

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

**FINANCIAL STATEMENTS AND  
SUPPLEMENTARY INFORMATION**

**YEARS ENDED JUNE 30, 2005 AND 2004**

**ADAIR COUNTY HEALTH SYSTEM  
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**ADAIR COUNTY HEALTH SYSTEM  
BOARD OF TRUSTEES AND OFFICIALS  
YEAR ENDED JUNE 30, 2005**

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
BOARD OF TRUSTEES AND OFFICIALS		
Roger Queck	Chairperson	2008
Sherri Kramer	Vice Chairperson	2006
John E. F. Schildberg, III	Secretary	2008
Paul Nelson	Treasurer	2010
Mike Cass	Member	2010
Everett Shepherd	Member	2006
Kara Ladd	Member	2008
HOSPITAL OFFICIALS		
Myrna Erb-Gundel	Administrator	
Lisa Blazek	Chief Financial Officer	

## INDEPENDENT AUDITORS' REPORT

Board of Trustees  
Adair County Health System  
Greenfield, Iowa

We have audited the accompanying financial statements of Adair County Health System as of and for the years ended June 30, 2005 and 2004, which collectively comprise the Health System's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Health System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Adair County Health System as of June 30, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 12, 2005 on our consideration of Adair County Health System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3 through 9 and analysis and budgetary comparison information on page 26 are not required parts of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurements and presentations of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information from pages 27-35 is presented for purpose of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Larson, Allen, Weishair & Co., LLP*

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

Austin, Minnesota  
August 12, 2005

**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT DISCUSSION AND ANALYSIS  
YEAR ENDED JUNE 30, 2005**

The Management Discussion and Analysis offers the readers of Adair County Health System's (the Health System) financial statements a narrative overview and analysis of the financial activities of Adair County Health System for the fiscal years ended June 30, 2005 and 2004. The analysis will focus on the Health System's financial performance as a whole and should be considered in conjunction with the audited financial report.

**Financial Highlights**

- The Health System's total assets increased by \$966,490 or 21% in 2005 and increased by \$107,292 or 1.2% in 2004.
- The Health System's patient service revenues increased \$840,580 or 16% from 2004 to 2005 and \$567,838 or 12.0% from 2003 to 2004.
- The accounts receivable increased by \$34,584 or 3% between 2004 and 2005 and increased by \$229,097 or 17% between 2003 and 2004.

**Required Financial Statements**

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

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

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

There were no significant changes in accounting policies for the year ended June 30, 2005.

**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT DISCUSSION AND ANALYSIS  
YEAR ENDED JUNE 30, 2005**

**Financial Analysis of the Health System**

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

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

	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Assets:</b>			
Current Assets	\$ 3,572,543	\$ 2,667,636	\$ 2,574,841
Noncurrent Cash and Investments	200,000	200,000	200,000
Capital Assets, Net	995,454	924,455	832,243
Succeeding Year Property Tax Receivable	799,692	796,065	765,898
Other Assets	46,782	59,825	167,707
<b>Total Assets</b>	<u><u>\$ 5,614,471</u></u>	<u><u>\$ 4,647,981</u></u>	<u><u>\$ 4,540,689</u></u>
<b>Liabilities:</b>			
Total Current Liabilities	\$ 1,135,284	\$ 696,756	\$ 800,950
Long-Term Debt (Less Current Maturities)	236,414	333,778	237,132
Deferred Revenue from Succeeding Year Property Tax Receivable	799,692	796,065	765,898
<b>Total Liabilities</b>	<u><u>2,171,390</u></u>	<u><u>1,826,599</u></u>	<u><u>1,803,980</u></u>
<b>Net Assets:</b>			
Invested in Capital Assets Net of Related Debt	627,122	483,323	512,811
Restricted For Capital Expenditures	52,217	20,020	-
Unrestricted	2,763,742	2,318,039	2,223,898
<b>Total Net Assets</b>	<u><u>3,443,081</u></u>	<u><u>2,821,382</u></u>	<u><u>2,736,709</u></u>
<b>Total Liabilities and Net Assets</b>	<u><u>\$ 5,614,471</u></u>	<u><u>\$ 4,647,981</u></u>	<u><u>\$ 4,540,689</u></u>

The most significant changes are in Cash and Investments, Patient Accounts Receivable, and Long Term Debt. Cash and Investments increased in 2005 due to \$193,000 in contributions and an increase revenue and cash collections. In 2004 Cash and Investments increased \$288,151. Long-term Debt decreased \$97,364 during 2005. This is attributed to pay off of two equipment leases this year, even though there were two new leases added. Long-term Debt increased \$121,700 during 2004. This is attributed to entering into equipment leases.

**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT DISCUSSION AND ANALYSIS  
YEAR ENDED JUNE 30, 2005**

**Financial Analysis of the Health System (Continued)**

Table 2 summarizes the information from the Statements of Revenues, Expenses, and Changes in Net Assets. Total revenues increased 15% during 2005. This is due to increased volumes and rate increases. Total revenues increased 12% during 2004. This was due to increased services provided. Expenses increased 6% during 2005 due to increased volumes and increased supply and labor costs. Expenses increased 23% during 2004 due to additional services provided and the first full year of clinic operations.

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

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Operating Revenue			
Net Patient Service Revenues	\$ 6,125,803	\$ 5,285,223	\$ 4,717,384
Other Revenues	276,168	297,219	255,859
Total Revenues	<u>6,401,971</u>	<u>5,582,442</u>	<u>4,973,243</u>
Operating Expenses			
Nursing Service	1,857,969	1,802,114	1,740,364
Other Professional Service	2,687,931	2,555,794	1,789,775
General Service	377,868	367,834	378,371
Fiscal, Administrative, and Unassigned Expenses	1,842,787	1,660,804	1,280,350
Depreciation and Amortization	169,788	156,742	128,663
Interest	29,263	22,258	14,798
Total Expenses	<u>6,965,606</u>	<u>6,565,546</u>	<u>5,332,321</u>
Operating Loss	(563,635)	(983,104)	(359,078)
Non-Operating Revenues (Expenses)	<u>1,075,351</u>	<u>1,010,966</u>	<u>916,944</u>
Excess of Revenues over Expenses Before Capital Grants and Contributions	511,716	27,862	557,866
Capital Grants and Contributions	<u>109,983</u>	<u>56,811</u>	<u>20,649</u>
Increase in Net Assets	621,699	84,673	578,515
Net Assets, Beginning of Year	<u>2,821,382</u>	<u>2,736,709</u>	<u>2,158,194</u>
Net Assets, End of Year	<u>\$ 3,443,081</u>	<u>\$ 2,821,382</u>	<u>\$ 2,736,709</u>

