

FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

HANCOCK COUNTY
MEMORIAL HOSPITAL

HANCOCK COUNTY MEMORIAL HOSPITAL

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**HANCOCK COUNTY MEMORIAL HOSPITAL
BOARD OF TRUSTEES AND HOSPITAL OFFICIALS**

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
<u>Board of Trustees</u>		
Mary Kopacek	Chairperson	December 31, 2010
Alvin Denny	Vice-Chairperson/Treasurer	December 31, 2008
Brian Cataldo	Secretary	December 31, 2012
Bill Paulus	Member	December 31, 2012
DeAnna Kelly	Member	December 31, 2008
Rob Willms	Member	December 31, 2010
Ron Eden	Member	December 31, 2010

Hospital Officials

Vance Jackson	Administrator
Laura Zwiefel	DON/Clinical Services
Julie Damm	Chief Financial Officer



CPAs & BUSINESS ADVISORS

INDEPENDENT AUDITOR'S REPORT

The Board of Trustees
Hancock County Memorial Hospital
Britt, Iowa

We have audited the accompanying balance sheets of Hancock County Memorial Hospital (HCMH) as of June 30, 2007 and 2006, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of HCMH'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 financial statements referred to above present fairly, in all material respects, the financial position of Hancock County Memorial Hospital as of June 30, 2007 and 2006, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As indicated in HCMH's Summary of Significant Accounting Policies in Note 1 to the financial statements, management has elected to report interest expense as an operating expense in the Statement of Revenues, Expenses, and Changes in Net Assets. Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, does not establish a definition of operating revenues and expenses versus nonoperating revenues and expenses. Rather, governments are required to establish their own policy defining operating revenues and expenses and apply the policy consistently. The common practice for governmental health care entities is to include interest expense in nonoperating revenues and expenses.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 10, 2007, on our consideration of Hancock County Memorial 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.

Management's Discussion and Analysis on pages 4 and 5 and the Budgetary Comparison Information on pages 25 and 26 are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion on it.

The image shows a handwritten signature in cursive script that reads "Eide Sully LLP". The signature is written in black ink and is positioned above the typed text.

Dubuque, Iowa
October 10, 2007

Hancock County Memorial Hospital

Management's Discussion and Analysis

This section of Hancock County Memorial Hospital's annual financial report presents background information and management's analysis of the financial performance during the fiscal year that ended June 30, 2007. We encourage readers to read this analysis in conjunction with the financial statements in this report.

Financial Highlights

- The Hospital's total assets increased by \$1,136,056 or 8%. A significant portion of this increase was in cash and cash equivalents and assets limited as to use or restricted funds.
- The Hospital's assets exceeded liabilities by \$10,433,551 at June 30, 2007.
- During the year, the Hospital's total operating revenues increased 4% to \$9,985,922, while the operating expenses increased 3% to \$9,943,664. The Hospital had income from operations of \$42,258 before affiliation agreement expenses, which is .4% of total operating revenues.
- The Hospital made capital equipment and building investments totaling \$360,057 during the fiscal year. The source of funding for these items was derived from operations and notes payable.

Overview of the Financial Statements

The basic financial statements of the Hospital report information using Governmental Accounting Standards Board (GASB) accounting principles. These statements offer short-term and long-term information about its activities.

The balance sheets provide information about the nature and amounts of the Hospital's assets and liabilities. The balance sheet at June 30, 2007, reports total assets of \$15,158,641, total liabilities of \$4,725,090 and net assets of \$10,433,551.

The statements of revenues, expenses, and changes in net assets provide information on the Hospital's revenues and expenses. These statements indicate total operating revenues of \$9,985,922 and total operating expenses of \$9,943,664 during fiscal year 2007. Operating income before affiliation agreement expenses was \$42,258 in 2007, compared to an operating loss of (\$50,538) in 2006.

There are notes to the financial statements included in the audit report. All of the notes are consistent with and similar to audit reports from prior years. There are also several supplementary schedules that provide the reader detail about the source of the Hospital's revenues and expenses. The reader is encouraged to examine these notes and schedules for additional information.

Long-term Debt

At year-end, Hancock County Memorial Hospital had \$2,861,820 in short-term and long-term debt. The debt was incurred for the 1996 1st floor hospital-remodeling project, 2000 Garner Family Practice building, 2003 2nd floor hospital renovation and HVAC upgrade project, and chemistry analyzer capitalized lease obligation.

Factors Bearing on Financial Future

Hancock County Memorial Hospital is beginning to work on a significant building renovation project that will update the emergency department area and the Britt Medical Clinic. This renovation is planned for FY2008. Also in FY2008 and FY2009, Hancock County Memorial Hospital will be implementing an Electronic Health Record system. This initiative focuses on providing safer and better care for patients.

Hancock County Memorial Hospital is looking at developing a Master Facility Plan that would include additional renovations and upgrades to the facility. This will cover a three to five year period anticipating enhanced services, growth, and hopefully, increased utilization and technology improvements.

Requests for Information

Questions regarding the information provided in this report or requests for additional financial information should be addressed to the office of the Chief Financial Officer at the following address:

Hancock County Memorial Hospital
Attn: Chief Financial Officer
532 1st St NW
Britt, IA 50423

HANCOCK COUNTY MEMORIAL HOSPITAL
BALANCE SHEETS
JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 2,435,009	\$ 1,834,108
Investments - Note 4	22,815	98,717
Assets limited as to use or restricted - Note 4	67,500	62,500
Receivables		
Patient, net of estimated uncollectibles		
of \$650,000 in 2007 and \$560,000 in 2006	1,408,290	1,324,134
Succeeding year property tax	801,928	794,166
Note	21,045	18,061
Other	42,624	37,308
Inventory	180,307	173,454
Prepaid expense	<u>94,981</u>	<u>65,750</u>
Total current assets	<u>5,074,499</u>	<u>4,408,198</u>
ASSETS LIMITED AS TO USE OR RESTRICTED - Note 4		
Internally designated for capital improvements	3,117,166	2,428,375
Restricted under bond agreement	338,331	316,644
Restricted foundation fund	351,751	323,945
Restricted plant replacement and expansion funds	114,138	108,408
Restricted for current liabilities	<u>(67,500)</u>	<u>(62,500)</u>
Assets limited as to use or restricted, less amounts restricted		
for current liabilities	<u>3,853,886</u>	<u>3,114,872</u>
LAND, BUILDINGS, AND EQUIPMENT, net - Note 6	<u>5,714,384</u>	<u>5,979,044</u>
OTHER ASSETS		
Real estate held for investment - Note 7	281,284	281,284
Bond issuance costs, net of accumulated amortization	128,385	139,387
Joint venture - Note 8	80,786	70,070
Physician recruitment fees, net of accumulated amortization	<u>25,417</u>	<u>29,730</u>
Total other assets	<u>515,872</u>	<u>520,471</u>
Total assets	<u>\$ 15,158,641</u>	<u>\$ 14,022,585</u>

See notes to financial statements.

