

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

**FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION**

YEARS ENDED JUNE 30, 2006 AND 2005

**ADAIR COUNTY HEALTH SYSTEM
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**ADAIR COUNTY HEALTH SYSTEM
BOARD OF TRUSTEES AND OFFICIALS
YEAR ENDED JUNE 30, 2006**

<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, 2006 and 2005, 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, 2006 and 2005, 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 17, 2006 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 8 and analysis and budgetary comparison information on page 24 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 25-33 is presented for purpose of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink that reads "Larson, Allen, Weishair & Co., LLP". The signature is written in a cursive, flowing style.

LARSON, ALLEN, WEISHAIR & CO., LLP

Austin, Minnesota
August 17, 2006

**ADAIR COUNTY HEALTH SYSTEM
MANAGEMENT DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

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, 2006 and 2005. 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 \$242,163 or 4% in 2006 and increased by \$966,490 or 21% in 2005.
- The Health System's patient service revenues increased \$569,847 or 9% from 2005 to 2006 and \$840,580 or 16.0% from 2004 to 2005.
- The Health System's accounts receivable decreased by \$282,604 or 25% between 2005 and 2006 and increased by \$34,584 or 3% between 2004 and 2005.

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, 2006.

**ADAIR COUNTY HEALTH SYSTEM
MANAGEMENT DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

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>2006</u>	<u>2005</u>	<u>2004</u>
Assets:			
Current Assets	\$ 3,533,354	\$ 3,572,543	\$ 2,667,636
Noncurrent Cash and Investments	-	200,000	200,000
Capital Assets, Net	1,327,526	995,454	924,455
Succeeding Year Property Tax Receivable	974,015	799,692	796,065
Other Assets	21,739	46,782	59,825
Total Assets	<u><u>\$ 5,856,634</u></u>	<u><u>\$ 5,614,471</u></u>	<u><u>\$ 4,647,981</u></u>
Liabilities:			
Total Current Liabilities	\$ 763,158	\$ 1,135,284	\$ 696,756
Long-Term Debt (Less Current Maturities)	169,875	236,414	333,778
Deferred Revenue from Succeeding Year Property Tax Receivable	974,015	799,692	796,065
Total Liabilities	<u>1,907,048</u>	<u>2,171,390</u>	<u>1,826,599</u>
Net Assets:			
Invested in Capital Assets Net of Related Debt	1,091,111	627,122	483,323
Restricted For Capital Expenditures	50,434	52,217	20,020
Unrestricted	2,808,041	2,763,742	2,318,039
Total Net Assets	<u>3,949,586</u>	<u>3,443,081</u>	<u>2,821,382</u>
Total Liabilities and Net Assets	<u><u>\$ 5,856,634</u></u>	<u><u>\$ 5,614,471</u></u>	<u><u>\$ 4,647,981</u></u>

The most significant changes are in Cash and Investments, Patient Accounts Receivable, and Long Term Debt. There was an increase in Cash and Investments of \$182,487 or 8%. There was a significant change to Patient Accounts Receivable, which decreased \$282,604 or 25%. Long-term Debt decreased \$66,539 during 2006. This is attributed to pay off of four equipment leases this year.

**ADAIR COUNTY HEALTH SYSTEM
MANAGEMENT DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

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 9% during 2006. This is due to increased volumes and rate increases. Total revenues increased 15% during 2005. This was due to increased services provided. Expenses increased 8% during 2006 due to increased labor force and supply cost. Expenses increased 6% during 2005 due to increased volumes and increased supply and labor costs

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

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Operating Revenue			
Net Patient Service Revenues	\$ 6,695,650	\$ 6,125,803	\$ 5,285,223
Other Revenues	299,072	276,168	297,219
Total Revenues	<u>6,994,722</u>	<u>6,401,971</u>	<u>5,582,442</u>
Operating Expenses			
Nursing Service	1,994,346	1,857,969	1,802,114
Other Professional Service	2,939,906	2,687,931	2,555,794
General Service	418,955	377,868	367,834
Fiscal, Administrative, and Unassigned Expenses	1,945,591	1,842,787	1,660,804
Depreciation and Amortization	204,274	169,788	156,742
Interest	15,991	29,263	22,258
Total Expenses	<u>7,519,063</u>	<u>6,965,606</u>	<u>6,565,546</u>
Operating Loss	(524,341)	(563,635)	(983,104)
Non-Operating Revenues (Expenses)	<u>935,320</u>	<u>1,075,351</u>	<u>1,010,966</u>
Excess of Revenues over Expenses Before Capital Grants and Contributions	410,979	511,716	27,862
Capital Grants and Contributions	<u>95,526</u>	<u>109,983</u>	<u>56,811</u>
Increase in Net Assets	506,505	621,699	84,673
Net Assets, Beginning of Year	<u>3,443,081</u>	<u>2,821,382</u>	<u>2,736,709</u>
Net Assets, End of Year	<u>\$ 3,949,586</u>	<u>\$ 3,443,081</u>	<u>\$ 2,821,382</u>

