

**SPENCER MUNICIPAL HOSPITAL
FINANCIAL STATEMENTS,
MANAGEMENT'S DISCUSSION AND ANALYSIS,
REQUIRED SUPPLEMENTARY INFORMATION,
SUPPLEMENTAL INFORMATION,
SCHEDULE OF FINDINGS, AND
INDEPENDENT AUDITORS' REPORTS
FOR THE YEARS ENDED
JUNE 30, 2006 AND 2005**

SPENCER MUNICIPAL HOSPITAL
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SPENCER MUNICIPAL HOSPITAL
BOARD OF TRUSTEES AND OFFICIALS
JUNE 30, 2006

BOARD OF TRUSTEES

TITLE

TERM EXPIRES

Gary VanHofwegen, DDS	Chairman	December 31, 2009
John Cotton	Vice Chairman	December 31, 2007
Neal Conover	Secretary/Treasurer	December 31, 2009
John Rahn	Trustee	December 31, 2007
Kris Van Berkum	Trustee	December 31, 2007

HOSPITAL OFFICIALS

Doug Doorn	President & CEO
Lois Morris	Vice-President - Finance & CFO
Brenda Tiefenthaler	Vice-President - Patient Care Services
Jason Harrington	Vice-President - Operations

WINTHER, STAVE & CO., LLP
Certified Public Accountants

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Spencer Municipal Hospital

We have audited the accompanying basic financial statements of Spencer Municipal Hospital's primary government as of and for the years ended June 30, 2006 and 2005, as listed as exhibits in the table of contents of this report. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with 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.

The financial statements referred to above include only the primary government of the Hospital, which consists of all funds, organizations, institutions, agencies, departments, and offices that comprise the Hospital's legal entity. The financial statements do not include financial data for the Hospital's legally separate component units, which U.S. generally accepted accounting principles require to be reported with the financial data of the Hospital's primary government. As a result, the primary government financial statements do not purport to, and do not, present fairly the financial position of the reporting entity of the Spencer Municipal Hospital 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 our opinion, the financial statements referred to above present fairly, in all material respects, the financial position for the primary government of Spencer Municipal Hospital as of June 30, 2006 and 2005, and the results of its operations and 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 11, 2006 on our consideration of Spencer Municipal Hospital'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 *Governmental Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Management's discussion and analysis on pages 4 - 10 and budgetary comparison schedule on page 28 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 measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were performed for the purpose of forming an opinion on the primary government financial statements that collectively comprise Spencer Municipal Hospital's basic financial statements. The supplemental information included in Schedules 1 through 7 is presented for purposes of additional analysis and is not a required part of the primary government financial statements. Such information, except for Schedules 4 and 7 which are marked "unaudited", on which we express no opinion, has been subjected to the auditing procedures applied in our audit of the aforementioned financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the primary government financial statements taken as a whole.

Wintell, Stone & Co., CP

August 11, 2006

SPENCER MUNICIPAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

Spencer Municipal Hospital (the Hospital) offers readers of our financial statements this narrative overview and analysis of the financial activities of the Hospital for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with the Hospital's financial statements, including the notes thereto.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Hospital's audited financial statements. The financial statements are composed of the balance sheet, statement of revenues, expenses, and changes in net assets, and the statement of cash flows. The financial statements also include notes to the financial statements that explain in more detail some of the information in the financial statements. The financial statements are designed to provide readers with a broad overview of the Hospital's financial position.

Required Financial Statements

The Hospital's financial statements report information of the Hospital using accounting methods similar to those used by private sector healthcare organizations. These statements offer short- and long-term information about its activities. The balance sheet includes all of the Hospital's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to Hospital creditors (liabilities). The balance sheet also provides the basis for evaluating the capital structure of the Hospital and assessing the liquidity and financial flexibility of the Hospital.

All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses, and changes in net assets. This statement measures the success of the Hospital's operations over the past two years and can be used to determine whether the Hospital has successfully recovered all of its costs through its patient service revenue and other revenue sources. The Hospital does not receive any funding from the City of Spencer. Revenues and expenses are reported on an accrual basis, which means the related cash could be received or paid in a subsequent period.

The final required statement is the statement of cash flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and capital and related financing activities. It also provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

Financial Highlights for 2006

- Total assets increased by \$2,187,513 to \$78,246,474.
- Net capital assets increased by \$3,754,154.
- Total noncurrent cash and investments increased by \$418,010.
- Total liabilities decreased by \$2,026,092.
- The operating margin for fiscal year 2006 was 7.3%.

SPENCER MUNICIPAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

Financial Analysis of the Hospital

The balance sheet and the statement of revenues, expenses, and changes in net assets report the net assets of the Hospital and the changes in them. The Hospital's net assets - the difference between assets and liabilities - is a way to measure financial health or financial position. Over time, sustained increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors such as changes in economic condition, population growth and new or changed governmental legislation should also be considered.

Net Assets

A summary of the Hospital's balance sheets at June 30, 2006, 2005, and 2004 are presented in Table 1 below:

Table 1

Condensed Balance Sheets

	<u>June 30, 2006</u>	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Current and other assets	\$31,699,855	\$33,266,496	\$29,944,730
Capital assets	<u>46,546,619</u>	<u>42,792,465</u>	<u>33,398,251</u>
TOTAL ASSETS	<u>\$78,246,474</u>	<u>\$76,058,961</u>	<u>\$63,342,981</u>
Long-term debt outstanding	\$16,185,176	\$17,635,779	\$10,294,580
Current liabilities	<u>8,066,785</u>	<u>8,642,274</u>	<u>7,712,312</u>
TOTAL LIABILITIES	<u>\$24,251,961</u>	<u>\$26,278,053</u>	<u>\$18,006,892</u>
Invested in capital assets - net of related debt	\$29,001,056	\$23,595,342	\$23,070,912
Restricted	780,462	775,948	1,990,289
Unrestricted	<u>24,212,995</u>	<u>25,409,618</u>	<u>20,274,888</u>
TOTAL NET ASSETS	<u>\$53,994,513</u>	<u>\$49,780,908</u>	<u>\$45,336,089</u>

Net assets increased by \$4,213,605 to \$53,994,513 in fiscal year 2006, up from \$49,780,908 in fiscal year 2005. The change in net assets results primarily from operating income.

During fiscal year 2006, the Hospital approved the construction of a \$5 million 40-bed inpatient medical surgical unit which is located on the second and third floors above the recently constructed surgery center. The completion and opening of the unit is slated for January 2007. Construction costs were funded using cash generated by operations and proceeds from debt financing.

SPENCER MUNICIPAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

Revenues, Expenses, and Changes in Net Assets

The following table presents a summary of the Hospital's historical revenues, expenses, and changes in net assets for each of the fiscal years ended June 30, 2006, 2005, and 2004.

Table 2

Condensed Statements of Revenues, Expenses, and Changes in Net Assets

	Year Ended June 30,		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Operating revenues	\$50,191,453	\$45,607,809	\$40,849,904
Operating expenses	<u>46,505,753</u>	<u>42,012,533</u>	<u>38,609,360</u>
Operating income	3,685,700	3,595,276	2,240,544
Nonoperating income	<u>316,765</u>	<u>645,183</u>	<u>757,192</u>
Excess of revenues over expenses before contributions	4,002,465	4,240,459	2,997,736
Contributions	<u>211,140</u>	<u>204,360</u>	<u>32,935</u>
Changes in net assets	4,213,605	4,444,819	3,030,671
Total net assets - beginning of year	<u>49,780,908</u>	<u>45,336,089</u>	<u>42,305,418</u>
 TOTAL NET ASSETS - END OF YEAR	 <u>\$53,994,513</u>	 <u>\$49,780,908</u>	 <u>\$45,336,089</u>

Operating and Financial Performance

The following discusses the Hospital's operations and statements of revenue, expenses, and changes in net assets between June 30, 2006 and 2005.

Volume: Inpatient admissions (excluding normal newborns) for fiscal year 2006 were 3,153 compared to 3,145 in fiscal year 2005. Patient days increased by 137 from 14,025 in 2005. Outpatient surgical visits increased during the year. Volumes increased in these outpatient areas: speech therapy, occupational therapy, laboratory, diagnostic imaging, ultrasound, CT scans, nuclear medicine, MRI, PET CT scan, enterostomal therapy, and EKGs. Adjusted patient days, which takes into consideration outpatient volume based on a ratio of outpatient revenues to total revenues, increased during fiscal year 2006.

Net Patient Service Revenue - Due to a rate increase of 8% effective July 1, 2005, and changes in patient volumes discussed above, net patient service revenues increased by \$3,410,199 or 7.9% in comparison to fiscal year 2005. During the fiscal year, the Hospital's reimbursement for Medicare inpatients under the prospective payment system saw an increase of 3%. For inpatient Medicare services, the Hospital is classified as a rural health care provider for purposes of determining the wage index.

SPENCER MUNICIPAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

The following table presents the relative percentages of gross charges billed for patient services by payer for the years ended June 30, 2006, 2005, and 2004.

Table 3

Payor Mix by Percentage

	<u>Year Ended June 30,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Medicare	53.87%	52.76%	54.70%
Wellmark/Blue Cross/Blue Shield	21.93%	22.42%	20.47%
Managed Care/Commercial	12.62%	13.16%	14.22%
Medicaid	8.38%	8.23%	7.05%
All other	3.20%	3.43%	3.56%
TOTAL	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>

Other Operating Revenue - Other operating revenue increased in part due to the net income from the Hospital's investment in Abben Cancer Center, LLC. The income from this investment increased by \$1,013,960, from \$724,934 in 2005 to \$1,738,894 in 2006.

Salaries - Salaries increased by \$1,970,849 from the prior year. For the fiscal year ended June 30, 2006, the Hospital employed a total of 457 full-time equivalent employees, compared to 423 for the fiscal year ended June 30, 2005. The Hospital is in a competitive wage market and utilizes numerous surveys to ensure a competitive compensation package is offered.