	<u>2007</u>	<u>2006</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current maturities of long-term debt - Note 9	\$ 267,838	\$ 252,087
Accounts payable		
Trade	189,223	143,481
Related party	249,526	198,336
Estimated third-party payor settlements	260,000	84,000
Accrued expenses		
Salaries, wages, and vacation	276,756	253,684
Interest	9,993	10,791
Payroll taxes and employee benefits	75,844	82,523
Deferred revenue for succeeding year property tax receivable	<u>801,928</u>	<u>794,166</u>
 Total current liabilities	 2,131,108	 1,819,068
 LONG-TERM DEBT, less current maturities - Note 9	 <u>2,593,982</u>	 <u>2,781,128</u>
 Total liabilities	 <u>4,725,090</u>	 <u>4,600,196</u>
NET ASSETS		
Invested in capital assets, net of related debt	2,852,564	2,945,829
Restricted		
Under bond agreement	338,331	316,644
Foundation fund	10,276	10,176
Plant replacement and expansion funds	114,138	108,408
Unrestricted	<u>7,118,242</u>	<u>6,041,332</u>
 Total net assets	 <u>10,433,551</u>	 <u>9,422,389</u>
 Total liabilities and net assets	 <u>\$ 15,158,641</u>	 <u>\$ 14,022,585</u>

HANCOCK COUNTY MEMORIAL HOSPITAL
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
OPERATING REVENUES		
Net patient service revenue (net of provision for bad debts of \$304,195 in 2007 and \$430,080 in 2006) - Notes 2 and 3	\$ 9,817,413	\$ 9,392,463
Other operating revenues	168,509	194,376
TOTAL OPERATING REVENUES	<u>9,985,922</u>	<u>9,586,839</u>
OPERATING EXPENSES		
Salaries and wages	3,418,881	3,273,835
Employee benefits	862,625	792,298
Supplies and other expenses	4,782,379	4,760,020
Depreciation	687,591	623,477
Interest and amortization	192,188	187,747
TOTAL OPERATING EXPENSES	<u>9,943,664</u>	<u>9,637,377</u>
OPERATING INCOME (LOSS) BEFORE AFFILIATION AGREEMENT	42,258	(50,538)
AFFILIATION AGREEMENT EXPENSE	<u>(21,129)</u>	<u>-</u>
OPERATING INCOME (LOSS)	<u>21,129</u>	<u>(50,538)</u>
NONOPERATING REVENUES (EXPENSES)		
County tax revenue	795,649	779,361
Investment income	150,597	89,424
Rental income	21,745	19,404
Noncapital contributions, net of related fundraising expenses	(10,666)	20,415
Loss on sale of property and equipment	(8,494)	(621)
Other income	10,726	12,744
NET NONOPERATING REVENUES	<u>959,557</u>	<u>920,727</u>
REVENUES IN EXCESS OF EXPENSES BEFORE CAPITAL CONTRIBUTIONS AND GRANTS	980,686	870,189
Capital contributions and grants	30,476	10,678
INCREASE IN NET ASSETS	1,011,162	880,867
NET ASSETS BEGINNING OF YEAR	<u>9,422,389</u>	<u>8,541,522</u>
NET ASSETS END OF YEAR	<u>\$ 10,433,551</u>	<u>\$ 9,422,389</u>

See notes to financial statements.

HANCOCK COUNTY MEMORIAL HOSPITAL
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts of patient service revenue	\$ 9,909,257	\$ 9,363,436
Payments of salaries and wages	(3,395,809)	(3,218,264)
Payments of supplies and other expenses	(5,611,964)	(5,567,697)
Other receipts and payments, net	<u>160,209</u>	<u>352,099</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>1,061,693</u>	<u>929,574</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Noncapital contributions received, net of related fundraising expenses	(10,666)	20,415
County tax revenue received	795,649	779,361
Other income	10,726	12,744
Rental income	<u>21,745</u>	<u>19,404</u>
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	<u>817,454</u>	<u>831,924</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of property and equipment	(360,057)	(364,342)
Proceeds from sale of property and equipment	2,500	2,759
Principal payments on long-term debt	(263,922)	(298,716)
Interest payments on long-term debt	(163,325)	(177,545)
Capital contributions and grants	<u>30,476</u>	<u>10,678</u>
NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(754,328)</u>	<u>(827,166)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment income	150,597	89,424
Increase in joint venture	(10,716)	(11,266)
Decrease (increase) in investments	75,902	(30,950)
Decrease (increase) in physician recruitment fees	4,313	(25,902)
Increase in assets limited as to use or restricted	<u>(744,014)</u>	<u>(523,289)</u>
NET CASH USED FOR INVESTING ACTIVITIES	<u>(523,918)</u>	<u>(501,983)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	600,901	432,349
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>1,834,108</u>	<u>1,401,759</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 2,435,009</u>	<u>\$ 1,834,108</u>

(continued)

HANCOCK COUNTY MEMORIAL HOSPITAL
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income (loss)	\$ 21,129	\$ (50,538)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities		
Depreciation	687,591	623,477
Amortization	11,002	11,001
Interest expense considered capital and related financing activity	181,186	176,746
Provision for bad debts	304,195	430,080
Changes in assets and liabilities		
Patient receivables	(388,351)	(92,117)
Other receivables	(8,300)	157,723
Inventory	(6,853)	(22,391)
Prepaid expense	(29,231)	(11,453)
Accounts payable - trade and related	96,932	(21,844)
Accrued expenses	16,393	95,880
Estimated third-party payor settlements	<u>176,000</u>	<u>(366,990)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 1,061,693</u>	<u>\$ 929,574</u>

SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES

HCMH entered into a capital lease obligation of \$92,528 for equipment in 2007.

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Hancock County Memorial Hospital (HCMH) is the county hospital of Hancock County, in the City of Britt, organized under Chapter 347, Code of Iowa. HCMH provides health care services under the name of Hancock County Memorial Hospital in accordance with a Master Affiliation Agreement – see Note 11. Services are provided primarily to residents of Hancock County and the surrounding area in north central Iowa. HCMH is exempt from income taxes as a political subdivision.

HCMH's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board.

Reporting Entity

For financial reporting purposes, HCMH has included all funds, organizations, agencies, boards, commissions, and authorities. HCMH has also considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with HCMH are such that exclusion would cause HCMH's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of HCMH to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on HCMH. Hancock County Memorial Hospital Foundation meets these criteria and is included in HCMH's financial statements under the provisions of GASB Statement No. 14. HCMH has no other component units, which meet the Governmental Accounting Standards Board criteria.

Basis of Presentation

The balance sheet displays HCMH's assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

Invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt attributable to the acquisition, construction or improvement of those assets.

Restricted net assets result when constraints placed on net asset use are either externally imposed or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets consist of net assets not meeting the definition of the two preceding categories. Unrestricted net assets often have constraints on resources imposed by management which can be removed or modified.

When both restricted and unrestricted resources are available for use, generally it is HCMH's policy to use restricted resources first.

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

Measurement Focus and Basis of Accounting

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

HCMH reports in accordance with accounting principles generally accepted in the United States of America as specified by the American Institute of Certified Public Accountants' *Audit and Accounting Guide for Health Care Organizations* and, as a governmental entity, also provides certain disclosures required by the Governmental Accounting Standards Board (GASB). The accompanying financial statements have been prepared on the accrual basis of accounting. Revenues are recognized when earned, and expenses are recorded when the liability is incurred.

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

Use of Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with original maturities of three months or less when purchased, excluding assets limited as to use or restricted and investments.

Patient Receivables

Patient receivables are uncollateralized patient and third-party payor obligations. Unpaid patient receivables are not charged interest on amounts owed. Accounts past due more than 85 days are turned over to collection agents.

Payments of patient receivables are allocated to the specific claims identified on the remittance advice or, if unspecified, are applied to the earliest unpaid claim.

The carrying amount of patient receivables is reduced by a valuation allowance that reflects management's best estimate of amounts that will not be collected from patients and third-party payors. Management reviews patient receivables by payor class and applies percentages to determine estimated amounts that will not be collected from third parties under contractual agreements and amounts that will not be collected from patients due to bad debts. Management considers historical write off and recovery information in determining the estimated bad debt provision. Management also reviews accounts to determine if classification as charity care is appropriate.

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

Property Tax Receivable

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

Inventory

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

Investments

Investments are valued at purchase cost, or fair market value at the date of acquisition if donated. Investments consist of non-negotiable certificates of deposit.

Issuance Costs

Deferred financing costs are amortized over the period the obligation is outstanding using the interest method. Amortization of deferred financing costs is capitalized during the period of construction of capital assets.

