\$ (106,396)
Items not requiring (providing) cash		
Loss on sale of capital assets	8,106	2,674
Depreciation and amortization	1,267,424	1,176,200
Amortization	29,632	15,842
Accrued self-insurance	(110,878)	120,000
Changes in		
Patient and other receivables	185,263	(929,601)
Supplies	(64,590)	(131,063)
Prepaid expenses	(6,492)	1,692
Accounts payable and accrued expenses	(408,751)	309,683
Estimated amounts due to third-party payers	(49,300)	221,956
Other	(89,132)	(80,632)
Net cash provided by operating activities	\$ 506,533	\$ 600,355
Supplemental Cash Flows Information		
Capital lease obligation incurred for capital assets	\$ —	\$ 205,062
Notes payable obligation incurred for capital asset	893,885	—
Capital asset acquisitions included in accounts payable	72,778	38,896

Boone County Hospital

Notes to Financial Statements

June 30, 2004 and 2003

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Boone County Hospital is a county public hospital under Chapter 347 of the Code of Iowa. The Hospital primarily earns revenues by providing inpatient, outpatient and emergency care services to patients in the Boone County area. The Hospital is exempt from income taxes as a political subdivision of the State of Iowa.

Basis of Accounting and Presentation

The financial statements of the Hospital have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally county appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program specific (such as county appropriations), property taxes, investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Hospital first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

The Hospital prepares its financial statements as a business-type activity in conformity with applicable pronouncements of the Governmental Accounting Standards Board (GASB). Pursuant to GASB Statement No. 20, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that were issued on or before November 30, 1989, and do not conflict with or contradict GASB pronouncements.

Use of Estimates

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

Risk Management

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

Boone County Hospital

Notes to Financial Statements

June 30, 2004 and 2003

The Hospital is self-insured for a portion of its exposure to risk of loss from employee health claims. Annual estimated provisions are accrued for the self-insured portion of employee health claims and include an estimate of the ultimate costs for both reported claims and claims incurred but not yet reported.

Patient Accounts Receivable

The Hospital reports patient accounts receivable for services rendered at net realizable amounts from third-party payers, patients and others. The Hospital provides an allowance for uncollectible accounts based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Noncurrent Cash and Deposits

Noncurrent cash and deposits include (1) assets permanently restricted by donors, (2) assets restricted under indenture agreements (in current assets) (3) internally designated as unrestricted assets set aside by the Board of Trustees for the Edward H. Peterson Endowment Fund and the Education Fund, and (4) internally designated unrestricted assets set aside by the Board of Trustees for future capital improvements over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Supplies

All supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

Capital Assets

Capital assets are recorded at cost at the date of acquisition, or fair value at the date of donation if acquired by gift. Depreciation is computed using the straight-line method over the estimated useful life of each asset. Assets under capital lease obligations and leasehold improvements are depreciated over the shorter of the lease term or their respective estimated useful lives. The following estimated useful lives are being used by the Hospital.

Land improvements	15 to 20 years
Buildings, improvements and fixed equipment	20 to 40 years
Major moveable equipment, computers and furniture	3 to 7 years

Boone County Hospital

Notes to Financial Statements

June 30, 2004 and 2003

Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered, and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts under reimbursement agreements with third-party payers. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Charity Care

The Hospital provides care without charge or at amounts less than its established rates to patients meeting certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as net patient service revenue. Charges excluded from revenue under the Hospital's charity care policy were \$131,619 and \$129,658 for 2004 and 2003, respectively.

Property Taxes

The Hospital received approximately 4% of its financial support from property tax revenues in the years ended June 30, 2004 and 2003, respectively, which were used to support operations. The Hospital levies the tax in March of each year based on assessed valuation of property in the County as of the second preceding January 1. Tax bills are sent by the County in August and the taxes are payable half on September 1 and March 1, and become delinquent after October 1 and April 1, respectively.

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 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.

Net Assets

Net assets of the Hospital are classified in four 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 unexpendable net assets are noncapital assets that must be used for a particular purpose, as specified by creditors, grantors, or donors external to the Hospital. Restricted expendable net assets include amounts as required by the revenue bond indentures. Restricted net assets are reduced

Boone County Hospital

Notes to Financial Statements

June 30, 2004 and 2003

by any liabilities payable from restricted assets. Restricted nonexpendable net assets equal the principal portion of permanent endowments. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Restricted Nonexpendable Net Assets

The restricted net assets include the Albert C. Linn Endowment Fund. This fund was established by resolution of the Board of Trustees, December 19, 1996, in the amount of \$57,440. The original assets of the fund were acquired from the estate of Albert C. Linn, whose will provided that they were to be used by the Hospital to create an endowment fund, the principal to be invested and retained intact and the income only to be used as directed by the Board of Trustees.

Compensated Absences

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

Deferred Financing Costs

Costs incurred in connection with issuance of the revenue bonds have been deferred and are being amortized to expense over the life of the bonds using the bonds outstanding method.

Medical Malpractice Coverage and Claims

The Hospital purchases medical malpractice insurance under a claims-made policy. Under such policy, only claims made and reported to the insurer are covered during the policy term, regardless of when the incident giving rise to the claim occurred. The cost of the coverage is accrued over the coverage period and includes both the minimum premium plus any estimated additional costs related to claims during the period. Adjustments of estimated to actual expenses after the policy terms are included in the period such adjustments are determined.

Boone County Hospital
Notes to Financial Statements
June 30, 2004 and 2003

Note 2: Net Patient Service Revenue

The Hospital has agreements with third-party payers that provide for payments to the Hospital at amounts different from its established rates. These payment arrangements include:

- **Medicare.** Inpatient acute care services and substantially all outpatient services rendered to Medicare Program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient swingbed services are paid at prospectively determined per diem rates that are based on the patient's acuity. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare Fiscal Intermediary.
- **Medicaid.** Inpatient and outpatient services rendered to Medicaid Program beneficiaries are reimbursed based upon prospectively determined rates.

