

POCAHONTAS COMMUNITY HOSPITAL
INDEPENDENT AUDITOR'S REPORT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FINANCIAL STATEMENTS AND ACCOMPANYING INFORMATION
COMMENTS AND RECOMMENDATIONS
YEARS ENDED JUNE 30, 2006 AND 2005

POCAHONTAS COMMUNITY HOSPITAL

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POCAHONTAS COMMUNITY HOSPITAL
 Officials
 June 30, 2006

| <u>Name</u> | <u>Title</u> | <u>Term Expires</u> |
|-----------------------------------|---------------------|---------------------|
| CITY COUNCIL | | |
| George Tuttle | Mayor | December, 2007 |
| Gus Holzmueller | Member | December, 2007 |
| Kent Wood | Member | December, 2007 |
| John DeWall | Member | December, 2010 |
| Brooks Taylor | Member | December, 2010 |
| Rod Stoullil | Member | December, 2006 |
| Jeffrey A. Johnson | City Treasurer | |
| HOSPITAL BOARD OF TRUSTEES | | |
| Rick Winegarden | President | December, 2007 |
| Bev Holzmueller | Vice-President | December, 2009 |
| Duane Wiemers | Secretary-Treasurer | December, 2009 |
| Don Beneke | Member | December, 2007 |
| Cheryl Smith | Member | December, 2007 |
| HOSPITAL OFFICIALS | | |
| James Roetman | CEO | |
| Lynne Raveling | CFO | |
| Sherrie Laubenthal | Director of Nursing | |

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

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DAVID A. GINTHER

INDEPENDENT AUDITOR'S REPORT

To the Board of Trustees
Pocahontas Community Hospital
Pocahontas, Iowa

We have audited the accompanying consolidated balance sheets of Pocahontas Community Hospital as of June 30, 2006 and 2005, and the related consolidated statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pocahontas Community Hospital as of June 30, 2006 and 2005, and the results of its operations, changes in net assets, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

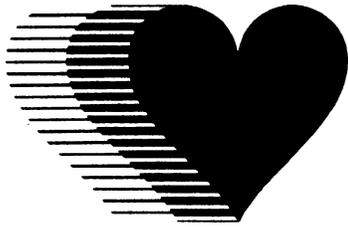
In accordance with Government Auditing Standards, we have also issued our report dated August 21, 2006 on our consideration of Pocahontas Community Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements 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 Government Auditing Standards and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 4 through 4d and the budgetary comparison schedule on page 18 are not a required part 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 required supplementary information. However, we did not audit the information and express no opinion on it.

To the Board of Trustees
Pocahontas Community Hospital

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. We previously audited, in accordance with the standards referred to in the second paragraph of this report, the financial statements for the three years ended June 30, 2004 (none of which are presented herein) and expressed unqualified opinions on those financial statements. The accompanying information (shown on pages 19 through 31) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Gronewald, Bell, Kuhn + Co. P.C.
Atlantic, Iowa
August 21, 2006



Pocahontas Community Hospital

Pocahontas Community Hospital Management's Discussion and Analysis

Our discussion and analysis of Pocahontas Community Hospital's (Hospital) financial performance provides an overview of the Hospital's and Pocahontas Community Healthcare Foundation's (a blended component unit) financial activity for the fiscal years ended June 30, 2006 and 2005. Please read it in conjunction with the Hospital's financial statements.

FINANCIAL HIGHLIGHTS

The Hospital's net assets increased in each of the past two years with a \$80,661 or 1.2 percent increase in 2006 and a \$470,914 or 7.4 percent increase in 2005.

The Hospital reported an operating loss of \$59,876 in 2006 and operating income of \$340,224 in 2005.

Nonoperating revenues, net increased by \$37,757 or 62 percent in 2006 and decreased by \$67,846 or 53% in 2005.

USING THIS ANNUAL REPORT

The Hospital's financial statements consist of three statements - a Balance Sheet; a Statement of Revenues, Expenses, and Changes in Net Assets; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purposes by contributors, grantors, or enabling legislation.

THE BALANCE SHEET AND STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The Balance Sheet and the Statement of Revenues, Expenses, and Changes in Net Assets report information about the Hospital's resources and its activities. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net assets and changes in them. The Hospital's net assets - the difference between assets and liabilities - is one way to measure the Hospital's financial health, or financial position. Other nonfinancial factors, however, such as changes in the Hospital's patient base and measures of the quality of service it provides to the community, as well as local economic factors need to be considered in assessing the overall health of the Hospital.

THE STATEMENT OF CASH FLOWS

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities.

Pocahontas Community Hospital
Management's Discussion and Analysis - Continued

THE HOSPITAL'S NET ASSETS

The Hospital's net assets are the difference between its assets and liabilities reported in the Balance Sheet on page 5 as you can see from Table 1.

Table 1: Assets, Liabilities, and Net Assets

| | <u>2006</u> | <u>2005</u> | <u>2004</u> |
|--|---------------------|---------------------|---------------------|
| Assets: | | | |
| Current assets | \$ 1,493,803 | \$ 1,743,377 | \$ 2,392,796 |
| Capital assets, net | 7,696,855 | 6,973,519 | 4,582,184 |
| Other assets, net | <u>256,111</u> | <u>399,189</u> | <u>909,897</u> |
| Total assets | <u>\$ 9,446,769</u> | <u>\$ 9,116,085</u> | <u>\$ 7,884,877</u> |
| Liabilities: | | | |
| Long-term debt, less current maturities | \$ 1,750,051 | \$ 985,092 | \$ 465,991 |
| Other current and noncurrent liabilities | <u>741,583</u> | <u>1,256,519</u> | <u>1,015,326</u> |
| Total liabilities | <u>\$ 2,491,634</u> | <u>\$ 2,241,611</u> | <u>\$ 1,481,317</u> |
| Net Assets: | | | |
| Invested in capital assets | \$ 5,696,855 | \$ 5,973,519 | \$ 4,082,184 |
| Restricted expendable assets | 101,476 | 180,876 | 277,160 |
| Unrestricted | <u>1,156,804</u> | <u>720,079</u> | <u>2,044,216</u> |
| Total net assets | <u>\$ 6,955,135</u> | <u>\$ 6,874,474</u> | <u>\$ 6,403,560</u> |

A significant component of the change in the Hospital's assets is the increase in capital assets and contributions related to the current building project. Net patient service revenue increased \$140,926 or 2.4% in 2006 (\$670,867 or 12.9% in 2005).

OPERATING RESULTS AND CHANGES IN THE HOSPITAL'S NET ASSETS

In 2006, the Hospital's net assets increased by \$80,661 or 1.2 percent, as shown in Table 2. This represents a decline of 7.4 percent compared with the increase in net assets of \$470,914 for 2005.

Pocahontas Community Hospital
Management's Discussion and Analysis - Continued

Table 2: Operating Results and Changes in Net Assets

| | <u>2006</u> | <u>2005</u> | <u>2004</u> |
|---|---------------------|---------------------|---------------------|
| Operating Revenues: | | | |
| Net patient service revenues | \$ 5,997,006 | \$ 5,856,080 | \$ 5,185,213 |
| Other operating revenues | <u>72,339</u> | <u>71,269</u> | <u>75,277</u> |
| Total operating revenues | 6,069,345 | 5,927,349 | 5,260,490 |
| Operating Expenses: | | | |
| Nursing service | 1,597,822 | 1,478,901 | 1,399,656 |
| Other professional service | 2,281,680 | 2,128,473 | 2,045,836 |
| General Service | 538,600 | 460,258 | 398,005 |
| Fiscal and administrative service | 1,124,143 | 1,043,054 | 980,961 |
| Provision for depreciation | <u>586,976</u> | <u>476,439</u> | <u>281,590</u> |
| Total operating expenses | <u>6,129,221</u> | <u>5,587,125</u> | <u>5,106,048</u> |
| Operating income (loss) | (59,876) | 340,224 | 154,442 |
| Nonoperating Revenues and Expenses: | | | |
| Noncapital gifts, grants and bequests | 79,244 | 24,773 | 56,160 |
| Investment income | 24,115 | 32,421 | 66,264 |
| Ambulance subsidy | 5,020 | 3,921 | 5,020 |
| Interest Expense | (4,164) | -- | -- |
| Clinic operations, net | (347) | (350) | (375) |
| Gain (loss) on disposal of equipment | <u>(5,461)</u> | <u>(115)</u> | <u>1,427</u> |
| Non-operating revenues, net | <u>98,407</u> | <u>60,650</u> | <u>128,496</u> |
| Excess of Revenues Over Expenses Before Capital Grants and Contributions | 38,531 | 400,874 | 282,938 |
| Capital Grants and Contributions | <u>42,130</u> | <u>70,040</u> | <u>219,194</u> |
| Increase in Net Assets | 80,661 | 470,914 | 502,132 |
| Net Assets Beginning of Year | <u>6,874,474</u> | <u>6,403,560</u> | <u>5,901,428</u> |
| Net Assets End of Year | <u>\$ 6,955,135</u> | <u>\$ 6,874,474</u> | <u>\$ 6,403,560</u> |

Pocahontas Community Hospital
Management's Discussion and Analysis - Continued

OPERATING INCOME

The first component of the overall change in the Hospital's net assets is its operating income, the difference between net patient service and other operating revenues and the expenses incurred to perform those services. In the past year, the Hospital reported an operating loss. Operating income decreased from \$340,224 in 2005 to (\$ 59,876) in 2006.