Land, Buildings, and Equipment

Land, buildings, and equipment acquisitions in excess of \$5,000 are capitalized and recorded at cost. Land, buildings, and equipment donated for HCMH's operations are recorded as additions to net assets at fair value at the date of receipt. Depreciation is provided over the estimated useful life of each depreciable asset and is computed using the straight-line method. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation in the financial statements. The estimated useful lives of land, buildings, and equipment are as follows:

Land improvements	10-40 years
Buildings and improvements	10-50 years
Equipment	3-20 years

Assets Limited as to Use or Restricted

Assets limited as to use or restricted include assets which have been internally designated by HCMH's Board of Trustees, assets which are restricted by debt agreements and assets which have been restricted by contributors or grantors. Board designated assets remain under the control of the Board of Trustees, which may at its discretion later use the funds for other purposes.

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

Restricted funds are used to differentiate funds which are limited by the donor to specific uses from funds on which the donor places no restriction or which arise as a result of the operation of HCMH for its stated purposes. Resources set aside for Board-designated purposes are not considered to be restricted. Resources restricted by donors or grantors for specific operating purposes are reported in nonoperating revenue to the extent expended within the period.

Compensated Absences

HCMH employees accumulate a limited amount of earned but unused vacation hours for subsequent use or for payment upon termination, death, or retirement. The cost of vacation payments is recorded as a current liability on the balance sheet. The compensated absences liability has been computed based on rates of pay in effect at June 30, 2007.

Deferred Revenue

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

Operating Revenues and Expenses

HCMH's statement of revenues, expenses, and changes in net assets distinguishes between operating and non-operating revenues and expenses. Operating revenues result from exchange and non-exchange transactions associated with providing health care services – HCMH's principal activity. Non-exchange revenues, including interest income, taxes, grants, unrestricted contributions, and release of restricted contributions, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, including interest expense.

Net Patient Service Revenue

HCMH has agreements with third-party payors that provide for payments to HCMH at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs, discounted charges, and per diem payments. 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 and a provision for uncollectible accounts. 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.

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 restricted to a specific operating purpose are reported as operating revenues. Amounts that are unrestricted are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

Advertising Costs

Costs incurred for producing and distributing advertising are expensed as incurred. HCMH incurred \$40,091 and \$39,045 for advertising costs for the years ended June 30, 2007 and 2006, respectively.

Charity Care

To fulfill its mission of community service, HCMH provides care to patients who meet certain criteria under the policy without charge or at amounts less than its established rates. Revenue from services to these patients is recorded in the accounting system at the established rates, but HCMH does not pursue collection of the amounts. The resulting adjustments are recorded as adjustments to patient service revenue depending on the timing of the charity determination.

Investment Income

Interest on cash and deposits is included in nonoperating revenues and expenses.

County Tax Revenue

Taxes are included in nonoperating revenues when received and distributed by the County Treasurer. No provision is made in the financial statements for taxes levied in the current year to be collected in a subsequent year.

Reclassifications

Certain items from the 2006 financial statements have been reclassified to conform to the current year presentation.

Other Significant Accounting Policies

Other significant accounting policies are set forth in the financial statements and the notes thereto.

NOTE 2 – CHARITY CARE

HCMH maintains records to identify and monitor the level of charity care it provides. The amount of charges foregone for services and supplies furnished under its charity care policy during the years ended June 30, 2007 and 2006, were \$57,392 and 39,482, respectively. The estimated costs of the charges foregone, based on the cost to charge ratio of the Medicare cost report, for the years ended June 30, 2007 and 2006, were \$46,805 and \$32,199, respectively.

NOTE 3 – NET PATIENT SERVICE REVENUE

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

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

Medicare: HCMH is licensed as a Critical Access Hospital (CAH). HCMH is reimbursed for most inpatient and outpatient services at 101% of cost with final settlement determined after submission of annual cost reports by HCMH and are subject to audits thereof by the Medicare fiscal intermediary. HCMH's Medicare cost reports have been settled by the Medicare fiscal intermediary through the year ended June 30, 2005. HCMH's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with HCMH.

Medicaid: Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid based on a cost reimbursement methodology. HCMH is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by HCMH and audits thereof by the Medicaid fiscal intermediary. HCMH's Medicaid cost reports have been processed by the Medicaid fiscal intermediary through June 30, 2002.

Other Payers: HCMH has also entered into payment agreements with certain commercial insurance carriers and other organizations. The basis for payment to HCMH under these agreements may include prospectively determined rates and discounts from established charges.

Laws and regulations governing the Medicare, Medicaid, and other programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Revenue from the Medicare and Medicaid programs accounted for approximately 52% and 3%, respectively, of HCMH's net patient service revenue for the year ended 2007, and 50% and 2%, respectively, of the HCMH's net patient service revenue for the year ended 2006.

A summary of patient service revenue, contractual adjustments, and provision for bad debts for the years ended June 30, 2007 and 2006, is as follows:

	<u>2007</u>	<u>2006</u>
Total patient service revenue	<u>\$ 13,400,215</u>	<u>\$ 12,849,993</u>
Contractual adjustments:		
Medicare	(2,021,568)	(1,698,895)
Medicaid	(294,125)	(243,603)
Blue Cross	(617,395)	(800,284)
Other	<u>(345,519)</u>	<u>(284,668)</u>
Total contractual adjustments	<u>(3,278,607)</u>	<u>(3,027,450)</u>
Net patient service revenue	10,121,608	9,822,543
Provision for bad debts	<u>(304,195)</u>	<u>(430,080)</u>
Net patient service revenue (net of provision for bad debts)	<u>\$ 9,817,413</u>	<u>\$ 9,392,463</u>

(continued on next page)

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 4 – CASH AND DEPOSITS

HCMH’s deposits in banks at June 30, 2007 and 2006, were entirely covered by federal depository insurance or the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

HCMH 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.

Investments reported are not subject to risk categorization. Amounts classified as investments in the financial statements are presented as cash and deposits in this note.

At June 30, 2007 and 2006, HCMH’s carrying amounts of cash and deposits are as follows:

Deposits and Investments	<u>2007</u>	<u>2006</u>
Hancock County Memorial Hospital:		
Checking and savings accounts	\$ 462,258	\$ 418,313
Money market accounts	436,221	692,652
Certificates of deposit	2,604,850	1,745,211
Interest receivable	20,676	7,035
Federal loan securities	88,780	88,933
	<u>3,612,785</u>	<u>2,952,144</u>
Hancock County Memorial Hospital Foundation:		
Checking and savings accounts	128,734	323,945
Asset and mortgage backed securities	9,980	-
Mutual funds	117,702	-
Beneficial interest in net assets of community foundation	75,000	-
	<u>331,416</u>	<u>323,945</u>
Total deposits	<u>\$ 3,944,201</u>	<u>\$ 3,276,089</u>
Included in the following balance sheet captions:		
Investments	\$ 22,815	\$ 98,717
Assets limited as to use or restricted	<u>3,921,386</u>	<u>3,177,372</u>
	<u>\$ 3,944,201</u>	<u>\$ 3,276,089</u>

(continued on next page)

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

Interest rate risk is the exposure to fair value losses resulting from rising interest rates. The primary objectives, in order of priority, of all investment activities involving the financial assets of HCMH are:

1. **Safety:** Safety and preservation of principal in the overall portfolio.
2. **Liquidity:** Maintaining the necessary liquidity to match expected liabilities.
3. **Return:** Obtaining a reasonable return.

HCMH attempts to limit its interest rate risk while investing within the guidelines of its investment policy and Chapter 12C of the Code of Iowa.

NOTE 5 – BENEFICIAL INTEREST IN NET ASSETS OF COMMUNITY FOUNDATION

Hancock County Memorial Hospital Foundation is a beneficiary of a Community Foundation maintained by an independent trustee. The assets maintained by the Community Foundation are to be held in perpetuity. Hancock County Memorial Hospital Foundation expects to receive annual distributions of its share of the Community Foundation's income. These distributions are recorded in the financial statements as investment income. The funds which have been invested directly by Hancock County Memorial Hospital are recorded as a beneficial interest in net assets of the Community Foundation at the fair market value of its interest in the Community Foundation. These funds amounted to \$75,000 and \$-0- at June 30, 2007 and 2006, respectively.

