

FINANCIAL STATEMENTS
JUNE 30, 2007 AND 2006

PALO ALTO COUNTY HOSPITAL
d/b/a
PALO ALTO COUNTY HEALTH SYSTEM

**PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM**

Table of Contents

	<u>Page</u>
BOARD OF TRUSTEES AND HEALTH SYSTEM OFFICIALS	1
INDEPENDENT AUDITOR’S REPORT	2-3
MANAGEMENT’S DISCUSSION AND ANALYSIS	4-5
BASIC FINANCIAL STATEMENTS	
Balance Sheets	6
Balance Sheets – Foundation	7
Statements of Revenues, Expenses, and Changes in Net Assets	8
Statements of Revenues, Expenses, and Changes in Net Assets – Foundation	9
Statements of Cash Flows	10-11
Statements of Cash Flows – Foundation	12
Notes to Financial Statements	13-25
REQUIRED SUPPLEMENTARY INFORMATION	
Budgetary Comparison Schedule of Revenues, Expenses, and Changes in Net Assets – Budget and Actual (Cash Basis)	26
Note to Required Supplementary Information – Budgetary reporting	27
OTHER SUPPLEMENTARY INFORMATION	
Independent Auditor’s Report on Supplementary Information Schedules	28
Net Patient and Resident Service Revenue	29
Other Operating Revenues	30
Operating Expenses	31-34
Patient and Resident Receivables and Allowance for Doubtful Accounts	35
Supplies and Prepaid Expense	36
Comparative Statistics (Unaudited)	37
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	38-39
SCHEDULE OF FINDINGS	40-41

**PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
BOARD OF TRUSTEES AND HEALTH SYSTEM OFFICIALS**

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
<u>Board of Trustees</u>		
James Hobart	Chair	December 31, 2010
Charles S. Wirtz	Treasurer	December 31, 2012
Pat Joyce	Secretary	December 31, 2012
Mick Conway	Member	December 31, 2010
Tom Magee	Member	December 31, 2012
Kris Ausborn	Member	December 31, 2008
Shirley Kruse	Member	December 31, 2008

Health System Officials

Thomas J. Lee	Chief Executive Officer
Renay Hauswirth	Director of Finance



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INDEPENDENT AUDITOR'S REPORT

The Board of Trustees
Palo Alto County Hospital
d/b/a Palo Alto County Health System
Emmetsburg, Iowa

We have audited the accompanying balance sheets of Palo Alto County Hospital, d/b/a Palo Alto County Health System, as of June 30, 2007 and 2006, and its discretely presented component unit as of December 31, 2006 and 2005, as listed in the table of contents, 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 the Health System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with 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 Palo Alto County Hospital, d/b/a Palo Alto County Health System, as of June 30, 2007 and 2006, and the financial statements for its discretely presented component unit as of December 31, 2006 and 2005, and the respective changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As indicated in the Health System'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 Auditing 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.

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In accordance with *Government Auditing Standards*, we have also issued our report dated September 14, 2007, on our consideration of the Health System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 4 and 5 and the Budgetary Comparison Information on pages 26 and 27 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.

A handwritten signature in cursive script that reads "Eide Bailly LLP". The signature is written in black ink and is positioned above the typed name and date.

Dubuque, Iowa
September 14, 2007

PALO ALTO COUNTY HEALTH SYSTEM

Management's Discussion and Analysis

This section of Palo Alto County Health System'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 Health System's total assets increased by \$10,709,568 or 44.6%. A significant portion of this increase represents investments in capital equipment and buildings.
- The Health System's assets exceeded liabilities by \$16,004,579 at June 30, 2007.
- During the year, the Health System's total operating revenues increased 9.9% to \$16,839,140, while the operating expenses increased 9.0% to \$16,618,297. The Health System had income from operations of \$110,421, which is 0.7% of total operating revenues.
- The Health System made capital equipment and building investments totaling \$4,973,618 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 Health System 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 Health System's assets and liabilities. The balance sheet at June 30, 2007, reports total assets of \$34,709,644, total liabilities of \$18,705,065 and net assets of \$16,004,579.