**ADAIR COUNTY HEALTH SYSTEM
MANAGEMENT DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

Financial Analysis of the Health System (Continued)

Table 3: Net Patient Service Revenue and Contractual Adjustments

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Total Patient Service Revenues	\$ 8,359,097	\$ 7,660,890	\$ 6,568,382
Contractual Adjustments and Provisions for Bad Debt			
Medicare	(1,069,851)	(1,031,991)	(684,121)
Medicaid	(78,165)	(99,102)	(94,388)
Provision for Bad Debt	(200,000)	(204,402)	(297,708)
Other	(315,431)	(199,592)	(206,942)
Total Contractual Adjustments and Provision for Bad Debt	<u>(1,663,447)</u>	<u>(1,535,087)</u>	<u>(1,283,159)</u>
Net Patient Service Revenue	<u>\$ 6,695,650</u>	<u>\$ 6,125,803</u>	<u>\$ 5,285,223</u>

Our contractual adjustments grew only slightly during 2006, mostly in the commercial, workers compensation and clinic area. We continued our 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.

Table 4: Other Revenues

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Cafeteria Meals	\$ 58,611	\$ 57,183	\$ 44,583
Grant Revenue	95,769	65,005	66,418
Revenues for Home Health Services	80,969	100,061	125,053
Revenues for Expenses of Ambulance, Adair County	-	-	737
Lifeline	27,865	30,792	29,055
Other	35,858	23,127	31,373
Total Other Revenues	<u>\$ 299,072</u>	<u>\$ 276,168</u>	<u>\$ 297,219</u>

As a result of an increase in cash received from patients and third parties and increase in patient revenues, accounts receivable decreased from 66 to 46 days in 2006 and decreased from 72 to 66 days in 2005.

Salary expense increased 7% during 2006 and increased 8% during 2005. Total expenses for the Health System increased 8% during 2006 and 6% during 2005.

The Health System's cash flows are consistent with the changes in operating income and financial performance as discussed earlier for 2006 and 2005.

**ADAIR COUNTY HEALTH SYSTEM
MANAGEMENT DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

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>2006</u>	<u>2005</u>	<u>2004</u>
Admissions			
Acute	394	414	326
ICU	4	9	9
Skilled	36	49	44
Total	<u>434</u>	<u>472</u>	<u>379</u>
Patient Days			
Acute	1,129	1,165	992
ICU	5	9	10
Skilled	270	394	329
Total	<u>1,404</u>	<u>1,568</u>	<u>1,331</u>
ER Visits	1,600	1,517	1,559
OP Surgery	236	213	187
24 Hour Observation	96	87	156
Home Health Visits	6,006	6,981	8,764
Stuart Clinic Visits	3,136	2,936	1,932
Greenfield Clinic Visits	10,175	11,165	8,543
Fontanelle/Hospital FP Clinic Visits	3,719	4,187	2,721
Average Length of Stay			
Acute	2.90	2.80	3.00
Skilled	7.50	8.10	7.30
Total	3.24	3.34	3.47
Medicare (Acute)	3.10	3.10	3.40
Average Hourly Length of Stay	66.60	63.96	68.77
Average Daily Census	3.84	4.29	3.64

Capital Assets

At June 30, 2006, the Health System had \$1,327,526 invested in capital assets net of accumulated depreciation. In 2006, the Health System purchased capital assets costing \$242,152, which includes \$42,695 for teleradiology equipment, partially funded by a USDA grant; \$53,064 for patient beds, funded by local grants from Adair Community Foundation, TN Howe Foundation, and Schildberg Foundation; and \$38,026 in computer software and equipment. 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 8 million dollars. A significant portion of the funding will be obtained through a low interest loan from USDA. At June 30, 2005 the Health System had \$995,454 invested in capital assets net of accumulated depreciation.

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**ADAIR COUNTY HEALTH SYSTEM
MANAGEMENT DISCUSSION AND ANALYSIS
YEAR ENDED JUNE 30, 2006**

Long Term Debt

Table 6: Long Term Debt

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Note Payable	\$ 236,415	\$ 301,618	\$ 379,219
Capital Lease Obligations	-	66,714	61,913
Total Long Term Debt	<u>\$ 236,415</u>	<u>\$ 368,332</u>	<u>\$ 441,132</u>

The Health System did not enter any new capital leases in 2006, and paid off 4 existing capital leases.

The details of the notes payable are:

There is 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, 2006 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. There is 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 there is a note payable for a boiler system in monthly installments of \$2,440 including interest at 4.75% through September 2009.

The Health System had agreements to acquire a hematology machine, computer equipment, and scope equipment 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 hematology equipment was paid in full July 2005. A lease for scope equipment set to mature in September 2005 at 0% rate was paid in full. A lease for computer equipment set to mature in December 2005 at a 6.58% rate which was 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. Funds from the county remained stable after decreasing over the prior 3 years. The dollars to ambulance, 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.