NOTE 6 – LAND, BUILDINGS, AND EQUIPMENT

Summaries of land, buildings, and equipment at June 30, 2007 and 2006, are as follows:

	June 30, 2006				June 30, 2007
	Balance	Additions	Deductions	Transfers	Balance
Cost					
Land and land improvements	\$ 420,019	\$ 13,972	\$ -	\$ -	\$ 433,991
Building	5,465,027	-	-	-	5,465,027
Fixed equipment	1,786,299	-	-	-	1,786,299
Major movable equipment	3,545,115	272,307	(335,346)	14,982	3,497,058
Construction in progress	20,291	148,216	-	(14,982)	153,525
Total	<u>11,236,751</u>	<u>\$ 434,495</u>	<u>\$ (335,346)</u>	<u>\$ -</u>	<u>11,335,900</u>
Accumulated depreciation					
Land improvements	223,980	\$ 31,694	\$ -	\$ -	255,674
Building	2,233,284	197,905	-	-	2,431,189
Fixed equipment	545,575	101,753	-	-	647,328
Major movable equipment	2,254,868	356,239	(323,782)	-	2,287,325
Total	<u>5,257,707</u>	<u>\$ 687,591</u>	<u>\$ (323,782)</u>	<u>\$ -</u>	<u>5,621,516</u>
Land, buildings, and equipment, net	<u>\$ 5,979,044</u>				<u>\$ 5,714,384</u>

(continued on next page)

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

	June 30, 2005				June 30, 2006
	Balance	Additions	Deductions	Transfers	Balance
Cost					
Land and land improvements	\$ 412,192	\$ 7,827	\$ -	\$ -	\$ 420,019
Building	5,465,027	-	-	-	5,465,027
Fixed equipment	1,786,299	-	-	-	1,786,299
Major movable equipment	3,281,152	109,537	(84,743)	239,169	3,545,115
Construction in progress	12,484	246,976	-	(239,169)	20,291
Total	<u>10,957,154</u>	<u>\$ 364,340</u>	<u>\$ (84,743)</u>	<u>\$ -</u>	<u>11,236,751</u>
Accumulated depreciation					
Land improvements	193,649	\$ 30,331	\$ -	\$ -	223,980
Building	2,035,361	197,923	-	-	2,233,284
Fixed equipment	443,173	102,402	-	-	545,575
Major movable equipment	2,043,412	292,819	(81,363)	-	2,254,868
Total	<u>4,715,595</u>	<u>\$ 623,475</u>	<u>\$ (81,363)</u>	<u>\$ -</u>	<u>5,257,707</u>
Land, buildings, and equipment, net	<u>\$ 6,241,559</u>				<u>\$ 5,979,044</u>

The majority of construction in progress at June 30, 2007, represents costs incurred for two construction projects at HCMH. The projects include a first floor remodel and the installation of new Electronic Health Record (EHR) software. The first floor remodel is expected to be completed in May of 2008 at an estimated total cost of \$2,786,000. The installation of the EHR software is expected to be completed in September 2008 at an estimated total cost of \$630,000. Both projects will be financed with HCMH's cash reserves.

NOTE 7 – REAL ESTATE HELD FOR INVESTMENT

The real estate held for investment consists of 151 acres of farmland in Hancock County. The asset value of \$281,284 represents the original purchase price. At June 30, 2007 and 2006, the market value was in excess of the carrying value.

NOTE 8 – JOINT VENTURE

The joint venture represents a 25% investment in Mobile Radiology, LLC, a mobile radiology unit limited liability corporation. This investment is accounted for using the equity method of accounting.

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 9 – LONG-TERM DEBT

A schedule of changes in long-term debt at June 30, 2007 and 2006, is as follows:

	Balance June 30, 2006	Additions	Payments	Balance June 30, 2007	Amounts Due Within One Year
Hospital revenue note, series A	\$ 685,000	\$ -	\$ (80,000)	\$ 605,000	\$ 85,000
Hospital general obligation county bonds	385,000	-	(45,000)	340,000	50,000
USDA - RECD hospital general obligation bonds	676,774	-	(46,514)	630,260	48,787
USDA - hospital revenue note #1	392,804	-	(20,605)	372,199	21,385
USDA - hospital revenue note #2	540,348	-	(22,102)	518,246	23,142
Farmers Trust & Savings Bank	336,900	-	(21,896)	315,004	23,078
Note payable - Alcon Laboratories	16,389	-	(16,389)	-	-
Capitalized lease obligation - Note 10	<u>-</u>	<u>92,528</u>	<u>(11,417)</u>	<u>81,111</u>	<u>16,446</u>
Total long-term debt	<u>\$3,033,215</u>	<u>\$ 92,528</u>	<u>\$ (263,923)</u>	<u>2,861,820</u>	<u>\$ 267,838</u>
Less current maturities				<u>(267,838)</u>	
Long-term debt, less current maturities				<u>\$ 2,593,982</u>	

	Balance June 30, 2005	Additions	Payments	Balance June 30, 2006	Amounts Due Within One Year
Hospital revenue note, Series A	\$ 760,000	\$ -	\$ (75,000)	\$ 685,000	\$ 80,000
Hospital general obligation county bonds	430,000	-	(45,000)	385,000	45,000
USDA - RECD hospital general obligation bonds	721,080	-	(44,306)	676,774	46,470
USDA - hospital revenue note #1	412,455	-	(19,651)	392,804	20,392
USDA - hospital revenue note #2	561,530	-	(21,182)	540,348	22,181
Farmers Trust & Savings Bank	357,291	-	(20,391)	336,900	21,655
Note payable - Alcon Laboratories	<u>89,575</u>	<u>-</u>	<u>(73,186)</u>	<u>16,389</u>	<u>16,389</u>
Total long-term debt	<u>\$3,331,931</u>	<u>\$ -</u>	<u>\$ (298,716)</u>	3,033,215	<u>\$ 252,087</u>
Less current maturities				<u>(252,087)</u>	
Long-term debt, less current maturities				<u>\$ 2,781,128</u>	

HCMH revenue note, Series A requires semi-annual payments of principal and interest on June 1 and December 1, with interest at the rate of 5.75% to 7.00%. Principal and interest payments are due through December 2012.

(continued on next page)

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

HCMH general obligation county bonds require semi-annual payments of principal and interest on June 1 and December 1, with interest at the rate of 4.00% to 5.50%. Principal and interest payments are due through December 2012.

USDA – RECD hospital general obligation bonds require monthly payments of principal and interest with interest at the rate of 4.875%. Principal and interest payments are due through December 2017.

USDA hospital revenue note #1 requires monthly payments of principal and interest with interest at the rate of 4.75%. Principal and interest payments are due through July 2020.

USDA hospital revenue note #2 requires monthly payments of principal and interest with interest at the rate of 4.25%. Principal and interest payments are due through June 2023.

Farmers Trust and Savings Bank requires monthly payments of principal and interest with interest at the rate of 6.63%. Principal and interest payments are due through June 2017.

The capital lease requires monthly payments of principal and interest with interest at the rate of 8.85%. Principal and interest payments are due through September 2011.

The bonds are payable solely and only from revenues and receipts of HCMH and do not constitute an indebtedness of the County. The notes are secured by HCMH building.