The statements of revenues, expenses, and changes in net assets provide information on the Health System's revenues and expenses. These statements indicate total operating revenues of \$16,839,140 and total operating expenses of \$16,618,297 during fiscal year 2007. The operating income was \$110,421 in 2007, compared to an operating income of \$42,088 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 Health System's revenues and expenses. The reader is encouraged to examine these notes and schedules for additional information.

Long-term Debt

At year-end, the Health System had \$14,972,491 in short-term and long-term debt. The debt was incurred for improvements of the Health System's acute, long-term care, and surgery areas.

Factors Bearing on Financial Future

Palo Alto County Health System continues to work on a significant building renovation project that will update the Acute Care, Long-term Care, Obstetrics, Surgical and Dietary areas. The estimated completion date is early fall of 2008. This renovation will allow for all patients to have private rooms. It will also improve the privacy of our surgical patients with a direct route to and from surgery. A large part of the project also consists of major renovation to the original mechanicals, including heating, ventilation and air conditioning.

Palo Alto County Health System is currently in the process of implementing an electronic medical record in conjunction with Mercy Medical Center – North Iowa and the other regional facilities. This implementation will bring about care transformation by integrating evidence-based practices, best practice design and technology solutions to automate processes and provide decision-support to standardize care. Implementation cost will be significant, but the benefits will be both quality and financial improvement for the future.

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:

Palo Alto County Health System
Attn: Chief Financial Officer
3201 1st Street
Emmetsburg, IA 50536

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
BALANCE SHEETS
JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 4,190,089	\$ 4,975,690
Restricted by bond agreement	436,838	320,223
Receivables		
Patient and resident, net of estimated uncollectibles of \$1,418,000 in 2007 and \$1,143,000 in 2006	2,161,410	2,020,941
Succeeding year property tax receivable	877,132	823,200
Estimated third party-payor settlements	140,000	-
Other	107,001	107,585
Supplies	303,261	280,742
Prepaid expense	121,774	98,952
	<u>8,337,505</u>	<u>8,627,333</u>
ASSETS LIMITED AS TO USE OR RESTRICTED		
Internally designated for capital improvements	2,579,546	4,145,494
Restricted by bond agreement	8,814,351	463,346
	<u>11,393,897</u>	<u>4,608,840</u>
CAPITAL ASSETS		
Land and construction in progress, not being depreciated	4,964,288	421,703
Other capital assets being depreciated	17,483,146	17,731,312
Less accumulated depreciation	(7,811,123)	(7,548,423)
	<u>14,636,311</u>	<u>10,604,592</u>
OTHER ASSETS		
Bond issuance costs, net of accumulated amortization	341,931	159,311
	<u>341,931</u>	<u>159,311</u>
Total assets	<u>\$ 34,709,644</u>	<u>\$ 24,000,076</u>

See notes to financial statements.

	<u>2007</u>	<u>2006</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current maturities of long-term debt	\$ 175,000	\$ 175,000
Accounts payable		
Trade	325,239	610,893
Construction	1,134,356	-
Accrued expenses		
Salaries and wages	272,717	234,978
Paid time-off	416,794	366,387
Interest	309,532	121,019
Payroll taxes and employee benefits	95,409	34,194
Estimated health claims payable	278,295	175,037
Estimated third-party payor settlements	-	733,001
Deferred revenue for succeeding year property tax receivable	877,132	823,200
	<u>3,884,474</u>	<u>3,273,709</u>
Total current liabilities		
OTHER LIABILITIES		
Security deposits	23,100	23,186
LONG-TERM DEBT, net of current maturities	<u>14,797,491</u>	<u>6,073,078</u>
Total liabilities	<u>18,705,065</u>	<u>9,369,973</u>
NET ASSETS		
Invested in capital assets, net of related debt	4,073,291	4,515,825
Restricted		
By bond agreement	9,251,189	783,569
Unrestricted	2,680,099	9,330,709
	<u>16,004,579</u>	<u>14,630,103</u>
Total net assets		
	<u>\$ 34,709,644</u>	<u>\$ 24,000,076</u>
Total liabilities and net assets		