The primary components of this decrease in operating incomes are:

The increase in supplies purchased relative to the construction/ renovation project to equip and furnish the recently completed areas.

A change in the capitalization policy, increasing the threshold at which assets are capitalized from \$2,000 to \$5,000 this resulted in an increase in operating expenses.

NONOPERATING REVENUES AND EXPENSES

Nonoperating revenues consist primarily of contributions, interest revenue and investment earnings and a county subsidy for providing ambulance services. Interest revenue decreased from \$32,421 in 2005 to \$24,115 in 2006. The Hospital used its reserves to fund the current building project, which reduced revenue from investments in 2006.

GRANTS AND CONTRIBUTIONS

The Hospital was the recipient of \$37,311 in grants through the SHIP, FLEX and HRSA grant programs in 2006.

The Pocahontas Community Hospital Healthcare Foundation was formed for the purpose of raising funds for the benefit of the Hospital. The foundation embarked on a capital campaign to raise money for the current building project at the Hospital. The foundation is also the conduit for the funds from the annual Hospice fund drive.

THE HOSPITAL'S CASH FLOWS

Changes in the Hospital's cash flows are consistent with changes in operating revenues and nonoperating revenues and expenses as discussed earlier.

BUDGETARY HIGHLIGHTS

The official budget of the Hospital for the year ended June 30, 2006 was prepared on a modified accrual basis. Actual expenditures were lower than the budget by approximately \$1,126,036 due to a delay in the timing of certain expenditures.

Pocahontas Community Hospital
Management's Discussion and Analysis - Continued

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets:

At the end of 2005, the Hospital had \$5,973,519 invested in capital assets, net of accumulated depreciation and related debt. In 2006, the Hospital purchased new equipment costing \$156,393 and completed phase III of the current building project, incurring costs of \$3,236,624. The Hospital had \$5,696,855 invested in capital assets net of accumulated depreciation and related debt at the end of 2006.

Debt:

At year-end, the Hospital had \$2,000,000 in debt outstanding. This is a \$2,000,000 promissory note signed by the City of Pocahontas on behalf of the Hospital for financing the current building project.

OTHER ECONOMIC FACTORS

Jack Links, a snack food processor began operations in Laurens in April 2005. This employer as of June 2006 employs 191 people from the surrounding area, and has had a positive impact on the services utilized at the Hospital. The Area Education Agency has built a new facility in Pocahontas, and will begin operations in August 2006. The Agency anticipates 60-80 new jobs in the Pocahontas area.

CONTACTING THE HOSPITAL'S FINANCIAL MANAGEMENT

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Chief Financial Officer, Pocahontas Community Hospital, 606 NW 7th St., Pocahontas, Iowa 50574.

POCAHONTAS COMMUNITY HOSPITAL
Consolidated Balance Sheets
June 30,

ASSETS

| | <u>2006</u> | <u>2005</u> |
|--|---------------------|---------------------|
| Current Assets: | | |
| Cash | \$ 245,254 | \$ 641,647 |
| Patient receivables, less allowances for doubtful accounts and for contractual adjustments (\$445,000 in 2006, \$648,000 in 2005) | 645,881 | 688,565 |
| Other receivables | 47,293 | 5,303 |
| Inventory | 95,823 | 86,538 |
| Prepaid expense | 67,791 | 49,115 |
| Estimated third-party payor settlement | 40,000 | -- |
| Internally designated assets | <u>352,273</u> | <u>272,209</u> |
| Total current assets | 1,494,315 | 1,743,377 |
| Designated and Restricted Assets: | | |
| Internally designated assets | 506,396 | 490,522 |
| Restricted assets | <u>101,476</u> | <u>180,876</u> |
| | 607,872 | 671,398 |
| Less amounts required to meet current liabilities | <u>352,273</u> | <u>272,209</u> |
| | 255,599 | 399,189 |
| Capital Assets: | | |
| Depreciable capital assets, net | 7,684,355 | 4,886,882 |
| Non-depreciable capital assets | <u>12,500</u> | <u>2,086,637</u> |
| | <u>7,696,855</u> | <u>6,973,519</u> |
| Total assets | <u>\$ 9,446,769</u> | <u>\$ 9,116,085</u> |

The accompanying notes are an integral part of these statements.

LIABILITIES AND NET ASSETS

| | <u>2006</u> | <u>2005</u> |
|---|---------------------|---------------------|
| Current Liabilities: | | |
| Current maturities of long-term debt | \$ 249,949 | \$ 14,908 |
| Accounts payable | 325,912 | 509,090 |
| Accrued employee compensation | 146,073 | 180,458 |
| Other accrued expenses | 15,485 | 32,063 |
| Accrued interest | 4,164 | -- |
| Estimated third-party payor settlements | -- | 520,000 |
| Total current liabilities | <u>741,583</u> | <u>1,256,519</u> |
| Long-Term Debt, less current maturities | <u>1,750,051</u> | <u>985,092</u> |
| Total liabilities | 2,491,634 | 2,241,611 |
| Net Assets: | | |
| Invested in capital assets, net of related debt | 5,696,855 | 5,973,519 |
| Restricted - expendable | 101,476 | 180,876 |
| Unrestricted | <u>1,156,804</u> | <u>720,079</u> |
| | <u>6,955,135</u> | <u>6,874,474</u> |
| | | |
| Total liabilities and net assets | <u>\$ 9,446,769</u> | <u>\$ 9,116,085</u> |

POCAHONTAS COMMUNITY HOSPITAL
Consolidated Statements of Revenues, Expenses and Changes in Net Assets
Year ended June 30,

| | <u>2006</u> | <u>2005</u> |
|---|---------------------|---------------------|
| Revenue: | | |
| Net patient service revenue | \$ 5,997,006 | \$ 5,856,080 |
| Other revenue | <u>72,339</u> | <u>71,269</u> |
| Total revenue | 6,069,345 | 5,927,349 |
| Expenses: | | |
| Nursing service | 1,597,822 | 1,478,901 |
| Other professional service | 2,281,680 | 2,128,473 |
| General service | 538,600 | 460,258 |
| Fiscal and administrative service | 1,124,143 | 1,043,054 |
| Provision for depreciation | <u>586,976</u> | <u>476,439</u> |
| Total expenses | <u>6,129,221</u> | <u>5,587,125</u> |
| Operating Income (Loss) | (59,876) | 340,224 |
| Non-Operating Revenues (Expenses): | | |
| Noncapital gifts, grants and bequests | 79,244 | 24,773 |
| Investment income | 24,115 | 32,421 |
| Ambulance subsidy | 5,020 | 3,921 |
| Interest expense | (4,164) | -- |
| Clinic operations, net | (347) | (350) |
| Loss on disposal of equipment | <u>(5,461)</u> | <u>(115)</u> |
| Non-operating revenues, net | <u>98,407</u> | <u>60,650</u> |
| Excess of Revenues Over Expenses Before Capital Grants and Contributions | 38,531 | 400,874 |
| Capital Grants and Contributions | <u>42,130</u> | <u>70,040</u> |
| Increase in Net Assets | 80,661 | 470,914 |
| Net Assets Beginning of Year | <u>6,874,474</u> | <u>6,403,560</u> |
| Net Assets End of Year | <u>\$ 6,955,135</u> | <u>\$ 6,874,474</u> |

The accompanying notes are an integral part of these statements.

POCAHONTAS COMMUNITY HOSPITAL
Consolidated Statements of Cash Flows
Year ended June 30,

| | 2006 | 2005 |
|--|--------------|--------------|
| Cash flows from operating activities: | | |
| Cash received from patients and third-party payors | \$ 5,437,700 | \$ 5,670,695 |
| Cash paid to suppliers | (3,440,409) | (2,996,337) |
| Cash paid to employees | (2,208,961) | (2,024,398) |
| Other operating revenue | 72,339 | 71,269 |
| Net cash provided by (used in) operating activities | (139,331) | 721,229 |
| Cash flows from non-capital financing activities: | | |
| Gifts, grants and bequests | 79,244 | 24,773 |
| Ambulance subsidy | 5,020 | 3,921 |
| Net cash provided by non-capital financing activities | 84,264 | 28,694 |
| Cash flows from capital and related financing activities: | | |
| Capital expenditures | (1,470,750) | (2,642,149) |
| Proceeds from long-term debt | 1,000,000 | 500,000 |
| Capital grants and contributions | 65,130 | 70,040 |
| Net cash used in capital and related financing activities | (405,620) | (2,072,109) |
| Cash flows from investing activities: | | |
| Change in designated and restricted assets | (13,909) | 209,286 |
| Investment income | 24,115 | 32,421 |
| Clinic operations, net | (347) | (350) |
| Net cash provided by investing activities | 9,859 | 241,357 |
| Net decrease in cash and cash equivalents | (450,828) | (1,080,829) |
| Cash and cash equivalents beginning of year | 861,729 | 1,942,558 |
| Cash and cash equivalents end of year | \$ 410,901 | \$ 861,729 |
| Reconciliation of cash and cash equivalents to the balance sheets: | | |
| Cash in current assets | \$ 245,254 | \$ 641,647 |
| Cash and cash equivalents in designated and restricted assets | 165,647 | 220,082 |
| Total cash and cash equivalents | \$ 410,901 | \$ 861,729 |