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

<u>Year Ending June 30,</u>	<u>Long-term Debt</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 267,838	\$ 150,903	\$ 418,741
2009	280,462	134,883	415,345
2010	298,498	117,873	416,371
2011	322,027	99,443	421,470
2012	316,101	79,173	395,274
2013-2017	1,024,015	198,959	1,222,974
2018-2022	309,682	38,320	348,002
2023-2027	43,197	855	44,052
	<u>\$2,861,820</u>	<u>\$ 820,409</u>	<u>\$3,682,229</u>

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 10 – LEASES

HCMH leases certain equipment and building space under noncancelable long-term lease agreements. Certain leases have been recorded as capitalized leases and others as operating leases. Total lease expense for the years ended June 30, 2007 and 2006, for all operating leases was \$27,105 and \$24,425, respectively. The capitalized leased assets consist of:

	<u>2007</u>	<u>2006</u>
Major movable equipment	\$ 92,528	\$ -
Less accumulated amortization (included as depreciation on the accompanying financial statements)	<u>(5,508)</u>	<u>-</u>
	<u>\$ 87,020</u>	<u>\$ -</u>

Minimum future lease payments for noncancelable capital and operating leases are as follows:

<u>Year Ending June 30,</u>	<u>Capital Leases</u>	<u>Operating Leases</u>
2008	\$ 22,968	\$ 33,600
2009	22,968	33,600
2010	22,968	33,600
2011	22,968	33,600
2012	<u>5,742</u>	<u>28,000</u>
Total minimum lease payments	97,614	<u>\$ 162,400</u>
Less interest	<u>(16,503)</u>	
Present value of minimum lease payments - Note 9	<u>\$ 81,111</u>	

NOTE 11 – PENSION AND RETIREMENT BENEFITS

HCMH 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 covered salary and HCMH is required to contribute 5.75% of annual covered payroll for the years ended June 30, 2007, 2006, and 2005. Contribution requirements are established by State statute. HCMH's contribution to IPERS for the years ended June 30, 2007, 2006, and 2005, were \$193,013, \$186,217, and \$158,929, respectively, equal to the required contributions for each year.

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 12 – RELATED ORGANIZATIONS

Master Affiliation Agreement

HCMH entered into a Master Affiliation Agreement with Mercy Medical Center – North Iowa to provide hospital, physician, and other health care services in Hancock County and the North Central Iowa region under the name of Hancock County Memorial Hospital. As a part of the Master Affiliation Agreement, HCMH entered into a professional services agreement with Mercy Medical Center – North Iowa whereby Mercy Medical Center – North Iowa provides professional medical services and other services. Amounts paid to Mercy Medical Center – North Iowa for the provision of these services amounted to \$2,233,167 and \$2,284,680 for the years ended June 30, 2007 and 2006, respectively.

Operating income and losses from the operation of HCMH services in Hancock County are shared in accordance to the formulas outlined in the Master Affiliation Agreement. Total operating gains to be allocated between Mercy Medical Center – North Iowa and HCMH amounted to \$21,129 for the year ended June 30, 2007. There was no payment due to either party under the terms of the agreement for the year ended June 30, 2006.

Management Services Agreement

HCMH entered into a contractual arrangement with Mercy Medical Center – North Iowa under which Mercy Medical Center – North Iowa provides administrative staff, management consultation, and other services to HCMH. The arrangement does not alter the authority or responsibility of the Board of Trustees of HCMH. Expenses for the administrative and management services received for the years ended June 30, 2007 and 2006, were \$403,845 and \$271,708, respectively.

Due to Affiliated Organization

As of June 30, 2007 and 2006, Hancock County Memorial Hospital's records reflect a due to Mercy Medical Center – North Iowa of \$249,526 and \$198,336, respectively, for the various services and distributions related to these agreements.

NOTE 13 – CONTINGENCIES

Malpractice Insurance

HCMH has malpractice insurance coverage to provide protection for professional liability losses on a claims made basis subject to a limit of \$1 million per claim and an aggregate limit of \$3 million. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, will be uninsured.

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

Healthcare Legislation and Regulation

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violation of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

Management believes that HCMH is in substantial compliance with fraud and abuse as well as other applicable government laws and regulations. While no regulatory inquiries have been made, compliance with such laws and regulations is subject to government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

NOTE 14 – DEFERRED COMPENSATION AGREEMENTS

HCMH has entered into deferred compensation agreements with certain employees, which provide that a portion of their compensation will be deferred, to be paid upon retirement or at specific dates. HCMH does not make any contributions under the agreements. The agreements indicate the amounts due the employees will be the amounts deferred plus or minus earnings or losses realized on the investments of the funds at the time payment is to be made.

On August 20, 1996, the provision of the Internal Revenue Code Section 457 were amended to enable plans to hold all assets and income of the plan in a trust for the exclusive benefit of participants and their beneficiaries. These assets were previously required to be held as property of HCMH. The Governmental Accounting Standards Board (GASB) issued Statement 32 in October 1997. GASB 32 is effective for the year ended June 30, 1999, or on the date (if earlier) that the plan changes its trust provisions. The HCMH plan has been amended to hold the plan assets in trust for the plan participants and their beneficiaries.

The agreements are funded with insurance contracts, stated at the greater of cost or cash value. The fair market value of the plan was \$427,597 and \$345,436 at June 30, 2007 and 2006, respectively.

NOTE 15 – RISK MANAGEMENT

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

HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

NOTE 16 – CONCENTRATION OF CREDIT RISK

HCMH grants credit without collateral to its patients, most of whom are insured under third-party payor agreements. The mix of receivables from third-party payors and patients at June 30, 2007 and 2006, was as follows:

	<u>2007</u>	<u>2006</u>
Medicare	30%	33%
Medicaid	4	3
Commercial insurance	38	38
Other third-party payors and patients	<u>28</u>	<u>26</u>
	<u>100%</u>	<u>100%</u>

**HANCOCK COUNTY
MEMORIAL HOSPITAL**

HANCOCK COUNTY MEMORIAL HOSPITAL
BUDGETARY COMPARISON SCHEDULE OF REVENUES, EXPENSES, AND
CHANGES IN NET ASSETS – BUDGET AND ACTUAL (CASH BASIS)
YEAR ENDED JUNE 30, 2007

	Actual Accrual Basis	Accrual Adjustments	Actual Cash Basis	Budget	Variance Favorable (Unfavorable)
Estimated amount to be raised by taxation	\$ 795,649	\$ -	\$ 795,649	\$ 794,166	\$ 1,483
Estimated other revenues/receipts	<u>10,199,466</u>	<u>79,691</u>	<u>10,279,157</u>	<u>10,713,204</u>	<u>(434,047)</u>
	10,995,115	79,691	11,074,806	11,507,370	(432,564)
Expenses/disbursements	<u>9,983,953</u>	<u>(178,160)</u>	<u>9,805,793</u>	<u>10,757,327</u>	<u>951,534</u>
Net	1,011,162	257,851	1,269,013	750,043	<u>\$ 518,970</u>
Balance beginning of year	<u>9,422,389</u>	<u>(4,312,192)</u>	<u>5,110,197</u>	<u>9,337,806</u>	
Balance end of year	<u>\$ 10,433,551</u>	<u>\$ (4,054,341)</u>	<u>\$ 6,379,210</u>	<u>\$ 10,087,849</u>	

**HANCOCK COUNTY MEMORIAL HOSPITAL
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION -
BUDGETARY REPORTING
YEAR ENDED JUNE 30, 2007**

NOTE 1 – BUDGETARY COMPARISON

This budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary prospective differences resulting from HCMH preparing a budget on the cash basis of accounting.

The Board of Trustees annually prepares and adopts a budget designating the amount necessary for the improvement and maintenance of HCMH on the cash basis following required public notice and hearing in accordance with Chapters 24 and 347 of the Code of Iowa. The Board of Trustees certifies the approved budget to the appropriate county auditors. The budget may be amended during the year utilizing similar statutorily prescribed procedures. Formal and legal budgetary control is based on total expenditures. HCMH did not amend its original budget during the year ended June 30, 2007.

For the year ended June 30, 2007, HCMH's expenditures did not exceed the amount budgeted.

**HANCOCK COUNTY
MEMORIAL HOSPITAL**



CPAs & BUSINESS ADVISORS

**INDEPENDENT AUDITOR'S REPORT ON
SUPPLEMENTARY INFORMATION**

The Board of Trustees
Hancock County Memorial Hospital
Britt, Iowa

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information, except for the Schedule of Statistical Information on page 36 marked "unaudited," has been subjected to the auditing procedures applied in the 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.