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
BALANCE SHEETS –
PALO ALTO COUNTY HEALTH CARE FOUNDATION
DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 69,220	\$ 19,195
Accrued interest	<u>12,067</u>	<u>12,671</u>
Total current assets	81,287	31,866
NONCURRENT CASH AND INVESTMENTS	1,573,105	1,483,051
CAPITAL ASSETS, NET	<u>42,757</u>	<u>45,292</u>
Total assets	<u>\$ 1,697,149</u>	<u>\$ 1,560,209</u>
 LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Property tax payable	\$ 781	\$ 768
NET ASSETS, unrestricted	<u>1,696,368</u>	<u>1,559,441</u>
Total liabilities and net assets	<u>\$ 1,697,149</u>	<u>\$ 1,560,209</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
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 and resident service revenue (net of provision for bad debts of \$520,296 in 2007 and \$494,332 in 2006)	\$ 15,994,815	\$ 14,384,311
Apartment revenue	366,382	359,709
Other operating revenues	477,943	577,684
Total operating revenues	<u>16,839,140</u>	<u>15,321,704</u>
OPERATING EXPENSES		
Salaries and wages	6,356,774	5,633,501
Employee benefits	2,080,777	1,638,007
Professional fees	2,489,362	2,532,852
Management, legal, and accounting fees	160,848	159,144
Utilities	259,633	258,747
Insurance	210,666	186,193
Supplies and other expenses	3,853,320	3,582,898
Depreciation	903,254	945,633
Interest and amortization	303,663	304,796
Total operating expenses	<u>16,618,297</u>	<u>15,241,771</u>
OPERATING INCOME BEFORE AFFILIATION AGREEMENT	220,843	79,933
AFFILIATION AGREEMENT EXPENSE	<u>(110,422)</u>	<u>(37,845)</u>
OPERATING INCOME	<u>110,421</u>	<u>42,088</u>
NONOPERATING REVENUES (EXPENSES)		
Investment income	403,095	172,446
County tax revenue	846,662	471,512
Noncapital grants and contributions	6,230	17,426
Other nonoperating gains	-	1,004
Gain (loss) on sale of capital assets	8,068	(5,076)
NET NONOPERATING REVENUES	<u>1,264,055</u>	<u>657,312</u>
INCREASE IN NET ASSETS	1,374,476	699,400
NET ASSETS, BEGINNING OF YEAR	<u>14,630,103</u>	<u>13,930,703</u>
NET ASSETS, END OF YEAR	<u>\$ 16,004,579</u>	<u>\$ 14,630,103</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS –
PALO ALTO COUNTY HEALTH CARE FOUNDATION
YEARS ENDED DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
OPERATING REVENUES		
Investment income	\$ 38,681	\$ 60,214
Rental income	6,875	7,500
Contributions	<u>100,969</u>	<u>48,582</u>
Total operating revenues	<u>146,525</u>	<u>116,296</u>
EXPENSES		
Depreciation	2,535	2,535
Property taxes	1,549	768
Other expenses	4,348	446
Contributions to health system	<u>1,166</u>	<u>114,264</u>
Total expenses	<u>9,598</u>	<u>118,013</u>
INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	136,927	(1,717)
NET ASSETS, BEGINNING OF YEAR	<u>1,559,441</u>	<u>1,561,158</u>
NET ASSETS, END OF YEAR	<u>\$ 1,696,368</u>	<u>\$ 1,559,441</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
OPERATING ACTIVITIES		
Receipts of patient and resident service revenue	\$ 15,348,311	\$ 14,539,917
Payments of salaries and wages	(6,268,628)	(5,664,010)
Payments of supplies and other expenses	(8,197,194)	(8,580,306)
Other receipts and payments, net	477,943	577,684
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>1,360,432</u>	<u>873,285</u>
NONCAPITAL FINANCING ACTIVITIES		
Noncapital grants and contribution received	6,230	17,426
County tax revenue received	846,662	471,512
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	<u>852,892</u>	<u>488,938</u>
CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal payments on long-term debt	(175,000)	(170,000)
Proceeds from the issuance of long-term debt	8,891,463	-
Bond issuance and deferred financing costs paid	(191,736)	-
Acquisition of capital assets	(4,973,618)	(853,140)
Interest payments on long-term debt	(393,625)	(292,147)
Net security deposits paid (received)	(86)	5,027
Cash received from insurance proceeds	-	1,004
NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES	<u>3,157,398</u>	<u>(1,309,256)</u>
INVESTING ACTIVITIES		
Purchase of investments	(11,368,392)	(1,145,631)
Sale and transfer of investments	4,552,200	2,383,976
Investment income received	659,869	312,075
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	<u>(6,156,323)</u>	<u>1,550,420</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>(785,601)</u>	<u>1,603,387</u>
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>4,975,690</u>	<u>3,372,303</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 4,190,089</u>	<u>\$ 4,975,690</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during 2007 for interest was \$393,625 and includes \$105,279 of interest that was capitalized as part of the construction project.		