(continued next page)

POCAHONTAS COMMUNITY HOSPITAL
Consolidated Statements of Cash Flows - Continued
Year ended June 30,

| | 2006 | 2005 |
|---|--------------|------------|
| Reconciliation of operating income (loss) to net cash provided by (used in) operating activities: | | |
| Operating income (loss) | \$(59,876) | \$ 340,224 |
| Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities | | |
| Depreciation | 586,976 | 476,439 |
| Provision for bad debts | 172,622 | 140,988 |
| Change in assets and liabilities | | |
| Accounts receivable | (171,928) | (308,373) |
| Inventory | (9,285) | 22,203 |
| Prepaid expense | (18,676) | 15,194 |
| Accounts payable - trade | (28,201) | 44,585 |
| Accrued employee compensation | (34,385) | 17,999 |
| Other accrued expenses | (16,578) | (10,030) |
| Estimated third-party payor settlements | (560,000) | (18,000) |
| Total adjustments | (79,455) | 381,005 |
| Net cash provided by (used in) operating activities | \$(139,331) | \$ 721,229 |

Non-Cash Transaction:

The Hospital also incurred the following non-cash transaction in addition to the transactions reflected in the reconciliation of operating income (loss) to net cash provided by (used in) operating activities:

| | 2006 | 2005 |
|-----------------------------|----------|-------|
| Book value of assets traded | \$ 3,107 | \$ -- |

The accompanying notes are an integral part of these statements.

POCAHONTAS COMMUNITY HOSPITAL
Notes to Consolidated Financial Statements
June 30, 2006 and 2005

NOTE A - REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING
POLICIES

1. Reporting Entity

The organization includes a hospital foundation and a 25 bed critical access acute care municipal hospital with related healthcare ancillary and outpatient services. Pocahontas Community Hospital (Hospital) is organized under Chapter 392 of the Code of Iowa; accordingly, it is a political subdivision of the State of Iowa and is therefore exempt from federal and state income taxes. It is governed by a five member board of trustees, elected for four year terms. In addition, the City Treasurer is considered to be a Co-Treasurer of the Board. The Hospital, a component unit of the City of Pocahontas, has 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 Hospital are such that exclusion would cause the Hospital's financial statements to be misleading or incomplete. The criteria for determining financial accountability include: appointing a majority of an organization's governing body, and (a) the Hospital's ability to impose its will on that organization, or (b) the potential for the organization to provide benefits to or impose financial burdens on the Hospital.

The Pocahontas Community Healthcare Foundation (Foundation) has been identified as a component unit of the Hospital, and accordingly, the assets, liabilities, and activities of the Foundation have been consolidated with those of the Hospital in their financial statements. The Foundation is a not-for-profit corporation exempt from income tax under Section 501 of the Internal Revenue Code. It was established to provide financial support to the Hospital.

2. Enterprise Fund Accounting

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), that do not conflict with or contradict GASB pronouncements.

3. Use of Estimates

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

4. Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less including designated and restricted assets.

POCAHONTAS COMMUNITY HOSPITAL
Notes to Consolidated Financial Statements
June 30, 2006 and 2005

NOTE A - REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING
POLICIES - Continued

5. Inventory Valuation

Inventory is valued at the lower of cost (first-in, first-out method) or market.

6. Investments

Investments are reported at fair value except for short-term highly liquid investments that have a remaining maturity at the time they are purchased of one year or less. These investments are carried at amortized cost. Interest, dividends, and gains and losses, both realized and unrealized, on investments are included in non-operating revenue when earned, unless restricted by donor or law.

7. Capital Assets

The Hospital's capital assets are reported at historical cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. Capital assets with lives in excess of four years and cost in excess of \$5,000 are capitalized. These capital assets, other than land, are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using their estimated useful lives (fifteen to fifty years for buildings and land improvements and five to twenty years for equipment).

8. Costs of Borrowing

Except for capital assets acquired through gifts, contributions, or capital grants, interest cost on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The Hospital capitalized \$75,395 of interest costs in 2006 (\$20,757 in 2005).

9. Compensated Absences

Hospital employees earn vacation days at varying rates depending on years of service. Vacation time accumulates to a maximum of 120 hours. Any excess over 120 hours accumulated by the employee's anniversary date is lost. The computed amount of vacation benefits earned by year end is recorded as part of accrued employee compensation. Employees also earn sick leave benefits based on varying rates depending on years of service. Employees may accumulate sick leave up to a specified maximum. Employees are not paid for accumulated sick leave if employment is ended.

10. Operating Revenues and Expenses

The Hospital'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 Hospital's principal activity. Nonexchange revenues, including taxes, 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, other than financing costs.

POCAHONTAS COMMUNITY HOSPITAL
Notes to Consolidated Financial Statements
June 30, 2006 and 2005

NOTE A - REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING
POLICIES - Continued

11. Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. 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 rendered and adjusted in future periods as final settlements are determined.

12. Grants and Contributions

Revenues from grants and contributions (including 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 non-operating revenues. Amounts restricted to capital acquisitions are reported after non-operating revenues and expenses.

13. Restricted Resources

Use of restricted or unrestricted resources for individual projects is determined by the Hospital Board of Trustees based on the facts regarding each specific situation.

14. Net Assets

Net assets of the Hospital are classified in four components. *Net assets invested in capital assets net of related debt* consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted 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 Hospital. *Restricted nonexpendable net assets* equal the principal portion of permanent endowments. *Unrestricted net assets* are remaining net assets that do not meet the definition of *invested in capital assets net of related debt or restricted*.

15. 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. Revenue from services to these patients is automatically recorded in the accounting system at the established rates, but the Hospital does not pursue collection of the amounts. The resulting adjustments are recorded as bad debts or charity service depending on the timing of the charity determination.

POCAHONTAS COMMUNITY HOSPITAL
Notes to Consolidated Financial Statements
June 30, 2006 and 2005

NOTE B - THIRD-PARTY PAYOR ARRANGEMENTS

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

Medicare and Medicaid - Inpatient acute services, inpatient nonacute services, certain outpatient services, and defined capital costs related to program beneficiaries are paid based on a cost reimbursement methodology. The Hospital is reimbursed for the cost of services at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the fiscal intermediaries. The Hospital's Medicare and Medicaid cost reports have been audited and finalized by the fiscal intermediaries through June 30, 2004. Outpatient services not paid based on a cost reimbursement methodology are paid based on a prospectively determined fee schedule.

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

NOTE C - ENDOWMENTS AND RESTRICTED NET ASSETS

Restricted expendable net assets are available for the following purposes:

| | <u>2006</u> | <u>2005</u> |
|--|-------------------|-------------------|
| Building | \$ 70,729 | \$ 90,069 |
| Cardiac rehabilitation | -- | 3,898 |
| Hospice services | 30,639 | 88,597 |
| Foundation discretionary | <u>108</u> | <u>(1,688)</u> |
| Total restricted expendable net assets | <u>\$ 101,476</u> | <u>\$ 180,876</u> |

Restricted nonexpendable net assets represent the principal amounts of permanent endowments, restricted to investment in perpetuity. The Hospital had no permanent endowments as of June 30, 2006 and 2005.

POCAHONTAS COMMUNITY HOSPITAL
Notes to Consolidated Financial Statements
June 30, 2006 and 2005

NOTE D - DONOR RESTRICTIONS RELEASED

Restricted assets were released from donor restrictions by incurring expenses satisfying the restricted purposes or by occurrence of other events specified by donors:

| | 2006 | 2005 |
|---------------------------------------|------------|------------|
| Purpose of Restrictions Accomplished: | | |
| Construction program | \$ 58,470 | \$ 150,000 |
| Hospice uncompensated care | 71,258 | 6,324 |
| Cardiac rehabilitation | -- | 6,402 |
| | \$ 129,728 | \$ 162,726 |

NOTE E - DESIGNATED NET ASSETS

Of the \$1,156,804 (\$720,079 as of June 30, 2005) of unrestricted net assets as of June 30, 2006, \$506,396 (\$490,522 for 2005) has been designated by the Hospital's Board of Trustees for capital acquisitions. These assets remain under the control of the Board of Trustees, which may, at its discretion, later use the funds for other purposes.

NOTE F - DEPOSITS AND INVESTMENTS

The Hospital's deposits 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 ensure there will be no loss of public funds. Investments are stated as indicated in Note A.

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; 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.

POCAHONTAS COMMUNITY HOSPITAL
Notes to Consolidated Financial Statements
June 30, 2006 and 2005

NOTE F - DEPOSITS AND INVESTMENTS - Continued

The composition of designated and restricted assets is as follows:

| | 2006 | 2005 |
|--------------------------------------|------------|------------|
| Internally Designated Assets: | | |
| Capital Improvements: | | |
| Cash and cash equivalents | \$ 106,171 | \$ 104,206 |
| Endowments: | | |
| Certificates of deposit | 395,725 | 385,220 |
| Interest receivable | 4,500 | 1,096 |
| | \$ 506,396 | \$ 490,522 |
| Restricted Assets: | | |
| Cash | \$ 59,476 | \$ 115,876 |
| Pledges receivable, net | 42,000 | 65,000 |
| | \$ 101,476 | \$ 180,876 |

The Hospital's investment policy limits the investment of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) in instruments that mature within 397 days. Funds not identified as operating funds may be invested in investments with maturities longer than 397 days but the maturities shall be consistent with the needs and use of the Hospital.