**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT DISCUSSION AND ANALYSIS  
YEAR ENDED JUNE 30, 2005**

**Financial Analysis of the Health System (Continued)**

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

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Total Patient Service Revenues	\$ 7,660,890	\$ 6,568,382	\$ 5,327,302
Contractual Adjustments and Provisions for Bad Debt			
Medicare	(1,031,991)	(684,121)	(276,391)
Medicaid	(99,102)	(94,388)	(86,678)
Provision for Bad Debt	(204,402)	(297,708)	(167,985)
Other	(199,592)	(206,942)	(78,864)
Total Contractual Adjustments and Provision for Bad Debt	<u>(1,535,087)</u>	<u>(1,283,159)</u>	<u>(609,918)</u>
Net Patient Service Revenue	<u>\$ 6,125,803</u>	<u>\$ 5,285,223</u>	<u>\$ 4,717,384</u>

Our contractual adjustments leveled off during 2005. One issue that influenced this was the conversion to Rural Health Clinic status for Medicare and Medicaid for our Physician Clinics. This payment system reimburses us based on costs much like the Critical Access method used to reimburse hospital services. Write offs and bad debts stabilized with only a small increase over last year. During 2004 contractual adjustments grew significantly due to the addition of the physician clinics and higher bad debt write-offs.

**Table 4: Other Revenues**

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Cafeteria Meals	\$ 57,183	\$ 44,583	\$ 33,868
Grant Revenue	65,005	66,418	36,014
Revenues for Home Health Services	100,061	125,053	123,090
Revenues for Expenses of Ambulance, Adair County	-	737	12
Lifeline	30,792	29,055	29,940
Other	23,127	31,373	32,935
Total Other Revenues	<u>\$ 276,168</u>	<u>\$ 297,219</u>	<u>\$ 255,859</u>

As a result of an increase in cash received from patients and third parties and increase in patient revenues, accounts receivable decreased from 72 to 66 days in 2005 and decreased from 99 to 72 days in 2004.

Salary expense increased 8% during 2005 and increased 14% during 2004. Total expenses for the Health System increased 6% during 2005 and 23% during 2004.

The Health System's cash flows are consistent with the changes in operating income and financial performance as discussed earlier for 2005 and 2004.

**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT DISCUSSION AND ANALYSIS  
YEAR ENDED JUNE 30, 2005**

**Hospital Statistical Data**

Table 5 shows the Health System statistical data. The admissions and patient days show an increase in comparison with the prior year in part due growth and stability in the physician practices.

**Table 5: Statistical Data**

	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Admissions</b>			
Acute	414	326	339
ICU	9	9	18
Skilled	49	44	58
Intermediate	0	0	3
Total	<u>472</u>	<u>379</u>	<u>418</u>
<b>Patient Days</b>			
Acute	1,165	992	1,185
ICU	9	10	26
Skilled	394	329	437
Intermediate	0	0	6
Total	<u>1,568</u>	<u>1,331</u>	<u>1,654</u>
ER Visits	1,517	1,559	1,631
OP Surgery	213	187	189
24 Hour Observation	87	156	201
Home Health Visits	6,981	8,764	9,141
Stuart Clinic Visits	2,936	1,932	2,775
Greenfield Clinic Visits	11,165	8,543	2,776
Fontanelle/Hospital FP Clinic Visits	4,187	2,721	3,828
<b>Average Length of Stay</b>			
Acute	2.80	3.00	3.40
Skilled	8.10	7.30	7.60
Total	3.34	3.47	3.98
Medicare (Acute)	3.10	3.40	3.60
<b>Average Hourly Length of Stay</b>	63.96	68.77	79.17
<b>Average Daily Census</b>	4.29	3.64	4.54

**Capital Assets**

At June 30, 2005, the Health System had \$995,454 invested in capital assets net of accumulated depreciation. In 2005, the Health System purchased capital assets costing \$235,851, which includes \$93,801 acquired under a capital lease agreement for computer and surgical equipment. It also includes purchase of an ambulance for \$63,000 of which \$60,000 was donated by the county. Currently in progress is planning for a new addition and major renovation of the existing facility. The project will add new patient rooms and remodel and expand the radiology, laboratory, emergency and outpatient surgery departments. The cost of the project is expected to be approximately 6 million dollars. A significant portion of the funding will be obtained through a low interest loan from USDA. At June 30, 2004 the Health System had \$924,455 invested in capital assets net of accumulated depreciation. In 2004, the Health System purchased capital assets costing \$241,701.

**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT DISCUSSION AND ANALYSIS  
YEAR ENDED JUNE 30, 2005**

**Long Term Debt**

**Table 6: Long Term Debt**

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Note Payable	\$ 301,618	\$ 379,219	\$ 235,963
Capital Lease Obligations	66,714	61,913	83,469
 Total Long Term Debt	 <u>\$ 368,332</u>	 <u>\$ 441,132</u>	 <u>\$ 319,432</u>

There are two new capital leases this year. One is for computer hardware and software. The lease had monthly payments of \$1,542 through October 2007, but it was paid in full in July 2005. The second is for surgical scope equipment. It is payable in monthly installments of \$3,656 through September 2005. During 2004 the Health System entered into two new notes payable.

The detail of the notes payable are:

A mortgage to finance the purchase of the home health agency building. The mortgage has monthly payments of \$726 through July 2012. The interest is variable and is adjustable in sixty months from July 2002. At June 30, 2005 the interest rate is 3.95 percent. A note payable to finance the purchase of medical and office equipment costs of a family practice clinic. The loan calls for monthly payments of \$2,645 the interest rate is 4.75% and the final payment is due April 2008. A note payable to finance the purchase of medical equipment with monthly payments of \$1,457 including interest at 4.75% through July 2005. A note payable for the purchase of a house and land used for office space adjacent to the hospital with monthly payments of \$506 including interest at 4.5% through February 2024. Finally a note payable for a boiler system in monthly installments of \$2,440 including interest at 4.75% through September 2009.

The Health System has entered into agreements to acquire a sterilizer, hematology machine, computer equipment, scope equipment and a time clock system under capital leases. The obligations were due in monthly installments totaling \$7,255, expiring on different dates through March 2009, including interest at rates of 6.58% to 10.92%. The lease for the time clock system and sterilizer were paid in full in FYE 2005. The lease for hematology equipment originally set to mature in May 2007 at a 10.92% rate, which was subsequently paid in full in July 2005. A lease for scope equipment set to mature in September 2005 at 0% rate. A lease for computer equipment set to mature in December 2005 at a 6.58% rate which was subsequently paid in full in July 2005.