(continued on next page)

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 110,421	\$ 42,088
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	903,254	945,633
Interest and amortization considered capital and related financing activity	303,663	306,213
Provision for bad debts	520,296	494,332
Changes in assets and liabilities		
Patient and resident receivables	(660,765)	(339,453)
Estimated third-party payor settlements receivable	(140,000)	-
Other receivables	584	(36,344)
Supplies	(22,519)	(17,009)
Prepaid expense	(22,822)	(50,706)
Accounts payable	848,702	(183,948)
Accrued expenses	149,361	(28,920)
Estimated health claims payable	103,258	64,037
Estimated third-party payor settlements payable	(733,001)	(322,638)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 1,360,432</u>	<u>\$ 873,285</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
STATEMENTS OF CASH FLOWS –
PALO ALTO COUNTY HEALTH CARE FOUNDATION
YEARS ENDED DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
OPERATING ACTIVITIES		
Change in unrestricted net assets	\$ 136,927	\$ (1,717)
Adjustments to reconcile change in unrestricted net assets to net cash provided by operating activities		
Depreciation	2,535	2,535
Amortization of premiums on investments	23,110	10,019
Changes in assets and liabilities		
Accrued interest receivable	604	2,758
Property tax payable	13	-
	<u>163,189</u>	<u>13,595</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES		
INVESTING ACTIVITIES		
Purchase of investments	(200,000)	(225,232)
Sale of investments	100,000	195,000
Interest capitalized to CDs	(13,164)	(12,088)
	<u>(113,164)</u>	<u>(42,320)</u>
NET CASH USED FOR INVESTING ACTIVITIES		
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	50,025	(28,725)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>19,195</u>	<u>47,920</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 69,220</u>	<u>\$ 19,195</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

NOTE 1 - ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization

Palo Alto County Hospital, d/b/a Palo Alto County Health System, (Health System) consists of a 25-bed acute care hospital and a 22-bed skilled nursing/long-term care facility, located in Emmetsburg, Iowa. It is organized under Chapter 347 of the Code of Iowa. The Health System provides health care services in accordance with a Master Affiliation Agreement discussed further in Note 8. Services are provided to residents of Palo Alto County and surrounding counties in Iowa. The Health System is exempt from income taxes as a political subdivision.

Reporting Entity

For financial reporting purposes, the Health System has included all funds, organizations, account groups, agencies, boards, commissions, and authorities. The Health System has also considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Health System are such that exclusion would cause the Health System's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Health System to impose its will on that organization or (2) the potential for the organization to provide specific benefits to, or impose specific financial burdens on the Health System.

Palo Alto County Health Care Foundation (the Foundation) is a legally separate, tax-exempt component unit of the Health System and has a year end of December 31. The Foundation's financial statements have been included as a discretely presented component unit. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the Health System in support of its operations and programs. The Health System does not appoint a voting majority of the Foundation's Board of Directors or in any way impose its will over the Foundation. However, the Foundation is included as a discretely presented component unit due to the nature and significance of its relationship to the Health System.

Basis of Presentation

The balance sheet displays the Health System'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.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

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

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.

The Health System 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, the Health System 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 estimates.

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.

Patient and Resident Receivables

Patient and resident receivables are uncollateralized customer and third-party payor obligations. Unpaid patient and resident receivables are not charged interest on amounts owed.

