

ZION RECOVERY SERVICES, INC.

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

YEARS ENDED JUNE 30, 2006 AND 2005

ZION RECOVERY SERVICES, INC.

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ZION RECOVERY SERVICES, INC.  
Officials  
June 30, 2006

Board of Directors:

Jim Richardson, Chairperson

Richard Dolan, Vice-Chairperson

Don Volk, Secretary-Treasurer

Dale Carlson

Brad Golightly

John Whipple

Address

Shenandoah, Iowa

Casey, Iowa

Atlantic, Iowa

Red Oak, Iowa

Perry, Iowa

Thurman, Iowa

Program Administrator:

Laurie Herrick

Atlantic, Iowa

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

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DAVID A. GINTHER

## INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying balance sheets of Zion Recovery Services, Inc. as of June 30, 2006 and 2005, and the related statements of activities and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Agency's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Zion Recovery Services, Inc. as of June 30, 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 September 8, 2006 on our consideration of Zion Recovery Services, Inc.'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.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying information (shown on page 10) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

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

Atlantic, Iowa  
September 8, 2006

ZION RECOVERY SERVICES, INC.  
Balance Sheets  
June 30,

ASSETS

	2006	2005
Current Assets:		
Cash and cash equivalents	\$ 95,628	\$ 75,925
Certificates of deposit	123,268	120,211
Accounts receivable, less allowance for doubtful accounts (\$22,000 in 2006 and \$20,000 in 2005)	46,279	43,689
Inventory	5,210	4,147
Prepaid expense	19,666	6,659
Total current assets	290,051	250,631
Property and Equipment, Net	77,709	84,386
Total assets	\$ 367,760	\$ 335,017

LIABILITIES AND NET ASSETS

Current Liabilities:		
Accounts payable	\$ 3,965	\$ 567
Accrued employee compensation	17,571	12,402
Payroll taxes withheld and accrued	4,604	12,418
Deferred revenue	3,750	--
Total current liabilities	29,890	25,387
Net Assets:		
Unrestricted	337,870	309,630
Total liabilities and net assets	\$ 367,760	\$ 335,017

The accompanying notes are an integral part of these statements.

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

	2006	2005
Support and Revenue:		
Support:		
Iowa Department of Public Health - Comprehensive Treatment: Iowa Managed Substance Abuse Care Plan - Non-Medicaid	\$ 729,203	\$ 740,859
Plan Iowa Improving Access and Continuation Project	3,750	--
County funding	19,903	15,274
Donations	33,355	27,398
Total support	786,211	783,531
Revenue:		
Client fees, net	136,900	149,227
Medicaid fees	141,427	111,371
Interest income	3,267	3,128
Other revenues	41,546	23,399
Total revenue	323,140	287,125
Total Support and Revenue	1,109,351	1,070,656
Expenses:		
Salaries and wages	605,905	621,162
Employee benefits	180,359	192,821
Advertising and promotion	4,443	4,712
Provision for depreciation	15,293	18,169
Food costs	58,730	60,490
Insurance	9,369	8,784
Miscellaneous	5,209	7,018
Professional services	17,671	18,807
Rent	59,308	59,985
Repairs and maintenance	16,860	26,187
Supplies and other expense	33,960	38,227
Telephone	20,916	18,010
Training costs	6,043	5,916
Travel	11,461	11,036
Utilities	35,584	29,564
Total expenses	1,081,111	1,120,888
Increase (Decrease) in Unrestricted Net Assets	28,240	( 50,232)
Net Assets at Beginning of Year	309,630	359,862
Net Assets at End of Year	\$ 337,870	\$ 309,630

The accompanying notes are an integral part of these statements.