In 2003, the Hospital received a one-time payment related to settlement of a Medicare reimbursement issue from 1995 in the amount of \$491,303, which was recorded in net patient service revenue at June 30, 2003.

Approximately 57% and 59% of net patient service revenues are from participation in the Medicare and state-sponsored Medicaid Programs for the years ended June 30, 2004 and 2003, respectively.

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

Note 3: Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements. The mix of receivables from patients and third-party payers at June 30, 2004 and 2003 was:

	<u>2004</u>	<u>2003</u>
Medicare and Medicaid	\$ 1,144,771	\$ 1,193,715
Other third-party payers	2,119,626	2,154,488
Patients	1,883,740	1,693,143
Clinics	<u>335,932</u>	<u>575,545</u>
	5,484,069	5,616,891
Less allowances for uncollectible accounts	<u>1,249,655</u>	<u>1,197,214</u>
	<u>\$ 4,234,414</u>	<u>\$ 4,419,677</u>

Boone County Hospital
Notes to Financial Statements
June 30, 2004 and 2003

Note 4: Deposits, Investments and Investment Income

Deposits

Custodial credit risk is the risk that in the event of a bank failure, a government's deposits may not be returned to it. The Hospital's deposit policy for custodial credit risk requires compliance with the provisions of the Code of Iowa. The Code of Iowa provides for additional assessments against the depositories to insure there will be no loss of public funds.

The Hospital had no bank balances exposed to custodial credit risk at June 30, 2004 and 2003.

Investments

The Hospital is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; 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 Hospital had no investments at June 30, 2004 and 2003.

Summary of Carrying Value

The carrying value of deposits included in the balance sheets is as follows:

	2004	2003
Deposits	\$ 3,513,054	\$ 3,465,957
Accrued interest receivable	9,469	14,352
	\$ 3,522,523	\$ 3,480,309
Included in the following balance sheet captions		
Cash	\$ 1,474,432	\$ 1,401,292
Short-term investments	25,000	100,000
Assets held under indenture agreement – Bond Fund	294,008	283,707
Noncurrent cash and deposits	1,729,083	1,695,310
	\$ 3,522,523	\$ 3,480,309

Boone County Hospital
Notes to Financial Statements
June 30, 2004 and 2003

Note 5: Capital Assets

Capital asset additions, retirements, and balances for the years ended June 30, 2004 and 2003, were as follows:

2004	Balance June 30, 2003	Additions	Retirements	Transfers	Balance June 30, 2004
Land and improvements	\$ 676,368	\$ 1,712	\$ —	\$ —	\$ 678,080
Buildings and improvements	12,604,304	17,406	(1,502)	181,460	12,801,668
Equipment	11,508,795	1,420,060	(315,625)	5,637	12,618,867
Construction in progress	<u>10,100</u>	<u>176,997</u>	<u>—</u>	<u>(187,097)</u>	<u>—</u>
	<u>24,799,567</u>	<u>1,616,175</u>	<u>(317,127)</u>	<u>0</u>	<u>26,098,615</u>
Less accumulated depreciation for					
Land and improvements	(120,950)	(9,139)	—	—	(130,089)
Buildings and improvements	(2,890,370)	(509,582)	801	—	(3,399,151)
Equipment	<u>(8,447,163)</u>	<u>(748,703)</u>	<u>305,420</u>	<u>—</u>	<u>(8,890,446)</u>
	<u>(11,458,483)</u>	<u>(1,267,424)</u>	<u>306,221</u>	<u>—</u>	<u>(12,419,686)</u>
	<u>\$ 13,341,084</u>	<u>\$ 348,751</u>	<u>\$ (10,906)</u>	<u>\$ 0</u>	<u>\$ 13,678,929</u>
2003	Balance June 30, 2002	Additions	Retirements	Transfers	Balance June 30, 2003
Land and improvements	\$ 669,738	\$ 6,630	\$ —	\$ —	\$ 676,368
Buildings and improvements	12,295,468	203,733	—	105,103	12,604,304
Equipment	10,883,454	682,913	(320,801)	263,229	11,508,795
Construction in progress	<u>30,875</u>	<u>347,557</u>	<u>—</u>	<u>(368,332)</u>	<u>10,100</u>
	<u>23,879,535</u>	<u>1,240,833</u>	<u>(320,801)</u>	<u>0</u>	<u>24,799,567</u>
Less accumulated depreciation for					
Land and improvements	(111,480)	(9,470)	—	—	(120,950)
Buildings and improvements	(2,401,658)	(488,712)	—	—	(2,890,370)
Equipment	<u>(8,087,772)</u>	<u>(670,518)</u>	<u>311,127</u>	<u>—</u>	<u>(8,447,163)</u>
	<u>(10,600,910)</u>	<u>(1,168,700)</u>	<u>311,127</u>	<u>0</u>	<u>(11,458,483)</u>
	<u>\$ 13,278,625</u>	<u>\$ 72,133</u>	<u>\$ (9,674)</u>	<u>\$ 0</u>	<u>\$ 13,341,084</u>

Boone County Hospital
Notes to Financial Statements
June 30, 2004 and 2003

Note 6: Long-term Debt

A schedule of changes in the Hospital's long-term debt for 2004 and 2003 follows.