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

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

The carrying amount of patient and resident receivables is reduced by a valuation allowance that reflects management's best estimate of amounts that will not be collected from patients, residents, and third-party payors. Management reviews patient and resident 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 and residents 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.

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

Deferred Revenue

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

Supplies

Supplies are stated at lower of average cost or market.

Unamortized Bond Issuance Costs and Expense

Bond issuance costs of \$191,736 from the Series 2006 Hospital Revenue Bonds are being amortized over the life of the bonds using the straight-line method. As of June 30, 2007, accumulated amortization was \$1,916. In addition, bond issuances costs of \$180,011 from the Series 2003 Hospital Revenue Bonds are being amortized over the life of the bonds using the straight-line method. As of June 30, 2007 and 2006, accumulated amortization was \$27,900 and \$20,700, respectively. Total amortization expense of the bond issuance costs for the years ended June 30, 2007 and 2006, were \$9,116 and \$7,200, respectively.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

Capital Assets

Capital asset acquisitions in excess of \$5,000 are capitalized and recorded at cost. Capital assets donated for the Health System'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. Interest expense related to construction projects is capitalized. The estimated useful lives of capital assets are as follows:

Land improvements	8-20 years
Buildings and fixed equipment	5-56 years
Major movable equipment	3-25 years

Compensated Absences

The Health Center employees accumulate a limited amount of earned but unused paid time-off for subsequent use or for payment upon termination, death, or retirement. The cost of paid time-off 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.

Assets Limited As to Use or Restricted

Assets limited as to use include assets set aside by the Board of Trustees for future capital improvements, over which the Board retains control and may, at its discretion, subsequently use for other purposes.

Restricted funds are used to differentiate resources, the use of which is restricted by donors or grantors, from resources of general funds on which donors or grantors place no restriction or which arise as a result of the operations of the Health Center for its stated purposes. Resources set aside for board designated purposes are not considered to be restricted. Contributions are reported in nonoperating revenue. Grants restricted for specific operating purposes are reported as other operating revenues.

Operating Revenues and Expenses

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

Net Patient and Resident Service Revenue

The Health Center has agreements with third-party payors that provide for payments to the Health Center at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs, discounted charges, and per diem payments. Patient and resident service revenue is reported at the estimated net realizable amounts from patients, residents, 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.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

Grants and Contributions

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

Charity Care

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

Advertising Costs

The Health System expenses advertising costs as incurred.

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.

NOTE 2 - CHARITY CARE

The Health System maintains records to identify and monitor the level of charity care it provides. The amounts of charges foregone for services and supplies furnished under its charity care policy during the years ended June 30, 2007 and 2006, were \$153,460 and \$147,743, 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 \$80,383 and \$77,389, respectively.

NOTE 3 - NET PATIENT AND RESIDENT SERVICE REVENUE

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

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

Medicare

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

Medicaid

Hospital

Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid based on a cost reimbursement methodology. The Health System is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Health System and audits thereof by the Medicaid fiscal intermediary. The Health System's Medicaid cost reports have been processed by the Medicaid fiscal intermediary through June 30, 2004.

Nursing Home

Routine services rendered to nursing home residents who are beneficiaries of the Medicaid program are paid according to a schedule of prospectively determined daily rates.

Other Payors

The Health System has also entered into payment agreements with Blue Cross and other commercial insurance carriers. The basis for reimbursement under these agreements may include discounts from established charges and prospectively determined rates.

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 43% and 9%, respectively, of the Health System's net patient and resident service revenue for the year ended 2007, and 55% and 8%, respectively, of the Health System's net patient and resident service revenue for the year ended 2006.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

A summary of patient and resident 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 and resident service revenue	<u>\$ 23,709,625</u>	<u>\$ 21,639,050</u>
Contractual adjustments		
Medicare	4,532,532	4,557,858
Medicaid	673,646	544,641
Other	<u>1,988,336</u>	<u>1,657,908</u>
Total contractual adjustments	<u>7,194,514</u>	<u>6,760,407</u>
Net patient and resident service revenue	16,515,111	14,878,643
Provision for bad debts	<u>(520,296)</u>	<u>(494,332)</u>
Net patient and resident service revenue (net of provision for bad debts)	<u>\$ 15,994,815</u>	<u>\$ 14,384,311</u>

NOTE 4 - DEPOSITS AND INVESTMENTS

The Health System'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.