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

	2006	2005
Cash flows from operating activities:		
Cash received from clients, third-party payors, and court system	\$ 317,283	\$ 303,811
Cash paid to suppliers and employees	( 1,045,780)	( 1,092,297)
Contract funding received	736,703	740,859
County funding received	19,903	15,274
Interest received	3,267	3,128
Net cash provided by (used in) operating activities	31,376	( 29,225)
Cash flows from investing activities:		
Capital expenditures	( 8,616)	( 4,842)
Purchase of certificates of deposit	( 3,057)	( 3,029)
Redemption of certificates of deposit	--	68,767
Net cash provided by (used in) investing activities	( 11,673)	60,896
Net increase in cash and cash equivalents	19,703	31,671
Cash and cash equivalents at beginning of year	75,925	44,254
Cash and cash equivalents at end of year	\$ 95,628	\$ 75,925
Reconciliation of change in net assets to net cash provided by (used in) operating activities:		
Change in net assets	\$ 28,240	\$( 50,232)
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities:		
Provision for depreciation	15,293	18,169
Changes in assets and liabilities		
Accounts receivable	( 2,590)	19,814
Inventory	( 1,063)	2,218
Prepaid expense	( 13,007)	4,715
Accounts payable	3,398	( 4,066)
Accrued employee compensation	5,169	( 22,492)
Payroll taxes withheld and accrued	( 7,814)	2,649
Deferred revenue	3,750	--
Total adjustments	3,136	21,007
Net cash provided by (used in) operating activities	\$ 31,376	\$( 29,225)

The accompanying notes are an integral part of these statements.

ZION RECOVERY SERVICES, INC.  
Notes to Financial Statements  
June 30, 2006 and 2005

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

1. Nature of Activities

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

2. Basis of Accounting and Presentation

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

3. Use of Estimates

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

4. Inventory

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

5. Property and Equipment

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

ZION RECOVERY SERVICES, INC.  
Notes to Financial Statements  
June 30, 2006 and 2005

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

6. Unrestricted Revenues and Support

- a. Client fees are recorded net of adjustments for uncollectible accounts. The adjustments for uncollectible accounts are \$67,528 for 2006 and \$54,641 for 2005.
- b. Contract revenues are recognized as income when contract requirements have been satisfied.

7. Cash and Cash Equivalents

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

NOTE B - MANAGED CARE CONTRACT

The Agency's substance abuse treatment and rehabilitation services are being reimbursed under a managed care contract administered by Magellan Behavioral Health, Inc. The Agency received approximately 66% of its total support and revenue through this contract for the year ended June 30, 2006 (69% for 2005). The Agency's managed care contract for its current six county service area has been renewed for fiscal year ending June 30, 2007.

NOTE C - PROPERTY AND EQUIPMENT

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

	2006	2005
Land	\$ 2,000	\$ 2,000
Land Improvements	141,314	134,644
Building	26,420	26,420
Equipment	126,528	124,582
	296,262	287,646
Less Accumulated Depreciation	218,553	203,260
	\$ 77,709	\$ 84,386

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

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

ZION RECOVERY SERVICES, INC.  
Notes to Financial Statements  
June 30, 2006 and 2005

NOTE D - FUNCTIONAL EXPENSES

Following is a summary of expenses classified by function:

	2006	2005
Outpatient and Residential Services	\$ 833,524	\$ 835,794
Management and General	247,587	285,094
	\$ 1,081,111	\$ 1,120,888

NOTE E - CONCENTRATION OF CREDIT RISK

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

	2006	2005
Medicaid	4%	20%
Other third-party payors and patients	96	80
	100%	100%

NOTE F - PENSION AND RETIREMENT BENEFITS

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

Plan members are required to contribute 3.70% of their annual salary and the Agency is required to contribute 5.75% of annual covered payroll. Contribution requirements are established by State statute. The Agency's contributions to IPERS for the years ended June 30, 2006 and 2005 were approximately \$35,000 and \$36,000 respectively, equal to the required contributions for each year.

ZION RECOVERY SERVICES, INC.  
Notes to Financial Statements  
June 30, 2006 and 2005

NOTE G - CONTINGENCIES

Off-Balance Sheet Risk

The Agency maintains its deposits at several banks in the area. At various times throughout the year and at year end, the deposits in one of the banks exceeded the FDIC insured deposit limits for one entity (by approximately \$95,600 and \$67,700 in 2006 and 2005, respectively in one bank at year end). Management of the Agency has received no indication of any potential viability problems with this bank by the date of this report.