Employee Benefits - The Hospital is self-insured for its employee health benefits. The Hospital's health claims losses incurred during fiscal year 2006 were approximately \$2.2 million, compared to \$2 million in the prior year. The Hospital had 7 claims that exceeded \$35,000 for a total of \$313,000 and one claim that exceeded the Hospital's stop loss amount of \$70,000.

Nonoperating Income - Nonoperating income consists primarily of earnings from investments, income from rental properties, interest expense, and gain or loss on disposal of assets. Unrealized gains caused primarily by the recovery of the stock market led to investment income of \$399,998 recognized for fiscal year 2006, compared to \$405,041 recognized in fiscal year 2005. Interest expense is up due to more interest being expensed after the completion of the surgery center.

Capital Assets

At June 30, 2006, the Hospital had \$80,223,857 invested in capital assets as shown in Table 4. The \$3,754,154 increase in net capital assets is primarily a result of increases in buildings, construction in progress, and equipment. Construction in progress increased by \$4,967,884 primarily due to the current construction of the medical/surgical unit and the implementation of a new hospital information system.

SPENCER MUNICIPAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

The following table summarizes the Hospital's capital assets as of June 30, 2006, 2005, and 2004.

Table 4

Capital Assets	<u>June 30, 2006</u>	<u>June 30, 2005</u>	<u>June 30, 2004</u>
Land	\$ 1,558,997	\$ 1,544,043	\$ 1,432,384
Land improvements	865,688	859,959	669,025
Buildings	37,032,945	36,931,746	17,978,993
Fixed equipment	8,509,448	8,501,108	7,585,496
Major movable equipment	26,877,155	24,799,541	21,092,438
Construction in progress	<u>5,379,624</u>	<u>411,740</u>	<u>12,267,005</u>
Subtotal	80,223,857	73,048,137	61,025,341
Less accumulated depreciation	<u>33,677,238</u>	<u>30,255,672</u>	<u>27,627,090</u>
 CAPITAL ASSETS - NET	 <u>\$46,546,619</u>	 <u>\$42,792,465</u>	 <u>\$33,398,251</u>

Long-Term Debt and Capital Leases

At June 30, 2006, the Hospital had \$17,635,778 in long-term debt related to the construction of the surgical center. Long-term debt decreased \$1,658,802 during 2006 due to principal payments made during the fiscal year. More detailed information about the Hospital's outstanding debt is presented in the financial statement notes. Total long-term debt (excluding current portion) represents 66.7% and 67.1% of the Hospital's total liabilities as of June 30, 2006 and 2005, respectively.

Performance Compared to Budget:

During the fiscal year ended June 30, 2006, the Hospital experienced increases in patient volumes and thus a subsequent increase in expenses. Accordingly on May 31, 2006, the Board of Trustees approved an amended budget which increased operating revenue by \$4,610,000 and increased expenses by \$2,360,000. Final comparisons of actual revenues and expenses to amended budgeted amounts yielded total operating revenue being over budget by \$1,491,453 and operating expenditures under budget by \$104,247.

SPENCER MUNICIPAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

The following table compares fiscal year 2006 actual to budget information for the statement of revenues, expenses, and changes in net assets.

Table 5

Budget vs. Actual

	FY 2006 <u>Budget</u>	FY 2006 <u>Actual</u>	Dollar <u>Variance</u>
Gross patient service revenue	\$89,700,000	\$89,282,333	\$ (417,667)
Contractual adjustments	<u>43,000,000</u>	<u>42,941,437</u>	<u>58,563</u>
Net patient service revenue	46,700,000	46,340,896	(359,104)
Other operating revenue	<u>2,000,000</u>	<u>3,850,557</u>	<u>1,850,557</u>
Total operating revenue	48,700,000	50,191,453	1,491,453
Operating expenses	<u>46,610,000</u>	<u>46,505,753</u>	<u>104,247</u>
Operating income	2,090,000	3,685,700	1,595,700
Nonoperating income	<u>1,480,000</u>	<u>316,765</u>	<u>(1,163,235)</u>
 Excess of revenues over expenses before contributions	 <u>\$ 3,570,000</u>	 <u>\$ 4,002,465</u>	 <u>\$ 432,465</u>

Economic and Other Factors and Next Year's Budget

The Hospital's Board and management considered many factors when setting the fiscal year 2007 budget. Of primary importance in setting the 2007 budget is the status of the economy, which takes into account market forces and environmental factors such as:

- Medicare and Medicaid reimbursement rates
- Privacy legislation (HIPAA)
- Increased expectations for quality at a lower price
- Workforce shortages
- Cost of supplies
- Surging drug costs
- Increasing number of uninsured patients
- Increasing insurance deductibles

Patient Satisfaction; Community Contribution

The Hospital's leadership believes that employees working in a positive environment provide great customer services; yielding satisfied patients.

The Hospital subscribes to a national service, Press Ganey, which performs patient satisfaction surveys for more than 900 hospitals across the country. The Hospital continues to focus on outstanding patient satisfaction with a goal of obtaining or exceeding the 90th percentile each quarter.

SPENCER MUNICIPAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS - Continued

During fiscal year 2006, the Hospital contributed much to the community. Charity care and uncompensated care totaled \$2,086,536 for the fiscal year. In addition, many programs were provided without receiving compensating revenue. Examples of this include: emergency services coverage at community events, wellness screenings, various health education classes, and providing the use of facilities to community groups.

Contacting the Hospital's Finance Department

The Hospital's financial statements are designed to present users with a general overview of the Hospital's finances and to demonstrate the Hospital's accountability. The Hospital's component unit, Abben Cancer Center, LLC, has prepared a separate financial statement. If you have questions about the report, the Hospital's report, or need additional financial information, please contact the finance department at Spencer Municipal Hospital, 1200 First Avenue East, Spencer, Iowa 51301.

SPENCER MUNICIPAL HOSPITAL
BALANCE SHEETS
JUNE 30, 2006 AND 2005

ASSETS

	<u>2006</u>	<u>2005</u>
CURRENT ASSETS:		
Cash and cash equivalents (Note 2)	\$12,211,671	\$10,824,785
Patient receivables (less allowance for doubtful accounts and contractual adjustments of \$7,730,000 in 2006 and \$6,290,000 in 2005)	7,095,448	6,120,406
Other receivables (Note 9)	570,428	749,698
Investments (Note 2)	4,490,989	8,791,110
Inventory	1,620,852	1,503,950
Prepaid expenses	213,617	209,360
TOTAL CURRENT ASSETS	<u>26,203,005</u>	<u>28,199,309</u>
NONCURRENT CASH AND INVESTMENTS (Note 2):		
Restricted by board for capital improvements	3,676,449	3,262,953
Restricted by donors for operations	177,318	174,084
Principal of permanent endowments	603,144	601,864
TOTAL NONCURRENT CASH AND INVESTMENTS	<u>4,456,911</u>	<u>4,038,901</u>
CAPITAL ASSETS (Notes 4, 7, 10, and 11):		
Land	1,558,997	1,544,043
Construction in progress	5,379,624	411,740
Depreciable property, plant, and equipment	73,285,236	71,092,354
TOTAL CAPITAL ASSETS	80,223,857	73,048,137
Less accumulated depreciation	33,677,238	30,255,672
CAPITAL ASSETS - NET	<u>46,546,619</u>	<u>42,792,465</u>
OTHER ASSETS:		
Investment in Cancer Center (Notes 5, 9, and 10)	949,724	930,830
Deferred finance costs - net of accumulated amortization of \$18,405 and \$11,164, respectively	90,215	97,456
TOTAL OTHER ASSETS	<u>1,039,939</u>	<u>1,028,286</u>
 TOTAL ASSETS	 <u>\$78,246,474</u>	 <u>\$76,058,961</u>

SPENCER MUNICIPAL HOSPITAL
BALANCE SHEETS - Continued
JUNE 30, 2006 AND 2005

LIABILITIES AND NET ASSETS

	<u>2006</u>	<u>2005</u>
CURRENT LIABILITIES:		
Current portion of long-term debt (Note 7)	\$ 1,450,602	\$ 1,658,801
Accounts payable	2,523,576	2,573,638
Accrued salaries and wages	2,193,163	2,822,607
Payroll taxes payable	352,475	177,138
Estimated third-party payor settlements (Note 3)	550,000	845,000
Other current liabilities (Note 8)	<u>996,969</u>	<u>565,090</u>
TOTAL CURRENT LIABILITIES	8,066,785	8,642,274
LONG-TERM DEBT - NET OF CURRENT PORTION (Note 7)	<u>16,185,176</u>	<u>17,635,779</u>
TOTAL LIABILITIES	<u>24,251,961</u>	<u>26,278,053</u>
NET ASSETS:		
Invested in capital assets, net of related debt	29,001,056	23,595,342
Net assets restricted by donor - nonexpendable	603,144	601,864
Net assets restricted by donor - expendable	177,318	174,084
Unrestricted net assets	<u>24,212,995</u>	<u>25,409,618</u>
TOTAL NET ASSETS	<u>53,994,513</u>	<u>49,780,908</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$78,246,474</u>	<u>\$76,058,961</u>