**Economic Factors**

The Health System improved several aspects of its financial position such as increasing its cash and investments, decreasing its debt, and increasing its patient revenues. We also finalized arrangements for a new primary care physician to start practice in our clinics August 1, 2005. Funds from the county remained stable after decreasing over the prior 3 years. The dollars to home care and public health programs continue to be in jeopardy as the county and state work to balance their budgets. The county has indicated future cuts may occur.

**ADAIR COUNTY HEALTH SYSTEM  
MANAGEMENT DISCUSSION AND ANALYSIS  
YEAR ENDED JUNE 30, 2005**

**Contacting the Health System**

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

**ADAIR COUNTY HEALTH SYSTEM  
BALANCE SHEETS  
YEAR ENDED JUNE 30, 2005**

	2005	2004
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and Cash Equivalents	\$ 1,132,400	\$ 791,187
Certificates of Deposit	1,039,605	545,447
Patient Receivables, Less Allowance for Uncollectible Accounts (2005 - \$199,000 and 2004 - \$139,000)	1,136,878	1,102,294
Accounts Receivable - Other	23,745	16,607
Third-Party Payor Settlement Payable	-	57,000
Inventories	196,407	108,144
Prepaid Expenses	43,508	46,957
Total Current Assets	3,572,543	2,667,636
<b>NONCURRENT CASH AND INVESTMENTS</b>		
Internally Designated By Board for Capital Expenditures	200,000	200,000
<b>CAPITAL ASSETS, NET</b>		
	995,454	924,455
<b>OTHER ASSETS</b>		
Succeeding Year Property Taxes Receivable	799,692	796,065
Other Assets	46,782	59,825
Total Other Assets	846,474	855,890
Total Assets	\$ 5,614,471	\$ 4,647,981

<b>LIABILITIES AND NET ASSETS</b>	<u>2005</u>	<u>2004</u>
<b>CURRENT LIABILITIES</b>		
Current Maturities of Long-Term Debt	\$ 131,918	\$ 107,354
Accounts Payable	201,071	279,866
Accrued Employee Compensation	328,753	309,536
Third-Party Payor Settlement Payable	473,542	-
Total Current Liabilities	<u>1,135,284</u>	<u>696,756</u>
<b>LONG-TERM DEBT</b> , Less Current Maturities	236,414	333,778
<b>DEFERRED REVENUE</b>		
Succeeding Year Property Taxes	<u>799,692</u>	<u>796,065</u>
Total Liabilities	2,171,390	1,826,599
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>NET ASSETS</b>		
Invested in Capital Assets Net of Related Debt	627,122	483,323
Restricted For Capital Expenditures	52,217	20,020
Unrestricted	<u>2,763,742</u>	<u>2,318,039</u>
Total Net Assets	<u>3,443,081</u>	<u>2,821,382</u>
Total Liabilities and Net Assets	<u>\$ 5,614,471</u>	<u>\$ 4,647,981</u>

**ADAIR COUNTY HEALTH SYSTEM  
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS  
YEARS ENDED JUNE 30, 2005 AND 2004**

	2005	2004
<b>OPERATING REVENUES</b>		
Net Patient Service Revenues (Net of provision for bad debts of \$204,402 in 2005 and \$297,708 in 2004)	\$ 6,125,803	\$ 5,285,223
Other Revenues	276,168	297,219
Total Revenues	6,401,971	5,582,442
<b>EXPENSES</b>		
Nursing Service	1,857,969	1,802,114
Other Professional Service	2,687,931	2,555,794
General Service	377,868	367,834
Fiscal, Administrative, and Unassigned Expenses	1,842,787	1,660,804
Depreciation and Amortization	169,788	156,742
Interest	29,263	22,258
Total Expenses	6,965,606	6,565,546
<b>OPERATING LOSS</b>	(563,635)	(983,104)
<b>NON-OPERATING REVENUE (EXPENSES)</b>		
Tax Apportionments	838,962	812,298
Investment Income	41,726	29,051
Unrestricted Contributions	194,663	256,401
Loss From Disposition of Joint Venture	-	(88,634)
Loss on Disposal of Property	-	1,850
Net Nonoperating Gains	1,075,351	1,010,966
<b>EXCESS OF REVENUES OVER EXPENSES BEFORE CAPITAL GRANTS AND CONTRIBUTIONS</b>	511,716	27,862
Capital Grants and Contributions	109,983	56,811
Increase in Net Assets	621,699	84,673
Net Assets Beginning of Year	2,821,382	2,736,709
Net Assets End of Year	\$ 3,443,081	\$ 2,821,382

See accompanying Notes to Financial Statements.

**ADAIR COUNTY HEALTH SYSTEM  
STATEMENTS OF CASH FLOWS  
YEARS ENDED JUNE 30, 2005 AND 2004**

	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Cash Received from Patients and Third Parties	\$ 6,621,761	\$ 5,382,320
Cash Paid to Employees	(2,747,640)	(2,509,983)
Cash Paid to Suppliers	(4,170,445)	(3,931,346)
Other Receipts and Payments, Net	276,168	291,013
Net Cash Used by Operating Activities	(20,156)	(767,996)
<b>CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES</b>		
Tax Appropriations	838,962	812,298
Contributions	304,646	313,212
Net Cash Provided by Non-Capital Financing Activities	1,143,608	1,125,510
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Purchase of Property and Equipment	(142,051)	(214,970)
Proceeds from Issuance of Long Term Debt	-	210,000
Payments on Long Term Debt	(158,493)	(101,186)
Interest Payments on Long-Term Debt	(29,263)	(22,258)
Net Cash Used by Capital and Related Financing Activities	(329,807)	(128,414)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest Income	41,726	29,051
Purchases of Certificates of Deposit, Net	(494,158)	(274,948)
Net Cash Used by Investing Activities	(452,432)	(245,897)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	341,213	(16,797)
Cash and Cash Equivalents - Beginning	791,187	807,984
<b>CASH AND CASH EQUIVALENTS - ENDING</b>	\$ 1,132,400	\$ 791,187

See accompanying Notes to Financial Statements.

