

ZION RECOVERY SERVICES, INC.

INDEPENDENT AUDITOR'S REPORT
FINANCIAL STATEMENTS AND ACCOMPANYING INFORMATION
COMMENTS AND RECOMMENDATIONS

YEARS ENDED JUNE 30, 2004 AND 2003

ZION RECOVERY SERVICES, INC.

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ZION RECOVERY SERVICES, INC.
Officials
June 30, 2004

Board of Directors:

Keith Hickey, Chairperson

Jim Richardson, Vice-Chairperson

Don Volk, Secretary-Treasurer

Richard Dolan

Dale Carlson

Brad Golightly

Address

Tabor, Iowa

Shenandoah, Iowa

Atlantic, Iowa

Casey, Iowa

Red Oak, Iowa

Adel, Iowa

Program Administrator:

Laurie Herrick

Atlantic, Iowa

Gronewold, Bell, Kyhnn & Co. P.C.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Zion Recovery Services, Inc.
Atlantic, Iowa

We have audited the accompanying balance sheets of Zion Recovery Services, Inc. as of June 30, 2004 and 2003, and the related statements of activities and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Agency'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 applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards and provisions 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 Zion Recovery Services, Inc. as of June 30, 2004 and 2003, and the results of its operations, changes in net assets, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying information (shown on page 10) 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 auditing procedures applied in our 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.

In accordance with Government Auditing Standards, we have also issued our report dated August 27, 2004 on our consideration Zion Recovery Services, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. 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.

Gronewold, Bell, Kyhnn & Co. P.C.

Atlantic, Iowa
August 27, 2004

ZION RECOVERY SERVICES, INC.
Balance Sheets
June 30,

ASSETS

	<u>2004</u>	<u>2003</u>
Current Assets:		
Cash and cash equivalents	\$ 44,254	\$ 68,014
Certificates of deposit	185,949	181,781
Accounts receivable, less allowance for doubtful accounts (\$24,100 in 2004 and \$31,100 in 2003)	63,503	48,216
Inventory	6,365	9,734
Prepaid expense	<u>11,374</u>	<u>5,194</u>
Total current assets	311,445	312,939
Property and Equipment, Net	<u>97,713</u>	<u>104,355</u>
Total assets	<u>\$ 409,158</u>	<u>\$ 417,294</u>

LIABILITIES AND NET ASSETS

Current Liabilities:		
Accounts payable	\$ 4,633	\$ 3,266
Accrued employee compensation	34,894	33,088
Payroll taxes withheld and accrued	<u>9,769</u>	<u>--</u>
Total current liabilities	49,296	36,354
Net Assets:		
Unrestricted	<u>359,862</u>	<u>380,940</u>
Total liabilities and net assets	<u>\$ 409,158</u>	<u>\$ 417,294</u>

The accompanying notes are an integral part of these statements.

ZION RECOVERY SERVICES, INC.
 Statements of Activities and Changes in Net Assets
 Year ended June 30,

	<u>2004</u>	<u>2003</u>
Support and Revenue:		
Support:		
Iowa Department of Public Health - Comprehensive Treatment: Iowa Managed Substance Abuse Care Plan - Non-Medicaid	\$ 750,118	\$ 679,278
County funding	15,578	19,286
Donations	<u>29,983</u>	<u>23,660</u>
Total support	795,679	722,224
Revenue:		
Client fees, net	152,142	91,417
Medicaid fees	97,464	125,624
Interest income	4,292	4,837
Other revenues	<u>24,767</u>	<u>22,597</u>
Total revenue	<u>278,665</u>	<u>244,475</u>
Total Support and Revenue	1,074,344	966,699
Expenses:		
Salaries and wages	620,641	602,657
Employee benefits	185,796	141,479
Advertising and promotion	5,226	6,582
Provision for depreciation	19,309	17,835
Food costs	58,025	40,646
Insurance	5,800	7,037
Miscellaneous	3,417	6,084
Professional services	15,767	20,410
Rent	49,984	37,789
Repairs and maintenance	20,055	13,699
Supplies and other expense	45,321	42,150
Telephone	17,580	15,790
Training costs	8,590	11,490
Travel	16,009	21,087
Utilities	<u>23,902</u>	<u>25,257</u>
Total expenses	<u>1,095,422</u>	<u>1,009,992</u>
Decrease in Unrestricted Net Assets Before Unusual Item	(21,078)	(43,293)
Unusual Item (Note I)	<u> --</u>	<u>132,690</u>
Increase (Decrease) in Unrestricted Net Assets	(21,078)	89,397
Net Assets at Beginning of Year	<u>380,940</u>	<u>291,543</u>
Net Assets at End of Year	<u>\$ 359,862</u>	<u>\$ 380,940</u>

The accompanying notes are an integral part of these statements.