SPENCER MUNICIPAL HOSPITAL
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
OPERATING REVENUE:		
Net patient service revenue (Note 3)	\$46,340,896	\$42,930,697
Other operating revenue	3,172,748	2,075,247
Clinic revenue	677,809	601,865
TOTAL OPERATING REVENUE	<u>50,191,453</u>	<u>45,607,809</u>
OPERATING EXPENSES:		
Salaries	18,011,322	16,040,473
Employee benefits	5,819,467	5,418,252
Professional services	2,910,272	2,667,350
Prescription drugs	3,810,945	3,953,247
Supplies and other	9,819,115	9,048,395
Clinic expenses	898,943	767,237
Depreciation	3,791,291	2,874,656
Bad debts	1,444,398	1,242,923
TOTAL OPERATING EXPENSES	<u>46,505,753</u>	<u>42,012,533</u>
OPERATING INCOME	<u>3,685,700</u>	<u>3,595,276</u>
NONOPERATING INCOME (EXPENSES):		
Interest income	732,460	383,553
Investment income - net of related expenses	399,998	405,041
Interest expense	(840,814)	(147,985)
Gain on sale of equipment and real estate	28,371	6,874
Scholarships granted	(3,250)	(2,300)
NET NONOPERATING INCOME	<u>316,765</u>	<u>645,183</u>
EXCESS OF REVENUES AND INCOME OVER EXPENSES	4,002,465	4,240,459
CAPITAL CONTRIBUTIONS AND GRANTS	<u>211,140</u>	<u>204,360</u>
CHANGE IN NET ASSETS	4,213,605	4,444,819
TOTAL NET ASSETS - BEGINNING OF YEAR	<u>49,780,908</u>	<u>45,336,089</u>
TOTAL NET ASSETS - END OF YEAR	<u>\$53,994,513</u>	<u>\$49,780,908</u>

SPENCER MUNICIPAL HOSPITAL
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from patients and third parties	\$44,304,265	\$41,311,804
Cash paid to suppliers for goods and services	(17,105,492)	(16,134,798)
Cash paid to employees for services	(24,284,896)	(21,240,513)
Other operating revenues	1,608,229	981,228
Other amounts paid	<u>(3,250)</u>	<u>(2,300)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>4,518,856</u>	<u>4,915,421</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Property, plant, and equipment purchases	(7,629,574)	(12,229,844)
Proceeds from sale of equipment and real estate	37,500	16,882
Proceeds from long-term debt	-	9,000,000
Payments on long-term debt	(1,658,802)	(905,234)
Interest paid on long-term debt	(831,698)	(116,438)
Capital contributions and grants received	<u>211,140</u>	<u>204,360</u>
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(9,871,434)</u>	<u>(4,030,274)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investments	(2,121,250)	(7,489,346)
Proceeds from sale and maturities of investments	6,854,521	2,284,744
Income on investments	704,203	448,886
Distributions from Cancer Center	<u>1,720,000</u>	<u>600,000</u>
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	<u>7,157,474</u>	<u>(4,155,716)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,804,896	(3,270,569)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>14,604,916</u>	<u>17,875,485</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$16,409,812</u>	<u>\$14,604,916</u>
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO THE BALANCE SHEETS:		
Cash and cash equivalents per balance sheets:		
Current assets	\$12,211,671	\$10,824,785
Noncurrent assets	<u>4,198,141</u>	<u>3,780,131</u>
TOTAL CASH AND CASH EQUIVALENTS	<u>\$16,409,812</u>	<u>\$14,604,916</u>

SPENCER MUNICIPAL HOSPITAL
STATEMENTS OF CASH FLOWS - Continued
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	\$ 3,685,700	\$ 3,595,276
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	3,791,291	2,874,656
Equity in earnings of Cancer Center	(1,738,894)	(724,934)
Components of non-operating and operating expenses reclassified for purposes of reporting cash flows:		
Scholarships awarded	(3,250)	(2,300)
(Increase) decrease in:		
Net patient receivables	(975,042)	(622,835)
Other receivables	174,375	(369,085)
Inventory	(116,902)	78,444
Prepaid expenses	(4,257)	(16,856)
Increase (decrease) in:		
Accounts payable	24,938	213,961
Accrued salaries and wages	(629,444)	194,952
Payroll taxes payable	175,337	23,260
Amounts due to contracting agencies	(295,000)	(355,000)
Other current liabilities	430,004	25,882
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 4,518,856</u>	<u>\$ 4,915,421</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES:		
Property, plant, and equipment purchases	\$ 7,554,574	\$12,278,878
Change in construction accounts payable	75,000	(43,000)
Deferred finance costs amortization capitalized	-	(6,034)
Cash paid to purchase property, plant, and equipment	<u>\$ 7,629,574</u>	<u>\$12,229,844</u>
Total interest expense paid	\$ 831,698	\$ 587,368
Less interest expense capitalized	-	470,930
Net interest paid on long-term debt	<u>\$ 831,698</u>	<u>\$ 116,438</u>

SPENCER MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Spencer Municipal Hospital (the Hospital) is a city public hospital organized under Chapter 392.6 of the Code of Iowa and operates a hospital in Spencer, Iowa, and two medical clinics in nearby communities. The Hospital is governed by a five-member board of trustees elected by the residents of Spencer for terms of four years. The majority of the Hospital's patients are from Spencer and northwest Iowa.

For financial reporting purposes, the Hospital is considered a primary government and has excluded the financial data of its component unit, the Abben Cancer Center, LLC (the Cancer Center). A primary government is a legal entity or body politic and includes all funds, organizations, institutions, agencies, departments, and offices that are not legally separate. Such legally separate entities are referred to as component units. Since these financial statements do not include the Hospital's component unit, they do not purport to be prepared in conformity with U.S. generally accepted accounting principles, as they relate to the exclusion of this component unit.

Basis of Presentation

The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Hospital considers savings accounts, money market mutual funds, and all other highly liquid investments (including restricted assets) with original maturities of three months or less to be cash equivalents.

Noncurrent Cash and Investments

Noncurrent cash and investments include proceeds from debt issues and funds of the Hospital deposited with a trustee which are restricted in accordance with the requirements of a bond resolution and related documents; funds restricted by donors for capital improvements or specific operations of the Hospital; permanently endowed funds; and assets set aside by the Board of Trustees for identified purposes and over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Permanent endowments require that the principal be retained in perpetuity.

Patient Receivables

Patient receivables are shown at the amount expected to be collected after estimating the allowance for doubtful accounts based on an aging of all the individual patient balances and estimating the contractual adjustments. Retroactively-calculated third party contractual adjustments are accrued on an estimated basis in the period the related services are rendered.

SPENCER MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - Continued

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Inventory

Inventory is valued at the lower of cost or market using the first-in, first-out method and consists primarily of patient supplies, including pharmaceuticals and operating supplies.

Capital Assets

Capital assets are stated at cost less accumulated depreciation. Depreciation is provided using the straight-line method over the estimated useful lives of the assets in accordance with the guidelines set forth by the American Hospital Association. Lives for the buildings and land improvements are five to fifty years while the equipment lives range from three to twenty years. Amortization of assets capitalized under lease obligations is included in depreciation expense.

Investments

Investments in common stocks are carried at fair value based on quoted market prices. Investments in real estate are carried at cost. Donated investments are reported at fair value at the date of receipt, which is then treated as cost.

The investment in the Cancer Center is accounted for by using the equity method, where the Hospital records its share of the earnings or losses.

Deferred Finance Costs

Deferred finance costs are stated at cost and are amortized over the term of the revenue bonds using the straight-line method. Amortization expense during the construction period is capitalized in the same manner as interest expense.

Operating Revenues and Expenses

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

Net Patient Service Revenue

Net patient service revenue and clinic revenue are 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 rendered and adjusted in future periods as final settlements are determined.

Interest and Investment Income

Interest and investment income are recorded as non-operating revenue. Investment income includes dividends, net rental income, and gains and losses, both realized and unrealized, on equity securities.

SPENCER MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - Continued

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

Interest Expense

Interest costs incurred on borrowed funds during the construction period of capital assets are capitalized as a component of the constructed assets. All of the borrowings from revenue bonds have been used to fund the construction projects.

Net Assets

Net assets are presented in the following components:

Invested in capital assets, net of related debt consist of capital assets, net of accumulated depreciation and reduced by the outstanding balances of long-term debt that are attributable to the acquisition, construction, or improvement of those assets.

Restricted nonexpendable net assets consist of the principal portion of permanent endowments.

Restricted expendable net assets consist of noncapital net assets that must be used for a particular purpose as specified by the donors.

Unrestricted net assets consist of net assets not meeting the definition of the three preceding categories.

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The Hospital maintains records to identify and monitor the level of charity it provides. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. The amount of charges forgone, based on established rates, for 2006 and 2005, were \$642,138 and \$158,463, respectively.

Income Taxes

The Hospital is exempt from federal and state income taxes on related income pursuant to Section 501(a) of the Internal Revenue Code of 1986.

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.

Reclassification

Certain amounts in the 2005 statements have been reclassified to conform to 2006's presentation. The reclassifications had no effect on the change in net assets or the net assets.

SPENCER MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - Continued

2. CASH AND INVESTMENTS

The Hospital's deposits at June 30, 2006 and 2005 were entirely covered by FDIC or SIPC insurance or the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This Chapter provides for additional assessments against members of the pool to insure there will be no loss of public funds.

The Hospital 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 of the Hospital; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; investments in common stocks; and warrants or improvement certificates of a drainage district.

The Hospital's cash and investments at June 30, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Cash and cash equivalents	\$16,409,812	\$14,604,916
Certificates of deposit with maturities up to one year	-	5,000,000
Common stocks	4,490,989	3,791,110
Real estate	<u>258,770</u>	<u>258,770</u>
 TOTAL CASH AND INVESTMENTS	 <u>\$21,159,571</u>	 <u>\$23,654,796</u>

The cash and investments shown above are included in the Hospital's balance sheets as follows:

	<u>2006</u>	<u>2005</u>
Current assets:		
Cash and cash equivalents	\$12,211,671	\$10,824,785
Investments	<u>4,490,989</u>	<u>8,791,110</u>
Subtotal	<u>16,702,660</u>	<u>19,615,895</u>
Noncurrent cash and investments:		
Cash and cash equivalents	4,198,141	3,780,131
Investments	<u>258,770</u>	<u>258,770</u>
Subtotal	<u>4,456,911</u>	<u>4,038,901</u>
 TOTAL CASH AND INVESTMENTS	 <u>\$21,159,571</u>	 <u>\$23,654,796</u>

The common stock investments are carried at quoted market prices. The net unrealized gain on the common stock investments at June 30, 2006 and 2005 was \$658,796 and \$582,622, respectively.