	Balance June 30, 2003	Additions	Reductions	Balance June 30, 2004	Amounts Due Within One Year
Series 1997 Hospital Revenue Bonds (A)	\$ 5,545,000	\$ —	\$ 445,000	\$ 5,100,000	\$ 465,000
Note payable to bank (C)	—	893,885	72,505	821,380	169,270
Capital lease obligations (B)	<u>190,141</u>	<u>—</u>	<u>23,903</u>	<u>166,238</u>	<u>45,927</u>
	<u>\$ 5,735,141</u>	<u>\$ 893,885</u>	<u>\$ 541,408</u>	<u>\$ 6,087,618</u>	<u>\$ 680,197</u>

	Balance June 30, 2002	Additions	Reductions	Balance June 30, 2003	Amounts Due Within One Year
Series 1997 Hospital Revenue Bonds (A)	\$ 5,970,000	\$ —	\$ (425,000)	\$ 5,545,000	\$ 445,000
Capital lease obligations (B)	<u>46,572</u>	<u>205,062</u>	<u>(61,493)</u>	<u>190,141</u>	<u>38,337</u>
	<u>\$ 6,016,572</u>	<u>\$ 205,062</u>	<u>\$ (486,493)</u>	<u>\$ 5,735,141</u>	<u>\$ 483,337</u>

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

	Long-term Debt		Capital Lease Obligations	
	Principal	Interest	Principal	Interest
2005	\$ 634,270	\$ 270,891	\$ 45,927	\$ 18,869
2006	660,116	242,359	52,603	12,193
2007	691,164	212,034	67,708	4,547
2008	722,420	179,761	—	—
2009	668,410	146,110	—	—
2010-2012	<u>2,545,000</u>	<u>264,844</u>	<u>—</u>	<u>—</u>
	<u>\$ 5,921,380</u>	<u>\$ 1,315,999</u>	<u>\$ 166,238</u>	<u>\$ 35,609</u>

Boone County Hospital
Notes to Financial Statements
June 30, 2004 and 2003

- (A) Hospital Revenue Bonds, Series 1997; \$7,500,000 maturing serially at varying amounts through 2012; semiannual interest payments at rates ranging from 4.70% to 5.30%; callable beginning December 1, 2007 and thereafter at varying amounts, collateralized by the Hospital's net revenues.
- (B) The capital lease obligation shown as long-term debt includes a lease for an MRI suite, which expires in 2007. The assets and liabilities under the capital lease is recorded at the present value of the minimum lease payments calculated using a maximum number of scans and the scan rate, to be paid during the term of the lease. Depreciation of asset under the capital lease is included in depreciation expense. At June 30, 2004 and 2003, the MRI suite and equipment under the capital lease amounted to \$205,062, and accumulated depreciation was \$30,759 and \$10,253, respectively.
- (C) The note payable to bank is due January 2009, with monthly principal and interest of \$16,225 at 3.4%. The note is secured by radiology equipment.

The Hospital Revenue Bond Indentures place limits on the incurrence of additional borrowings and require that the Hospital satisfy certain measures of financial performance as long as the bonds are outstanding.

Note 7: Employee Health Insurance Claims

The Hospital is self-insured for the first \$75,000 per individual of employee health insurance risks. The Hospital purchases insurance coverage above the self-insurance limits. Losses from asserted claims and from unasserted claims are accrued based on estimates that incorporate the Hospital's past experience, as well as other considerations, including relevant trend factors. Activity in the Hospital's accrued health insurance claims liability during 2004 and 2003 is summarized as follows:

	<u>2004</u>	<u>2003</u>
Balance, beginning of year	\$ 280,000	\$ 160,000
Current year claims incurred and changes in estimates for claims incurred in prior year	1,165,017	1,252,407
Payments for claims	<u>(1,275,895)</u>	<u>(1,132,407)</u>
Balance, end of year	<u>\$ 169,122</u>	<u>\$ 280,000</u>

Boone County Hospital
Notes to Financial Statements
June 30, 2004 and 2003

Note 8: Boone County Health Care Foundation

The Boone County Health Care Foundation is a not-for-profit corporation organized in 1992 for the purpose of supporting and promoting health care services in Boone County, of which the Hospital is the primary beneficiary. The Foundation donated \$25,000 and \$0 to the Hospital for the years ended June 30, 2004 and 2003, respectively. The Hospital provided for the expenses of the Foundation director in the amount of \$10,286 and \$12,285 in 2004 and 2003, respectively. The unaudited financial position and results of operations of the Foundation for 2004 and 2003 are summarized as follows:

	2004	2003
Cash and investments	\$ <u>173,340</u>	\$ <u>190,557</u>
Net assets	\$ <u>173,340</u>	\$ <u>190,557</u>
Revenue	\$ 41,500	\$ 69,570
Expenses	<u>58,717</u>	<u>54,804</u>
Revenue over (under) expenses	\$ <u>(17,217)</u>	\$ <u>14,766</u>

Note 9: Operating Leases

Noncancellable operating leases for primary care outpatient clinic offices and equipment expire in various years through 2012. These leases generally contain renewal options for periods ranging from one to ten years and require the Hospital to pay all executory costs (maintenance and insurance). Rental payments include minimum rentals.

Future minimum lease payments at June 30, 2004, were:

2005	\$ 502,434
2006	501,008
2007	501,008
2008	104,118
2009	104,118
2010 – 2012	<u>321,031</u>
Future minimum lease payments	\$ <u>2,033,717</u>

Rental expense for all operating leases totaled \$652,486 and \$497,282 for 2004 and 2003, respectively.

Boone County Hospital
Notes to Financial Statements
June 30, 2004 and 2003

Note 10: Defined Benefit Pension Plan

Plan Description

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

Funding Policy

Plan members are required to contribute 3.7% of their annual covered salary and the Hospital is required to contribute 5.75% of annual covered payroll for 2004 and 2003. Contribution requirements are established by State statute. The Hospital's contributions to the plan for 2004, 2003 and 2002 were \$616,758, \$559,089 and \$427,275, respectively, which equaled the required contributions for each year.

Note 11: Commitment, Management Agreement

In January 2003, the Hospital entered into a new five-year management agreement with Quorum Health Resources, Inc. Under the agreement, the Hospital will pay Quorum a management fee of \$227,836 for each year of the agreement, subject to an annual adjustment to reflect changes in the *Consumer Price Index*. In addition, Quorum will provide certain key personnel (presently, the administrator and chief financial officer) whose salaries, fringe benefits and employment and payroll taxes are reimbursable under the agreement. Total fees and reimbursements paid to Quorum pursuant to the agreement amounted to \$606,830 and \$555,638 for the years ended June 30, 2004 and 2003, respectively.