ZION RECOVERY SERVICES, INC.
Statements of Cash Flows
Year ended June 30,

	2004	2003
Cash flows from operating activities:		
Cash received from clients, third-party payors, and court system	\$ 258,055	\$ 244,884
Cash paid to suppliers and employees	(1,037,274)	(976,567)
Contract funding received	750,118	811,968
County funding received	15,578	19,286
Other operating revenues	1,031	132
Interest received	4,292	4,837
Donations received	1,275	126
Net cash provided by (used in) operating activities	(6,925)	104,666
Cash flows from investing activities:		
Capital expenditures	(12,667)	(24,630)
Purchase of certificates of deposit	(4,168)	(34,465)
Net cash used in investing activities	(16,835)	(59,095)
Net increase (decrease) in cash and cash equivalents	(23,760)	45,571
Cash and cash equivalents at beginning of year	68,014	22,443
Cash and cash equivalents at end of year	\$ 44,254	\$ 68,014
Reconciliation of change in net assets to net cash provided by (used in) operating activities:		
Change in net assets	\$(21,078)	\$ 89,397
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Provision for depreciation	19,309	17,835
Changes in assets and liabilities		
Accounts receivable	(15,287)	5,378
Inventory	3,369	(3,427)
Prepaid expense	(6,180)	(550)
Accounts payable	1,367	(369)
Accrued employee compensation	1,806	(3,598)
Payroll tax withheld and accrued	9,769	--
Total adjustments	14,153	15,269
Net cash provided by (used in) operating activities	\$(6,925)	\$ 104,666

The accompanying notes are an integral part of these statements.

ZION RECOVERY SERVICES, INC.
Notes to Financial Statements
June 30, 2004 and 2003

NOTE A - NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING
POLICIES

1. Nature of Activities

Zion Recovery Services, Inc. (formerly known as Alcohol and Drug Assistance Agency, Inc.) was created in 1973 as a non-profit corporation under the provisions of the Iowa Non-Profit Corporation Act, Chapter 504A of the Code of Iowa. The purpose of the Agency is to provide for the care, maintenance, education and treatment of the substance abuser. The Agency presently serves the six-county area of Adair, Cass, Dallas, Fremont, Montgomery and Page Counties and maintains a residential facility for intermediate care in Orient, Iowa. The Agency is a not for profit corporation and is exempt from income tax under Section 501(c)(3) of the Internal Revenue Code.

2. Basis of Accounting and Presentation

The accompanying financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Revenues are recognized when earned and expenses are recorded when the liability is incurred. Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are reported as increases or decreases in unrestricted net assets unless their use is restricted by explicit donor stipulation or by law.

3. 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.

4. Inventory

The Agency values the food donations received and food inventory at its estimated wholesale cost to show a realistic cost of providing meals to the patients of the residential treatment center.

5. Property and Equipment

Property and equipment is stated at cost. Property and equipment donated for Agency operations are recorded at fair value. The Agency computes depreciation using the straight-line method. Useful lives of equipment range from three to seven years. The useful lives of the building and improvements range from five to fifteen years.

ZION RECOVERY SERVICES, INC.
Notes to Financial Statements
June 30, 2004 and 2003

NOTE A - NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING
POLICIES - Continued

6. Unrestricted Revenues and Support

- a. Client fees are recorded net of adjustments for uncollectible accounts. The adjustments for uncollectible accounts are \$44,057 for 2004 and \$61,945 for 2003.
- b. Contract revenues are recognized as income when contract requirements have been satisfied.

7. Cash and Cash Equivalents

For purposes of the statement of cash flows, the Agency considers all highly liquid debt instruments purchased with a maturity of three months or less and food stamps received for payment of client services to be cash equivalents.

NOTE B - MANAGED CARE CONTRACT

The Agency's substance abuse treatment and rehabilitation services are being reimbursed under a managed care contract administered by Magellan Behavioral Health, Inc. The Agency received approximately 70% of its total support and revenue through this contract for the year ended June 30, 2004 (74% for 2003). The Agency's managed care contract for its current six county service area has been renewed for fiscal year ending June 30, 2005.

NOTE C - PROPERTY AND EQUIPMENT

Property and equipment is stated at acquisition cost. The cost by major category and accumulated depreciation at June 30 are as follows:

	2004	2003
Land	\$ 2,000	\$ 2,000
Land Improvements	132,976	127,814
Building	26,420	22,340
Equipment	121,408	118,771
	282,804	270,925
Less Accumulated Depreciation	185,091	166,570
	\$ 97,713	\$ 104,355

Title to the land, building and improvements is in the names of the corporation and the six counties listed in Note A. In the event of dissolution of the corporation, these assets would belong to the counties.

Equipment includes items purchased with state funds. In the event of dissolution of the corporation, these assets would belong to the State of Iowa.

ZION RECOVERY SERVICES, INC.
Notes to Financial Statements
June 30, 2004 and 2003

NOTE D - FUNCTIONAL EXPENSES

Following is a summary of expenses classified by function:

	2004	2003
Outpatient and Residential Services	\$ 843,932	\$ 780,170
Management and General	251,490	229,822
	\$ 1,095,422	\$ 1,009,992

NOTE E - CONCENTRATION OF CREDIT RISK

The Agency grants credit without collateral to its clients, most of whom are area residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2004 and 2003, was as follows:

	2004	2003
Medicaid	32%	35%
Other third-party payors and patients	68	65
	100%	100%

NOTE F - PENSION AND RETIREMENT BENEFITS

Beginning July 1, 2003, the Agency 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 Agency is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Agency's contribution to IPERS for the year ended June 30, 2004 was approximately \$33,700, equal to the required contribution for the year.