NOTE G - ACCOUNTS RECEIVABLE AND CONCENTRATION OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2006 and 2005, was as follows:

| | 2006 | 2005 |
|---|------------|------------|
| Receivable From: | | |
| Patients | \$ 284,850 | \$ 245,485 |
| Medicare | 433,339 | 662,663 |
| Medicaid | 93,851 | 88,343 |
| Blue Cross | 150,857 | 161,828 |
| Workers Compensation | 37,536 | 58,265 |
| Others | 90,448 | 119,981 |
| | 1,090,881 | 1,336,565 |
| Less allowances for doubtful accounts and contractual adjustments | 445,000 | 648,000 |
| | \$ 645,881 | \$ 688,565 |

POCAHONTAS COMMUNITY HOSPITAL
Notes to Consolidated Financial Statements
June 30, 2006 and 2005

NOTE H - CAPITAL ASSETS

Capital assets, additions, disposals and balances for the years ended June 30, 2006 and 2005 were as follows:

| <u>Cost</u> | <u>Balance 2005</u> | <u>Additions</u> | <u>Disposals</u> | <u>Balance 2006</u> |
|------------------------------------|-------------------------|--------------------|--------------------|-------------------------|
| Land Improvements | \$ 131,244 | \$ 7,716 | \$ -- | \$ 138,960 |
| Buildings | 4,826,889 | 3,192,958 | -- | 8,019,847 |
| Fixed Equipment | 535,817 | 35,950 | -- | 571,767 |
| Major Movable Equipment | <u>2,563,605</u> | <u>156,393</u> | <u>94,007</u> | <u>2,625,991</u> |
| | 8,057,555 | 3,393,017 | 94,007 | 11,356,565 |
| <u>Depreciation</u> | | | | |
| Land Improvements | 87,213 | 10,324 | -- | 97,537 |
| Buildings | 1,387,373 | 209,950 | 932 | 1,596,391 |
| Fixed Equipment | 194,896 | 31,607 | 307 | 226,196 |
| Major Movable Equipment | <u>1,501,191</u> | <u>335,095</u> | <u>84,200</u> | <u>1,752,086</u> |
| Total Depreciation | <u>3,170,673</u> | <u>586,976</u> | <u>85,439</u> | <u>3,672,210</u> |
| Depreciable Capital Assets, Net | <u>\$ 4,886,882</u> | <u>\$2,806,041</u> | <u>\$ 8,568</u> | <u>\$ 7,684,355</u> |
| Construction in Progress | \$ 2,074,137 | \$1,118,821 | \$3,192,958 | \$ -- |
| Land | <u>12,500</u> | <u>--</u> | <u>--</u> | <u>12,500</u> |
| | <u>\$ 2,086,637</u> | <u>\$1,118,821</u> | <u>\$3,192,958</u> | <u>\$ 12,500</u> |
| | | | | |
| <u>Cost</u> | <u>Balance 2004</u> | <u>Additions</u> | <u>Disposals</u> | <u>Balance 2005</u> |
| Land Improvements | \$ 131,244 | \$ -- | \$ -- | \$ 131,244 |
| Buildings | 3,379,087 | 1,447,802 | -- | 4,826,889 |
| Fixed Equipment | 506,285 | 29,532 | -- | 535,817 |
| Major Movable Equipment | <u>2,252,126</u> | <u>447,783</u> | <u>136,304</u> | <u>2,563,605</u> |
| | 6,268,742 | 1,925,117 | 136,304 | 8,057,555 |
| <u>Depreciation</u> | | | | |
| Land Improvements | 74,890 | 12,323 | -- | 87,213 |
| Buildings | 1,225,642 | 161,731 | -- | 1,387,373 |
| Fixed Equipment | 164,819 | 30,077 | -- | 194,896 |
| Major Movable Equipment | <u>1,365,072</u> | <u>272,308</u> | <u>136,189</u> | <u>1,501,191</u> |
| Total Depreciation | <u>2,830,423</u> | <u>476,439</u> | <u>136,189</u> | <u>3,170,673</u> |
| Depreciable Capital Assets, Net | <u>\$ 3,438,319</u> | <u>\$1,448,678</u> | <u>\$ 115</u> | <u>\$ 4,886,882</u> |
| Construction in Progress | \$ 1,131,365 | \$2,390,574 | \$1,447,802 | \$ 2,074,137 |
| Land | <u>12,500</u> | <u>--</u> | <u>--</u> | <u>12,500</u> |
| | <u>\$ 1,143,865</u> | <u>\$2,390,574</u> | <u>\$1,447,802</u> | <u>\$ 2,086,637</u> |

POCAHONTAS COMMUNITY HOSPITAL
Notes to Consolidated Financial Statements
June 30, 2006 and 2005

NOTE I - LONG-TERM DEBT

A schedule of long-term debt for the years ended June 30, 2006 and 2005 follows:

| | Balance 2005 | Additions | Reductions | Balance 2006 | Current Portion |
|--------------|--------------------|--------------------|--------------|--------------------|--------------------|
| Note Payable | <u>\$1,000,000</u> | <u>\$1,000,000</u> | <u>\$ --</u> | <u>\$2,000,000</u> | <u>\$ 249,949</u> |
| | Balance 2004 | Additions | Reductions | Balance 2005 | Current Portion |
| Note Payable | <u>\$ 500,000</u> | <u>\$ 500,000</u> | <u>\$ --</u> | <u>\$1,000,000</u> | <u>\$ 14,908</u> |

In September of 2003, the City of Pocahontas incurred a promissory note payable to a local bank, for up to \$2,000,000. This made funds available to be drawn from the bank as the construction program progressed. Although the debt is in the name of the City of Pocahontas, the Hospital is responsible for all loan principal and interest payments, therefore, as the funds were drawn, the liability was recorded on the Hospital's financial statements. Under terms of the note, monthly interest payments were due through June, 2006. Combined principal and interest payments will be made beginning in July, 2006 and ending in June, 2013. The interest rate on the note is 4.75%, with an adjustment based on the Wall Street Journal prime rate plus .50% after 2 years. The note is collateralized by all assets and revenues of the Hospital.

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

| Year Ending June 30, | Long-Term Debt | |
|----------------------|---------------------|-------------------|
| | Principal | Interest |
| 2007 | \$ 249,949 | \$ 85,894 |
| 2008 | 258,070 | 77,773 |
| 2009 | 250,120 | 117,248 |
| 2010 | 272,228 | 95,140 |
| 2011 | 296,290 | 76,077 |
| 2012-2013 | <u>673,343</u> | <u>56,391</u> |
| | <u>\$ 2,000,000</u> | <u>\$ 508,523</u> |

NOTE J - PENSION AND RETIREMENT BENEFITS

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, P.O. Box 9117, Des Moines, Iowa, 50306-9117.

POCAHONTAS COMMUNITY HOSPITAL
Notes to Consolidated Financial Statements
June 30, 2006 and 2005

NOTE J - PENSION AND RETIREMENT BENEFITS - Continued

Plan members are required to contribute 3.70% of their annual salary and the Hospital is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Hospital's contribution to IPERS for the years ended June 30, 2006, 2005, and 2004, were approximately \$124,700, \$116,700, and \$113,700, respectively, equal to the required contributions for each year.

NOTE K - COMMITMENTS AND CONTINGENCIES

Rental Obligation

The Hospital has agreed to rent building space from the City of Pocahontas for approximately \$15,000 per year through 2014. This rented space is currently used for specialty clinic reception and for the home health/hospice offices.

Risk Management

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

Agreement with Donor

During 1999, the Hospital received a \$100,000 donation restricted for the purchase of equipment and properly expended the funds. During 2000, the Hospital received a request from the donor to consider the \$100,000 as a non-callable, non-interest bearing, note payable which will be forgiven after ten years. Hospital management agreed to the treatment, however, since the note will be forgiven, no liability has been recorded on these financial statements.

* * *

REQUIRED SUPPLEMENTARY INFORMATION

POCAHONTAS COMMUNITY HOSPITAL
 Budgetary Comparison Schedule
 Year Ended June 30, 2006

This budgetary comparison is presented as Required Supplementary Information in accordance with Government Auditing Standards. In accordance with the Code of Iowa, the Board of Trustees annually adopts a budget which is filed with the City Clerk to be included in the official city budget. The annual budget may be amended during the year utilizing similar statutorily-prescribed procedures.