**ADAIR COUNTY HEALTH SYSTEM  
STATEMENTS OF CASH FLOWS (CONTINUED)  
YEARS ENDED JUNE 30, 2005 AND 2004**

<b>RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES</b>	2005	2004
Operating Loss	\$ (563,635)	\$ (983,104)
Adjustments to Reconcile Income from Operations to Net Cash Provided by Operating Activities		
Interest Expense	29,263	22,258
Depreciation and Amortization	169,788	156,742
Decrease (Increase) in -		
Patient Receivables	(34,584)	229,097
Third Party Payor Settlements Receivable	57,000	(57,000)
Other Receivables	(7,138)	179
Inventories	(88,263)	(2,408)
Prepaid Expenses	3,449	(4,512)
Increase (Decrease) in -		
Accounts Payable	(78,795)	(87,546)
Accrued Salaries, Wages, Benefits and Other	19,217	39,504
Third Party Payor Settlements Payable	473,542	(75,000)
Due to Related Organization	-	(6,206)
Net Cash Used by Operating Activities	\$ (20,156)	\$ (767,996)
 <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>		
Noncash Investing and Financing Activities		
Equipment Acquired Under Capital Leases	\$ 93,801	\$ 12,886

See accompanying Notes to Financial Statements.

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

**NOTE 1 SIGNIFICANT ACCOUNTING POLICIES**

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

**A. Reporting Entity**

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

**B. Basis of Accounting**

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

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

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

**C. Use of Estimates**

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

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

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

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

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

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

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

*Patient Receivables* – The Health System provides an allowance for uncollectible accounts based on the allowance method using management's judgment. Patients are not required to provide collateral for services rendered. Payment for services is required within 30 days of receipt of invoice or claim submitted. Accounts past due more than 90 days are turned over to collection agents. In addition, an allowance is estimated for other accounts based on historical experience in the Health System. At June 30, 2005 and 2004, the allowance for uncollectible accounts was \$199,000 and \$139,000, respectively. Accounts receivable are shown at the amount expected to be collected after determining the allowance for doubtful accounts.

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

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

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

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

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

**D. Assets, Liabilities, and Net Assets (Continued)**

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

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

*Net Assets* – Net assets of the Health System are classified into three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors or contributors external to the Health System. Unrestricted net assets are remaining net assets that do not meet the definition of invested capital assets net of related debt or restricted. As of June 30, 2005 and 2004 restricted net assets consisted of \$52,217 and \$20,020 for capital expenditures.

**E. Operating Revenues and Expenses**

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

**F. Net Patient Service Revenue**

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

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

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

**G. Contributions**

From time to time the Health System receives contributions from individuals and private organizations. Revenues from contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

**H. Restricted Resources**

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

**I. Charity Care**

The Health System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Health System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Total charity care provided amounted to \$16,537 and \$22,018 for the years ended June 30, 2005 and 2004, respectively.

**J. County Tax Revenue**

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

**K. Other Assets**

Other assets consist of costs related to the purchase of medical records. Medical records are being amortized over five years using the straight-line method. Accumulated amortization was \$30,434 and \$17,391 at June 30, 2005 and 2004, respectively.

**L. Reclassification of 2004 Data**

Data in 2004 financial statements have been reclassified to conform with the 2005 basis of presentation. The reclassifications have no effect on the previously reported net income or equity.

**NOTE 2 DESIGNATED NET ASSETS**

Of the \$2,763,742 and \$2,318,039 of unrestricted net assets at June 30, 2005 and 2004, respectively, \$200,000 has been designated by the Health System's Board of Trustees for capital acquisitions. Designated funds remain under the control of the Board of Trustees, which may at its discretion later use the funds for other purposes.

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

**NOTE 3 NET PATIENT SERVICE REVENUE**

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

**Medicare**

The Health System is certified as a Critical Access Hospital (CAH) and receives reimbursement for services provided to Medicare beneficiaries based on the cost of providing those services. Interim payment rates are established for inpatient and outpatient services, with settlement for over or under payments determined based on year-end cost reports. The Health System's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Health System. The Health System's Medicare cost reports have been finalized by the Medicare intermediary through June 30, 2002.

**Medicaid**

The Health System is certified as a Critical Access Health System (CAH) and receives reimbursement for services provided to Medicaid beneficiaries based on the cost of providing those services. Interim payment rates are established for inpatient and outpatient services, with settlement for over or under payments determined based on year-end cost reports. The Health System's Medicaid cost reports have been finalized by the Medicaid intermediary through June 30, 2002.

**Other**

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

Revenue from the Medicare and Medicaid programs accounted for approximately 52% percent and 6% percent, respectively, of the Health System's net patient revenue for the year ended 2005, and 56% percent and 6% percent, respectively, of the Health System's net patient revenue, for the year ended 2004. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

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

	<u>2005</u>	<u>2004</u>
Total Patient Service Revenue	\$ 7,660,890	\$ 6,568,382
Contractual Adjustments:		
Medicare	(1,031,991)	(684,121)
Medicaid	(99,102)	(94,388)
Provision for Bad Debt	(204,402)	(297,708)
Other	(199,592)	(206,942)
Total Contractual Adjustments and Bad Debts	<u>(1,535,087)</u>	<u>(1,283,159)</u>
Net Patient Service Revenue	<u>\$ 6,125,803</u>	<u>\$ 5,285,223</u>

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

**NOTE 4 PATIENT RECEIVABLES**

Patient receivables reported as current assets by the Health System at June 30, 2005 and 2004 consisted of the following:

	2005	2004
Receivable from Patients and Their Insurance Carriers	\$ 796,965	\$ 725,506
Receivable from Medicare	451,964	426,621
Receivable from Medicaid	86,949	89,167
Total Patient Receivables	1,335,878	1,241,294
Less Allowance for Doubtful Accounts	(199,000)	(139,000)
Patient Receivables, Net	\$ 1,136,878	\$ 1,102,294

**NOTE 5 DEPOSITS AND INVESTMENTS**

The Health System's deposits in banks at June 30, 2005 were entirely covered by federal depository insurance or the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This Chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

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

Deposits are Included in the Following Balance Sheet Captions:

	2005	2004
Cash and Cash Equivalents	\$ 1,132,400	\$ 791,187
Certificates of Deposit	1,039,605	545,447
Noncurrent Cash and Investments		
Internally Designated By Board for Capital Expenditures	200,000	200,000
Total Deposits	\$ 2,372,005	\$ 1,536,634

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

**NOTE 6 CAPITAL ASSETS**

Summaries of capital assets for the years ended June 30, 2005 and 2004 are as follows:

<b>Capital Assets</b>	July 1, 2004	Additions	(Retirements)	June 30, 2005
Land Improvements	\$ 190,548	\$ -	\$ -	\$ 190,548
Building	884,044	5,460	-	889,504
Fixed Equipment	586,281	-	-	586,281
Movable Equipment	743,465	181,270	352,136	1,276,871
Leased Equipment	463,440	43,867	(387,031)	120,276
Construction in Progress	20,697	5,254	(8,107)	17,844
Totals	<u>2,888,475</u>	<u>\$ 235,851</u>	<u>\$ (43,002)</u>	<u>3,081,324</u>
<b>Accumulated Depreciation</b>				
Land Improvements	65,624	11,781	-	77,405
Building	594,909	27,002	-	621,911
Fixed Equipment	387,975	18,765	-	406,740
Movable Equipment	537,201	62,983	324,431	924,615
Leased Equipment	378,311	36,214	(359,326)	55,199
Totals	<u>1,964,020</u>	<u>\$ 156,745</u>	<u>\$ (34,895)</u>	<u>2,085,870</u>
	<u>\$ 924,455</u>			<u>\$ 995,454</u>
<b>Capital Assets</b>	July 1, 2003	Additions	(Retirements)	June 30, 2004
Land Improvements	\$ 176,523	\$ 14,025	\$ -	\$ 190,548
Building	812,654	71,390	-	884,044
Fixed Equipment	473,869	126,439	(14,027)	586,281
Movable Equipment	730,541	16,963	(4,039)	743,465
Leased Equipment	450,556	12,884	-	463,440
Construction in Progress	26,486	125,643	(131,432)	20,697
Totals	<u>2,670,629</u>	<u>\$ 367,344</u>	<u>\$ (149,498)</u>	<u>2,888,475</u>
<b>Accumulated Depreciation</b>				
Land Improvements	53,794	11,830	-	65,624
Building	568,721	26,188	-	594,909
Fixed Equipment	384,811	17,246	(14,082)	387,975
Movable Equipment	502,309	38,875	(3,983)	537,201
Leased Equipment	328,751	49,560	-	378,311
Totals	<u>1,838,386</u>	<u>\$ 143,699</u>	<u>\$ (18,065)</u>	<u>1,964,020</u>
	<u>\$ 832,243</u>			<u>\$ 924,455</u>

Construction in progress as of June 30, 2005 and 2004 relates to costs incurred during the planning of a facility renovation. The project is currently in the preliminary phases of planning and is expected to cost \$5.2 to \$6.0 million. The project is to be funded with a USDA loan of \$3,000,000, cash reserves of the hospital ranging from \$600K to \$800K, \$1,000,000 in capital contributions and the remainder in private loans. The project is expected to be completed in two phases the first of which beginning in the spring of 2006 and the second to follow in the subsequent year.

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

**NOTE 7 INVESTMENT IN JOINT VENTURE**

The Health System entered into an agreement with Mercy Medical Center – Des Moines to be a joint owner of a clinic, Adair County Medical Associates, L.L.C. (ACMA) in Stuart, Iowa during fiscal year 2003. The Health System owned a 50% share of the joint venture. This investment was accounted for using the equity method of accounting. In fiscal 2005, the joint venture was dissolved. In 2004 the Health System recognized a loss on impairment of the joint venture for \$88,634 for the year ended June 30, 2004. Clinic revenues and expenses were included with the Health System operations for fiscal 2004.

**NOTE 8 OTHER ASSETS**

The Health System purchased a physician practice in Adair County during the year ended June 30, 2003. As part of the clinic purchase, the Health System acquired the medical records of the clinic, which are included in other assets. The Health System is amortizing the value of the medical records over a five year period. The cost of the medical records was \$65,216. Accumulated amortization is \$30,434 and \$17,391 at June 30, 2005 and 2004, respectively.

**NOTE 9 LONG-TERM DEBT**

A schedule of changes in the Health System's long-term debt for 2005 and 2004 is as follows:

	Balance July 1, 2004	Additions	(Payments)	Balance June 30, 2005	Amounts Due Within One Year
Notes Payable	\$ 379,219	\$ -	\$ (77,601)	\$ 301,618	\$ 65,204
Obligations Under Capital Lease	61,913	93,801	(89,000)	66,714	66,714
Total Long-Term Debt	<u>\$ 441,132</u>	<u>\$ 93,801</u>	<u>\$ (166,601)</u>	<u>\$ 368,332</u>	<u>\$ 131,918</u>
	Balance July 1, 2003	Additions	(Payments)	Balance June 30, 2004	Amounts Due Within One Year
Notes Payable	\$ 235,963	\$ 210,000	\$ (66,744)	\$ 379,219	\$ 77,600
Obligations Under Capital Lease	83,469	12,886	(34,442)	61,913	29,754
Total Long-Term Debt	<u>\$ 319,432</u>	<u>\$ 222,886</u>	<u>\$ (101,186)</u>	<u>\$ 441,132</u>	<u>\$ 107,354</u>

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

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

**Notes Payable**

The Health System has entered into notes payable as follows:

- Mortgage to finance the purchase and improvement costs of its home health agency building. The mortgage calls for monthly payments of \$726 including interest through July 2012. The interest is variable and is adjustable every sixty months beginning July 8, 2002. At June 30, 2005 the interest rate is 3.95%.
- Note payable to finance the purchase of medical and office equipment costs of its clinic. The loan calls for monthly payments of \$2,645 including interest. The interest rate is 4.75% and the final payment is due April 2008.
- Note payable to finance the purchase of medical equipment. The loan calls for monthly payments of \$1,457 including interest at 4.75% through July 2005.
- Note payable for the purchase of a house and land adjacent to the Health System building to be used for office space. The note is payable in monthly installments of \$506, including principal and interest at 4.5% through February 2024.
- Note payable for a boiler system payable in monthly installments of \$2,440 including interest at 4.75% through September 2009.

**Obligations Under Capital Lease**

The Health System has entered into agreements to acquire medical, computer, and telephone equipment under capital leases. The obligations are due in monthly installments totaling \$7,255, including interest at rates of 6.58% to 10.92%. Subsequent to the year ended June 30, 2005 the capital leases were paid off. The remaining balances of these capital leases are included as current maturities in 2006.

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

Years Ending June 30:	Notes Payable		Capital Lease Obligations	
	Principal	Interest	Principal	Interest
2006	\$ 65,204	\$ 12,291	\$ 66,714	\$ 3,717
2007	66,540	9,264	-	-
2008	61,722	6,145	-	-
2009	17,818	4,221	-	-
2010	11,065	3,720	-	-
2011-2015	36,198	12,311	-	-
2016-2020	23,531	6,822	-	-
2021-2025	19,540	1,338	-	-
	\$ 301,618	\$ 56,112	\$ 66,714	\$ 3,717

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

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

The following is the leased equipment by major class at June 30, 2005 and 2004:

	2005	2004
Equipment	\$ 120,276	\$ 463,440
Less Accumulated Depreciation	(55,199)	(378,311)
Net Property Under Capital Lease	\$ 65,077	\$ 85,129

**NOTE 10 DEFINED BENEFIT PENSION PLAN**

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

Plan members are required to contribute 3.70% of their annual salary and the Health System is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Health System's contributions to IPERS for the years ended June 30, 2005, 2004, and 2003 were \$156,511, \$143,699, and \$124,500, respectively, equal to the required contributions for each year.