ZION RECOVERY SERVICES, INC.
Notes to Financial Statements
June 30, 2004 and 2003

NOTE G - CONTINGENCY

Risk Management

The Agency is insured by a claims-made policy for protection against liability claims resulting from professional services provided or which should have been provided. Management believes that the malpractice insurance coverage is adequate to cover all asserted and any unasserted claims, therefore no related liability has been accrued. Zion Recovery Services, Inc. is exposed to various other common business risks for which it is covered by commercial insurance. Settled claims from these risks have not exceeded insurance coverage during the past three years.

NOTE H - NON-CASH TRANSACTIONS

The cash transactions of the Agency are presented on the statements of cash flows. The Agency also incurred the following non-cash transactions in addition to the transactions reflected in the reconciliation of change in net assets to net cash provided by (used in) operating activities.

	<u>2004</u>	<u>2003</u>
Iowa Food Bank donations	<u>\$ 28,708</u>	<u>\$ 23,534</u>

NOTE I - UNUSUAL ITEM

In December, 2002, the Agency received incentive payments totaling \$132,690 from the Iowa Department of Public Health related to its fiscal years ended June 30, 2002 and 2001 contracts. The Agency was eligible for this additional funding based on performance of certain outcome measures or other indicators for services provided.

* * *

ACCOMPANYING INFORMATION

ZION RECOVERY SERVICES, INC.
Schedule of Expenditures by Activity
Year ended June 30, 2004

	<u>DUI Services</u>	<u>Outpatient Services</u>	<u>Residential Services</u>	<u>Total</u>
Salaries and wages	\$ 5,042	\$ 406,761	\$ 208,838	\$ 620,641
Employee benefits	722	135,089	49,985	185,796
Advertising and promotion	--	5,088	138	5,226
Provision for depreciation	--	19,309	--	19,309
Food costs	--	--	58,025	58,025
Insurance	--	3,481	2,319	5,800
Miscellaneous	--	3,342	75	3,417
Professional services	600	8,780	6,387	15,767
Rent	4,400	45,584	--	49,984
Repairs and maintenance	--	10,020	10,035	20,055
Supplies and other expense	1,550	29,651	14,120	45,321
Telephone	1	12,573	5,006	17,580
Training costs	--	7,303	1,287	8,590
Travel	53	12,084	3,872	16,009
Utilities	--	5,414	18,488	23,902
	<u>\$ 12,368</u>	<u>\$ 704,479</u>	<u>\$ 378,575</u>	<u>\$ 1,095,422</u>

See Independent Auditor's Report.

COMMENTS AND RECOMMENDATIONS

Gronewold, Bell, Kyhnn & Co. P.C.

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors
Zion Recovery Services, Inc.
Atlantic, Iowa

We have audited the financial statements of Zion Recovery Services, Inc. as of and for the year ended June 30, 2004, and have issued our report thereon dated August 27, 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 Zion Recovery Services, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, non-compliance 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 non-compliance that are required to be reported under Government Auditing Standards.

Comments involving statutory and other legal matters about the Agency'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 Agency. 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. Prior year statutory comments have been resolved.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Zion Recovery Services, Inc.'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 Zion Recovery Services, Inc.'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 Part I of the accompanying Schedule of Findings.

To the Board of Directors
Zion Recovery Services, Inc.

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, of the reportable conditions described in the Schedule of Findings, we believe item 04-I-A is a material weakness. Prior year reportable conditions have been resolved except for item 04-I-A.

This report, a public record by law, is intended solely for the information and use of Zion Recovery Services, Inc. and other parties to whom the Agency may report. This report is not intended to be and should not be used by anyone other than these specified parties.

Gronwald, Bell, Kyhan & W.P.C.

Atlantic, Iowa
August 27, 2004

ZION RECOVERY SERVICES, INC.
Schedule of Findings
Year ended June 30, 2004

PART I - REPORTABLE CONDITIONS

04-I-A Segregation of Duties: A limited number of people have the primary responsibility for most of the accounting and financial duties. As a result, some of those aspects of internal accounting control which rely upon an adequate segregation of duties are, for all practical purposes, missing in the Agency.

Recommendation: We recognize that it may not be economically feasible for the Agency to employ additional personnel for the sole purpose of segregating duties, however, it is our professional responsibility to bring this control deficiency to your attention. We recommend that the Board be aware of the lack of segregation of duties and that they act as an oversight group to the accounting personnel.

Response: The Board is aware of this lack of segregation of duties, but it is not economically feasible for the Agency to employ additional personnel for this reason. The Board will continue to act as an oversight group.

Conclusion: Response accepted.

* * *

PART II - OTHER COMMENT AND RECOMMENDATION

04-II-A Board Minutes: We noted during the audit that the minutes of Board meetings have not been signed.

Recommendation: We recommend that all Board minutes be properly signed after their reading and approval.

Response: The Board minutes will be properly signed in the future.

Conclusion: Response accepted.

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