Eide Bailly LLP

Dubuque, Iowa
October 10, 2007

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HANCOCK COUNTY MEMORIAL HOSPITAL
SCHEDULES OF NET PATIENT SERVICE REVENUE
YEARS ENDED JUNE 30, 2007 AND 2006

	TOTAL	
	2007	2006
PATIENT CARE SERVICES		
Adults and pediatrics	\$ 971,113	\$ 832,884
OTHER PROFESSIONAL SERVICES		
Operating room	1,003,489	1,023,397
Recovery room	257,919	266,278
Radiology	2,110,159	2,027,168
Nuclear medicine	19,085	11,716
Laboratory	2,929,052	2,687,412
Blood	58,322	52,525
Respiratory therapy	225,400	234,057
Physical therapy	376,088	443,470
Occupational therapy	65,095	51,322
Speech therapy	15,032	6,530
Electrocardiology	166,871	174,473
Medical and surgical supplies	161,648	213,702
Pharmacy	864,777	741,925
Cardiac rehabilitation	82,751	53,983
Diabetic education	17,124	10,385
Massage therapy	4,435	-
Nail care	8,825	-
Britt clinic	1,395,676	1,467,590
Garner clinic	1,392,208	1,540,607
Wesley clinic	212,833	182,256
Kanawha clinic	84,094	87,649
Emergency services	1,030,034	777,823
Ambulance	5,577	2,323
Total	13,457,607	12,889,475
Charity care	(57,392)	(39,482)
Total patient service revenue	<u>13,400,215</u>	<u>12,849,993</u>
CONTRACTUAL ADJUSTMENTS		
Medicare	(2,021,568)	(1,698,895)
Medicaid	(294,125)	(243,603)
Blue Cross	(617,395)	(800,284)
Other	(345,519)	(284,668)
Total contractual adjustments	<u>(3,278,607)</u>	<u>(3,027,450)</u>
NET PATIENT SERVICE REVENUE	10,121,608	9,822,543
PROVISION FOR BAD DEBTS	<u>(304,195)</u>	<u>(430,080)</u>
NET PATIENT SERVICE REVENUE (NET OF PROVISION FOR BAD DEBTS)	<u>\$ 9,817,413</u>	<u>\$ 9,392,463</u>

INPATIENT		OUTPATIENT	
2007	2006	2007	2006
\$ 864,403	\$ 740,126	\$ 106,710	\$ 92,758
43,110	26,740	960,379	996,657
8,977	5,491	248,942	260,787
130,441	136,237	1,979,718	1,890,931
-	-	19,085	11,716
302,482	273,429	2,626,570	2,413,983
36,986	35,306	21,336	17,219
134,533	132,074	90,867	101,983
70,539	63,213	305,549	380,257
49,400	27,862	15,695	23,460
12,307	5,213	2,725	1,317
12,270	13,741	154,601	160,732
28,018	31,238	133,630	182,464
423,231	332,207	441,546	409,718
-	-	82,751	53,983
-	-	17,124	10,385
-	-	4,435	-
-	-	8,825	-
-	-	1,395,676	1,467,590
-	-	1,392,208	1,540,607
-	-	212,833	182,256
-	-	84,094	87,649
13,914	15,370	1,016,120	762,453
5,577	2,323	-	-
<u>\$ 2,136,188</u>	<u>\$ 1,840,570</u>	<u>\$ 11,321,419</u>	<u>\$ 11,048,905</u>

**HANCOCK COUNTY MEMORIAL HOSPITAL
SCHEDULES OF OTHER OPERATING REVENUES
YEARS ENDED JUNE 30, 2007 AND 2006**

	<u>2007</u>	<u>2006</u>
OTHER OPERATING REVENUES		
Meals sold	\$ 83,514	\$ 87,812
Grant revenues	67,921	81,301
Dietary assessment and consulting	5,084	6,263
Medical records transcripts	938	1,543
Other	<u>11,052</u>	<u>17,457</u>
 TOTAL OTHER OPERATING REVENUES	 <u>\$ 168,509</u>	 <u>\$ 194,376</u>

HANCOCK COUNTY MEMORIAL HOSPITAL
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
NURSING ADMINISTRATION		
Salaries and wages	\$ 39,745	\$ 19,813
Supplies and other expenses	<u>19,717</u>	<u>97,979</u>
	<u>59,462</u>	<u>117,792</u>
ADULTS AND PEDIATRICS		
Salaries and wages	686,798	651,869
Supplies and other expenses	<u>105,284</u>	<u>221,568</u>
	<u>792,082</u>	<u>873,437</u>
OPERATING AND RECOVERY ROOMS		
Salaries and wages	60,398	67,109
Supplies and other expenses	<u>79,447</u>	<u>71,191</u>
	<u>139,845</u>	<u>138,300</u>
ANESTHESIOLOGY		
Supplies and other expenses	<u>111,234</u>	<u>149,469</u>
RADIOLOGY		
Salaries and wages	171,368	162,623
Supplies and other expenses	<u>414,097</u>	<u>418,574</u>
	<u>585,465</u>	<u>581,197</u>
LABORATORY		
Salaries and wages	247,601	228,232
Supplies and other expenses	<u>260,312</u>	<u>258,808</u>
	<u>507,913</u>	<u>487,040</u>
BLOOD		
Salaries and wages	3,542	3,813
Supplies and other expenses	<u>18,643</u>	<u>25,200</u>
	<u>22,185</u>	<u>29,013</u>
RESPIRATORY THERAPY		
Salaries and wages	1,759	3,438
Supplies and other expenses	<u>18,733</u>	<u>16,236</u>
	<u>20,492</u>	<u>19,674</u>
PHYSICAL THERAPY		
Salaries and wages	131,634	141,262
Supplies and other expenses	<u>15,652</u>	<u>17,178</u>
	<u>147,286</u>	<u>158,440</u>

(continued)

HANCOCK COUNTY MEMORIAL HOSPITAL
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
OCCUPATIONAL THERAPY		
Supplies and other expenses	<u>\$ 28,107</u>	<u>\$ 26,957</u>
SPEECH THERAPY		
Supplies and other expenses	<u>8,081</u>	<u>4,387</u>
ELECTROCARDIOLOGY		
Salaries and wages	5,963	6,504
Supplies and other expenses	<u>9,821</u>	<u>11,492</u>
	<u>15,784</u>	<u>17,996</u>
MEDICAL AND SURGICAL SUPPLIES		
Supplies and other expenses	<u>53,904</u>	<u>80,251</u>
PHARMACY		
Salaries and wages	12,959	14,030
Supplies and other expenses	<u>243,638</u>	<u>244,972</u>
	<u>256,597</u>	<u>259,002</u>
CENTRAL SUPPLY		
Salaries and wages	72,003	70,734
Supplies and other expenses	<u>3,841</u>	<u>8,596</u>
	<u>75,844</u>	<u>79,330</u>
CARDIAC REHABILITATION		
Salaries and wages	19,206	15,147
Supplies and other expenses	<u>2,842</u>	<u>6,241</u>
	<u>22,048</u>	<u>21,388</u>
MASSAGE THERAPY		
Salaries and wages	3,406	-
Supplies and other expenses	<u>581</u>	<u>57</u>
	<u>3,987</u>	<u>57</u>
NAIL CARE		
Salaries and wages	10,210	-
Supplies and other expenses	<u>3,905</u>	<u>-</u>
	<u>14,115</u>	<u>-</u>
BRITT CLINIC		
Salaries and wages	329,471	337,208
Supplies and other expenses	<u>721,759</u>	<u>770,816</u>
	<u>1,051,230</u>	<u>1,108,024</u>

(continued)