**NOTE 11 RELATED ORGANIZATION**

**Mercy Medical Center – Des Moines**

The Health System has a contractual arrangement with Mercy Medical Center – Des Moines, under which Mercy Medical Center – Des Moines provides an administrator, management consultation, and other services to Adair County Health System. The arrangement does not alter the authority or responsibility of the Board of Trustees of Adair County Health System. Expenses for the administrative and management services received were approximately \$137,412 and \$141,957 for the years ended June 30, 2005 and 2004, respectively.

**ADAIR COUNTY HEALTH SYSTEM  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2005 AND 2004**

**NOTE 12 COMMITMENTS AND CONTINGENCIES**

**Health System Risk Management**

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

**Rental Agreements**

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

<u>Year Ended June 30,</u>	
2006	\$ 63,600
2007	63,600
2008	<u>47,700</u>
Total Rental Payments	<u>\$ 174,900</u>

Rent expense of \$57,000 and \$60,000 on the rental agreement is included in the clinic's expenses for the years ended June 30, 2005 and 2004, respectively.

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**REQUIRED SUPPLEMENTARY INFORMATION**

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**ADAIR COUNTY HEALTH SYSTEM  
BUDGETARY COMPARISON SCHEDULE OF REVENUES, EXPENSES AND CHANGES IN NET  
ASSETS AND NOTES  
YEAR ENDED JUNE 30, 2005**

	Actual Accrual Basis	Accrual Adjustments	Cash Basis	Budget	Actual Cash Basis Variance
Estimated Amount to be Raised by Taxation	\$ 838,962	\$ -	\$ 838,962	\$ 796,065	\$ 42,897
Estimated Other Revenues/Receipts	6,748,343	149,586	6,897,929	6,887,480	10,449
	<u>7,587,305</u>	<u>149,586</u>	<u>7,736,891</u>	<u>7,683,545</u>	<u>53,346</u>
Expenses/Disbursements	6,965,606	430,072	7,395,678	7,683,300	(287,622)
Net	<u>621,699</u>	<u>(280,486)</u>	<u>341,213</u>	<u>245</u>	<u>340,968</u>
Balance Beginning of Year	<u>2,821,382</u>	<u>(1,830,195)</u>	<u>991,187</u>	<u>1,196,663</u>	<u>(205,476)</u>
Balance End of Year	<u><u>\$ 3,443,081</u></u>	<u><u>\$ (2,110,681)</u></u>	<u><u>\$ 1,332,400</u></u>	<u><u>\$ 1,196,908</u></u>	<u><u>\$ 135,492</u></u>

**NOTE 1**

This budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary prospective differences.

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

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## OTHER SUPPLEMENTARY INFORMATION

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF NET PATIENT SERVICE REVENUES  
YEARS ENDED JUNE 30, 2005 AND 2004**

	TOTAL	
	2005	2004
<b>PATIENT CARE SERVICES</b>		
Medical and Surgical	\$ 558,395	\$ 430,385
Swing Bed	100,400	80,490
Total	<u>658,795</u>	<u>510,875</u>
<b>OTHER PROFESSIONAL SERVICES</b>		
Operating Room	491,487	288,322
Recovery Room	43,575	32,292
Anesthesiology	83,757	78,002
Radiology	1,372,025	1,074,863
Blood Service	19,158	13,860
Laboratory	1,057,076	983,941
Intravenous Therapy	64,057	52,169
Respiratory Therapy	170,647	135,253
Physical Therapy	294,041	300,773
Occupational Therapy	25,845	49,069
Speech Therapy	3,285	10,514
Electrocardiology	170,694	188,363
Home Health Services	515,704	449,385
Ambulance	268,479	245,557
Medical and Surgical Supplies	222,232	140,694
Pharmacy	448,339	402,649
Emergency	368,576	418,740
Observation Room	121,422	118,764
Clinic	1,278,233	1,096,315
Total	<u>7,018,632</u>	<u>6,079,525</u>
Total Patient Service Revenues	7,677,427	6,590,400
Charity Care	<u>(16,537)</u>	<u>(22,018)</u>
Total Gross Patient Service Revenue	7,660,890	6,568,382
Adjustments to Patient Service Revenues	<u>(1,535,087)</u>	<u>(1,283,159)</u>
Net Patient Service Revenues	<u>\$ 6,125,803</u>	<u>\$ 5,285,223</u>

INPATIENTS		OUTPATIENTS	
2005	2004	2005	2004
\$ 558,395	\$ 430,385	\$ -	\$ -
100,400	80,490	-	-
<u>658,795</u>	<u>510,875</u>	<u>-</u>	<u>-</u>
28,161	19,468	463,326	268,854
1,757	1,416	41,818	30,876
5,047	4,527	78,710	73,475
208,107	152,144	1,163,918	922,719
8,322	13,860	10,836	-
188,007	177,883	869,069	806,058
14,277	10,678	49,780	41,491
165,430	126,284	5,217	8,969
34,414	23,060	259,627	277,713
8,455	7,755	17,390	41,314
540	2,796	2,745	7,718
33,328	42,571	137,366	145,792
-	-	515,704	449,385
1,812	2,244	266,667	243,313
66,280	48,639	155,952	92,055
228,966	179,096	219,373	223,553
185	560	368,391	418,180
260	1,399	121,162	117,365
-	-	1,278,233	1,096,315
<u>993,348</u>	<u>814,380</u>	<u>6,025,284</u>	<u>5,265,145</u>
<u>\$ 1,652,143</u>	<u>\$ 1,325,255</u>	<u>\$ 6,025,284</u>	<u>\$ 5,265,145</u>

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF ADJUSTMENTS TO NET PATIENT SERVICE REVENUES  
AND OTHER REVENUES  
YEARS ENDED JUNE 30, 2005 AND 2004**

	2005	2004
<b>ADJUSTMENTS TO PATIENT SERVICE REVENUES</b>		
Contractual Adjustments - Medicare	\$ 1,031,991	\$ 684,121
Contractual Adjustments - Medicaid	99,102	94,388
Provision for Bad Debt	204,402	297,708
Other Allowances and Adjustments	199,592	206,942
 Total Adjustments	 \$ 1,535,087	 \$ 1,283,159
<b>OTHER REVENUES</b>		
Cafeteria Meals	\$ 57,183	\$ 44,583
Grant Revenue	65,005	66,418
Revenues for Expenses of Home Health Services	100,061	125,053
Revenues for Expenses of Ambulance, Adair County	-	737
Lifeline	30,792	29,055
Other	23,127	31,373
 Total Other Revenues	 \$ 276,168	 \$ 297,219