The following is a comparison of reported amounts to the accrual basis budget for the year ended June 30, 2006 (Hospital only, excluding Foundation).

| | <u>Total Per Hospital Statements</u> | <u>Budget</u> | <u>Amount Under Budget</u> |
|----------|--|---------------------|------------------------------------|
| Expenses | <u>\$ 6,123,964</u> | <u>\$ 7,250,000</u> | <u>\$ 1,126,036</u> |

* * *

ACCOMPANYING INFORMATION

POCAHONTAS COMMUNITY HOSPITAL
Consolidating Balance Sheets
June 30, 2006

ASSETS

| | <u>Hospital</u> | <u>Foundation</u> | <u>Total</u> |
|--|---------------------|-------------------|---------------------|
| Current Assets: | | | |
| Cash | \$ 245,254 | \$ -- | \$ 245,254 |
| Patient receivables, net | 645,881 | -- | 645,881 |
| Other receivables | 47,293 | -- | 47,293 |
| Inventory | 95,823 | -- | 95,823 |
| Prepaid expense | 67,791 | -- | 67,791 |
| Estimated third-party payor settlement | 40,000 | -- | 40,000 |
| Internally designated assets | <u>352,273</u> | <u>--</u> | <u>352,273</u> |
| Total Current Assets | 1,494,315 | -- | 1,494,315 |
| Designated and Restricted Assets: | | | |
| Internally designated assets | 506,396 | -- | 506,396 |
| Restricted assets | -- | 101,476 | 101,476 |
| Current portion | <u>(352,273)</u> | <u>--</u> | <u>(352,273)</u> |
| | 154,123 | 101,476 | 255,599 |
| Depreciable Capital Assets, Net | 7,684,355 | -- | 7,684,355 |
| Non-depreciable Capital Assets | <u>12,500</u> | <u>--</u> | <u>12,500</u> |
| Total Assets | <u>\$ 9,345,293</u> | <u>\$ 101,476</u> | <u>\$ 9,446,769</u> |

LIABILITIES AND NET ASSETS

| | | | |
|---|---------------------|-------------------|---------------------|
| Current Liabilities: | | | |
| Current maturities of long-term debt | \$ 249,949 | \$ -- | \$ 249,949 |
| Accounts payable | 325,912 | -- | 325,912 |
| Accrued employee compensation | 146,073 | -- | 146,073 |
| Other accrued expenses | 15,485 | -- | 15,485 |
| Accrued interest | <u>4,164</u> | <u>--</u> | <u>4,164</u> |
| Total Current Liabilities | 741,583 | -- | 741,583 |
| Long-Term Debt, less current maturities | 1,750,051 | -- | 1,750,051 |
| Net Assets: | | | |
| Invested in capital assets, net | 5,696,855 | -- | 5,696,855 |
| Restricted - expendable | -- | 101,476 | 101,476 |
| Unrestricted | <u>1,156,804</u> | <u>--</u> | <u>1,156,804</u> |
| Total Liabilities and Net Assets | <u>\$ 9,345,293</u> | <u>\$ 101,476</u> | <u>\$ 9,446,769</u> |

See Independent Auditor's Report.

POCAHONTAS COMMUNITY HOSPITAL
Consolidating Balance Sheets
June 30, 2005

ASSETS

| | <u>Hospital</u> | <u>Foundation</u> | <u>Eliminations</u> | <u>Total</u> |
|--|----------------------------|--------------------------|---------------------------|----------------------------|
| Current Assets: | | | | |
| Cash | \$ 641,647 | \$ -- | \$ -- | \$ 641,647 |
| Patient receivables, net | 688,565 | -- | -- | 688,565 |
| Other receivables | 5,303 | -- | -- | 5,303 |
| Inventory | 86,538 | -- | -- | 86,538 |
| Prepaid expense | 49,115 | -- | -- | 49,115 |
| Internally designated assets | 272,209 | -- | -- | 272,209 |
| Total Current Assets | 1,743,377 | -- | -- | 1,743,377 |
| Designated and Restricted Assets: | | | | |
| Internally designated assets | 490,522 | -- | -- | 490,522 |
| Restricted assets | 15,346 | 180,876 | (15,346) | 180,876 |
| Current portion | (272,209) | -- | -- | (272,209) |
| | 233,659 | 180,876 | (15,346) | 399,189 |
| Depreciable Capital Assets, Net | 4,886,882 | -- | -- | 4,886,882 |
| Non-depreciable Capital Assets | 2,086,637 | -- | -- | 2,086,637 |
| Total Assets | <u>\$ 8,950,555</u> | <u>\$ 180,876</u> | <u>\$(15,346)</u> | <u>\$ 9,116,085</u> |

LIABILITIES AND NET ASSETS

| | | | | |
|---|----------------------------|--------------------------|---------------------------|----------------------------|
| Current Liabilities: | | | | |
| Current maturities of long-term debt | \$ 14,908 | \$ -- | \$ -- | \$ 14,908 |
| Accounts payable | 509,090 | 15,346 | (15,346) | 509,090 |
| Accrued employee compensation | 180,458 | -- | -- | 180,458 |
| Other accrued expenses | 32,063 | -- | -- | 32,063 |
| Estimated third-party payor settlement | 520,000 | -- | -- | 520,000 |
| Total Current Liabilities | 1,256,519 | 15,346 | (15,346) | 1,256,519 |
| Long-Term Debt, less current maturities | 985,092 | -- | -- | 985,092 |
| Net Assets: | | | | |
| Invested in capital assets | 5,973,519 | -- | -- | 5,973,519 |
| Restricted - expendable | 15,346 | 165,530 | -- | 180,876 |
| Unrestricted | 720,079 | -- | -- | 720,079 |
| Total Liabilities and Net Assets | <u>\$ 8,950,555</u> | <u>\$ 180,876</u> | <u>\$(15,346)</u> | <u>\$ 9,116,085</u> |

See Independent Auditor's Report.

POCAHONTAS COMMUNITY HOSPITAL
Consolidating Statements of Revenues, Expenses and Changes in Net Assets
Year ended June 30, 2006

| | <u>Hospital</u> | <u>Foundation</u> | <u>Eliminations</u> | <u>Total</u> |
|--|---------------------|-------------------|---------------------|---------------------|
| Revenue: | | | | |
| Net patient service revenue | \$ 5,997,006 | \$ -- | \$ -- | \$ 5,997,006 |
| Other revenue | <u>72,339</u> | <u>--</u> | <u>--</u> | <u>72,339</u> |
| Total revenue | 6,069,345 | -- | -- | 6,069,345 |
| Expenses: | | | | |
| Nursing service | 1,597,822 | -- | -- | 1,597,822 |
| Other professional service | 2,281,680 | -- | -- | 2,281,680 |
| General service | 538,600 | -- | -- | 538,600 |
| Fiscal and administrative service | 1,114,722 | 129,728 | (120,307) | 1,124,143 |
| Provision for depreciation | <u>586,976</u> | <u>--</u> | <u>--</u> | <u>586,976</u> |
| Total expenses | <u>6,119,800</u> | <u>129,728</u> | <u>(120,307)</u> | <u>6,129,221</u> |
| Operating Income (Loss) | (50,455) | (129,728) | 120,307 | (59,876) |
| Non-Operating Revenues (Expenses): | | | | |
| Noncapital gifts, grants, and bequests | 75,755 | 24,747 | (21,258) | 79,244 |
| Investment income | 22,318 | 1,797 | -- | 24,115 |
| Ambulance subsidy | 5,020 | -- | -- | 5,020 |
| Interest expense | (4,164) | -- | -- | (4,164) |
| Clinic operations, net | (347) | -- | -- | (347) |
| Loss on disposal of equipment | <u>(5,461)</u> | <u>--</u> | <u>--</u> | <u>(5,461)</u> |
| Non-operating revenues, net | <u>93,121</u> | <u>26,544</u> | <u>(21,258)</u> | <u>98,407</u> |
| Excess of Revenues Over (Under) Expenses Before Capital Grants and Contributions | 42,666 | (103,184) | 99,049 | 38,531 |
| Capital Grants and Contributions | <u>102,049</u> | <u>39,130</u> | <u>(99,049)</u> | <u>42,130</u> |
| Increase (Decrease) in Net Assets | 144,715 | (64,054) | -- | 80,661 |
| Net Assets Beginning of Year | <u>6,708,944</u> | <u>165,530</u> | <u>--</u> | <u>6,874,474</u> |
| Net Assets End of Year | <u>\$ 6,853,659</u> | <u>\$ 101,476</u> | <u>\$ --</u> | <u>\$ 6,955,135</u> |

See Independent Auditor's Report.