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, 2006 AND 2005**

ASSETS	2006	2005
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 1,358,663	\$ 1,132,400
Certificates of Deposit	995,829	1,039,605
Patient Receivables, Less Allowance for Uncollectible Accounts (2006 - \$258,000 and 2005 - \$199,000)	854,274	1,136,878
Accounts Receivable - Other	24,658	23,745
Third-Party Payor Settlement Receivable	50,000	-
Inventories	208,255	196,407
Prepaid Expenses	41,675	43,508
Total Current Assets	3,533,354	3,572,543
NONCURRENT CASH AND INVESTMENTS		
Internally Designated By Board for Capital Expenditures	-	200,000
CAPITAL ASSETS, NET	1,327,526	995,454
OTHER ASSETS		
Succeeding Year Property Taxes Receivable	974,015	799,692
Other Assets	21,739	46,782
Total Other Assets	995,754	846,474
Total Assets	\$ 5,856,634	\$ 5,614,471

LIABILITIES AND NET ASSETS	<u>2006</u>	<u>2005</u>
CURRENT LIABILITIES		
Current Maturities of Long-Term Debt	\$ 66,540	\$ 131,918
Accounts Payable	483,934	201,071
Accrued Employee Compensation	212,684	328,753
Third-Party Payor Settlement Payable	-	473,542
Total Current Liabilities	<u>763,158</u>	<u>1,135,284</u>
LONG-TERM DEBT , Less Current Maturities	169,875	236,414
DEFERRED REVENUE		
Succeeding Year Property Taxes	<u>974,015</u>	<u>799,692</u>
Total Liabilities	1,907,048	2,171,390
COMMITMENTS AND CONTINGENCIES		
NET ASSETS		
Invested in Capital Assets Net of Related Debt	1,091,111	627,122
Restricted For Capital Expenditures	50,434	52,217
Unrestricted	<u>2,808,041</u>	<u>2,763,742</u>
Total Net Assets	<u>3,949,586</u>	<u>3,443,081</u>
Total Liabilities and Net Assets	<u>\$ 5,856,634</u>	<u>\$ 5,614,471</u>

**ADAIR COUNTY HEALTH SYSTEM
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2006 AND 2005**

	2006	2005
OPERATING REVENUES		
Net Patient Service Revenues (Net of provision for bad debts of \$200,000 in 2006 and \$204,402 in 2005)	\$ 6,695,650	\$ 6,125,803
Other Revenues	299,072	276,168
Total Operating Revenues	6,994,722	6,401,971
EXPENSES		
Nursing Service	1,994,346	1,857,969
Other Professional Service	2,939,906	2,687,931
General Service	418,955	377,868
Fiscal, Administrative, and Unassigned Expenses	1,945,591	1,842,787
Depreciation and Amortization	204,274	169,788
Interest	15,991	29,263
Total Operating Expenses	7,519,063	6,965,606
OPERATING LOSS	(524,341)	(563,635)
NON-OPERATING REVENUES		
Tax Apportionments	838,564	838,962
Investment Income	83,236	41,726
Unrestricted Contributions	13,520	194,663
Total Nonoperating Revenues	935,320	1,075,351
EXCESS OF REVENUES OVER EXPENSES BEFORE CAPITAL GRANTS AND CONTRIBUTIONS	410,979	511,716
Capital Grants and Contributions	95,526	109,983
Increase in Net Assets	506,505	621,699
Net Assets Beginning of Year	3,443,081	2,821,382
Net Assets End of Year	\$ 3,949,586	\$ 3,443,081

See accompanying Notes to Financial Statements.

**ADAIR COUNTY HEALTH SYSTEM
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2006 AND 2005**

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Patients and Third Parties	\$ 6,454,712	\$ 6,621,761
Cash Paid to Employees	(3,074,007)	(2,747,640)
Cash Paid to Suppliers	(4,068,925)	(4,170,445)
Other Receipts and Payments, Net	299,072	276,168
Net Cash Used by Operating Activities	(389,148)	(20,156)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Tax Appropriations	838,564	838,962
Contributions	109,046	304,646
Net Cash Provided by Non-Capital Financing Activities	947,610	1,143,608
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of Property and Equipment	(523,303)	(142,051)
Payments on Long Term Debt	(131,917)	(158,493)
Interest Payments on Long-Term Debt	(15,991)	(29,263)
Net Cash Used by Capital and Related Financing Activities	(671,211)	(329,807)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Income	95,236	41,726
Sale (Purchase) of Certificates of Deposit, Net	43,776	(494,158)
Change in Non-Current Cash and Investments	200,000	-
Net Cash Provided (Used) by Investing Activities	339,012	(452,432)
NET INCREASE IN CASH AND CASH EQUIVALENTS	226,263	341,213
Cash and Cash Equivalents - Beginning	1,132,400	791,187
CASH AND CASH EQUIVALENTS - ENDING	\$ 1,358,663	\$ 1,132,400

See accompanying Notes to Financial Statements.