The Health System is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Board of Trustees; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts, and warrants or improvement certificates of a drainage district.

At June 30, 2007 and 2006, the Health System's carrying amounts of cash and deposits are as follows:

	<u>2007</u>	<u>2006</u>
Cash and cash equivalents	\$ 4,292,654	\$ 5,368,814
Certificates of deposit	303,457	815,693
Money market accounts	8,947,731	40,255
Fixed income securities	<u>2,476,982</u>	<u>3,679,991</u>
	<u>\$ 16,020,824</u>	<u>\$ 9,904,753</u>

Included in the following balance sheet captions:

	<u>2007</u>	<u>2006</u>
Cash and cash equivalents	\$ 4,190,089	\$ 4,975,690
Assets limited as to use or restricted	<u>11,830,735</u>	<u>4,929,063</u>
	<u>\$ 16,020,824</u>	<u>\$ 9,904,753</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

Interest rate risk is the exposure to fair value losses resulting from rising interest rates. The Health System's investment policy limits the investment of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) in instruments that mature within 397 days. Funds not identified as operating funds may be invested in investments with maturities longer than 397 days, but the maturities shall be consistent with the needs and use of the Health System. Maturities are consistent with this policy.

NOTE 5 - CAPITAL ASSETS

Summaries of capital assets at June 30, 2007 and 2006, are as follows:

	Balance June 30, 2006	Additions	Deductions	Transfers	Balance June 30, 2007
Cost					
Land and land improvements	\$ 351,581	\$ 27,885	\$ -	\$ -	\$ 379,466
Buildings	10,677,052	7,073	-	48,459	10,732,584
Fixed equipment	2,016,117	72,200	(77,024)	93,277	2,104,570
Major movable equipment	4,826,928	157,046	(577,085)	-	4,406,889
Construction in progress	281,337	4,684,324	-	(141,736)	4,823,925
	<u>18,153,015</u>	<u>\$4,948,528</u>	<u>\$ (654,109)</u>	<u>\$ -</u>	<u>22,447,434</u>
Accumulated depreciation					
Land improvements	127,889	\$ 17,718	\$ -	\$ -	145,607
Buildings	2,892,901	352,964	-	-	3,245,865
Fixed equipment	1,313,442	79,936	(69,001)	-	1,324,377
Major movable equipment	3,214,191	452,636	(571,553)	-	3,095,274
	<u>7,548,423</u>	<u>\$ 903,254</u>	<u>\$ (640,554)</u>	<u>\$ -</u>	<u>7,811,123</u>
Capital assets, net	<u>\$ 10,604,592</u>				<u>\$ 14,636,311</u>
	Balance June 30, 2005	Additions	Deductions	Transfers	Balance June 30, 2006
Cost					
Land and land improvements	\$ 351,581	\$ -	\$ -	\$ -	\$ 351,581
Buildings	10,661,790	15,262	-	-	10,677,052
Fixed equipment	1,982,256	36,950	(3,089)	-	2,016,117
Major movable equipment	4,632,445	528,857	(334,374)	-	4,826,928
Construction in progress	9,266	272,071	-	-	281,337
	<u>17,637,338</u>	<u>\$ 853,140</u>	<u>\$ (337,463)</u>	<u>\$ -</u>	<u>18,153,015</u>
Accumulated depreciation					
Land improvements	111,117	\$ 16,772	\$ -	\$ -	127,889
Buildings	2,541,650	351,251	-	-	2,892,901
Fixed equipment	1,233,384	82,428	(2,370)	-	1,313,442
Major movable equipment	3,046,826	495,182	(327,817)	-	3,214,191
	<u>6,932,977</u>	<u>\$ 945,633</u>	<u>\$ (330,187)</u>	<u>\$ -</u>	<u>7,548,423</u>
Capital assets, net	<u>\$ 10,704,361</u>				<u>\$ 10,604,592</u>

(continued on next page)

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

Construction in progress at June 30, 2007, consists of costs incurred for a project related to the renovation and addition of space to the acute, long-term care, obstetrics, surgery, and dietary areas. The project is expected to be completed in September 2008. The total cost to complete the project is estimated to be approximately \$12,000,000, of which \$9,000,000 will be funded through tax exempt bond financing. The remaining cost will be funded through hospital operations.