POCAHONTAS COMMUNITY HOSPITAL
Consolidating Statements of Revenues, Expenses and Changes in Net Assets
Year ended June 30, 2005

| | <u>Hospital</u> | <u>Foundation</u> | <u>Eliminations</u> | <u>Total</u> |
|--|---------------------|-------------------|---------------------|---------------------|
| Revenue: | | | | |
| Net patient service revenue | \$ 5,856,080 | \$ -- | \$ -- | \$ 5,856,080 |
| Other revenue | <u>71,269</u> | <u>--</u> | <u>--</u> | <u>71,269</u> |
| Total revenue | 5,927,349 | -- | -- | 5,927,349 |
| Expenses: | | | | |
| Nursing service | 1,478,901 | -- | -- | 1,478,901 |
| Other professional service | 2,128,473 | -- | -- | 2,128,473 |
| General service | 460,258 | -- | -- | 460,258 |
| Fiscal and administrative service | 1,034,770 | 158,284 | (150,000) | 1,043,054 |
| Provision for depreciation | <u>476,439</u> | <u>--</u> | <u>--</u> | <u>476,439</u> |
| Total expenses | <u>5,578,841</u> | <u>158,284</u> | <u>(150,000)</u> | <u>5,587,125</u> |
| Operating Income (Loss) | 348,508 | (158,284) | 150,000 | 340,224 |
| Non-Operating Revenues (Expenses): | | | | |
| Noncapital gifts, grants, and bequests | 24,773 | -- | -- | 24,773 |
| Investment income | 30,507 | 1,914 | -- | 32,421 |
| Ambulance subsidy | 3,921 | -- | -- | 3,921 |
| Clinic operations, net | (350) | -- | -- | (350) |
| Loss on disposal of equipment | <u>(115)</u> | <u>--</u> | <u>--</u> | <u>(115)</u> |
| Non-operating revenues, net | <u>58,736</u> | <u>1,914</u> | <u>--</u> | <u>60,650</u> |
| Excess of Revenues Over (Under) Expenses Before Capital Grants and Contributions | 407,244 | (156,370) | 150,000 | 400,874 |
| Capital Grants and Contributions | <u>150,000</u> | <u>70,040</u> | <u>(150,000)</u> | <u>70,040</u> |
| Increase (Decrease) in Net Assets | 557,244 | (86,330) | -- | 470,914 |
| Net Assets Beginning of Year | <u>6,151,700</u> | <u>251,860</u> | <u>--</u> | <u>6,403,560</u> |
| Net Assets End of Year | <u>\$ 6,708,944</u> | <u>\$ 165,530</u> | <u>\$ --</u> | <u>\$ 6,874,474</u> |

See Independent Auditor's Report.

POCAHONTAS COMMUNITY HOSPITAL
Patient Receivables
June 30,

Analysis of Aging:

| <u>Days Since Discharge</u> | <u>2006</u> | | <u>2005</u> | |
|---------------------------------------|-------------------|-------------------------|-------------------|-------------------------|
| | <u>Amount</u> | <u>Percent to Total</u> | <u>Amount</u> | <u>Percent to Total</u> |
| 0 - 30 | \$ 520,943 | 47.7% | \$ 717,360 | 53.7% |
| 31 - 90 | 230,877 | 21.2 | 297,760 | 22.3 |
| 91 - 150 | 109,461 | 10.0 | 117,426 | 8.8 |
| 151 - 180 | 30,348 | 2.8 | 32,737 | 2.4 |
| 181 and over | <u>199,252</u> | <u>18.3</u> | <u>171,282</u> | <u>12.8</u> |
| | <u>1,090,881</u> | <u>100.0%</u> | <u>1,336,565</u> | <u>100.0%</u> |
| Allowance for doubtful accounts | 145,000 | | 128,000 | |
| Allowance for contractual adjustments | <u>300,000</u> | | <u>520,000</u> | |
| | <u>\$ 645,881</u> | | <u>\$ 688,565</u> | |

Allowance for Doubtful Accounts:

| | <u>Year ended June 30,</u> | |
|---|----------------------------|-------------------|
| | <u>2006</u> | <u>2005</u> |
| Balance, beginning | \$ 128,000 | \$ 98,000 |
| Provision for bad debts | 172,622 | 140,988 |
| Recoveries of accounts previously written off | <u>69,610</u> | <u>58,781</u> |
| | <u>370,232</u> | <u>297,769</u> |
| Accounts written off | <u>225,232</u> | <u>169,769</u> |
| Balance, ending | <u>\$ 145,000</u> | <u>\$ 128,000</u> |

See Independent Auditor's Report.

POCAHONTAS COMMUNITY HOSPITAL
Inventory/Prepaid Expense
June 30,

| | 2006 | 2005 |
|----------------------------|-----------|-----------|
| <u>Inventory</u> | | |
| Medical and surgical | \$ 20,010 | \$ 18,526 |
| Pharmacy | 50,069 | 40,125 |
| Laboratory and radiology | 25,744 | 27,887 |
| | \$ 95,823 | \$ 86,538 |
| <u>Prepaid Expense</u> | | |
| Insurance | \$ 32,730 | \$ 25,102 |
| Service contracts | 35,061 | 24,013 |
| | \$ 67,791 | \$ 49,115 |

See Independent Auditor's Report.

POCAHONTAS COMMUNITY HOSPITAL
Patient Service Revenue
Year ended June 30,

| | 2006 | | |
|-------------------------------------|-------------------|---------------------|-------------------|
| | Inpatient | Outpatient | Swing Bed |
| Daily Patient Services: | | | |
| Medical and surgical | \$ 267,580 | \$ -- | \$ -- |
| Swing bed | -- | -- | 89,125 |
| | <u>267,580</u> | <u>--</u> | <u>89,125</u> |
| Other Nursing Services: | | | |
| Operating and recovery rooms | 52,640 | 845,400 | 3,770 |
| Emergency service | 8,255 | 211,101 | 33 |
| Central services and supply | 111,642 | 240,382 | 40,304 |
| Intravenous therapy | 19,531 | 29,162 | 5,820 |
| Observation | -- | 76,154 | -- |
| | <u>192,068</u> | <u>1,402,199</u> | <u>49,927</u> |
| Other Professional Services: | | | |
| Emergency room physician | -- | 134,244 | -- |
| Anesthesiology | 20,790 | 300,070 | 1,275 |
| Laboratory | 170,547 | 1,608,176 | 21,905 |
| Radiology | 68,610 | 1,279,139 | 9,405 |
| Blood administration | 16,010 | 36,390 | 500 |
| Pharmacy | 116,283 | 287,337 | 75,376 |
| Chemotherapy | -- | 165,738 | -- |
| Electrocardiology | 6,015 | 178,395 | 500 |
| Physical therapy | 5,620 | 237,979 | 11,530 |
| Speech therapy | 150 | 8,825 | 630 |
| Occupational therapy | 135 | 56,575 | 7,065 |
| Cardiac rehabilitation | -- | 84,360 | -- |
| Ambulance services | 5,955 | 134,708 | 842 |
| Industrial Health | 57,589 | -- | -- |
| Home Health Care | -- | 158,308 | -- |
| Hospice | 22,741 | 500,468 | -- |
| Clinic services | -- | 38,675 | -- |
| | <u>490,445</u> | <u>5,209,387</u> | <u>129,028</u> |
| | <u>\$ 950,093</u> | <u>\$ 6,611,586</u> | <u>\$ 268,080</u> |

See Independent Auditor's Report.

| <u>2006</u> | <u>2005</u> |
|--------------|--------------|
| <u>Total</u> | <u>Total</u> |
| \$ 267,580 | \$ 291,300 |
| 89,125 | 131,670 |
| 356,705 | 422,970 |
| 901,810 | 732,135 |
| 219,389 | 195,094 |
| 392,328 | 392,224 |
| 54,513 | 39,640 |
| 76,154 | 68,735 |
| 1,644,194 | 1,427,828 |
| 134,244 | 113,543 |
| 322,135 | 259,572 |
| 1,800,628 | 1,738,868 |
| 1,357,154 | 1,389,852 |
| 52,900 | 26,769 |
| 478,996 | 508,810 |
| 165,738 | 169,900 |
| 184,910 | 203,324 |
| 255,129 | 216,022 |
| 9,605 | 6,460 |
| 63,775 | 46,911 |
| 84,360 | 120,745 |
| 141,505 | 135,010 |
| 57,589 | 59,859 |
| 158,308 | 137,515 |
| 523,209 | 521,218 |
| 38,675 | 47,031 |
| 5,828,860 | 5,701,409 |
| \$ 7,829,759 | \$ 7,552,207 |

POCAHONTAS COMMUNITY HOSPITAL
Revenue and Related Adjustments
Year ended June 30,

| | 2006 | 2005 |
|------------------------------------|---------------------|---------------------|
| <u>Net Patient Service Revenue</u> | | |
| Patient service revenue | \$ 7,829,759 | \$ 7,552,207 |
| Contractual adjustments | (1,624,617) | (1,554,638) |
| Provision for bad debts | (172,622) | (140,988) |
| Charity care | (31,487) | (501) |
| Employee discounts | (4,027) | -- |
| | <u>\$ 5,997,006</u> | <u>\$ 5,856,080</u> |
| <u>Other Revenue</u> | | |
| Meals sold | \$ 17,103 | \$ 21,643 |
| Histories | 16,175 | 15,631 |
| Lifeline | 12,395 | 4,033 |
| Sale of x-ray film | 25 | 10 |
| Rebates and refunds | -- | 178 |
| Rent income | 21,224 | 25,502 |
| Miscellaneous | 5,417 | 4,272 |
| | <u>\$ 72,339</u> | <u>\$ 71,269</u> |

See Independent Auditor's Report.