HANCOCK COUNTY MEMORIAL HOSPITAL
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
GARNER CLINIC		
Salaries and wages	\$ 296,521	\$ 297,624
Supplies and other expenses	<u>571,965</u>	<u>719,310</u>
	<u>868,486</u>	<u>1,016,934</u>
WESLEY CLINIC		
Salaries and wages	63,780	50,326
Supplies and other expenses	<u>182,651</u>	<u>134,275</u>
	<u>246,431</u>	<u>184,601</u>
KANAWHA CLINIC		
Salaries and wages	26,156	22,682
Supplies and other expenses	<u>59,795</u>	<u>55,901</u>
	<u>85,951</u>	<u>78,583</u>
EMERGENCY SERVICES		
Salaries and wages	115,354	94,575
Supplies and other expenses	<u>678,192</u>	<u>331,057</u>
	<u>793,546</u>	<u>425,632</u>
AMBULANCE		
Supplies and other expenses	<u>7,104</u>	<u>5,800</u>
SOCIAL SERVICES		
Salaries and wages	11,359	9,428
Supplies and other expenses	<u>6</u>	<u>-</u>
	<u>11,365</u>	<u>9,428</u>
MEDICAL RECORDS		
Salaries and wages	152,335	142,730
Supplies and other expenses	<u>40,993</u>	<u>32,394</u>
	<u>193,328</u>	<u>175,124</u>
DIETARY		
Salaries and wages	169,485	164,802
Supplies and other expenses	<u>90,423</u>	<u>71,476</u>
	<u>259,908</u>	<u>236,278</u>
OPERATION OF PLANT		
Salaries and wages	188,856	191,005
Supplies and other expenses	<u>225,572</u>	<u>238,831</u>
	<u>414,428</u>	<u>429,836</u>
HOUSEKEEPING		
Salaries and wages	70,064	78,884
Supplies and other expenses	<u>18,695</u>	<u>18,928</u>
	<u>88,759</u>	<u>97,812</u>

(continued)

HANCOCK COUNTY MEMORIAL HOSPITAL
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
LAUNDRY AND LINEN		
Salaries and wages	\$ 6,253	\$ 5,339
Supplies and other expenses	<u>18,207</u>	<u>19,748</u>
	<u>24,460</u>	<u>25,087</u>
ADMINISTRATIVE SERVICES		
Salaries and wages	522,655	494,658
Supplies and other expenses	<u>769,178</u>	<u>702,328</u>
	<u>1,291,833</u>	<u>1,196,986</u>
UNASSIGNED EXPENSES		
Depreciation	687,591	623,477
Interest and amortization	192,188	187,747
Employee benefits	<u>862,625</u>	<u>792,298</u>
	<u>1,742,404</u>	<u>1,603,522</u>
TOTAL OPERATING EXPENSES	<u>\$ 9,943,664</u>	<u>\$ 9,637,377</u>

HANCOCK COUNTY MEMORIAL HOSPITAL
SCHEDULES OF PATIENT RECEIVABLES AND ALLOWANCE FOR DOUBTFUL ACCOUNTS
JUNE 30, 2007 AND 2006

ANALYSIS OF AGING Days Since Discharge	2007		2006	
	Amount	Percent to Total	Amount	Percent to Total
30 days or less	\$ 1,098,601	53.37%	\$ 1,058,264	56.17%
31 to 60 days	352,535	17.13%	262,698	13.94%
61 to 90 days	157,832	7.67%	136,360	7.24%
91 days and over	<u>449,322</u>	<u>21.83%</u>	<u>426,812</u>	<u>22.65%</u>
	2,058,290	100.00%	1,884,134	100.00%
Less: Allowance for doubtful accounts	300,000		285,000	
Allowance for contractual adjustments	<u>350,000</u>		<u>275,000</u>	
Net	<u>\$ 1,408,290</u>		<u>\$ 1,324,134</u>	
Net patient service revenue per calendar day - excluding bad debts	<u>\$ 26,897</u>		<u>\$ 25,733</u>	
Days of net revenue in net accounts receivable at year end	<u>52</u>		<u>51</u>	

ALLOWANCE FOR DOUBTFUL ACCOUNTS	2007	2006
Beginning balance	<u>\$ 285,000</u>	<u>\$ 193,639</u>
Add:		
Provision for bad debts	304,195	430,080
Recoveries previously written off	<u>123,308</u>	<u>145,597</u>
	<u>427,503</u>	<u>575,677</u>
Less:		
Accounts written off	<u>(412,503)</u>	<u>(484,316)</u>
Ending balance	<u>\$ 300,000</u>	<u>\$ 285,000</u>

HANCOCK COUNTY MEMORIAL HOSPITAL
SCHEDULES OF INVENTORY AND PREPAID EXPENSE
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
INVENTORY		
Central supply	\$ 69,609	\$ 77,283
Pharmacy	67,558	65,467
General	<u>43,140</u>	<u>30,704</u>
 Total inventory	 <u><u>\$ 180,307</u></u>	 <u><u>\$ 173,454</u></u>
 PREPAID EXPENSE		
Service contracts/other	\$ 69,171	\$ 42,994
Insurance	14,820	10,720
Membership dues	<u>10,990</u>	<u>12,036</u>
 Total prepaid expense	 <u><u>\$ 94,981</u></u>	 <u><u>\$ 65,750</u></u>

HANCOCK COUNTY MEMORIAL HOSPITAL
SCHEDULES OF STATISTICAL INFORMATION (UNAUDITED)
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
PATIENT DAYS		
Acute (includes hospice)	763	742
Swing-bed	1,278	980
ADMISSIONS		
Acute (includes hospice)	256	228
Swing-bed	94	124
DISCHARGES		
Acute (includes hospice)	258	228
Swing-bed	88	126
AVERAGE LENGTH OF STAY		
Acute (includes hospice)	2.96	3.25
Swing-bed	14.52	7.78
BEDS	25	25
OCCUPANCY PERCENTAGE		
Acute (includes hospice), based on 25 beds	8.4%	8.1%
Swing-bed, based on 10 beds	35.0%	26.8%
OUTPATIENT VISITS	16,565	16,162
CLINIC VISITS		
Britt	10,365	10,574
Garner	8,126	9,139
Kanawha	689	815
Wesley	1,656	1,456
Visiting Specialists	8,126	9,139



CPAs & BUSINESS ADVISORS

**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**

The Board of Trustees
Hancock County Memorial Hospital
Britt, Iowa

We have audited the accompanying balance sheets of Hancock County Memorial Hospital (HCMH) as of June 30, 2007 and 2006, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended and have issued our report thereon dated October 10, 2007. 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.

Internal Control over Financial Reporting

In planning and performing our audit, we considered HCMH's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of HCMH's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of HCMH's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of the control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects HCMH's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of HCMH's financial statements that is more than inconsequential will not be prevented or detected by HCMH's internal control. We consider the deficiencies in internal control described in Part I of the accompanying Schedule of Findings to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies that results in more than a remote likelihood a material misstatement of the financial statements will not be prevented or detected by HCMH's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we believe that none are material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of HCMH 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 HCMH's operations for the year ended June 30, 2007, are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of HCMH. 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.

HCMH's responses to findings identified in our audit are described in the accompanying Schedule of Findings. While we have expressed our conclusions on HCMH's responses, we did not audit HCMH's responses, and accordingly, we express no opinion on them.

We also noted certain additional matters that we reported to management of HCMH in a separate letter dated October 10, 2007.

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

We would like to acknowledge the many courtesies and assistance extended to us by personnel of Hancock County Memorial Hospital during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

A handwritten signature in black ink that reads "Eric Bailly LLP". The signature is written in a cursive, flowing style.

Dubuque, Iowa
October 10, 2007

HANCOCK COUNTY MEMORIAL HOSPITAL
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2007

Part I: Findings Related to the Financial Statements:

SIGNIFICANT DEFICIENCIES:

I-A-07 Segregation of Duties – One important aspect of internal controls is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. The limited number of office personnel prevents a proper segregation of accounting functions necessary to assure optimal internal control.

Recommendation – This is not an unusual condition in organizations of your size. We realize that with a limited number of office employees, segregation of duties is difficult. We also recognize that in some instances it may not be cost effective to employ additional personnel for the purpose of segregating duties. However, HCMH should continually review its internal control procedures, other compensating controls and monitoring procedures to obtain the maximum internal control possible under the circumstances. Furthermore, HCMH should periodically evaluate its procedures to identify potential areas where the benefits of further segregation of duties or addition of other compensating controls and monitoring procedures exceed the related costs.