**ADAIR COUNTY HEALTH SYSTEM
STATEMENTS OF CASH FLOWS (CONTINUED)
YEARS ENDED JUNE 30, 2006 AND 2005**

RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES	2006	2005
Operating Loss	\$ (524,341)	\$ (563,635)
Adjustments to Reconcile Income from Operations to Net Cash Used by Operating Activities		
Interest Expense	15,991	29,263
Depreciation and Amortization	204,274	169,788
Decrease (Increase) in -		
Patient Receivables	282,604	(34,584)
Third Party Payor Settlements Receivable	(50,000)	57,000
Other Receivables	(913)	(7,138)
Inventories	(11,848)	(88,263)
Prepaid Expenses	1,833	3,449
Increase (Decrease) in -		
Accounts Payable	282,863	(78,795)
Accrued Salaries, Wages, Benefits and Other	(116,069)	19,217
Third Party Payor Settlements Payable	(473,542)	473,542
Net Cash Used by Operating Activities	\$ (389,148)	\$ (20,156)

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Noncash Investing and Financing Activities		
Equipment Acquired Under Capital Leases	\$ -	\$ 93,801

See accompanying Notes to Financial Statements.

**ADAIR COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

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, 2006 AND 2005**

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

D. 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, 2006 and 2005, the allowance for uncollectible accounts was \$258,000 and \$199,000, 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, 2006 AND 2005**

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, 2006 and 2005 restricted net assets consisted of \$50,434 and \$52,217 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, 2006 AND 2005**

NOTE 1 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. Grants and Contributions

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

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 \$31,624 and \$16,537 for the years ended June 30, 2006 and 2005, respectively.

J. County Tax Revenue

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

NOTE 2 DESIGNATED NET ASSETS

Of the \$2,763,742 of unrestricted net assets at June 30, 2005, \$200,000 had 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. During 2006 the Board of Trustees undesignated the funds.

**ADAIR COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

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, 2004.

Medicaid

The Health System is certified as a Critical Access Hospital (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, 2004.

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 51% percent and 9% percent, respectively, of the Health System's net patient revenue for the year ended 2006, and 52% percent and 6% percent, respectively, of the Health System's net patient revenue, for the year ended 2005. 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:

	2006	2005
Total Patient Service Revenue	\$ 8,359,097	\$ 7,660,890
Contractual Adjustments:		
Medicare	(1,069,851)	(1,031,991)
Medicaid	(78,165)	(99,102)
Provision for Bad Debt	(200,000)	(204,402)
Other	(315,431)	(199,592)
Total Contractual Adjustments and Bad Debts	(1,663,447)	(1,535,087)
Net Patient Service Revenue	\$ 6,695,650	\$ 6,125,803

**ADAIR COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

NOTE 4 PATIENT RECEIVABLES

Patient receivables reported as current assets by the Health System at June 30, 2006 and 2005 consisted of the following:

	2006	2005
Receivable from Patients and Their Insurance Carriers	\$ 784,202	\$ 820,090
Receivable from Medicare	250,887	426,621
Receivable from Medicaid	77,185	89,167
Total Patient Receivables	1,112,274	1,335,878
Less Allowance for Doubtful Accounts	(258,000)	(199,000)
Patient Receivables, Net	\$ 854,274	\$ 1,136,878

NOTE 5 DEPOSITS AND INVESTMENTS

The Health System's deposits in banks at June 30, 2006 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.

Custodial Credit Risk - Custodial credit risk is the risk that in the event of bank failure, the Health System's deposits may not be returned to it. The Health System's deposit policy for custodial credit risk follows Iowa Statutes for deposits.

Interest Rate Risk - The Health System does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

Deposits are Included in the Following Balance Sheet Captions:

	2006	2005
Cash and Cash Equivalents	\$ 1,358,663	\$ 1,132,400
Certificates of Deposit	995,829	1,039,605
Noncurrent Cash and Investments		
Internally Designated By Board for Capital Expenditures	-	200,000
Total Deposits	\$ 2,354,492	\$ 2,372,005

**ADAIR COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

NOTE 6 CAPITAL ASSETS

Summaries of capital assets for the years ended June 30, 2006 and 2005 are as follows:

Capital Assets	July 1, 2005	Additions	Transfers (Retirements)	June 30, 2006
Land Improvements	\$ 190,548	\$ -	\$ -	\$ 190,548
Building	889,504	35,990	-	925,494
Fixed Equipment	586,281	6,695	-	592,976
Movable Equipment	1,276,871	199,467	77,314	1,553,652
Leased Equipment	120,276	-	(120,276)	-
Construction in Progress	17,844	281,151	-	298,995
Totals	<u>3,081,324</u>	<u>\$ 523,303</u>	<u>\$ (42,962)</u>	<u>3,561,665</u>
Accumulated Depreciation				
Land Improvements	77,405	11,781	-	89,186
Building	621,911	28,291	-	650,202
Fixed Equipment	406,740	17,838	-	424,578
Movable Equipment	924,615	126,921	18,637	1,070,173
Leased Equipment	55,199	6,400	(61,599)	-
Totals	<u>2,085,870</u>	<u>\$ 191,231</u>	<u>\$ (42,962)</u>	<u>2,234,139</u>
	<u>\$ 995,454</u>			<u>\$ 1,327,526</u>
Capital Assets	July 1, 2004	Additions	Transfers (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>
Accumulated Depreciation				
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>

Construction in progress as of June 30, 2006 and 2005 relates to costs incurred during the planning of a facility renovation. The project is currently in the planning phases and is expected to cost approximately \$8 million. The project is anticipated to be funded with a USDA loan of \$3,000,000, cash reserves of the Health System of \$1,000,000 and the remainder in capital contributions. The project is expected to commence in the Fall of 2006 and to be completed in one phase.

**ADAIR COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

NOTE 7 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 \$43,477 and \$30,434 at June 30, 2006 and 2005, respectively.

NOTE 8 LONG-TERM DEBT

A schedule of changes in the Health System's long-term debt for 2006 and 2005 is as follows:

	Balance July 1, 2005	Additions	(Payments)	Balance June 30, 2006	Amounts Due Within One Year
Notes Payable	\$ 301,618	\$ -	\$ (65,203)	\$ 236,415	\$ 66,540
Obligations Under Capital Lease	66,714	-	(66,714)	-	-
Total Long-Term Debt	<u>\$ 368,332</u>	<u>\$ -</u>	<u>\$ (131,917)</u>	<u>\$ 236,415</u>	<u>\$ 66,540</u>

	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>

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, 2006 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 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.

**ADAIR COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

NOTE 8 LONG-TERM DEBT (CONTINUED)

Obligations Under Capital Lease

The Health System had entered into agreements to acquire medical, computer, and telephone equipment under capital leases. The obligations were due in monthly installments totaling \$7,255, including interest at rates of 6.58% to 10.92%. During 2006 all of the Health System's capital leases were paid off.

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

<u>Years Ending June 30:</u>	<u>Notes Payable</u>	
	<u>Principal</u>	<u>Interest</u>
2007	\$ 66,540	\$ 9,264
2008	61,721	6,145
2009	17,818	4,221
2010	11,065	3,720
2011	11,529	3,257
2012-2016	28,445	11,349
2017-2021	24,070	6,284
2022-2026	15,227	961
	<u>\$ 236,415</u>	<u>\$ 45,201</u>

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

	<u>2005</u>
Equipment	\$ 120,276
Less Accumulated Depreciation	<u>(55,199)</u>
Net Property Under Capital Lease	<u>\$ 65,077</u>

NOTE 9 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, 2006, 2005, and 2004 were \$168,113, \$156,511, and \$143,699, respectively, equal to the required contributions for each year.

**ADAIR COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2006 AND 2005**

NOTE 10 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 \$146,602 and \$137,412 for the years ended June 30, 2006 and 2005, respectively.

NOTE 11 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 previously discussed. The following schedule represents the commitment for future rent payments:

Year Ended June 30,		
2007	\$	63,600
2008		63,600
2009		47,700
Total Rental Payments	\$	174,900

Rent expense of \$59,000 and \$57,000 on the rental agreement is included in the Health System's expenses for the years ended June 30, 2006 and 2005, respectively.

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, 2006**

	Actual Accrual Basis	Accrual Adjustments	Cash Basis	Budget	Actual Cash Basis Variance
Estimated Amount to be Raised by Taxation	\$ 838,564	\$ -	\$ 838,564	\$ 799,692	\$ 38,872
Estimated Other Revenues/Receipts	<u>7,187,004</u>	<u>(185,162)</u>	<u>7,001,842</u>	<u>6,841,881</u>	<u>159,961</u>
	8,025,568	(185,162)	7,840,406	7,641,573	198,833
Expenses/Disbursements Net	<u>7,519,063</u>	<u>295,080</u>	<u>7,814,143</u>	<u>7,577,822</u>	<u>236,321</u>
	506,505	(480,242)	26,263	63,751	(37,488)
Balance Beginning of Year	<u>3,443,081</u>	<u>(2,110,681)</u>	<u>1,332,400</u>	<u>3,389,197</u>	<u>(2,056,797)</u>
Balance End of Year	<u>\$ 3,949,586</u>	<u>\$ (2,590,923)</u>	<u>\$ 1,358,663</u>	<u>\$ 3,452,948</u>	<u>\$ (2,094,285)</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, 2006 AND 2005**