In accordance with its investment policy, the Hospital manages its exposure to declines in fair values by owning investments with various maturities. These investments include fixed money market accounts, certificates of deposit, and equity securities. The Hospital's philosophy for investing funds allows for fluctuation in yearly returns without putting the Hospital's ability to meet current expenditures at risk.

SPENCER MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - Continued

3. NET PATIENT SERVICE REVENUE

As a provider of health care services, the Hospital has agreements with third-party payors that provide for payment of services at amounts different from established rates. The basis for payment varies by payor and includes prospectively determined rates per discharge, discounts from established charges, and retroactively determined cost-based rates. Approximately 92 percent of gross patient charges determined at established rates for the years ended June 30, 2006 and 2005 resulted from patients covered by these third-party reimbursement programs. Significant changes have been made and may be made in certain of these programs which could have a material adverse impact on the financial condition of the Hospital in future years.

The following summarizes the differences between gross patient service revenue determined at established rates and net patient service revenue:

	<u>2006</u>	<u>2005</u>
Gross patient service revenue - at established rates	\$89,282,333	\$80,492,306
Deductions:		
Medicare program	(29,497,987)	(26,726,340)
Medicaid program	(4,883,706)	(3,859,681)
Blue Cross	(6,466,803)	(5,655,594)
Other payors	(1,450,803)	(1,161,531)
Charity care	<u>(642,138)</u>	<u>(158,463)</u>
Net Patient Service Revenue	<u>\$46,340,896</u>	<u>\$42,930,697</u>

SPENCER MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - Continued

4. CAPITAL ASSETS

A summary of changes in capital assets for 2006 and 2005 is as follows:

	Year Ended June 30, 2006			Ending Balance
	Beginning Balance	Additions	Disposals and Transfers - Net	
Capital assets not being depreciated:				
Land	\$ 1,544,043	\$ 14,954	\$ -	\$ 1,558,997
Construction in progress	<u>411,740</u>	<u>6,917,298</u>	<u>(1,949,414)</u>	<u>5,379,624</u>
Total capital assets not being depreciated	<u>1,955,783</u>	<u>6,932,252</u>	<u>(1,949,414)</u>	<u>6,938,621</u>
Other capital assets:				
Land improvements	859,959	-	5,729	865,688
Buildings	36,931,746	81,945	19,254	37,032,945
Fixed equipment	8,501,108	-	8,340	8,509,448
Major moveable equipment ..	<u>24,799,541</u>	<u>540,377</u>	<u>1,537,237</u>	<u>26,877,155</u>
Total other capital assets	<u>71,092,354</u>	<u>622,322</u>	<u>1,570,560</u>	<u>73,285,236</u>
Total capital assets	<u>73,048,137</u>	<u>7,554,574</u>	<u>(378,854)</u>	<u>80,223,857</u>
Less accumulated depreciation for:				
Land improvements	429,377	50,247	-	479,624
Buildings	7,533,297	1,265,845	-	8,799,142
Fixed equipment	5,271,498	328,508	-	5,600,006
Major moveable equipment ..	<u>17,021,500</u>	<u>2,146,691</u>	<u>(369,725)</u>	<u>18,798,466</u>
Total accumulated depreciation	<u>30,255,672</u>	<u>3,791,291</u>	<u>(369,725)</u>	<u>33,677,238</u>
CAPITAL ASSETS - NET	<u>\$42,792,465</u>	<u>\$3,763,283</u>	<u>\$ (9,129)</u>	<u>\$46,546,619</u>

SPENCER MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - Continued

4. CAPITAL ASSETS - Continued

	Year Ended June 30, 2005			
	Beginning Balance	Additions	Disposals and Transfers - Net	Ending Balance
Capital assets not being depreciated:				
Land	\$ 1,432,384	\$ 112,935	\$ (1,276)	\$ 1,544,043
Construction in progress	<u>12,267,005</u>	<u>10,753,011</u>	<u>(22,608,276)</u>	<u>411,740</u>
Total capital assets not being depreciated	<u>13,699,389</u>	<u>10,865,946</u>	<u>(22,609,552)</u>	<u>1,955,783</u>
Other capital assets:				
Land improvements	669,025	2,646	188,288	859,959
Buildings	17,978,993	124,626	18,828,127	36,931,746
Fixed equipment	7,585,496	-	915,612	8,501,108
Major moveable equipment ..	<u>21,092,438</u>	<u>1,285,660</u>	<u>2,421,443</u>	<u>24,799,541</u>
Total other capital assets	<u>47,325,952</u>	<u>1,412,932</u>	<u>22,353,470</u>	<u>71,092,354</u>
Total capital assets	<u>61,025,341</u>	<u>12,278,878</u>	<u>(256,082)</u>	<u>73,048,137</u>
Less accumulated depreciation for:				
Land improvements	386,202	43,175	-	429,377
Buildings	6,807,429	728,235	(2,367)	7,533,297
Fixed equipment	4,992,883	278,615	-	5,271,498
Major moveable equipment ..	<u>15,440,576</u>	<u>1,824,631</u>	<u>(243,707)</u>	<u>17,021,500</u>
Total accumulated depreciation	<u>27,627,090</u>	<u>2,874,656</u>	<u>(246,074)</u>	<u>30,255,672</u>
CAPITAL ASSETS - NET	<u>\$33,398,251</u>	<u>\$ 9,404,222</u>	<u>\$ (10,008)</u>	<u>\$42,792,465</u>

Included in major moveable equipment is medical equipment capitalized under the lease obligation described in Note 7. The cost of the equipment was \$1,150,000 and the related accumulated depreciation was \$1,130,833 and \$900,833 at June 30, 2006 and 2005, respectively.

SPENCER MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - Continued

5. INVESTMENT IN ABBEN CANCER CENTER, LLC

The Cancer Center is an Iowa limited liability company that operates a cancer radiation treatment center in Spencer, Iowa. The Hospital owns 100% of the Cancer Center. Condensed financial information of the Cancer Center is as follows:

	<u>2006</u>	<u>2005</u>
Current and total assets	\$ 953,120	\$ 884,254
Current and total liabilities	\$ 259,862	\$ 209,890
Member's equity	<u>693,258</u>	<u>674,364</u>
Total liabilities and member's equity	<u>\$ 953,120</u>	<u>\$ 884,254</u>
Net patient service revenue	\$4,003,659	\$ 2,536,756
Nonoperating income	22,332	6,660
Total expenses	<u>(2,287,097)</u>	<u>(1,818,482)</u>
Net income	<u>\$1,738,894</u>	<u>\$ 724,934</u>

The investment in the Cancer Center was approximately \$256,000 greater than the underlying member's equity at June 30, 2006 and 2005. The difference is attributable to goodwill which is tested for impairment on an annual basis.

Complete financial statements for the Cancer Center can be obtained from the administrative office of the Hospital. See Note 9 for related party transaction information.

6. RETIREMENT PLAN

The Hospital 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, PO Box 9117, Des Moines, Iowa 50306-9117.

Plan members are required to contribute 3.70% of their annual covered salary and the Hospital is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Hospital's contributions to IPERS for 2006, 2005, and 2004 were \$1,087,287, \$959,976, and \$880,422, respectively, equal to the required contributions for each year.

SPENCER MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - Continued

7. LONG-TERM DEBT

Long-term debt activity as of and for the years ended June 30, 2006 and 2005 is as follows:

	June 30, 2005	<u>Borrowings</u>	<u>Payments</u>	June 30, 2006	Due Within One Year
2003 Hospital Revenue Bonds Series A (A)	\$10,000,000	\$ -	\$ (740,736)	\$ 9,259,264	\$ 740,736
2003 Hospital Revenue Bonds, Series B (B)	8,999,992	-	(666,672)	8,333,320	666,672
Capital lease obligations (C)	<u>294,588</u>	<u>-</u>	<u>(251,394)</u>	<u>43,194</u>	<u>43,194</u>
	<u>\$19,294,580</u>	<u>\$ -</u>	<u>\$(1,658,802)</u>	<u>\$17,635,778</u>	<u>\$1,450,602</u>

	June 30, 2004	<u>Borrowings</u>	<u>Payments</u>	June 30, 2005	Due Within One Year
2003 Hospital Revenue Bonds, Series A	\$ 1,000,000	\$9,000,000	\$ -	\$10,000,000	\$ 740,736
2003 Hospital Revenue Bonds, Series B	9,666,664	-	(666,672)	8,999,992	666,672
Capital lease obligations .	<u>533,150</u>	<u>-</u>	<u>(238,562)</u>	<u>294,588</u>	<u>251,393</u>
	<u>\$11,199,814</u>	<u>\$9,000,000</u>	<u>\$ (905,234)</u>	<u>\$19,294,580</u>	<u>\$1,658,801</u>

- (A) Series A revenue bonds allowed borrowings up to \$10 million through June 30, 2005. Interest only monthly payments at variable rates set at 77.1% of a LIBOR rate plus 2.25% (5.86% and 4.31% at June 30, 2006 and 2005, respectively) adjustable monthly were due through June 30, 2005 with monthly principal payments of \$61,728 plus interest due thereafter through November 2018.
- (B) Series B revenue bonds with monthly principal payments of \$55,556 through December 2018 plus interest at 4.02%. The interest rate is fixed for 5 year increments; to be reset in 2008 and 2013 at 77.1% of the 5-year U.S. Treasury constant maturity rate plus 2%.
- (C) Capital lease obligation for medical equipment with 60 monthly payments of \$21,739 through September 2006 at an annual imputed interest rate of 5.25%.

The maturities and payment components of the Hospital's long-term debt are as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 1,450,602	\$ 845,404	\$ 2,296,006
2008	1,407,408	774,937	2,182,345
2009	1,407,408	704,754	2,112,162
2010	1,407,408	634,571	2,041,979
2011	1,407,408	564,388	1,971,796
2012 - 2016	7,037,040	1,769,197	8,806,237
2017 - 2019	<u>3,518,504</u>	<u>226,634</u>	<u>3,745,138</u>
TOTAL	<u>\$17,635,778</u>	<u>\$5,519,885</u>	<u>\$23,155,663</u>

The revenue bonds were issued under the provisions of Chapter 384.24A of the Code of Iowa and as such the principal and interest payments are payable solely from the revenues of the Hospital and do not constitute a liability or obligation of the City of Spencer.