Note 12: Budget and Budgetary Accounting

In accordance with the Code of Iowa, the Board of Trustees annually adopts a budget on the cash basis following required public notice and hearings for all funds. The annual budget may be amended during the year utilizing similar statutorily-prescribed procedures.

Boone County Hospital
Notes to Financial Statements
June 30, 2004 and 2003

The following is a reconciliation between reported amounts and cash basis presentation as well as a comparison to budget:

	Book Basis	Actual Accrual Adjustments	Cash Basis	Budget
Amount to be raised by taxation	\$ 904,211	\$ —	\$ 904,211	\$ 904,212
Other revenues/receipts	<u>25,195,473</u>	<u>135,963</u>	<u>25,331,436</u>	<u>25,934,772</u>
	26,099,684	135,963	26,235,647	26,838,984
Expenses/disbursements	<u>25,638,576</u>	<u>479,833</u>	<u>26,118,409</u>	<u>26,868,500</u>
	461,108	(343,870)	117,238	(29,516)
Balance, beginning of year	<u>13,774,802</u>	<u>2,426,814</u>	<u>16,201,616</u>	<u>16,201,616</u>
Balance, end of year	<u>\$ 14,235,910</u>	<u>\$ 2,082,944</u>	<u>\$ 16,318,854</u>	<u>\$ 16,172,100</u>

Note 13: Significant Estimates and Concentrations

Significant estimates and current vulnerability due to certain concentrations include the following:

- Estimates of allowances for adjustments included in net patient service revenue are described in Note 2. Estimates related to the accrual for self-insured health benefits are described in Notes 1 and 7.
- The Hospital is served by three groups of physicians whose patients comprise 71% of the Hospital's net patient service revenue at June 30, 2004.

Note 14: Restricted and Designated Net Assets

At June 30, 2004 and 2003, restricted expendable net assets were available for the following purposes.

	2004	2003
Debt service	\$ <u>272,482</u>	\$ <u>260,477</u>

Boone County Hospital
Notes to Financial Statements
June 30, 2004 and 2003

At June 30, 2004 and 2003, unrestricted net assets had been designated by the Hospital's Board of Trustees for the following purposes.

	2004	2003
Edward H. Peterson Endowment Fund	\$ 241,859	\$ 237,282
Capital and other expenditures	1,422,884	1,393,756
Education Fund	6,900	6,832
Total unrestricted designated net assets	\$ 1,671,643	\$ 1,637,870

Designated net assets remain under the control of the Board of Trustees, which may, at its discretion, later use these net assets for other purposes.

At June 30, 2004 and 2003, \$57,440 represents nonexpendable net assets related to the Albert C. Linn Endowment Fund.

Independent Accountants' Report on Supplementary Information

Board of Trustees
Boone County Hospital
Boone, Iowa

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The nature of our audit procedures is more fully described in our report on the basic financial statements. The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the procedures applied in the audits 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.

/s/ **BKD, LLP**

Kansas City, Missouri
August 6, 2004

Boone County Hospital
Schedules of Patient Service Revenues
Years Ended June 30, 2004 and 2003

	2004			2003		
	Total	Inpatient	Outpatient	Total	Inpatient	Outpatient
Routine Services						
Acute nursing care	\$ 4,870,259	\$ 4,870,259		\$ 4,878,886	\$ 4,878,886	
Nursing Services						
Operating room	4,948,473	1,263,626	\$ 3,684,847	4,661,070	1,164,746	\$ 3,496,324
Recovery room	2,470	2,470		3,361	2,942	419
Emergency room	3,762,020	691,733	3,070,287	2,977,814	664,169	2,313,645
Public health nursing/home health	<u>976,964</u>	<u> </u>	<u>976,964</u>	<u>1,052,691</u>	<u> </u>	<u>1,052,691</u>
	<u>9,689,927</u>	<u>1,957,829</u>	<u>7,732,098</u>	<u>8,694,936</u>	<u>1,831,857</u>	<u>6,863,079</u>
Other Professional Services						
Central service and supply	293,403	252,807	40,596	262,235	226,458	35,777
Laboratory	4,131,234	1,242,391	2,888,843	3,727,081	1,200,060	2,527,021
Radiology	3,335,348	535,908	2,799,440	3,104,611	560,042	2,544,569
MRI	1,542,251	111,692	1,430,559	1,221,697	85,012	1,136,685
CT Scan	1,955,853	459,736	1,496,117	1,541,536	394,129	1,147,407
Pharmacy	5,364,443	3,215,140	2,149,303	4,984,756	3,271,783	1,712,973
Anesthesiology	517,537	110,215	407,322	511,663	149,812	361,851
Physical therapy	2,037,897	351,636	1,686,261	1,937,335	348,740	1,588,595
Speech therapy	115,354	50,641	64,713	93,315	58,320	34,995
Occupational therapy	377,782	167,444	210,338	295,709	138,943	156,766
Cardiac rehab	207,029		207,029	206,585		206,585
Centre OB/GYN				84,375		84,375
Specialty clinics	132,783	116	132,667	100,216	113	100,103
Electrocardiology	2,206,002	1,461,588	744,414	2,031,074	1,366,239	664,835
Ambulance service	1,099,713	422,859	676,854	1,061,789	425,560	636,229
Madrid clinic	30,746		30,746			
BCFM Boone	3,737,868		3,737,868	3,151,277		3,151,277
Ogden clinic	521,534		521,534	468,562		468,562
Clinical psychology	<u>129,435</u>	<u> </u>	<u>129,435</u>	<u>122,290</u>	<u> </u>	<u>122,290</u>
	<u>27,736,212</u>	<u>8,382,173</u>	<u>19,354,039</u>	<u>24,906,106</u>	<u>8,225,211</u>	<u>16,680,895</u>
Patient Service Revenue	42,296,398	\$ <u>15,210,261</u>	\$ <u>27,086,137</u>	38,479,928	\$ <u>14,935,954</u>	\$ <u>23,543,974</u>
Contractual Allowances	<u>17,833,871</u>			<u>15,144,295</u>		
Net Patient Service Revenue, before Provision for Uncollectible Accounts	24,462,527			23,335,633		
Provision for Uncollectible Accounts	<u>(1,153,818)</u>			<u>(1,122,807)</u>		
Net Patient Service Revenue	\$ <u>23,308,709</u>			\$ <u>22,212,826</u>		