	TOTAL	
	2006	2005
PATIENT CARE SERVICES		
Medical and Surgical	\$ 600,000	\$ 558,395
Swing Bed	71,595	100,400
Total	<u>671,595</u>	<u>658,795</u>
OTHER PROFESSIONAL SERVICES		
Operating Room	592,598	491,487
Recovery Room	53,464	43,575
Anesthesiology	135,375	83,757
Radiology	1,495,174	1,372,025
Blood Service	64,816	19,158
Laboratory	1,115,439	1,057,076
Intravenous Therapy	86,188	64,057
Respiratory Therapy	148,432	170,647
Physical Therapy	330,370	294,041
Occupational Therapy	29,061	25,845
Speech Therapy	3,601	3,285
Electrocardiology	211,300	170,694
Home Health Services	519,834	515,704
Ambulance	289,947	268,479
Medical and Surgical Supplies	272,646	222,232
Pharmacy	527,316	448,339
Emergency	414,603	368,576
Observation Room	160,141	121,422
Clinic	1,268,821	1,278,233
Total	<u>7,719,126</u>	<u>7,018,632</u>
Total Patient Service Revenues	8,390,721	7,677,427
Charity Care	<u>(31,624)</u>	<u>(16,537)</u>
Total Gross Patient Service Revenue	8,359,097	7,660,890
Adjustments to Patient Service Revenues	<u>(1,663,447)</u>	<u>(1,535,087)</u>
Net Patient Service Revenues	<u>\$ 6,695,650</u>	<u>\$ 6,125,803</u>

INPATIENTS		OUTPATIENTS	
2006	2005	2006	2005
\$ 600,000	\$ 558,395	\$ -	\$ -
71,595	100,400	-	-
<u>671,595</u>	<u>658,795</u>	<u>-</u>	<u>-</u>
55,659	28,161	536,939	463,326
3,494	1,757	49,970	41,818
13,112	5,047	122,263	78,710
158,464	208,107	1,336,710	1,163,918
42,796	8,322	22,020	10,836
174,838	188,007	940,601	869,069
11,501	14,277	74,687	49,780
141,301	165,430	7,131	5,217
24,834	34,414	305,536	259,627
11,714	8,455	17,347	17,390
1,321	540	2,280	2,745
33,440	33,328	177,860	137,366
-	-	519,834	515,704
2,670	1,812	287,277	266,667
83,023	66,280	189,623	155,952
254,546	228,966	272,770	219,373
1,032	185	413,571	368,391
130	260	160,011	121,162
4,804	-	1,264,017	1,278,233
<u>1,018,679</u>	<u>993,348</u>	<u>6,700,447</u>	<u>6,025,284</u>
<u>\$ 1,690,274</u>	<u>\$ 1,652,143</u>	<u>\$ 6,700,447</u>	<u>\$ 6,025,284</u>

**ADAIR COUNTY HEALTH SYSTEM
SCHEDULES OF ADJUSTMENTS TO NET PATIENT SERVICE REVENUES
AND OTHER REVENUES
YEARS ENDED JUNE 30, 2006 AND 2005**

	2006	2005
ADJUSTMENTS TO PATIENT SERVICE REVENUES		
Contractual Adjustments - Medicare	\$ 1,069,851	\$ 1,031,991
Contractual Adjustments - Medicaid	78,165	99,102
Provision for Bad Debt	200,000	204,402
Other Allowances and Adjustments	315,431	199,592
 Total Adjustments	 \$ 1,663,447	 \$ 1,535,087
OTHER REVENUES		
Cafeteria Meals	\$ 58,611	\$ 57,183
Grant Revenue	95,769	65,005
Revenues for Expenses of Home Health Services	80,969	100,061
Lifeline	27,865	30,792
Other	35,858	23,127
 Total Other Revenues	 \$ 299,072	 \$ 276,168

**ADAIR COUNTY HEALTH SYSTEM
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2006 AND 2005**

	2006	2005
NURSING SERVICE EXPENSES		
NURSING ADMINISTRATION		
Salaries	\$ 60,729	\$ 54,853
Supplies and Expenses	2,007	289
	62,736	55,142
MEDICAL AND SURGICAL		
Salaries	687,896	628,701
Supplies and Expenses	248,963	254,118
	936,859	882,819
OBSERVATION		
Salaries	1,675	916
	1,675	916
OPERATING ROOM		
Salaries	58,887	48,821
Supplies and Expenses	31,569	34,886
	90,456	83,707
INTRAVENOUS THERAPY		
Supplies and Expenses	24,220	12,172
EMERGENCY SERVICE		
Salaries	24,744	33,727
Professional Fees	147,360	95,989
Supplies and Expenses	4,806	3,842
	176,910	133,558
HOME HEALTH		
Salaries	400,356	397,091
Professional Fees	2,930	2,655
Supplies and Expenses	94,174	87,170
	497,460	486,916
AMBULANCE		
Salaries	174,731	172,874
Supplies and Expenses	29,299	29,865
	204,030	202,739
TOTAL NURSING SERVICE EXPENSES	\$ 1,994,346	\$ 1,857,969
OTHER PROFESSIONAL SERVICE EXPENSES		
LABORATORY		
Salaries	\$ 143,141	\$ 137,846
Professional Fees	58,413	60,958
Supplies and Expenses	173,034	120,019
	374,588	318,823
BLOOD SERVICE		
Supplies and Expenses	24,298	10,129