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF OPERATING EXPENSES  
YEARS ENDED JUNE 30, 2005 AND 2004**

	2005	2004
<b>NURSING SERVICE EXPENSES</b>		
<b>NURSING ADMINISTRATION</b>		
Salaries	\$ 54,853	\$ 51,384
Supplies and Expenses	289	784
	55,142	52,168
<b>MEDICAL AND SURGICAL</b>		
Salaries	628,701	535,593
Supplies and Expenses	254,118	281,878
	882,819	817,471
<b>OBSERVATION</b>		
Salaries	916	9,337
	916	9,337
<b>OPERATING ROOM</b>		
Salaries	48,821	33,044
Supplies and Expenses	34,886	22,197
	83,707	55,241
<b>INTRAVENOUS THERAPY</b>		
Supplies and Expenses	12,172	4,263
<b>EMERGENCY SERVICE</b>		
Salaries	33,727	53,961
Professional Fees	95,989	124,569
Supplies and Expenses	3,842	6,033
	133,558	184,563
<b>HOME HEALTH</b>		
Salaries	397,091	420,058
Professional Fees	2,655	2,636
Supplies and Expenses	87,170	84,627
	486,916	507,321
<b>AMBULANCE</b>		
Salaries	172,874	154,367
Supplies and Expenses	29,865	17,383
	202,739	171,750
<b>TOTAL NURSING SERVICE EXPENSES</b>	<b>\$ 1,857,969</b>	<b>\$ 1,802,114</b>
<b>OTHER PROFESSIONAL SERVICE EXPENSES</b>		
<b>LABORATORY</b>		
Salaries	\$ 137,846	\$ 121,285
Professional Fees	60,958	101,419
Supplies and Expenses	120,019	115,919
	318,823	338,623
<b>BLOOD SERVICE</b>		
Supplies and Expenses	10,129	7,028

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF OPERATING EXPENSES  
YEARS ENDED JUNE 30, 2005 AND 2004**

	2005	2004
<b>OTHER PROFESSIONAL SERVICE EXPENSES (CONTINUED)</b>		
<b>ELECTROCARDIOLOGY</b>		
Salaries	\$ 5,625	\$ 4,973
Professional Fees	55,825	68,529
	61,450	73,502
<b>RADIOLOGY</b>		
Salaries	147,458	144,547
Professional Fees	94,428	91,253
Supplies and Expenses	393,168	286,637
	635,054	522,437
<b>CT SCANS</b>		
Professional Fees	43,795	43,510
Purchased Services	22,900	38,034
	66,695	81,544
<b>PHARMACY</b>		
Professional Fees	24,438	24,000
Drugs	157,082	155,977
Supplies and Expenses	543	846
	182,063	180,823
<b>ANESTHESIOLOGY</b>		
Professional Fees	51,355	48,210
Supplies and Expenses	12,350	13,476
	63,705	61,686
<b>INHALATION THERAPY</b>		
Supplies and Expenses	14,213	16,037
<b>PHYSICAL THERAPY</b>		
Professional Fees	147,101	164,256
Supplies and Expenses	2,784	3,150
	149,885	167,406
<b>OCCUPATIONAL THERAPY</b>		
Professional Fees	16,266	29,760
<b>SPEECH THERAPY</b>		
Professional Fees	1,734	5,755
<b>MEDICAL RECORDS</b>		
Salaries	56,215	54,229
Supplies and Expenses	13,340	20,456
	69,555	74,685
<b>CLINICS</b>		
Salaries	496,085	402,196
Supplies and Expenses	602,274	594,312
	1,098,359	996,508
<b>TOTAL OTHER PROFESSIONAL SERVICE EXPENSES</b>	<b>\$ 2,687,931</b>	<b>\$ 2,555,794</b>

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF OPERATING EXPENSES  
YEARS ENDED JUNE 30, 2005 AND 2004**

	2005	2004
<b>GENERAL SERVICE EXPENSES</b>		
<b>DIETARY</b>		
Salaries	\$ 105,251	\$ 95,418
Food	26,944	24,737
Supplies and Expenses	9,407	7,449
	141,602	127,604
<b>PLANT OPERATION AND MAINTENANCE</b>		
Salaries	43,892	42,142
Utilities	51,170	46,827
Supplies and Expenses	48,459	53,545
	143,521	142,514
<b>HOUSEKEEPING</b>		
Salaries	46,717	51,580
Supplies and Expenses	9,051	11,225
	55,768	62,805
<b>LAUNDRY AND LINEN</b>		
Salaries	32,613	30,076
Supplies and Expenses	4,364	4,835
	36,977	34,911
<b>TOTAL GENERAL SERVICE EXPENSES</b>	\$ 377,868	\$ 367,834
<b>FISCAL, ADMINISTRATIVE AND UNASSIGNED EXPENSES</b>		
<b>FISCAL AND ADMINISTRATIVE SERVICES</b>		
Salaries	\$ 358,172	\$ 345,275
Management Service	137,412	141,957
Supplies and Purchased Services	202,901	212,330
Telephone	26,046	26,799
Professional Fees	35,609	30,059
Collection Fees	37,759	15,100
Physician Recruitment Expenses	61,853	55,722
Lifeline Salaries	-	22
Lifeline Expense	15,993	16,193
Foundation Expense	23,676	22,303
	899,421	865,760
<b>UNASSIGNED EXPENSES</b>		
Insurance	54,911	45,998
Employee Benefits	888,455	749,046
	943,366	795,044
<b>TOTAL FISCAL, ADMINISTRATIVE AND UNASSIGNED EXPENSES</b>	\$ 1,842,787	\$ 1,660,804

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF ANALYSIS OF ACCOUNTS RECEIVABLE FROM PATIENTS  
AND ALLOWANCE FOR DOUBTFUL ACCOUNTS  
YEARS ENDED JUNE 30, 2005 AND 2004**

**Analysis of Aging**

Age of Accounts (by Date of Discharge)	2005		2004	
	Amount	Percent	Amount	Percent
1-30 days (Includes Patients in Hospital June 30)	\$ 773,039	53.11 %	\$ 617,924	44.26 %
31-60 Days	240,184	16.50 %	272,048	19.49 %
61-90 Days	115,454	7.93 %	126,625	9.07 %
91 Days and Over	326,987	22.46 %	379,573	27.18 %
Total Accounts Receivable	<u>1,455,664</u>	<u>100.00 %</u>	<u>1,396,170</u>	<u>100.00 %</u>