Boone County Hospital
Schedules of Other Revenues
Years Ended June 30, 2004 and 2003

	<u>2004</u>	<u>2003</u>
Health Center	\$ 382,367	\$ 355,191
Public health nursing services support	171,940	145,226
Cafeteria and catering services	88,349	91,781
Meals on Wheels	110,532	93,684
Rent income	49,913	50,994
Sale of drugs	420,607	352,574
Home Care Aid services support	221,565	216,259
Purchase discounts	62,302	68,975
Medical records fees	3,020	7,168
Diet education		3,726
Diabetes education	54,275	30,895
Adult daycare grants	61,622	—
Lifeline	48,656	48,192
Other	<u>105,610</u>	<u>4,719</u>
	<u>\$ 1,780,758</u>	<u>\$ 1,469,384</u>

Boone County Hospital

Schedules of Operating Expenses

Years Ended June 30, 2004 and 2003

	2004			2003		
	Total	Salaries	Other	Total	Salaries	Other
Nursing Services						
Nursing administration	\$ 493,647	\$ 451,339	\$ 42,308	\$ 446,467	\$ 432,742	\$ 13,725
Medical/surgical	1,627,615	1,504,236	123,379	1,634,595	1,457,832	176,763
Special care unit	338,998	320,380	18,618	327,823	312,257	15,566
Obstetrics	363,792	297,741	66,051	392,619	260,996	131,623
Operating room	1,307,262	573,008	734,254	1,200,522	580,214	620,308
Same day surgery	83,291	75,788	7,503	72,704	67,174	5,530
Emergency room	1,226,542	475,673	750,869	1,168,418	440,518	727,900
Public health nursing/home health	935,751	746,198	189,553	893,093	714,997	178,096
	<u>6,376,898</u>	<u>4,444,363</u>	<u>1,932,535</u>	<u>6,136,241</u>	<u>4,266,730</u>	<u>1,869,511</u>
Other Professional Services						
Central service and supply	166,450		166,450	155,822		155,822
Laboratory	1,071,760	492,658	579,102	990,745	460,778	529,967
Radiology	1,214,686	400,691	813,995	982,415	370,411	612,004
Occupational therapy	139,549		139,549	93,443		93,443
Cardiac rehab	105,749	98,079	7,670	105,425	97,193	8,232
MRI	364,532		364,532	279,980		279,980
Pharmacy	1,704,220	158,375	1,545,845	1,553,280	156,951	1,396,329
Anesthesiology	287,140		287,140	269,809		269,809
Physical therapy	812,063	50,038	762,025	779,875	49,856	730,019
Audiology	41,555		41,555	33,373		33,373
Health education	55,005	49,061	5,944	54,259	46,617	7,642
Health promotion	109,470	32,058	77,412	106,713	28,880	77,833
Ambulance service	452,132	406,446	45,686	438,083	400,151	37,932
Electrocardiology	342,190	233,417	108,773	319,485	211,090	108,395
Specialty clinics	116,448	84,319	32,129	112,590	87,122	25,468
Centre OB/GYN	360		360	227,732	194,125	33,607
Clinical Psychology	121,856	112,707	9,149	122,870	110,205	12,665
BCFM Boone	2,572,735	1,858,915	713,820	2,107,063	1,455,476	651,587
BCFM Ogden	377,783	283,618	94,165	301,762	209,343	92,419
Madrid clinic	39,040	15,085	23,955	27,915	21,323	6,592
	<u>10,094,723</u>	<u>4,275,467</u>	<u>5,819,256</u>	<u>9,062,639</u>	<u>3,899,521</u>	<u>5,163,118</u>
General Services						
Dietary	459,324	264,880	194,444	453,167	242,114	211,053
Operation of plant	819,944	211,258	608,686	804,095	204,061	600,034
Housekeeping	307,589	261,705	45,884	279,230	244,310	34,920
Laundry	122,925		122,925	147,413		147,413
	<u>1,709,782</u>	<u>737,843</u>	<u>971,939</u>	<u>1,683,905</u>	<u>690,485</u>	<u>993,420</u>
Administrative Services						
Medical records	285,397	204,923	80,474	308,501	206,732	101,769
Administration	2,028,361	695,227	1,333,134	1,969,042	602,937	1,366,105
Quality management	194,075	121,524	72,551	184,198	115,424	68,774
Health center	407,588	195,060	212,528	384,166	196,797	187,369
Health care foundation	11,495	10,286	1,209	13,174	12,137	1,037
Diabetes education	7,706	2,413	5,293	5,266	148	5,118
	<u>2,934,622</u>	<u>1,229,433</u>	<u>1,705,189</u>	<u>2,864,347</u>	<u>1,134,175</u>	<u>1,730,172</u>
Insurance	<u>246,700</u>		<u>246,700</u>	<u>174,759</u>		<u>174,759</u>
Employee Benefits	<u>2,699,067</u>		<u>2,699,067</u>	<u>2,690,515</u>		<u>2,690,515</u>
Depreciation and Amortization	<u>1,282,424</u>		<u>1,282,424</u>	<u>1,176,200</u>		<u>1,176,200</u>
	<u>\$ 25,344,216</u>	<u>\$ 10,687,106</u>	<u>\$ 14,657,110</u>	<u>\$ 23,788,606</u>	<u>\$ 9,990,911</u>	<u>\$ 13,797,695</u>