SPENCER MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - Continued

8. HOSPITAL RISK MANAGEMENT

The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illness; natural disasters; and employee health and accident benefits. Certain of these risks are covered by commercial insurance purchased from independent third parties. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

The Hospital is self-insured for the following types of risk exposures:

Health Benefits

The Hospital has established an Employee Health Insurance Plan that self insures health benefits. Self-insurance is in effect up to a specific stop loss amount of \$70,000 per individual (\$100,000 on a specific individual) and an aggregate stop loss amount of approximately \$2,806,000. Coverage from private insurance companies is maintained for losses in excess of the aggregate stop loss amount up to a maximum of \$1,000,000. All claims handling procedures are performed by an independent claims administrator. Losses are accrued based upon the Hospital's estimates of the aggregate liability for claims incurred using certain assumptions followed in the insurance industry and based on the Hospital's experience. The amounts of unpaid claims included in the financial statements were \$762,978 and \$371,915 at June 30, 2006 and 2005, respectively, and are included in other current liabilities.

Unemployment Compensation

The Hospital is also self-insured for unemployment compensation claims. Unemployment is charged quarterly as the state assesses the Hospital based upon actual claims paid.

9. RELATED PARTY TRANSACTIONS

Spencer Regional Healthcare Foundation

The Spencer Regional Healthcare Foundation (Foundation) was formed in 1993 and is organized as a non-profit organization to solicit contributions for qualifying health care facilities within a 20-mile radius of Spencer, Iowa. Due to the existence of common board members, the Hospital and the Foundation are considered related parties. The Foundation made charitable contributions to the Hospital in the amount of \$43,389 and \$203,759 during 2006 and 2005, respectively.

Cancer Center

The Hospital has entered into various agreements with the Cancer Center whereby the Hospital will provide management and operating services and lease a building and related equipment to the Cancer Center. The agreements include defined methodologies to calculate the rates and are cancelable by either party 90 days prior to the anniversary date of the agreements. The following summarizes the transactions with the Cancer Center:

	<u>2006</u>	<u>2005</u>
Personnel service fees	\$ <u>143,010</u>	\$ <u>153,987</u>
Building and equipment rental income	\$ <u>306,183</u>	\$ <u>320,790</u>

SPENCER MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - Continued

9. RELATED PARTY TRANSACTIONS - Continued

At June 30, 2006 and 2005, the receivable from the Cancer Center was \$175,840 and \$171,913, respectively, which is included in other receivables. The balance consists of the above fees and cash advances for direct operating expenses less cash repayments.

Board of Trustees

The Hospital has depository accounts at a local financial institution whose chairman is a Hospital trustee. The Hospital earned interest income of \$148,290 and \$91,223 in 2006 and 2005, respectively, on accounts held at this financial institution.

The Hospital purchased supplies of \$6,266 and \$9,262 from a company owned in part by a Hospital trustee in 2006 and 2005, respectively.

10. OPERATING LEASES

The Hospital has entered into noncancelable operating lease agreements involving office equipment and three medical clinics. The original terms of the leases expire at various dates through 2010, have optional renewal clauses and are subject to increased rates if the renewal options are exercised. The rental expense for 2006 and 2005, under the agreements, was \$432,906 and \$427,669, respectively.

The following is a schedule of future minimum rental payments to be made:

<u>Year Ending June 30,</u>	<u>Amount</u>
2007	\$432,906
2008	313,980
2009	76,128
2010	<u>63,440</u>
TOTAL	<u>\$886,454</u>

The Hospital subleases one of the above clinics and leases office space in its medical office building to unrelated parties under noncancelable operating lease agreements. The original terms of the leases expire at various dates through 2008, have optional renewal clauses, and annual rental increase clauses to recover increased expenses. The rental income under the agreements for 2006 and 2005 was \$446,395 and \$435,621, respectively, and is included in investment income.

The following is a schedule of future minimum rental payments to be received including the subleases:

<u>Year Ending June 30,</u>	<u>Amount</u>
2007	\$451,157
2008	<u>181,467</u>
TOTAL	<u>\$632,624</u>

SPENCER MUNICIPAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS - Continued

10. OPERATING LEASES - Continued

The cost and accumulated depreciation of the leased property including the property leased to the Cancer Center are as follows:

	<u>2006</u>	<u>2005</u>
Medical office building	\$3,300,339	\$3,300,339
Medical clinic equipment	88,055	85,425
Cancer Center building	1,267,994	1,267,994
Cancer Center equipment	2,768,656	2,713,775
Other real estate	<u>718,537</u>	<u>538,491</u>
Total property and equipment	8,143,581	7,906,024
Less accumulated depreciation	<u>3,397,109</u>	<u>3,039,912</u>
 Net property and equipment	 <u>\$4,746,472</u>	 <u>\$4,866,112</u>

11. COMMITMENTS

The Hospital has entered into various agreements that have committed the Hospital to future payments. The commitments include construction agreements, binding equipment purchase orders, supplemental payments to a physicians' group, and physician recruiting agreements. The total amount expected to be paid in 2007 on these commitments is approximately \$5,250,000.

**SPENCER MUNICIPAL HOSPITAL
REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED JUNE 30, 2006**

SPENCER MUNICIPAL HOSPITAL
BUDGETARY COMPARISON SCHEDULE AND RELATED NOTES
FOR THE YEAR ENDED JUNE 30, 2006

	Original <u>Budget</u>	Final <u>Budget</u>	<u>Actual</u>	Variance Favorable (Unfavorable)
Net patient service revenue	\$43,000,000	\$46,700,000	\$46,340,896	\$ (359,104)
Other operating revenue	<u>2,000,000</u>	<u>2,000,000</u>	<u>3,850,557</u>	<u>1,850,557</u>
Total operating revenue	45,000,000	48,700,000	50,191,453	1,491,453
Operating expenses	(44,250,000)	(46,610,000)	(46,505,753)	104,247
Nonoperating income	<u>570,000</u>	<u>1,480,000</u>	<u>316,765</u>	<u>(1,163,235)</u>
 Net - Excess of Revenues over Expenses before Contributions and Grants	 1,320,000	 3,570,000	 4,002,465	 432,465
Capital contributions and grants	-	-	211,140	211,140
Net assets - beginning of year	<u>47,619,089</u>	<u>47,619,089</u>	<u>49,780,908</u>	<u>2,161,819</u>
 NET ASSETS - END OF YEAR	 <u>\$48,939,089</u>	 <u>\$51,189,089</u>	 <u>\$53,994,513</u>	 <u>\$2,805,424</u>

NOTES

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

The Board of Trustees annually prepares and adopts a budget designating the amount necessary for the improvement and maintenance of the Hospital following required public notice and hearing in accordance with Chapters 24 and 392.6 of the Code of Iowa. The Board of Trustees certifies the approved budget to the appropriate city officials. The budget may be amended during the year utilizing similar statutorily prescribed procedures. Formal and legal budgetary control is based on total expenditures.

**SPENCER MUNICIPAL HOSPITAL
SUPPLEMENTAL INFORMATION
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005**

SPENCER MUNICIPAL HOSPITAL
GROSS PATIENT SERVICE REVENUE
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006				2005
	Inpatient	Outpatient	Skilled Care	Home Health	Total
DAILY PATIENT SERVICE:					
Medical and surgery.....	\$ 4,935,955	-	-	-	\$ 4,935,955
Mental health.....	2,560,018	-	-	-	2,560,018
Nursery.....	307,163	-	-	-	307,163
Special care unit.....	1,367,497	-	-	-	1,367,497
Skilled care.....	-	-	638,493	-	638,493
TOTAL DAILY PATIENT SERVICES	9,170,633	-	638,493	-	9,809,126
OTHER NURSING SERVICES:					
Partial hospitalization.....	-	381,321	-	-	381,321
Same day surgery.....	-	1,072,437	-	-	1,072,437
Intravenous therapy.....	844,935	616,021	69,465	-	1,530,421
Delivery and labor rooms.....	400,815	335,355	-	-	736,170
Operating rooms.....	4,168,635	9,432,488	14,855	-	13,615,978
Recovery rooms.....	644,878	1,329,261	4,438	-	1,978,577
Emergency service.....	1,690,107	4,472,734	4,262	-	6,167,103
Medical supplies.....	8,472,496	4,923,194	70,914	2,398	13,469,002
Oncology.....	47	956,170	-	-	956,217
TOTAL OTHER NURSING SERVICES	16,221,913	23,518,981	163,934	2,398	39,907,226
OTHER PROFESSIONAL SERVICES:					
Respiratory therapy.....	523,738	49,704	58,595	-	632,037
Ambulance.....	-	1,093,525	-	-	1,093,525
Laboratory.....	1,649,630	2,243,218	81,031	-	3,973,879
Blood bank.....	96,974	32,522	2,290	-	131,786
Electrocardiology.....	522,527	873,816	6,232	-	1,402,575
Electroencephalography.....	6,896	16,445	-	-	23,341
Radiology.....	696,165	2,237,322	30,065	-	2,963,552
Ultrasound.....	128,694	1,260,757	-	-	1,389,451
Stereotactic biopsy.....	96	193,755	-	-	193,851

See Independent Auditors' Report.

Schedule 1 - Cont.