**ALLOWANCES**

Contractual - Medicare Medicaid and Other	(120,107)	(154,637)
Doubtful Accounts	(198,679)	(139,239)
Net Accounts Receivable	<u>\$ 1,136,878</u>	<u>\$ 1,102,294</u>
Net Patient Service Revenue per Calendar Day	<u>\$ 17,343</u>	<u>\$ 15,296</u>
Days of Net Patient Service Revenue in Accounts Receivable at Year End	<u>66</u>	<u>72</u>

**Analysis of Allowance for Doubtful Accounts**

	2005		2004	
	Amount	Percent of Net Patient Service Revenue	Amount	Percent of Net Patient Service Revenue
Beginning Balance	\$ 139,239		\$ 150,000	
Add:				
Provision for Doubtful Accounts	204,402	3.23%	297,708	5.33%
Recoveries Previously Written Off	161,196	2.55%	35,870	0.64%
	<u>504,837</u>		<u>483,578</u>	
Deduct:				
Accounts Written Off	(306,158)	(4.84)%	(344,339)	(6.17)%
Ending Balance	<u>\$ 198,679</u>		<u>\$ 139,239</u>	

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF INVENTORIES AND PREPAID EXPENSES  
YEARS ENDED JUNE 30, 2005 AND 2004**

	June 30,	
	2005	2004
<b>INVENTORIES</b>		
Pharmacy	\$ 41,350	\$ 34,162
Medical Surgical	93,723	35,769
Lab	33,302	14,102
Home Care	3,664	2,242
Clinics	11,368	3,889
Administrative/Office	13,000	17,980
Total Inventories	\$ 196,407	\$ 108,144
 <b>PREPAID EXPENSES</b>		
Insurance	\$ 25,557	\$ 33,206
Dues	2,715	2,422
Maintenance	15,236	11,329
Total Prepaid Expenses	\$ 43,508	\$ 46,957

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULES OF HOME HEALTH CARE REVENUES AND EXPENSES  
YEARS ENDED JUNE 30, 2005 AND 2004**

	2005	2004
<b>REVENUES</b>		
Net Patient Service Revenue	\$ 439,873	\$ 383,260
Other Revenues and Support	165,066	191,471
Total Revenues	604,939	574,731
<b>EXPENSES</b>		
Salaries	397,091	420,058
Employee Benefits	103,718	98,222
Professional Fees	31,419	17,376
Contracted Services	1,400	1,400
Supplies	37,306	41,968
Other	47,556	54,061
Total Expenses	618,490	633,085
Net Income (Loss)	\$ (13,551)	\$ (58,354)

**REPORT ON INTERNAL CONTROL OVER FINANCIAL  
REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Trustees  
Adair County Health System  
Greenfield, Iowa

We have audited the financial statements of Adair County Health System as of and for the years ended June 30, 2005 and 2004, and have issued our report thereon dated August 12, 2005. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered Adair County Health System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion 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 Adair County Health System'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 as items 05-I-1, 05-I-2 and 05-I-3

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 caused by error or fraud 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 weakness. We noted no matters involving internal control over financial reporting and its operations that we consider to be material weaknesses.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Adair County Health System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of non-compliance or other matters that are required to be reported under *U.S. Government Auditing Standards*. These instances of non-compliance are described in Part II of the accompanying schedule of findings.

Comments involving statutory and other legal matters about the Health System's operations for the year ended June 30, 2005 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Health System. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

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

A handwritten signature in cursive script that reads "James Allen Weishaar". To the right of the signature are the initials "JAW" and a stylized flourish.

LARSON, ALLEN, WEISHAIR & CO., LLP

Austin, Minnesota  
August 12, 2005

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULE OF FINDINGS  
YEAR ENDED JUNE 30, 2005**

**Part I: Findings Related to Financial Statements:**

**Reportable Conditions**

**05-I-1     Segregation of Duties**

The accountant currently has the ability to create new vendors, enter invoices and print checks.

**Recommendation**

We recommend the ability to create a new vendor be limited to one individual who does not have access to other areas of the disbursement cycle.

**Response**

Processing procedures will be modified in order to adequately segregate responsibilities.

**Conclusion**

Response is accepted.

**05-I-2     Segregation of Duties**

The individual who prints payroll checks also has the ability to enter new employees in the information system, enter the hours, and change wages.

**Recommendation**

We recommend limiting the ability to create a new employee to an individual who does not have access to other areas of the payroll cycle.

**Response**

Processing procedures will be modified in order to adequately segregate responsibilities.

**Conclusion**

Response is accepted.

**05-I-3     Internal Control Over Financial Reporting**

We noted lapses, gaps, and missing receipts in one of the clinic locations cash receipts documentation and general weaknesses within the overall process.

**Recommendation**

We recommend modifying the cash receipts process in this location, and ensuring all receipts received at the clinic be sent to the hospital on a daily basis; copies of all receipts should be maintained; and personnel in the finance department responsible for reconciling clinic deposits should account for all pre-numbered cash receipts on a daily basis.

**Response**

The procedures regarding clinic cash receipts will be modified to ensure there is adequate internal control over financial reporting.

**Conclusion**

Response is accepted.

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULE OF FINDINGS  
YEAR ENDED JUNE 30, 2005**

**Part II: Other Findings Related to Required Statutory Reporting:**

**05-II-1 Official Depositories**

A resolution naming official depositories has been adopted by the Board of Trustees. The maximum deposit amounts stated in the resolution were not exceeded during the year ended June 30, 2005, however one depository had a name change and the Health System's resolution was not updated.

**Recommendation**

The depository resolution should be updated when new depositories are added, maximum deposit limits change or previously approved depositories change their names.

**Response**

We will update our depository resolution as described above.

**Conclusion**

Response is accepted.

**05-II-2 Certified Budget**

Health System cash basis expenditures during the year ended June 30, 2005, did not exceed budgeted amounts.

**05-II-3 Questionable Expenditures**

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

**05-II-4 Travel Expenses**

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

**05-II-5 Business Transactions**

Paul Nelson, Health System Treasurer, is employed by Union State Bank, an official depository of the Health System. The Health System has five outstanding loans, certificates of deposit, and checking and savings accounts with Union State Bank.

Mike Cass, Health System Board Member, is employed by First National Bank, an official depository of the Health System. The Health System has two outstanding loans, certificates of deposit, and checking and savings accounts with First National Bank.

**05-II-6 Board Minutes**

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

**05-II-7 Deposits and Investments**

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

**ADAIR COUNTY HEALTH SYSTEM  
SCHEDULE OF FINDINGS  
YEAR ENDED JUNE 30, 2005**

**05-II-8 Publication of Bills Allowed and Salaries**

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