POCAHONTAS COMMUNITY HOSPITAL
Schedule of Expenses
Year ended June 30,

| | 2006 | | |
|---|-----------------------|----------------------|-----------------------------------|
| | Salaries and Wages | Employee Benefits | Supplies and Other Expenses |
| <u>Daily Patient Services</u> | | | |
| Nursing administration | \$ 63,322 | \$ -- | \$ -- |
| Medical and surgical | 546,391 | -- | 106,420 |
| | <u>609,713</u> | <u>--</u> | <u>106,420</u> |
| <u>Other Nursing Services</u> | | | |
| Operating and recovery rooms | 143,548 | -- | 82,089 |
| Central services and supply | 13,881 | -- | 135,650 |
| Emergency service | 69,781 | -- | 13,885 |
| | <u>227,210</u> | <u>--</u> | <u>231,624</u> |
| <u>Other Professional Services</u> | | | |
| Laboratory | 170,680 | -- | 167,901 |
| Blood administration | -- | -- | 22,360 |
| Electrocardiology | -- | -- | 66 |
| Radiology | 154,601 | -- | 83,955 |
| Cardiac rehabilitation | 82,423 | -- | 3,849 |
| Pharmacy | 218 | -- | 243,500 |
| Chemotherapy | 13,501 | -- | 58,717 |
| Anesthesiology | -- | -- | 294 |
| Ambulance services | 65,804 | -- | 24,393 |
| Physical therapy | 20,815 | -- | 1,650 |
| Speech therapy | -- | -- | -- |
| Occupational therapy | -- | -- | 1,286 |
| Industrial Health | 26,998 | -- | 5,093 |
| Home Health Care | 163,919 | -- | 22,334 |
| Medical records | 81,862 | -- | 29,496 |
| Hospice | 104,007 | -- | 133,079 |
| | <u>884,828</u> | <u>--</u> | <u>797,973</u> |
| <u>General Services</u> | | | |
| Dietary | 96,707 | -- | 59,472 |
| Plant operations | 90,414 | -- | 191,414 |
| Housekeeping | 58,879 | -- | 13,390 |
| Laundry and linen | -- | -- | 17,873 |
| | <u>246,000</u> | <u>--</u> | <u>282,149</u> |
| <u>Fiscal and Administrative Services</u> | 206,825 | 538,259 | 231,677 |
| <u>Provision for Depreciation</u> | <u>--</u> | <u>--</u> | <u>586,976</u> |
| Total all departments | <u>\$ 2,174,576</u> | <u>\$ 538,259</u> | <u>\$ 2,236,819</u> |

See Independent Auditor's Report.

| <u>2006</u> | | | |
|------------------------------|---------------------|-----------------------|--|
| <u>Professional Fees</u> | <u>Total</u> | <u>2005 Total</u> | |
| \$ -- | \$ 63,322 | \$ 56,907 | |
| -- | <u>652,811</u> | <u>625,232</u> | |
| -- | 716,133 | 682,139 | |
| 128 | 225,765 | 166,990 | |
| -- | 149,531 | 172,811 | |
| <u>422,727</u> | <u>506,393</u> | <u>456,961</u> | |
| 422,855 | 881,689 | 796,762 | |
| 48,442 | 387,023 | 370,783 | |
| -- | 22,360 | 9,540 | |
| 12,316 | 12,382 | 13,128 | |
| 156,070 | 394,626 | 395,822 | |
| -- | 86,272 | 91,070 | |
| 38,765 | 282,483 | 262,130 | |
| -- | 72,218 | 90,419 | |
| 170,253 | 170,547 | 133,432 | |
| -- | 90,197 | 68,369 | |
| 129,191 | 151,656 | 133,128 | |
| 5,562 | 5,562 | 3,816 | |
| 38,280 | 39,566 | 28,096 | |
| -- | 32,091 | 29,574 | |
| -- | 186,253 | 170,720 | |
| -- | 111,358 | 94,619 | |
| -- | <u>237,086</u> | <u>233,827</u> | |
| 598,879 | 2,281,680 | 2,128,473 | |
| 10,451 | 166,630 | 160,788 | |
| -- | 281,828 | 211,809 | |
| -- | 72,269 | 70,058 | |
| -- | <u>17,873</u> | <u>17,603</u> | |
| 10,451 | 538,600 | 460,258 | |
| 147,382 | 1,124,143 | 1,043,054 | |
| -- | <u>586,976</u> | <u>476,439</u> | |
| <u>\$ 1,179,567</u> | <u>\$ 6,129,221</u> | <u>\$ 5,587,125</u> | |

POCAHONTAS COMMUNITY HOSPITAL
Fiscal and Administrative Service Expenses
Year ended June 30,

| | <u>2006</u> | <u>2005</u> |
|----------------------------------|---------------------|---------------------|
| Fiscal and Administrative: | | |
| Salaries and wages | \$ 206,825 | \$ 196,053 |
| Professional fees | 147,382 | 137,499 |
| Dues | 7,484 | 3,752 |
| Telephone | 13,060 | 12,364 |
| Supplies and other expense | <u>137,738</u> | <u>140,885</u> |
| | 512,489 | 490,553 |
| Employee Welfare: | | |
| Payroll taxes | 289,846 | 268,558 |
| Group health insurance | 233,569 | 196,987 |
| Other employee benefits | <u>14,844</u> | <u>12,459</u> |
| | 538,259 | 478,004 |
| Insurance: | | |
| Liability and property insurance | 63,974 | 66,213 |
| Foundation Expenditures: | | |
| Supplies and other expense | <u>9,421</u> | <u>8,284</u> |
| | <u>\$ 1,124,143</u> | <u>\$ 1,043,054</u> |

See Independent Auditor's Report.

POCAHONTAS COMMUNITY HOSPITAL
Comparative Statistics
Year ended June 30,

| | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|
| Acute Care: | | | | | |
| Admissions | 166 | 213 | 242 | 241 | 197 |
| Discharges | 167 | 212 | 247 | 237 | 195 |
| Patient Days | 535 | 648 | 760 | 781 | 586 |
| Average Length of Stay | 3.2 | 3.1 | 3.1 | 3.3 | 3.0 |
| Average Occupied Beds | 1.5 | 1.8 | 2.1 | 2.1 | 1.6 |
| Swing Bed: | | | | | |
| Admissions | 52 | 74 | 81 | 84 | 89 |
| Discharges | 55 | 70 | 83 | 85 | 87 |
| SNF Days | 339 | 525 | 589 | 535 | 560 |
| ICF Days | 29 | 61 | 47 | 216 | 452 |
| Combined Average Occupied Beds | 2.5 | 3.4 | 3.8 | 4.2 | 4.4 |
| Outpatient Occasions of Service | 33,287 | 24,588 | 23,299 | 25,304 | 26,887 |
| Home Healthcare Visits | 2,599 | 2,335 | 2,224 | 2,288 | 2,137 |

See Independent Auditor's Report.

POCAHONTAS COMMUNITY HOSPITAL
Comparative Balance Sheets
June 30,

| | <u>2006</u> | <u>2005</u> |
|---|---------------------|---------------------|
| Current Assets: | | |
| Cash | \$ 245,254 | \$ 641,647 |
| Receivables | 693,174 | 693,868 |
| Inventory | 95,823 | 86,538 |
| Prepaid expense | 67,791 | 49,115 |
| Estimated third-party payor settlement | 40,000 | -- |
| Internally designated assets | <u>352,273</u> | <u>272,209</u> |
| Total current assets | 1,494,315 | 1,743,377 |
| Other Assets: | | |
| Designated and restricted assets | 255,599 | 399,189 |
| Capital assets, net | <u>7,696,855</u> | <u>6,973,519</u> |
| | <u>7,952,454</u> | <u>7,372,708</u> |
| Total assets | <u>\$ 9,446,769</u> | <u>\$ 9,116,085</u> |
| Current Liabilities: | | |
| Current maturities | \$ 249,949 | \$ 14,908 |
| Accounts payable | 325,912 | 509,090 |
| Accrued expenses | 161,558 | 212,521 |
| Accrued interest | 4,164 | -- |
| Estimated third party payor settlements | <u>--</u> | <u>520,000</u> |
| Total current liabilities | 741,583 | 1,256,519 |
| Long-Term Debt, Net | <u>1,750,051</u> | <u>985,092</u> |
| Total liabilities | 2,491,634 | 2,241,611 |
| Net Assets | <u>6,955,135</u> | <u>6,874,474</u> |
| Total liabilities and net assets | <u>\$ 9,446,769</u> | <u>\$ 9,116,085</u> |

* Excludes amounts from Foundation which were first consolidated for 2003.