SPENCER MUNICIPAL HOSPITAL
GROSS PATIENT SERVICE REVENUE - Continued
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	2006					2005
	Inpatient	Outpatient	Skilled Care	Home Health	Total	Total
OTHER PROFESSIONAL SERVICES-						
Continued:						
CT scan.....	\$ 772,217	\$ 4,057,732	\$ -	\$ -	\$ 4,829,949	\$ 3,877,571
MRI.....	162,591	2,375,792	-	-	2,538,383	2,491,002
Nuclear medicine.....	58,455	938,326	-	-	996,781	892,399
Radiation oncology.....	101,299	-	-	-	101,299	7,598
Pharmacy.....	2,218,491	8,755,848	268,141	-	11,242,480	11,207,077
Therapy pool.....	2,288	159,588	-	-	161,876	200,310
Physical therapy.....	371,465	881,106	126,025	20,687	1,399,283	1,326,854
Speech therapy.....	16,189	202,817	14,523	-	233,529	209,373
Occupational therapy.....	168,091	457,691	67,091	-	692,873	571,606
Pulmonary function testing.....	6,688	60,224	-	-	66,912	34,046
Cardio-pulmonary diagnostics.....	-	348,968	-	-	348,968	335,296
Invasive procedures.....	1,994	541	541	-	3,076	4,423
Pulmonary rehab.....	-	38,584	-	-	38,584	11,416
Cardiac rehab.....	-	155,002	-	-	155,002	176,935
Hemodialysis.....	-	1,617,282	-	-	1,617,282	1,717,945
Dialysis-Spirit Lake.....	-	1,080,967	-	-	1,080,967	1,052,213
Home health:						
Registered nurse care.....	-	-	-	602,816	602,816	551,624
Aides care.....	-	-	-	416,474	416,474	359,169
County assistance.....	-	-	-	90,000	90,000	90,000
Other care.....	-	-	-	1,145,450	1,145,450	723,081
TOTAL OTHER PROFESSIONAL SERVICES	7,504,488	29,131,532	654,534	2,275,427	39,565,981	36,624,542
TOTAL GROSS PATIENT SERVICE REVENUE	\$ 32,897,034	\$ 52,650,513	\$ 1,456,961	\$ 2,277,825	\$ 89,282,333	\$ 80,492,306

See Independent Auditors' Report.

SPENCER MUNICIPAL HOSPITAL
NET PATIENT SERVICE REVENUE
AND OTHER OPERATING REVENUE
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
GROSS PATIENT SERVICE REVENUE (Schedule 1).....	\$ 89,282,333	\$ 80,492,306
ADJUSTMENTS TO PATIENT SERVICE REVENUE:		
Medicare program.....	29,497,987	26,726,340
Medicaid program.....	4,883,706	3,859,681
Blue Cross.....	6,466,803	5,655,594
Other payors.....	1,450,803	1,161,531
Charity care.....	642,138	158,463
TOTAL ADJUSTMENTS TO PATIENT SERVICE REVENUE	<u>42,941,437</u>	<u>37,561,609</u>
NET PATIENT SERVICE REVENUE	<u>\$ 46,340,896</u>	<u>\$ 42,930,697</u>
OTHER OPERATING REVENUE:		
Cafeteria sales.....	\$ 293,275	\$ 267,181
Photo service.....	401	1,059
Medical record transcripts.....	16,017	15,267
Miscellaneous.....	153,760	92,756
Steam sold.....	15,450	9,613
Purchase discounts.....	7,518	8,160
Education programs.....	63,625	41,809
AG health and safety clinic.....	74,938	126,491
Enterostomal therapy.....	57,890	53,257
Speech therapy.....	20,600	16,926
Occupational therapy-outreach services.....	27,548	18,922
Occupational health.....	2,550	6,847
Physical therapy.....	66,882	42,535
Athletic enhancement.....	70,875	84,500
Pharmacy services.....	605	934
Lifeline.....	105,611	83,939
Cancer Center fees:		
Personnel services.....	143,010	153,987
Building and equipment rental.....	306,183	320,790
Equity in earnings of Cancer Center.....	1,738,894	724,934
Employee health.....	7,116	5,340
TOTAL OTHER OPERATING REVENUE	<u>\$ 3,172,748</u>	<u>\$ 2,075,247</u>

See Independent Auditors' Report.

SPENCER MUNICIPAL HOSPITAL
SALARIES, PROFESSIONAL SERVICES, AND SUPPLIES AND OTHER EXPENSES
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	Salaries		Professional Services		Supplies and Other Expenses	
	2006	2005	2006	2005	2006	2005
Clinical resources.....	\$ 257,634	\$ 228,673	71,518	\$ 130,058	32,551	\$ 34,247
Medical and surgery.....	2,004,902	1,874,524	41,447	23,022	113,943	103,197
Obstetrics.....	541,306	517,048	2,724	2,299	36,629	27,454
Mental health.....	720,559	640,413	9,084	4,042	15,970	16,894
Special care.....	521,856	518,429	19,741	-	33,404	37,799
Intravenous therapy.....	-	-	-	-	34,267	37,638
Operating room.....	959,507	863,829	176,703	150,000	554,325	436,941
Recovery room.....	333,732	226,185	-	-	42,524	34,338
Emergency service.....	522,288	452,283	773,450	754,586	56,924	50,071
Central sterilization.....	137,958	98,665	-	-	109,306	99,124
Service aide.....	35,426	29,845	-	-	-	-
Same day surgery.....	759,347	685,597	1,655	627	32,596	32,185
Home health.....	812,632	743,065	7,569	7,379	55,359	46,740
Hospice.....	131,050	142,391	63,623	73,634	16,842	8,472
Enterostomal service.....	73,257	68,397	1,675	1,172	12,625	10,861
Hemodialysis.....	374,535	374,061	20,249	9,960	100,056	112,321
Dialysis - Spirit Lake.....	169,606	171,225	37,305	43,089	145,924	133,910
Partial hospitalization.....	47,648	54,106	-	-	4,363	4,076
Oncology.....	188,622	185,024	-	-	16,250	21,565
Childbirth.....	788	1,853	-	-	423	335
Respiratory therapy.....	235,683	183,486	45,962	138,971	62,946	64,475
Laboratory.....	510,033	463,584	205,811	187,518	341,191	251,227
Blood bank.....	-	-	-	-	107,362	110,890
Electrocardiology.....	82,668	59,842	61,783	56,937	1,880	2,268
Electroencephalography.....	-	-	11,040	17,342	69	-

See Independent Auditors' Report.

SPENCER MUNICIPAL HOSPITAL
SALARIES, PROFESSIONAL SERVICES, AND SUPPLIES AND OTHER EXPENSES - Continued
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	Salaries		Professional Services		Supplies and Other Expenses	
	2006	2005	2006	2005	2006	2005
Radiology.....	\$ 417,191	\$ 303,441	\$ 188,269	\$ 202,280	\$ 232,079	\$ 200,869
Ultrasound.....	164,796	164,468	-	-	59,824	64,825
Stereotactic biopsy.....	-	-	74,026	58,640	384	121
MRI.....	54,518	52,699	-	-	163,850	150,709
Occupational health.....	-	1,195	-	-	-	122
Athletic enhancement.....	104,487	108,662	-	25	9,151	6,268
Nuclear medicine.....	94,531	61,269	-	-	137,498	135,858
Pharmacy.....	744,350	440,618	88,493	112,552	35,010	31,714
Anesthesiology.....	9,929	-	-	-	61,542	74,386
Physical therapy.....	496,097	440,621	1,375	385	24,571	18,017
Ambulance.....	469,437	448,001	323	157	73,046	48,637
Social services.....	150,837	160,757	-	-	698	1,843
Cardiac rehabilitation.....	125,242	120,226	-	-	10,712	10,205
Medical records.....	481,184	435,931	68,129	70,016	97,291	86,341
CT scan.....	134,981	124,206	83,297	34,597	204,856	235,778
Occupational therapy.....	233,241	177,157	3,363	74,910	11,217	8,519
Infection control.....	42,000	41,544	685	685	1,262	1,543
Speech therapy.....	105,044	91,049	2,712	4,827	5,814	6,331
AG health and safety clinic.....	51,920	88,827	2,051	6,423	38,016	33,724
AG health -grant expense.....	-	-	-	-	11	2,775
Cardio-pulmonary diagnostic.....	45,443	42,882	-	-	5,063	4,869
Library.....	-	-	-	-	6,732	7,107
Sports medicine.....	-	-	176,004	114,233	40,279	27,647
Lifeline.....	25,348	24,116	47,079	39,022	33,215	32,685

See Independent Auditors' Report.

SPENCER MUNICIPAL HOSPITAL
SALARIES, PROFESSIONAL SERVICES, AND SUPPLIES AND OTHER EXPENSES - Continued
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	Salaries		Professional Services		Supplies and Other Expenses	
	2006	2005	2006	2005	2006	2005
Therapy pool.....	\$ -	-	\$ -	-	\$ 2,832	\$ 1,933
Plant.....	491,533	479,684	-	-	303,462	257,025
Utilities.....	-	-	-	-	931,652	583,542
Housekeeping.....	444,952	413,334	8,178	2,902	70,017	73,125
Laundry.....	140,090	131,308	12,819	234	45,753	45,503
Nutrition services.....	601,141	567,071	990	3,617	397,241	349,726
Valet.....	53,099	50,182	-	-	12,172	7,231
General accounting.....	230,476	204,336	12,122	6,047	18,514	23,272
Human resources.....	127,373	110,533	-	1,015	142,640	194,867
Patient accounts.....	797,596	703,782	45,498	38,348	132,120	139,485
Information systems.....	354,417	353,119	17,018	69,973	156,736	180,007
Administration.....	642,805	507,801	388,415	163,593	341,404	206,198
Materials management.....	116,142	93,752	4,745	2,450	33,341	25,896
Communications.....	-	-	8,364	10,619	73,914	56,529
Central supply.....	64,568	75,194	-	-	3,567,233	3,679,400
Printing and duplicating.....	25,124	22,430	-	-	123,747	114,405
Insurance.....	-	-	-	-	237,738	217,815
Staff development.....	107,434	90,753	4,723	6,553	20,595	9,403
Medical care evaluation.....	399,962	327,000	33,630	13,861	18,047	14,871
PET/CT scan.....	-	-	86,625	28,750	1,285	241
Clinical technology.....	42,997	-	-	-	4,056	-
Women's health.....	-	-	-	-	316	-
Penalties.....	-	-	-	-	4,450	-
TOTAL	\$ 18,011,322	\$ 16,040,473	\$ 2,910,272	\$ 2,667,350	\$ 9,819,115	\$ 9,048,395

See Independent Auditors' Report.