Risk Management

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

NOTE H - NON-CASH TRANSACTIONS

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

	<u>2006</u>	<u>2005</u>
Iowa Food Bank donations	<u>\$ 33,355</u>	<u>\$ 27,398</u>

\* \* \*

**ACCOMPANYING INFORMATION**

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

	2006			2005	
	DUI Services	Outpatient Services	Residential Services	Total	Total
Salaries and wages	\$ 5,900	\$ 419,952	\$ 180,053	\$ 605,905	\$ 621,162
Employee benefits	778	120,806	58,775	180,359	192,821
Advertising and promotion	--	4,280	163	4,443	4,712
Provision for depreciation	--	15,293	--	15,293	18,169
Food costs	--	--	58,730	58,730	60,490
Insurance	--	5,621	3,748	9,369	8,784
Miscellaneous	980	3,633	596	5,209	7,018
Professional services	--	12,744	4,927	17,671	18,807
Rent	4,800	54,508	--	59,308	59,985
Repairs and maintenance	--	11,738	5,122	16,860	26,187
Supplies and other expense	3,000	21,857	9,103	33,960	38,227
Telephone	--	15,751	5,165	20,916	18,010
Training costs	--	4,763	1,280	6,043	5,916
Travel	228	8,036	3,197	11,461	11,036
Utilities	--	6,561	29,023	35,584	29,564
	<u>\$ 15,686</u>	<u>\$ 705,543</u>	<u>\$ 359,882</u>	<u>\$1,081,111</u>	<u>\$1,120,888</u>

See Independent Auditor's Report.

## COMMENTS AND RECOMMENDATIONS

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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 Directors  
Zion Recovery Services, Inc.  
Atlantic, Iowa

We have audited the financial statements of Zion Recovery Services, Inc. as of and for the year ended June 30, 2006, and have issued our report thereon dated September 8, 2006. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

### Internal Control Over Financial Reporting

In planning and performing our audit, we considered Zion Recovery Services, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Zion Recovery Services, Inc.'s ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in Part I of the accompanying Schedule of Findings.

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. However, of the reportable conditions described above, we believe item 06-I-A is a material weakness.

To the Board of Directors  
Zion Recovery Services, Inc.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Zion Recovery Services, Inc.'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, 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. The results of our tests disclosed no instances of non-compliance or other matters that are required to be reported under Government Auditing Standards.

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

This report, a public record by law, is intended solely for the information and use of the officials, employees and constituents of Zion Recovery Services, Inc. and other parties to whom Zion Recovery Services, Inc. may report, including federal awarding agencies and pass-through entities. This report is not intended to be and should not be used by anyone other than these specified parties.

Granowald, Bell, Kyhan & Co. P.C.

Atlantic, Iowa  
September 8, 2006

ZION RECOVERY SERVICES, INC.  
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 Agency.

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

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

Conclusion: Response accepted.

06-I-B Payroll Error: During the audit, we discovered that employees paid an annual salary were being overpaid. It appears that the approved employee salaries were divided by 24 to determine the employees' gross wages to be paid each pay period; however, the employees were paid over 26 pay periods. The error resulted in the salaried employees being overpaid by approximately 8.33%. We performed a limited investigation of the error and found that it appears that the error had also occurred during the fiscal year ended June 30, 2005. The overpayment for the year ended June 30, 2006 is estimated at \$31,001; \$27,338 for salaries, \$2,091 for FICA tax, and \$1,572 for IPERS. The overpayment for the year ended June 30, 2005 is estimated at \$29,811; \$26,288 for salaries, \$2,011 for FICA tax, and \$1,512 for IPERS.

Recommendation: We recommend that the error be addressed by management and the Board to determine if there are any potential consequences with funding agencies. The Board should determine if any of the overpaid wages will be recovered from the employees, if possible, or approve the salaries as paid. If the overpaid salaries are to be recovered from the employees, amended payroll tax and IPERS reports should be filed for a refund of the overpaid FICA tax and IPERS contributions, and amended W-2s should be completed. The current salary amounts being paid for the year ended June 30, 2007 should be corrected or approved.

Response: The Board approved the employee wages as paid, and the payroll accounts were adjusted to the correct amounts for the second payroll paid in July, 2006. The Agency's funding sources were notified of the error. There will be no payback of contract revenues.

Conclusion: Response accepted.

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