Response – Management concurs with the finding and recommendation. We are aware of the situation and will continually review the assignment of duties, other compensating controls and monitoring procedures to obtain the maximum internal control possible under the circumstances.

Conclusion – Response accepted.

I-B-07 Preparation of Financial Statements – HCMH does not have an internal control system designed to provide for the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America. Therefore, as auditors, we were requested to draft the financial statements and accompanying notes to the financial statements.

Recommendation – We realize that obtaining the expertise necessary to prepare the financial statements, including all necessary disclosures in accordance with accounting principles generally accepted in the United States of America can be considered costly and ineffective. However, management and those charged with governance of HCMH should decide whether to accept the degree of risk associated with this condition because of cost or other considerations.

Response – We are aware of the situation and will continually review the risks associated with this condition because of cost or other considerations.

Conclusion – Response accepted.

HANCOCK COUNTY MEMORIAL HOSPITAL
SCHEDULE OF FINDINGS
YEAR ENDED JUNE 30, 2007

Part II: Other Findings Related to Required Statutory Reporting:

- II-A-07 Certified Budget – Disbursements during the year ended June 30, 2007, did not exceed the amount budgeted.

- II-B-07 Questionable Expenditures – We noted no expenditures that we believe would be in conflict with the requirements of public purpose as defined in an Attorney General’s opinion dated April 25, 1979.

- II-C-07 Travel Expense – No expenditures of HCMH money for travel expenses of spouses of HCMH officials and/or employees were noted.

- II-D-07 Business Transactions – We noted no material business transactions between HCMH and HCMH officials and/or employees.

- II-E-07 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.

- II-F-07 Deposits and Investments – No instances of non-compliance with the deposit and investment provisions of Chapters 12B and 12C of the Code of Iowa and HCMH’s investment policy were noted.

- II-G-07 Publication of Bills Allowed and Salaries – Chapter 347.13(14) of the Code of Iowa states “There shall be published quarterly in each of the official newspapers of the County as selected by the Board of Supervisors pursuant to Section 349.1 the schedule of bills allowed and there shall be published annually in such newspapers the schedule of salaries paid by job classification and category...” HCMH published a schedule of bills allowed and a schedule of salaries paid as required by the Code.

- II-H-07 Chapter 28E Organization – HCMH has entered into a joint venture agreement under the provisions of Chapter 28E of the Code of Iowa for the provision of ultrasound services. The provisions of Chapter 28E require that a joint venture with gross receipts in excess of \$100,000 have a financial statement audit. The joint venture has conducted an audit in compliance with the provisions of Chapter 28E.



CPAs & BUSINESS ADVISORS

To the Board of Trustees
Hancock County Memorial Hospital
Britt, Iowa

We have audited the financial statements of Hancock County Memorial Hospital (HCMH) for the year ended June 30, 2007, and have issued our report thereon dated October 10, 2007. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under Auditing Standards Generally Accepted in the United States of America and Government Auditing Standards

As stated in our engagement letter dated June 7, 2007, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute, assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of HCMH. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of HCMH's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by Hancock County Memorial Hospital are described in Note 1 to the financial statements. No new accounting policies were adopted, and the application of existing policies was not changed during the year ended June 30, 2007. We noted no transactions entered into by HCMH during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

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Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements relate to the collectibility of patient receivables and the amounts either owed to or receivable from third-party payors.

Management's estimate of the collectibility of patient receivables is based on historical trends for uncollectible accounts and contractual adjustments. The estimate of the amounts either owed to or receivable from third-party payors is based on both final and tentatively settled cost reports. We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole. However, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. There is a reasonable possibility that recorded estimates will change by a material amount in the near term. Management believes the estimates for all open years are adequate. Any differences between the estimates and the final settlements will be recorded in the period the final settlements are made and will not be treated as prior period adjustments.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on HCMH's financial reporting process (that is, cause future financial statements to be materially misstated). All of the adjustments we proposed were posted by HCMH.

We discussed all adjustments to the financial statements with HCMH's staff during the audit. The following adjustments were made during the fiscal year 2007 audit:

Increase in net assets prior to audit adjustments	\$ 1,021,359
To adjust allowance for contractual accounts	(81,054)
To adjust third-party payor settlements	63,959
To adjust allowance for bad debts	17,973
To dispose of equipment	(10,143)
Other adjustments	<u>(932)</u>
 Increase in net assets as reported	 <u>\$ 1,011,162</u>

There were no significant passed adjustments.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to HCMH’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as HCMH’s auditors. However, these discussions occurred in the normal course of our professional relationship, and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no difficulties in dealing with management in performing and completing our audit.

Other Comments

We have included additional comments regarding HCMH’s operations.

This information is intended solely for the use of the officials, employees, and constituents of Hancock County Memorial Hospital and is not intended to be and should not be used by anyone other than these specified parties.

As always, we will be happy to discuss these or any other topics at your convenience. We would like to take this opportunity to express our appreciation to you and your staff for the fine cooperation that we received during the course of the audit. We look forward to many years of continued service to Hancock County Memorial Hospital.

A handwritten signature in cursive script that reads "Eide Bailly LLP".

Dubuque, Iowa
October 10, 2007

xc: Mr. Vance Jackson

HANCOCK COUNTY MEMORIAL HOSPITAL

YEAR ENDED JUNE 30, 2007

OTHER COMMENTS

Segregation of Duties and Compensating Controls over Accounting Procedures

We realize that an optimal segregation of duties in organizations of your size is difficult. However, during our review of the Hospital's internal controls related to accounting functions, we identified some areas where other compensating controls or monitoring procedures could be implemented to obtain the maximum internal control possible under the circumstances. Those recommendations are as follows:

Patient Accounts Receivable

The Business Office Manager and billings clerks have the capability to perform all functions of writing off uncollectible accounts receivable within HCMH's computer system. Without proper review procedures in place, the possibility exists for a patient account to be improperly written off and not detected by HCMH's management. We recommend that the Chief Financial Officer periodically reviews patient accounts written off to allowance for doubtful accounts per the general ledger and any other miscellaneous adjustments that reduce patient account balances for appropriateness and accuracy.

Payroll

The Human Resource Director is involved in processing the checks, preparing related payroll reports, and reconciling the related general ledger accounts. This individual also has the authority to add employees and change pay rates in the master file. As a result, this individual has the capability to create improper checks to fictitious employees or process payments at improper rates. To reduce this risk, we recommend that the human resource department distribute a detailed "pay distribution report" by employee to the department heads periodically for their review. Furthermore, we recommend that the Chief Financial Officer exercise an appropriate level of review over the Human Resource Director's pay and benefits.

Risk Assessment Audit Standards

The Auditing Standards Board of the American Institute of Certified Public Accountants has issued a suite of new auditing standards (Statements of Auditing Standards Nos. 104-111) related to the consideration of audit risk.

These Statements establish standards and provide guidance concerning the auditor's assessment of the risks of material misstatement (whether caused by error or fraud) in a financial statement audit. They also provide guidance on designing and performing audit procedures that are responsive to those assessed risks. Additionally, the Statements establish standards and provide guidance on planning and supervision (determining audit risk and materiality), the nature of audit evidence, and evaluating whether the audit evidence obtained affords a reasonable basis for an opinion on the financial statements under audit.

The primary objective of these standards is to enhance the auditor's consideration of audit risk by specifying, among other things:

- A more in-depth understanding of the entity and its environment, including its internal control, to identify the risks of material misstatement in the financial statements and what the entity is doing to mitigate those risks.
- Based upon the understanding obtained, a more rigorous assessment of the risks of where and how financial statements could be materially misstated.
- Improved linkage between the auditor's assessment of risks and the nature, timing, and extent of audit procedures performed in response to those risks.

HANCOCK COUNTY MEMORIAL HOSPITAL

YEAR ENDED JUNE 30, 2007

OTHER COMMENTS

Auditors will be required to implement these standards for all audit engagements for periods beginning on or after December 15, 2006. As a result, these standards will be in effect for the audit of your financial statements for the year ending June 30, 2008. These standards may have an impact on HCMH's audit.