Boone County Hospital
Schedules of Patient Receivables and Allowance
for Uncollectible Accounts
Years Ended June 30, 2004 and 2003

Schedules of Patient Receivables

	2004		2003	
	Amounts	Percent to Total	Amounts	Percent to Total
Days Since Discharge				
0-30 days	\$ 3,123,685	45.0	\$ 3,146,570	47.6
31-60 days	1,296,461	19.0	979,793	14.8
61-90 days	776,238	11.0	572,874	8.7
91-120 days	357,879	5.0	422,378	6.4
Over 4 months	1,318,015	20.0	1,489,731	22.5
Total	6,872,278	100.0	6,611,346	100.0
Clinic and other receivables	336,373		575,545	
Less contractual allowances	1,724,582		1,570,000	
Less allowance for uncollectible accounts	1,249,655		1,197,214	
Net patient receivables	\$ 4,234,414		\$ 4,419,677	

Allowance for Uncollectible Accounts

	2004	2003
Balance, beginning of year	\$ 1,197,214	\$ 1,102,538
Provision for year	1,153,818	1,122,807
Recoveries of accounts previously written off	343,010	290,862
	2,694,042	2,516,207
Accounts written off	1,444,387	1,318,993
Balance, end of year	\$ 1,249,655	\$ 1,197,214

Boone County Hospital
Schedule of Officials
June 30, 2004

Name	Title	Term Expires
Board of Trustees		
Tim Buckner	Chairman	2009
David Grant	Vice Chairman	2009
Patricia Henkel	Treasurer	2005
Maxine Redeker	Secretary	2007
Keith Kudej	Member	2009
Thomas Good	Member	2007
Bruce Anderson	Member	2007
Hospital Officials		
Joseph Smith	Chief Executive Officer	
Dave Mellett	Chief Financial Officer	

Boone County Hospital
Schedules of Supplies and Prepaid Expenses
Years Ended June 30, 2004 and 2003

Supplies

	2004	2003
General	\$ 56,971	\$ 57,528
Pharmacy	222,663	197,518
BCFM Clinics	33,380	19,518
Dietary	11,271	9,677
Plant operation and maintenance	13,267	3,362
Laboratory	54,726	36,726
Operating room	267,476	274,375
Other supplies	47,521	43,981
	\$ 707,275	\$ 642,685

Prepaid Expenses

	2004	2003
Maintenance and other	\$ 31,785	\$ 25,293

Boone County Hospital
Schedule of Insurance Coverage
June 30, 2004

The Cincinnati Insurance Company

Policy No. BES 265-90-14; \$1,000 deductible
 Boiler & Machinery; 7/1/01 – 7/1/04 \$ 9,000,000

Physicians Insurance Company of Wisconsin, Inc.

Policy No. 133428; 7/1/03 – 7/1/04
 Professional Liability
 Institutional each claim \$ 1,000,000
 Institutional aggregate \$ 3,000,000
 Personal Injury/Property Damage each \$ 1,000,000
 Personal Injury/Property Damage aggregate \$ 3,000,000

Physicians Insurance Company of Wisconsin, Inc.

Policy No. 133430; 7/01/03-7/01/04
 General Liability each \$ 1,000,000
 Damage to premises rented \$ 1,000,000
 Medical expense limit \$ 10,000
 Personal and Advertising Injury limit \$ 1,000,000
 Employee Benefits Liability limit \$ 1,000,000
 General aggregate \$ 3,000,000
 Products/Completed Operations aggregate \$ 1,000,000
 Fire Damage limit \$ 1,000,000

Physicians Insurance Company of Wisconsin, Inc.

Policy No. 133431; 7/1/03 – 7/1/04
 Umbrella Policy
 Professional liability each \$ 5,000,000
 Professional liability aggregate \$ 5,000,000
 Umbrella each \$ 5,000,000
 Umbrella aggregate \$ 5,000,000

Physicians Insurance Company of Wisconsin, Inc.

Policy No. 133432; 7/01/03-7/01/04
 Entity Professional Liability Excess
 Each professional health care incident \$ 5,000,000
 Annual aggregate \$ 5,000,000

Jester Insurance

Policy No. NDP 76048917; 7/1/03 – 7/1/04
 Directors and Officers Liability; \$7,500 deductible
 Each loss \$ 2,000,000
 Aggregate \$ 2,000,000

Employers Mutual Casualty Company

Policy No. OB6-60-22-04; 7/1/03 – 7/1/04
 Business Protection/Inland Marine; \$1,000 deductible
 Buildings \$ 28,709,176
 Personal property \$ 10,202,810
 Data processing equipment \$ 550,000
 Business income \$ 5,500,000

(Continued)

Boone County Hospital
Schedule of Insurance Coverage
June 30, 2004

Farm Bureau

Policy No. 7264582; 7/1/03 – 7/1/04

Workers compensation

Bodily injury – each accident	\$	500,000
Bodily injury – by disease – each employee	\$	500,000
Bodily injury – by disease – policy limit	\$	500,000

Employers Mutual Casualty Company

Policy No. OE6-60-22-04; 7/1/03 – 7/1/04

Automobile liability	\$	1,000,000
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Allied Mutual Insurance Company

Bond No. BD 79 0 0575087; 7/1/03 – 7/1/04

Employee dishonesty	\$	50,000
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Policies expiring in July 2004 have been renewed for a minimum of one year.



Independent Accountants' Report on Compliance and Internal Control Over Financial Reporting Based on the Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Trustees
Boone County Hospital
Boone, Iowa

We have audited the financial statements of Boone County Hospital as of and for the year ended June 30, 2004, and have issued our report thereon dated August 6, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, 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.