See Independent Auditor's Report.

| <u>2004</u> | <u>2003</u> | <u>2002*</u> |
|---------------------|---------------------|---------------------|
| \$ 1,627,693 | \$ 1,446,785 | \$ 1,133,529 |
| 526,483 | 420,886 | 522,501 |
| 108,741 | 154,488 | 105,298 |
| 64,309 | 72,895 | 40,500 |
| -- | -- | -- |
| <u>65,570</u> | <u>170,160</u> | <u>14,519</u> |
| <u>2,392,796</u> | <u>2,265,214</u> | <u>1,816,347</u> |
| 909,897 | 2,503,236 | 2,457,545 |
| <u>4,582,184</u> | <u>2,277,648</u> | <u>1,627,495</u> |
| <u>5,492,081</u> | <u>4,780,884</u> | <u>4,085,040</u> |
| <u>\$ 7,884,877</u> | <u>\$ 7,046,098</u> | <u>\$ 5,901,387</u> |
| \$ 34,009 | \$ -- | \$ -- |
| 238,765 | 525,377 | 344,287 |
| 204,552 | 189,293 | 141,153 |
| -- | -- | -- |
| <u>538,000</u> | <u>430,000</u> | <u>260,000</u> |
| <u>1,015,326</u> | <u>1,144,670</u> | <u>745,440</u> |
| 465,991 | -- | -- |
| <u>1,481,317</u> | <u>1,144,670</u> | <u>745,440</u> |
| <u>6,403,560</u> | <u>5,901,428</u> | <u>5,155,947</u> |
| <u>\$ 7,884,877</u> | <u>\$ 7,046,098</u> | <u>\$ 5,901,387</u> |

POCAHONTAS COMMUNITY HOSPITAL
 Comparative Statements of Revenues and Expenses
 Year ended June 30,

| | <u>2006</u> | <u>2005</u> |
|---|---------------------|---------------------|
| Patient Service Revenue | \$ 7,829,759 | \$ 7,552,207 |
| Adjustments to Patient Service Revenue | <u>(1,832,753)</u> | <u>(1,696,127)</u> |
| Net Patient Service Revenue | 5,997,006 | 5,856,080 |
| Other Revenue | <u>72,339</u> | <u>71,269</u> |
| Total Revenue | 6,069,345 | 5,927,349 |
| Expenses | <u>6,129,221</u> | <u>5,587,125</u> |
| Operating Income (Loss) | (59,876) | 340,224 |
| Non-Operating Revenues, Net | <u>98,407</u> | <u>60,650</u> |
| Excess of Revenues Over Expenses Before Capital Grants and Contributions | 38,531 | 400,874 |
| Capital Grants and Contributions | <u>42,130</u> | <u>70,040</u> |
| Increase in Net Assets | <u>\$ 80,661</u> | <u>\$ 470,914</u> |

* Excludes amounts from Foundation which were first consolidated for 2003.

See Independent Auditor's Report.

| <u>2004</u> | <u>2003</u> | <u>2002*</u> |
|---------------------|---------------------|---------------------|
| \$ 6,633,508 | \$ 6,497,621 | \$ 5,818,931 |
| <u>(1,448,295)</u> | <u>(1,392,737)</u> | <u>(1,344,644)</u> |
| 5,185,213 | 5,104,884 | 4,474,287 |
| <u>75,277</u> | <u>54,260</u> | <u>62,145</u> |
| 5,260,490 | 5,159,144 | 4,536,432 |
| <u>5,106,048</u> | <u>4,622,355</u> | <u>4,129,096</u> |
| 154,442 | 536,789 | 407,336 |
| <u>128,496</u> | <u>143,188</u> | <u>751,404</u> |
| 282,938 | 679,977 | 1,158,740 |
| <u>219,194</u> | <u>63,004</u> | <u>35,500</u> |
| <u>\$ 502,132</u> | <u>\$ 742,981</u> | <u>\$ 1,194,240</u> |

COMMENTS AND RECOMMENDATIONS

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

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Independent Auditor's 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

To the Board of Trustees of
Pocahontas Community Hospital
Pocahontas, Iowa

We have audited the consolidated financial statements of Pocahontas Community Hospital as of and for the year ended June 30, 2006, and have issued our report thereon dated August 21, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 Pocahontas Community Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Pocahontas Community Hospital's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Part I of the accompanying Schedule of Findings.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described in the Schedule of Findings, we believe item 06-I-A is a material weakness.

To the Board of Trustees of
Pocahontas Community Hospital

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Pocahontas Community Hospital's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. However, we noted certain immaterial instances of non-compliance or other matters that are described in Part II in the accompanying Schedule of Findings.

Comments involving statutory and other legal matters about the Hospital's operations for the year ended June 30, 2006 are based exclusively on knowledge obtained from procedures performed during our audit of the consolidated financial statements of the 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.

This report, a public record by law, is intended solely for the information and use of Pocahontas Community Hospital and other parties to whom the Hospital may report. This report is not intended to be and should not be used by anyone other than these specified parties.

Gronewald, Bell, Kuhn + Co. P.C.
Atlantic, Iowa
August 21, 2006

POCAHONTAS COMMUNITY HOSPITAL
Schedule of Findings
Year ended June 30, 2006

PART I - REPORTABLE CONDITIONS

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

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

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

Conclusion: Response accepted.

06-I-B Credit Cards: For convenience, the Hospital maintains two credit cards. No formal written policy has been established regarding credit card use.

Recommendation: The Hospital should adopt a formal written policy regarding credit card use. At a minimum the policy should address: who is authorized to use them, who maintains them, purposes they can be used for, and the retention and filing of invoices or receipts to document appropriateness of purchases.

Response: We will adopt a written policy governing credit card use and documentation requirements.

Conclusion: Response accepted.

06-I-C Petty Cash Fund: Current Hospital policy allows employees to obtain cash by writing a check to the petty cash fund. In our review of the fund, we located an employee's check without any restrictive endorsement.

Recommendation: To attain proper controls over petty cash, the Hospital should establish a policy preventing employees from writing checks to petty cash. Any checks received should be stamped with a restrictive endorsement immediately upon receipt.

Response: We will adopt a written policy limiting the check cashing privileges to employees only, and limiting the amount to a maximum of \$10. The policy will include a requirement for immediate restrictive endorsements on all checks.

Conclusion: This would be a control improvement, however, preventing the practice would provide the best control.

* * *

POCAHONTAS COMMUNITY HOSPITAL
Schedule of Findings - Continued
Year ended June 30, 2006

PART II - REQUIRED STATUTORY REPORTING

06-II-A Certified Budget: As a component unit of the City of Pocahontas, the Hospital is required to annually (in February) provide a copy of its summary budget to the City, to allow its inclusion in the official City budget documents. The Hospital complied with its requirement and provided a copy of its budget to the City by February, 2006.

Recommendation: We recommend that the Hospital continue to file its summary budget with the City of Pocahontas by February and retain documentation that it has done so.

Response: We will continue to meet our obligation of filing our original budget with the City in future years.

Conclusion: Response accepted.

06-II-B Questionable Expenditures: During the audit, we noted certain expenditures which may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979. The public benefits to be derived have not been clearly documented. The majority of these expenditures were paid for by credit card. These expenditures are detailed as follows:

| <u>Paid to</u> | <u>Purpose</u> | <u>Amount</u> |
|---------------------------|--|-----------------|
| Carroll County State Bank | Home Plate - gift certificate | \$ 50 |
| Carroll County State Bank | Michaels - Décor | 48 |
| Carroll County State Bank | Kohls - Décor | 142 |
| Carroll County State Bank | Family Table - Maintenance Dinner | 27 |
| Carroll County State Bank | Laurens Food Pride - Retirement Party | 14 |
| Carroll County State Bank | Floral Creations - Sympathy Flowers | 32 |
| Palmer House | Employee Dinner | 1,491 |
| Berg Jewelers | Engraved Plaques | 44 |
| Allstate Sign & Plaque | Engraved Plaques | 41 |
| Total | | <u>\$ 1,889</u> |

According to the opinion, it is possible for certain expenses to meet the test of serving a public purpose under certain circumstances, although such expenses will certainly be subject to a deserved close scrutiny. The line to be drawn between a proper and an improper purpose is very thin.

Recommendation: The Board of Trustees should thoroughly consider and document the public purpose and propriety of these expenses or if appropriate, request reimbursement. The Hospital should establish written policies and procedures, including requirements for proper documentation. Expenditures of this nature, if allowed, should be clearly identified in the accounting records.

Response: We will establish written policies and document the public purpose in the future.

Conclusion: Response accepted.

POCAHONTAS COMMUNITY HOSPITAL
 Schedule of Findings - Continued
 Year ended June 30, 2006

PART II - REQUIRED STATUTORY REPORTING - Continued

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 and/or employees are detailed as follows:

| <u>Name, Title and Business Connection</u> | <u>Description</u> | <u>Amount</u> |
|--|---------------------------------|-----------------|
| Gustave Holzmueller, City Council Member, Owner of Pocahontas Ford and wife, Bev Holzmueller, Board Member | Miscellaneous | <u>\$ 212</u> |
| Rick Winegarden, Board President, Owner of Salebarn Realty | Rented semi-trailer for storage | <u>\$ 1,200</u> |

The transactions with these vendors do not appear to represent conflicts of interest since the total for each does not exceed \$2,500.

06-II-E Board Minutes: No transactions were found that we believe should have been approved in the Board minutes but were not.

06-II-F Deposits and Investments: We noted 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.

06-II-G Economic Development: During the year ended June 30, 2006, the Hospital paid \$500 to the Pocahontas County Economic Development Commission. This may not be an appropriate expenditure of public funds since the public benefits to be derived have not been clearly documented.

According to Chapter 15A of the Code of Iowa and an Attorney General's opinion dated August 28, 1986, government financing of economic development may, in appropriate circumstances, serve a public purpose. The opinion advises the governing body to evaluate the public benefits to be obtained and discusses the specific criteria to be considered in documenting public purpose.

Recommendation: The Board should evaluate and document the public purpose served by these expenditures before authorizing further payments and should require the Development Commission to provide documentation of how the funds were used to accomplish economic development activities.

Response: We will document the public purpose in the future.

Conclusion: Response accepted.

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