**ADAIR COUNTY HEALTH SYSTEM
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2006 AND 2005**

	2006	2005
OTHER PROFESSIONAL SERVICE EXPENSES (CONTINUED)		
ELECTROCARDIOLOGY		
Salaries	\$ 6,211	\$ 5,625
Professional Fees	62,441	55,825
	68,652	61,450
RADIOLOGY		
Salaries	163,498	147,458
Professional Fees	111,449	94,428
Supplies and Expenses	331,236	393,168
	606,183	635,054
CT SCANS		
Professional Fees	40,280	43,795
Purchased Services	25,646	22,900
	65,926	66,695
PHARMACY		
Professional Fees	25,529	24,438
Drugs	174,644	157,082
Supplies and Expenses	852	543
	201,025	182,063
ANESTHESIOLOGY		
Professional Fees	61,955	51,355
Supplies and Expenses	12,535	12,350
	74,490	63,705
INHALATION THERAPY		
Supplies and Expenses	11,953	14,213
PHYSICAL THERAPY		
Professional Fees	102,769	147,101
Supplies and Expenses	3,648	2,784
	106,417	149,885
OCCUPATIONAL THERAPY		
Professional Fees	16,563	16,266
SPEECH THERAPY		
Professional Fees	4,140	1,734
MEDICAL RECORDS		
Salaries	68,069	56,215
Supplies and Expenses	13,770	13,340
	81,839	69,555
CLINICS		
Salaries	562,988	496,085
Supplies and Expenses	740,844	602,274
	1,303,832	1,098,359
TOTAL OTHER PROFESSIONAL SERVICE EXPENSES	\$ 2,939,906	\$ 2,687,931

**ADAIR COUNTY HEALTH SYSTEM
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2006 AND 2005**

	2006	2005
GENERAL SERVICE EXPENSES		
DIETARY		
Salaries	\$ 113,239	\$ 105,251
Food	26,554	26,944
Supplies and Expenses	12,690	9,407
	152,483	141,602
PLANT OPERATION AND MAINTENANCE		
Salaries	44,803	43,892
Utilities	62,632	51,170
Supplies and Expenses	57,899	48,459
	165,334	143,521
HOUSEKEEPING		
Salaries	51,699	46,717
Supplies and Expenses	10,673	9,051
	62,372	55,768
LAUNDRY AND LINEN		
Salaries	29,261	32,613
Supplies and Expenses	9,505	4,364
	38,766	36,977
TOTAL GENERAL SERVICE EXPENSES	\$ 418,955	\$ 377,868
FISCAL, ADMINISTRATIVE AND UNASSIGNED EXPENSES		
FISCAL AND ADMINISTRATIVE SERVICES		
Salaries	\$ 366,011	\$ 358,172
Management Service	146,602	137,412
Supplies and Purchased Services	222,626	202,901
Telephone	36,453	26,046
Professional Fees	23,847	35,609
Collection Fees	30,051	37,759
Physician Recruitment Expenses	47,993	61,853
Lifeline Salaries	-	-
Lifeline Expense	17,322	15,993
Foundation Expense	21,983	23,676
	912,888	899,421
UNASSIGNED EXPENSES		
Insurance	54,727	54,911
Employee Benefits	977,976	888,455
	1,032,703	943,366
TOTAL FISCAL, ADMINISTRATIVE AND UNASSIGNED EXPENSES	\$ 1,945,591	\$ 1,842,787

**ADAIR COUNTY HEALTH SYSTEM
SCHEDULES OF ANALYSIS OF ACCOUNTS RECEIVABLE FROM PATIENTS
AND ALLOWANCE FOR DOUBTFUL ACCOUNTS
YEARS ENDED JUNE 30, 2006 AND 2005**

Analysis of Aging

Age of Accounts (by Date of Discharge)	2006		2005	
	Amount	Percent	Amount	Percent
1-30 days (Includes Patients in Hospital June 30)	\$ 719,572	54.72 %	\$ 773,039	53.11 %
31-60 Days	165,253	12.57 %	240,184	16.50 %
61-90 Days	70,307	5.35 %	115,454	7.93 %
91 Days and Over	359,943	27.37 %	326,987	22.46 %
Total Accounts Receivable	<u>1,315,075</u>	<u>100.01 %</u>	<u>1,455,664</u>	<u>100.00 %</u>