Compliance

As part of obtaining reasonable assurance about whether the Hospital'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 *Government Auditing Standards*.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the Hospital'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. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Hospital's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items No. 04-1, 04-2, 04-3 and 04-4.

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider the reportable condition described in No. 04-1 to be a material weakness. We also noted other matters involving the internal control over financial reporting and its operation that we have reported to the Hospital's management in a separate letter dated August 6, 2004.

Compliance with Certain Provisions of Iowa Law

The following comments about the Hospital's compliance with certain provisions of Iowa law for the year ended June 30, 2004 are based exclusively on knowledge obtained from procedures performed during our independent audit of the financial statements of the Hospital for the year ended June 30, 2004. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily examined. In addition, it should be noted that our audit was not directed primarily toward obtaining knowledge of compliance with the following items. Our procedures do not provide a legal determination on the Hospital's compliance with those requirements.

Official Depository Banks

A resolution naming official depositories has been adopted by the Board. The maximum deposit amounts stated in the resolution were exceeded at one depository during the year ended June 30, 2004.

Certified Budget

Hospital expenditures during the year ended June 30, 2004 did not exceed amounts budgeted.

Entertainment Expense

We did not note any expenditures for parties, banquets or other entertainment for employees that we believe may constitute an unlawful expenditure from public funds as defined in an Attorney General's opinion dated April 25, 1979.

Travel Expense

No expenditures of Hospital money for travel expenses of spouses of Hospital officials and/or employees were noted. Mileage reimbursement was approved for employees not in excess of the IRS limits.

Business Transactions

We noted no transactions between the Hospital and Hospital officials or employees other than those exempted by law; i.e., bankers on the Board of Trustees.

Trustee Minutes

No transactions were found that we believe should have been approved in the Trustee minutes but were not.

Deposits and Investments

We noted no instances of noncompliance with the deposit and investment provisions of Chapters 12B and 12C of the Code of Iowa and the Hospital's investment policy.

This report is intended solely for the information and use of the governing body, management and the State of Iowa and is not intended to be and should not be used by anyone other than these specified parties.

/s/ **BKD, LLP**

Kansas City, Missouri
August 6, 2004

Boone County Hospital
Schedule of Findings and Questioned Costs
Year Ended June 30, 2004

Findings Required to be Reported by *Government Auditing Standards*

Reference Number	Finding	Questioned Costs
04-1	The Hospital has certain individuals in the revenue, purchases and payroll functions who perform duties that are not fully segregated from an internal control perspective. Hospital management should periodically reconsider whether further segregation of duties is warranted.	None
04-2	We noted that the cashiers and business manager had both access to cash as well as the ability to post payments to patient accounts as part of the BCFM Clinics' accounts receivable and cash receipts procedures. To strengthen internal controls over cash receipts, we recommend that employees reconcile the cash receipts listing to both the daily cash deposit and a report of the daily cash postings to patient accounts. A review should be made by management of all adjustments/writeoffs on a periodic basis. Hospital management should periodically reconsider whether further segregation of duties is warranted.	None
04-3	There is one person in the Madrid Clinic who has responsibility for collecting cash and office responsibilities. We recommend that a periodic review be performed to ensure all patients who visit the Clinic have a charge generated and, thus, proper payment recorded including the co-pay amount received by the individual. Hospital management should periodically reconsider whether further segregation of duties is warranted.	None
04-4	The Hospital included supply inventory on consignment in the supply inventory total at June 30, 2004. Items on consignment are not owned by the Hospital and should not be recorded as supply inventory.	None

Boone County Hospital
Summary Schedule of Prior Audit Findings
Year Ended June 30, 2004

Findings Required to be Reported by *Government Auditing Standards*

Reference Number	Summary of Finding	Status
03-1	The Hospital has certain individuals in the revenue, purchases and payroll functions who perform duties that are not fully segregated from an internal control perspective. Hospital management should periodically reconsider whether further segregation of duties is warranted.	Resolved
03-2	The Hospital was late in filing its Certificate of Compliance regarding the self-funded health insurance plan. Hospital management should review all policies and procedures to ensure controls are in place to file all documents timely.	Resolved
03-3	We noted that the cashiers and business manager had both access to cash as well as the ability to post payments to patient accounts as part of the Clinic accounts receivable and cash receipts procedures. To strengthen internal controls over cash receipts, we recommend that employees reconcile the cash receipts listing to both the daily cash deposit and a report of the daily cash postings to patient accounts. A review should be made by management of all adjustments/writeoffs on a periodic basis. Hospital management should periodically reconsider whether further segregation of duties is warranted.	Resolved



Board of Trustees
Boone County Hospital
Boone, Iowa

As part of our audit of the financial statements of Boone County Hospital for the year ended June 30, 2004, we studied and evaluated the Hospital's internal control structure. Because the study and evaluation was only part of the overall audit plan regarding the financial statements, it was not intended to be a complete review of all your accounting procedures and, therefore, would not necessarily disclose all reportable conditions or opportunities for improvement. A reportable condition involves matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the Hospital's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. We observed the following matters and offer these comments and suggestions. Previously we made observations as a result of our 2003 audit engagement in a letter dated August 12, 2003.

Internal Controls

Certain matters regarding internal controls were included in the Independent Accountants' Report on Compliance and Internal Control Over Financial Reporting Based on the Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*.

We noted the following areas of segregation of duties issues with the following positions:

- Accounts payable clerk in the Purchases cycle
- Accountant in the Purchases, Revenue and Payroll cycles
- CFO in the Purchases cycle
- Billing clerk and billing office manager in the Revenue cycle

Segregation of accounting duties is an essential element of effective internal controls, involving the separation of custody of assets from related recording of transactions. Segregation of conflicting duties within the Hospital's accounting department may be difficult because of the limited number of personnel. However, there may be compensating controls management could implement to reduce the possibility of errors or irregularities going undetected in the normal course of business.