SPENCER MUNICIPAL HOSPITAL
 PATIENT RECEIVABLES AND ALLOWANCE FOR DOUBTFUL ACCOUNTS
 FOR THE YEARS ENDED JUNE 30, 2006 AND 2005
 UNAUDITED

PATIENT RECEIVABLES ANALYSIS OF AGING:

	2006		2005	
	Amount	Percent To Total	Amount	Percent To Total
DAYS SINCE DISCHARGE:				
00 - 30.....	\$ 4,765,736	32.15%	\$ 2,851,160	22.97%
31 - 60.....	1,729,056	11.66%	1,725,812	13.92%
61 - 90.....	767,019	5.17%	703,647	5.67%
91 - 120.....	572,463	3.86%	540,423	4.35%
Over 120.....	2,141,072	14.44%	2,467,598	19.88%
Clinic receivables, net.....	87,043	0.59%	113,002	0.91%
TOTAL RECEIVABLES BILLED	10,062,389	67.87%	8,401,642	67.70%
In Hospital.....	4,763,059	32.13%	4,228,527	34.07%
Medicare advances.....	-	0.00%	(219,763)	-1.77%
TOTAL PATIENT RECEIVABLES	14,825,448	100.00%	12,410,406	100.00%
Allowance for doubtful accounts.....	(2,030,000)		(1,960,000)	
Allowance for contractual adjustments.....	(5,700,000)		(4,330,000)	
PATIENT RECEIVABLES - NET	\$ 7,095,448		\$ 6,120,406	

ALLOWANCE FOR DOUBTFUL ACCOUNTS:

	2006	2005
BALANCE - BEGINNING OF YEAR.....	\$ 1,960,000	\$ 1,350,000
Provision.....	1,703,381	1,488,124
Recoveries of accounts previously written off.....	258,983	245,201
TOTAL	3,922,364	3,083,325
Accounts written off.....	(1,892,364)	(1,123,325)
BALANCE - END OF YEAR	\$ 2,030,000	\$ 1,960,000

See Independent Auditors' Report.

SPENCER MUNICIPAL HOSPITAL
INVENTORY AND PREPAID EXPENSES
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
INVENTORY:		
Store room.....	\$ 262,582	\$ 260,901
Nutrition services.....	24,107	15,025
Laboratory.....	103,324	116,612
Laundry.....	12,205	9,061
Pharmacy.....	346,848	368,736
Radiology.....	31,238	32,841
Surgery.....	756,033	622,777
Various other departments.....	84,515	77,997
	<u>\$ 1,620,852</u>	<u>\$ 1,503,950</u>
PREPAID EXPENSES:		
Service contracts.....	\$ 167,452	\$ 162,272
Association dues.....	26,933	25,495
Fees/Licenses.....	1,000	-
Insurance.....	18,232	21,593
	<u>\$ 213,617</u>	<u>\$ 209,360</u>

See Independent Auditors' Report.

SPENCER MUNICIPAL HOSPITAL
INVESTMENT TRANSACTIONS
FOR THE YEAR ENDED JUNE 30, 2006

	Balance Beginning of Year	Additions During Year	Sales During Year	Realized & Unrealized Gains	Balance End of Year
Certificates of deposit...	\$ 5,000,000	\$ -	\$ (5,000,000)	\$ -	\$ -
Common stocks.....	<u>3,791,110</u>	<u>2,121,250</u>	<u>(1,854,521)</u>	<u>433,150</u>	<u>4,490,989</u>
TOTAL	<u>\$ 8,791,110</u>	<u>\$ 2,121,250</u>	<u>\$ (6,854,521)</u>	<u>\$ 433,150</u>	<u>\$ 4,490,989</u>

See Independent Auditors' Report.

SPENCER MUNICIPAL HOSPITAL
COMPARATIVE STATISTICS
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005
UNAUDITED

	<u>2006</u>	<u>2005</u>
Admissions:		
Medical/surgery, obstetrics & special care.....	2,404	2,403
Mental health unit.....	522	440
Swing bed and comfort care.....	227	302
Newborns.....	<u>259</u>	<u>261</u>
TOTAL	<u><u>3,412</u></u>	<u><u>3,406</u></u>
Discharges:		
Medical/surgery, obstetrics & special care.....	2,363	2,370
Mental health unit.....	516	438
Swing bed and comfort care.....	262	328
Newborns.....	<u>267</u>	<u>259</u>
TOTAL	<u><u>3,408</u></u>	<u><u>3,395</u></u>
Average Length of Stay (Days):		
Medical/surgery, obstetrics & special care.....	3.34	3.31
Mental health unit.....	6.84	7.76
Swing bed and comfort care.....	8.76	6.96
Newborns.....	2.23	2.18
Patient Days:		
Medical/surgery, obstetrics & special care.....	8,024	7,943
Mental health unit.....	3,571	3,413
Swing bed and comfort care.....	1,989	2,101
Newborns.....	<u>578</u>	<u>568</u>
TOTAL	<u><u>14,162</u></u>	<u><u>14,025</u></u>
Average number of patients per day:		
Medical/surgery, obstetrics & special care.....	21.98	21.76
Mental health unit.....	9.78	9.35
Swing bed and comfort care.....	5.45	5.76
Newborns.....	1.58	1.56
Outpatient occasions of service.....	35,360	33,310
Licensed beds at end of year:		
Hospital.....	99	99
Swing bed and comfort care.....	<u>21</u>	<u>21</u>
TOTAL	<u><u>120</u></u>	<u><u>120</u></u>

See Independent Auditors' Report.

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

To the Board of Trustees of
Spencer Municipal Hospital

We have audited the basic financial statements of Spencer Municipal Hospital's primary government as of and for the year ended June 30, 2006 and 2005, and have issued our report thereon dated August 11, 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.

Compliance

As part of obtaining reasonable assurance about whether Spencer Municipal Hospital's primary government financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Comments involving statutory and other legal matters about Spencer Municipal Hospital's operations for the year ended June 30, 2006 are based exclusively on knowledge obtained from procedures performed during our audit of the primary government financial statements of Spencer Municipal Hospital. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Spencer Municipal Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the primary government financial statements and not to provide an opinion on the internal control over financial reporting.

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 weaknesses. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to the Board of Trustees of the Hospital in a separate letter dated August 11, 2006.

This report, a public record by law, is intended solely for the information and use of the officials, employees, and constituents of Spencer Municipal Hospital and other parties to whom Spencer Municipal Hospital may report. This report is not intended to be and should not be used by anyone other than those specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of Spencer Municipal Hospital during the course of our audit.

Wentzel, Steve Co., LLP

August 11, 2006

SPENCER MUNICIPAL HOSPITAL
SCHEDULE OF FINDINGS
FOR THE YEAR ENDED JUNE 30, 2006

Part I: Findings Related to the Primary Government Financial Statements

None

Part II: Other Findings Related to Required Statutory Reporting

06-II-A Certified Budget

For the year ended June 30, 2006, the Hospital's revenue and nonoperating income were \$328,218 more than the certified budget and the Hospital's operating expenses were \$104,247 less than certified budget, resulting in a net favorable variance of \$432,465.

06-II-B Questionable Expenditures

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 were noted.

06-II-C Travel Expense

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

06-II-D Business Transactions

Business transactions between the Hospital and Hospital officials or employees are detailed as follows:

<u>Business Connection</u>	<u>Transaction Description</u>	<u>Amount</u>
Neal Conover, Board member Chairman of Northwest Federal Savings Bank	Interest income from Northwest Federal Savings Bank	\$148,290
Kris Van Berkum, Board member Co-owner Janitor's Closet Ltd	Purchase of cleaning supplies	\$ 6,266

The transactions with Neal Conover's bank do not appear to represent a conflict of interest since the transactions were entered into through competitive bidding in accordance with Chapter 362.5(4), and the bank has been approved by the board of trustees in accordance with Chapter 362.5(2) of the Code of Iowa.

Recommendation - The transactions with Janitor's Closet Ltd. may represent a conflict of interest since the amounts spent in the fiscal year exceeded the statutory amount of \$1,500. The Hospital should research this issue to determine if it is in compliance with Chapter 362.5 of the Code of Iowa.

SPENCER MUNICIPAL HOSPITAL
SCHEDULE OF FINDINGS - Continued
FOR THE YEAR ENDED JUNE 30, 2006

Part II: Other Findings Related to Required Statutory Reporting - Continued

06-II-D Business Transactions - Continued

Response - The Hospital will research and resolve this matter in accordance with the Code.

Conclusion - Response accepted.

06-II-E Board Minutes

No transactions were found that we believe should have been approved in Board minutes but were not. The Board minutes were examined and appeared to give a condensed, accurate account of business transacted by the Board.

06-II-F Deposits and Investments

No instances of non-compliance with the deposit and investment provisions of Chapter 12B and Chapter 12C of the Code of Iowa and the Hospital's investment policy were noted.

**SPENCER MUNICIPAL HOSPITAL
MANAGEMENT COMMENT LETTER
FOR THE YEAR ENDED JUNE 30, 2006**

WINTHER, STAVE & CO., LLP
Certified Public Accountants

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To the Board of Trustees of
Spencer Municipal Hospital
Spencer, IA 51301

In planning and performing our audit of the basic financial statements of Spencer Municipal Hospital's primary government for the year ended June 30, 2006, we considered the Hospital's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the primary government financial statements and not to provide assurance on internal control. However, during the audit, we did become aware of the following matters that are opportunities for strengthening internal controls and operating efficiency.