ALLOWANCES

Contractual -		
Medicare Medicaid and Other	(202,801)	(119,786)
Doubtful Accounts	(258,000)	(199,000)
Net Accounts Receivable	<u>\$ 854,274</u>	<u>\$ 1,136,878</u>
 Net Patient Service Revenue per Calendar Day	 <u>\$ 18,892</u>	 <u>\$ 17,343</u>
 Days of Net Patient Service Revenue in Accounts Receivable at Year End	 <u>45</u>	 <u>66</u>

Analysis of Allowance for Doubtful Accounts

	2006		2005	
	Amount	Percent of Net Patient Service Revenue	Amount	Percent of Net Patient Service Revenue
Beginning Balance	\$ 199,000		\$ 139,000	
Add:				
Provision for Doubtful Accounts	200,000	2.90%	204,402	3.23%
Recoveries Previously Written Off	<u>73,863</u>	1.07%	<u>161,196</u>	2.55%
	472,863		504,598	
Deduct:				
Accounts Written Off	<u>(214,863)</u>	(3.12)%	<u>(305,598)</u>	(4.83)%
Ending Balance	<u>\$ 258,000</u>		<u>\$ 199,000</u>	

**ADAIR COUNTY HEALTH SYSTEM
SCHEDULES OF INVENTORIES AND PREPAID EXPENSES
YEARS ENDED JUNE 30, 2006 AND 2005**

	2006	2005
INVENTORIES		
Pharmacy	\$ 56,878	\$ 41,350
Medical Surgical	95,801	93,723
Lab	29,825	33,302
Home Care	4,134	3,664
Clinics	8,740	11,368
Administrative/Office	12,877	13,000
 Total Inventories	 \$ 208,255	 \$ 196,407
	2006	2005
PREPAID EXPENSES		
Insurance	\$ 23,457	\$ 25,557
Dues	3,179	2,715
Maintenance	15,039	15,236
 Total Prepaid Expenses	 \$ 41,675	 \$ 43,508

**ADAIR COUNTY HEALTH SYSTEM
SCHEDULES OF HOME HEALTH CARE REVENUES AND EXPENSES
YEARS ENDED JUNE 30, 2006 AND 2005**

	2006	2005
REVENUES		
Net Patient Service Revenue	\$ 475,054	\$ 439,873
Other Revenues and Support	176,738	165,066
Total Revenues	651,792	604,939
EXPENSES		
Salaries	400,356	397,091
Employee Benefits	104,770	103,718
Professional Fees	23,354	31,419
Contracted Services	700	1,400
Supplies	54,124	37,306
Other	51,783	47,556
Total Expenses	635,087	618,490
Net Income (Loss)	\$ 16,705	\$ (13,551)

**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, 2006 and 2005, and have issued our report thereon dated August 17, 2006. 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 Part I of the accompanying Schedule of Findings.

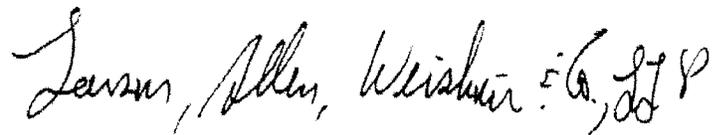
A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being 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 grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed one instance of non-compliance and no other matters that are required to be reported under *Government Auditing Standards*. The instance of non-compliance is 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, 2006 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.



LARSON, ALLEN, WEISHAIR & CO., LLP

Austin, Minnesota
August 17, 2006

**ADAIR COUNTY HEALTH SYSTEM
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2006**

Part I: Findings Related to Financial Statements:

Reportable Conditions

06-I-1 Disbursements Cycle

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.

06-I-2 Disbursements Cycle

The CFO currently has the ability to generate, authorize and perform Electronic Funds Transfer (EFTs) and has the ability to perform manual journal entries.

Recommendation

We recommend establishing an EFT policy where by someone without access to make manual journal entries are performing EFTs.

Response

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

Conclusion

Response is accepted.

06-I-3 Payroll Cycle

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.

**ADAIR COUNTY HEALTH SYSTEM
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2006**

Part I: Findings Related to Financial Statements (Continued):

06-I-4 Financial Reporting

The CFO currently has the ability to generate, authorize and perform all manual journal entries without a review process.

Recommendation

We recommend establishing a review process for all manual journal entries performed by the CFO.

Response

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

Conclusion

Response is accepted.

06-I-5 Patient Payments Cycle

Currently the Business Office Manager has access to patient payments and has the ability to post payments and adjustments in the patient accounting system.

Recommendation

We recommend removing the Business Office Manager's access to patient payments or adding a procedure that summarizes all payments before the Business Office Manager's gains access to the patient payments.

Response

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

Conclusion

Response is accepted.

**ADAIR COUNTY HEALTH SYSTEM
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2006**

Part II: Other Findings Related to Required Statutory Reporting:

06-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, 2006.

06-II-2 Certified Budget

Health System cash basis expenditures during the year ended June 30, 2006, exceeded budgeted amounts.

06-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.

06-II-4 Travel Expenses

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

06-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.

06-II-6 Board Minutes

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

06-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.

06-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.