We encourage you to limit, to the extent possible, performance of incompatible duties by individuals in the Hospital's accounting department. Consider implementing the following changes to improve controls:

- Where review procedures have been implemented to reduce the risk from lack of segregation, demonstrate written evidence of this review process, either directly on the item being reviewed or on a daily review log.
- Limit access to master file screens within the computer systems to necessary individuals via passwords.

- Review of bank statements and enclosures by management of the Hospital prior to submission to the accountant for reconciliation.
- In the Revenue cycle, limit access to actual cash deposits by the employee posting cash receipts to the general ledger by having that employee use a cash receipts listing for posting rather than handling daily deposits. No one person should have access to incoming receipts and ability to record or make adjustments to accounts receivable.
- In the Purchases cycle, the accountant and accounts payable clerk have access to signed checks and the general ledger. The accountant is also responsible for the reconciliation of accounts. We recommend someone other than the accountant or accounts payable clerk mail checks after they have been signed.
- In the Payroll cycle, the accountant has access to signed payroll checks, the ability to record payroll in the general ledger and reconciles the payroll reports to the general ledger. We recommend there be an independent review/approval of the payroll register and of the payroll reconciliation to the general ledger.
- In the Purchases cycle, we recommend the CFO should not be given access to signed checks prior to them being mailed.

Capitalization Policy

Currently, the Hospital capitalizes assets greater than \$500 with a minimum two-year useful life. The Medicare capitalization threshold has increased to \$5,000, allowing the Hospital to expense more items in the year they are acquired. We understand management is evaluating the present capitalization policy and considering some increase in the capitalization threshold, which may be beneficial in reducing the tracking and accounting for such items. The capitalization threshold will effect Medicare reimbursement under certain designations.

Compliance Program Assessment

The Hospital operates under the guidance of a corporate compliance program to promote the Hospital's commitment to conduct business in accordance with health insurance laws and regulations. During the year ended June 30, 2004, we noted the Hospital conducted compliance committee meetings and internal reviews as part of its compliance efforts, but did not have an independent review of the compliance program to determine if the Hospital was following its compliance plan and to evaluate the effectiveness of its compliance activities. The Office of Inspector General has recommended that health care organizations have independent reviews of their compliance activities on a regular basis to determine if the organization is following its compliance plan.

New Accounting Standard

The Governmental Accounting Standards Board recently issued its Statement No. 39 (GASBS No. 39), *Determining Whether Certain Organizations Are Component Units*. The Statement provides additional guidance to determine whether certain organizations for which the Hospital is not financially accountable should be reported as component units in the Hospital's financial statements based on the nature and significance of their relationship with the Hospital. GASBS No. 39 generally requires reporting, as discretely presented component units, organizations that raise and hold economic resources for the direct benefit of the Hospital or one or more of its component units. The Hospital has adopted GASBS No. 39 during the year ended June 30, 2004, which had no effect. The Hospital will need to continue to evaluate on a yearly basis the Boone County Health Care Foundation for inclusion in the Hospital's reporting entity under GASBS No. 39.

Charge Audits

The Hospital performed no charge audits during the year. We recommend the Hospital perform these audits periodically during the year and formally document procedures used, any findings and resolutions, as well as reports to the Compliance Committee to support the Hospital's position in its compliance efforts.

Managed Care and Insurance Discounts

The Hospital is currently not cross-checking the discounts given per managed care and insurance remittance advices against the contracts to ensure the Hospital is being reimbursed in accordance with the agreed rate. We recommend performing this procedure on a selection of higher dollar claims received during the year to ensure the Hospital is receiving the appropriate reimbursement.

Supply Inventory

In performing inventory price testing, we noted some items on consignment were included in inventory. We suggest segregating all consignment items from inventory when counting to ensure these items are not included in the final inventory counts, and ultimately recorded as assets on the Hospital's records.

Accounts Receivable Collections

In evaluating the bad debt and contractual allowances, it is beneficial to look at a retrospective review of actual results in comparison to estimates. This provides evidence to support the estimates are reasonable in light of actual payments from third party payers and patients. In performing this retrospective review, creating a report segregating actual cash receipts received on certain service dates is used to compare to the net accounts receivable recorded. The Hospital's accounting system was unable to produce a report of this nature. We understand management is in process of changing some parameters in the information system to allow this payment data to be extracted and used.

Health Insurance Portability and Accountability Act

Industry associations continue to focus attention on compliance with the Health Insurance Portability and Accountability Act (HIPAA). HIPAA's far reaching provisions impact hospital information systems, operating policies and procedures and strategic planning. As regulations for HIPAA's components continue to be released and clarified, organizations often have a relatively short period in which to comply. While compliance with the privacy and transaction and code set regulations of HIPAA's administrative provisions has previously been the main focus of many organizations, another HIPAA area that will be receiving increased attention in the upcoming year revolves around the security standards.

The primary focus of the security rule is the safeguarding of information and systems that store, process and transmit that information. The major provisions of the rule involve administrative, physical and technical safeguards. Compliance with these provisions is required by April 21, 2005. Maintaining compliance will be an ongoing effort as systems are upgraded and new systems are added.

The security rule requires you to perform risk assessments and this expense should be budgeted. The Hospital should begin the risk assessment and remediation process early, as this process could prove lengthy and time-consuming. As with the other HIPAA provisions, documentation of decisions and good-faith efforts will help you defend possible complaints.

* * * * *

We appreciate the opportunity to present these comments and suggestions. This letter does not express an opinion on the Hospital's overall internal control structure; it does, however, include items that we believe merit your consideration. We can discuss these matters further at your convenience and provide any implementation assistance for changes or improvements you may require.

This letter is intended solely for the information and use of the Board of Trustees and management and is not intended to be and should not be used by anyone other than these specified parties.

/s/ **BKD, LLP**

Kansas City, Missouri
August 6, 2004