Patient Account Processing:

We understand the Hospital is in the process installing a new comprehensive computer system for substantially all areas of the Hospital's operations. In conjunction with the conversion to the new system, we would recommend that the Hospital take this opportunity to evaluate some legacy processes and consider updating them. The following items have been identified as possible areas for change in the patient accounts area:

- Checks received should be endorsed at the earliest possible time, ideally upon the opening of the mail.
- Taking the deposits to the bank at the end of the day instead of keeping them at the Hospital overnight and taking them the next day.
- Consider locking the safe at an earlier time, such as 6 pm.
- Generating computerized receipts for payments received at the Hospital's cashier's desk instead of using handwritten ones.
- Re-evaluate the need to run two calculator tapes of checks received. Consider using the system's batch report to balance to the first tape.
- Having a second person perform spot checks of adjustments to patient accounts to determine that the adjustments are valid.

Individually and collectively the above steps would further enhance the Hospital's internal controls and safekeeping in the important area of receiving and processing patients' payments.

Credit Card Purchases:

Occasionally the Hospital uses a corporate credit card to purchase goods and services. During our review of selected purchases, we noted that some of the items did not have third-party documentation in the file or the documentation was provided after the monthly payment was made. Ultimately the documentation was located on the selected items. In order to safeguard the Hospital's assets, assist the accounting department in managing the credit card process, and provide sufficient internal controls in this area, we recommend that the credit card users forward to the accounting department their authorized third-party documentation before the monthly payment is disbursed. We acknowledge and understand the accounting department identified this as an issue during the year and has been working with the other departments to correct this situation.

** ** ** ** ** **

We have reported on the Hospital's compliance and on internal control over financial reporting in our report dated August 11, 2006. This letter does not affect the aforementioned report nor does it affect the Independent Auditors' Report dated August 11, 2006 on the financial statements of Spencer Municipal Hospital.

We will review the status of the comments during our next audit engagement. We have already discussed the items with Hospital personnel, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.



August 11, 2006

**ABBEN CANCER CENTER, LLC
(AN IOWA LIMITED LIABILITY COMPANY)
FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT
FOR THE YEARS ENDED
JUNE 30, 2006 AND 2005**

WINTHER, STAVE & CO., LLP
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INDEPENDENT AUDITORS' REPORT

To the Board of Managers
Abben Cancer Center, LLC
Spencer, IA 51301

We have audited the accompanying balance sheets of Abben Cancer Center, LLC (an Iowa limited liability company), a component unit of Spencer Municipal Hospital, as of June 30, 2006 and 2005, and the related statements of income and member's equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 Abben Cancer Center, LLC 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 accounting principles generally accepted in the United States of America.

Wintner, Stave & Co., LLP

August 4, 2006

ABBEN CANCER CENTER, LLC
BALANCE SHEETS
JUNE 30, 2006 AND 2005

ASSETS

	<u>2006</u>	<u>2005</u>
CURRENT ASSETS:		
Cash	\$ 518,847	\$ 524,390
Patient accounts receivable, net of allowance for doubtful accounts of \$78,600 in 2006 and \$91,400 in 2005	400,104	326,198
Prepaid expenses	<u>34,169</u>	<u>33,666</u>
 TOTAL ASSETS	 <u>\$ 953,120</u>	 <u>\$ 884,254</u>

LIABILITIES AND MEMBER'S EQUITY

CURRENT LIABILITIES:		
Accounts payable	\$ 84,022	\$ 37,977
Accounts payable to Spencer Municipal Hospital (Note 2)	<u>175,840</u>	<u>171,913</u>
TOTAL CURRENT LIABILITIES	259,862	209,890
 MEMBER'S EQUITY	 <u>693,258</u>	 <u>674,364</u>
 TOTAL LIABILITIES AND MEMBER'S EQUITY	 <u>\$ 953,120</u>	 <u>\$ 884,254</u>

ABBEN CANCER CENTER, LLC
 STATEMENTS OF INCOME AND MEMBER'S EQUITY
 FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
NET PATIENT SERVICE REVENUE	<u>\$4,003,659</u>	<u>\$2,536,756</u>
EXPENSES (Note 2):		
Professional medical services	1,383,984	1,056,629
Medical supplies	14,234	13,243
Facility expenses	515,424	532,373
General and administrative	<u>373,455</u>	<u>216,237</u>
TOTAL EXPENSES	<u>2,287,097</u>	<u>1,818,482</u>
OPERATING INCOME	<u>1,716,562</u>	<u>718,274</u>
NONOPERATING INCOME:		
Interest income	17,858	4,417
Contributions and other income	<u>4,474</u>	<u>2,243</u>
TOTAL NONOPERATING INCOME	<u>22,332</u>	<u>6,660</u>
NET INCOME	1,738,894	724,934
MEMBER'S EQUITY - BEGINNING OF YEAR	674,364	549,430
DISTRIBUTIONS	<u>(1,720,000)</u>	<u>(600,000)</u>
MEMBER'S EQUITY - END OF YEAR	<u>\$ 693,258</u>	<u>\$ 674,364</u>

ABBEN CANCER CENTER, LLC
 STATEMENTS OF CASH FLOWS
 FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$1,738,894	\$ 724,934
Adjustments to reconcile net income to net cash provided by operating activities:		
(Increase) decrease in patient accounts receivable	(73,906)	154,574
Increase in prepaid expenses	(503)	(5,787)
Increase (decrease) in accounts payable	46,045	(62,985)
Increase in accounts payable to Spencer Municipal Hospital	3,927	71,983
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>1,714,457</u>	<u>882,719</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Distributions	<u>(1,720,000)</u>	<u>(600,000)</u>
NET CASH USED BY FINANCING ACTIVITIES	<u>(1,720,000)</u>	<u>(600,000)</u>
NET INCREASE (DECREASE) IN CASH	(5,543)	282,719
CASH AT BEGINNING OF YEAR	<u>524,390</u>	<u>241,671</u>
CASH AT END OF YEAR	<u>\$ 518,847</u>	<u>\$ 524,390</u>

ABBEN CANCER CENTER, LLC
NOTES TO FINANCIAL STATEMENTS

1. BUSINESS ACTIVITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Business Activities

Abben Cancer Center, LLC (the Company) is an Iowa limited liability company that operates a cancer treatment center in Spencer, Iowa. The Company is a wholly-owned component unit of Spencer Municipal Hospital (Hospital) as defined by the Governmental Accounting Standards Board. Substantially all of its patients are from Northwest Iowa.

The Company was organized on June 20, 1996 and shall continue in existence until June 20, 2026 unless dissolved sooner in accordance with the terms of the Company's operating agreement.

Summary of Significant Accounting Policies

Cash and Concentration of Credit Risk

For purposes of the statement of cash flows, cash on deposit, cash on hand, and cash in savings accounts are considered cash. At June 30, 2006 and 2005, the Company had uninsured bank balances of \$415,116 and \$424,390, respectively.

Patient Accounts Receivable - Patient accounts receivable are reported at the amount expected to be collected after estimating the contractual adjustments and determining the allowance for doubtful accounts based on an aging of all the individual patient balances and an analysis of the delinquent accounts. Management reviews delinquent receivables and contractual adjustments on a monthly basis and writes off accounts when collection procedures have been exhausted.

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.

Income Taxes

The Company is not a taxpaying entity for federal and state income tax purposes, and thus no income tax expenses have been recorded in the statements.

Use of Estimates

The preparation of the Company's financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

ABBEN CANCER CENTER, LLC
NOTES TO FINANCIAL STATEMENTS - Continued

2. RELATED PARTY TRANSACTIONS

Spencer Municipal Hospital

The Company has entered into various transactions and agreements with the Hospital. The agreements and their related expenses for 2006 and 2005 are summarized as follows:

	<u>2006</u>	<u>2005</u>
Medical and office equipment lease	<u>\$226,024</u>	<u>\$242,586</u>
Office space lease agreement	<u>\$ 80,159</u>	<u>\$ 78,204</u>
Personnel service agreement:		
Leased employees' salaries	\$352,792	\$361,239
Leased employees' benefits	116,558	128,473
Personnel administration and other services	<u>26,452</u>	<u>25,514</u>
Total Personnel Service Agreement Expense	<u>\$495,802</u>	<u>\$515,226</u>

The agreements include defined methodologies to calculate the rates and are cancelable by either party 90 days prior to the anniversary date of the agreements.

Additionally, the Hospital paid substantially all of the Company's third-party vendors and billed the Company for the payments. The accounts payable to the Hospital is the result of the above transactions less cash payments.

Board Member

The Company has entered into a medical direction and professional services agreement with a company owned and controlled by a board member. The agreement is for a three-year period ending July 1, 2007 and shall be renewed automatically for successive one-year terms unless terminated by either party upon written notice 90 days prior to the anniversary date. Fees under the agreement are calculated based upon a percentage of net patient revenue that is reviewed and agreed to annually. Total fees paid under the agreement for 2006 and 2005 were \$812,708 and \$478,859, respectively.

**ABBEN CANCER CENTER, LLC
MANAGEMENT COMMENT LETTER
FOR THE YEAR ENDED JUNE 30, 2006**

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August 4, 2006

To the Board of Managers of
Abben Cancer Center, LLC
Spencer, IA 51301

In planning and performing our audit of the financial statements of Abben Cancer Center, LLC for the year ended June 30, 2006, we considered the Company's internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on internal control. However, during the audit, we did become aware of the following matter that warrants your attention.

During our review of the Company's billing system, we noted patient balance adjustments are classified into eight different adjustment types. Acknowledging that the Company has review procedures in place for the vast majority of the adjustments, we noted two areas of improvement for your consideration.

First, we would recommend that management perform a post adjustment review of the bad debt and charity care adjustments to insure that the proper accounts were written off.

Second, we would recommend the other adjustments that are not system generated or pre-approved by management be subject to a review. Due to the current small dollar amounts of these adjustments, a post review of the adjustments may be sufficient. This situation should be monitored and changed if the number or amounts increase significantly.

This letter does not affect the independent auditors' report dated August 4, 2006 on the financial statements of Abben Cancer Center, LLC. We will review the status of this comment during our next audit engagement. We have already discussed this item with Company personnel and will be pleased to discuss it in further detail at your convenience, to perform any additional study of this matter, or to assist you in implementing the recommendation.

Wintner, Stave & Co., LLP