NOTE 6 - LONG-TERM DEBT

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

	Balance June 30, 2006	Additions	Payments (Amortization)	Balance June 30, 2007	Amounts Due Within One Year
Hospital Revenue Bonds, Series 2003	\$ 6,400,000	\$ -	\$ (175,000)	\$ 6,225,000	\$ 175,000
Hospital Revenue Bonds, Series 2006	-	9,000,000	-	9,000,000	-
	6,400,000	9,000,000	(175,000)	15,225,000	175,000
Bond discount	(20,616)	-	932	(19,684)	-
Deferred loss on bond refinancing	(131,306)	-	5,934	(125,372)	-
Bond OID less premium 2006	-	(108,538)	1,085	(107,453)	-
Total long-term debt	<u>\$ 6,248,078</u>	<u>\$ 8,891,462</u>	<u>\$ (167,049)</u>	<u>\$ 14,972,491</u>	<u>\$ 175,000</u>

	Balance June 30, 2005	Additions	Payments (Amortization)	Balance June 30, 2006	Amounts Due Within One Year
Hospital Revenue Bonds, Series 2003	\$ 6,570,000	\$ -	\$ (170,000)	\$ 6,400,000	\$ 175,000
Bond discount	(21,548)	-	932	(20,616)	-
Deferred loss on bond refinancing	(137,240)	-	5,934	(131,306)	-
Total long-term debt	<u>\$ 6,411,212</u>	<u>\$ -</u>	<u>\$ (163,134)</u>	<u>\$ 6,248,078</u>	<u>\$ 175,000</u>

The Hospital Revenue Bonds, Series 2003 were issued in the amount of \$6,735,000 on August 1, 2003. Payments of interest at rates from 1.7% to 5.4% are payable semi-annually on February 1 and August 1, and principal payments are due annually on August 1 through 2029. The bonds are collateralized by the patient and resident revenues of the Health System.

The Hospital Revenue Bonds, Series 2006 were issued in the amount of \$9,000,000 on August 1, 2006. Payments of interest at rates from 4.125% to 5.25% are payable semi-annually on February 1 and August 1, and principal payments are due annually on August 1 through 2036. The bonds are collateralized by the patient and resident revenues of the Health System.

The Health System is subject to certain covenants under the bond agreement regarding the funding of debt service reserve and sinking fund accounts. The Health System was in compliance with these covenants for the years ended June 30, 2007 and 2006.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

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

Year Ending June 30,	Long-term Debt		
	Principal	Interest	Total
2008	\$ 175,000	\$ 740,427	\$ 915,427
2009	180,000	735,187	915,187
2010	270,000	727,517	997,517
2011	275,000	717,281	992,281
2012	290,000	705,957	995,957
2013 to 2017	1,635,000	3,324,648	4,959,648
2018 to 2022	2,065,000	2,879,793	4,944,793
2023 to 2027	2,655,000	2,278,442	4,933,442
2028 to 2032	3,365,000	1,597,919	4,962,919
2033 to 2036	4,315,000	574,641	4,889,641
	<u>\$ 15,225,000</u>	<u>\$ 14,281,812</u>	<u>\$ 29,506,812</u>

The bond resolution of the Series 2003 bonds requires the establishment of the following “Funds”:

SINKING FUND – into which the Health System is required to deposit a monthly sum equal to at least one-sixth of the interest coming due on the bonds on the next interest payment date. In addition, the Health System is required to deposit a monthly sum equal to at least one-twelfth of the principal coming due on the bonds on the next principal date.

DEBT SERVICE RESERVE FUND – into which the Health System was required to deposit an amount equal to the lesser of (i) 100% of the maximum principal and interest due in any fiscal year with respect to the bonds, (ii) 125% of the average annual debt service payment with respect to the bonds, (iii) 10% of the original principal amount of the bonds.

The bond resolution of the Series 2006 bonds requires the establishment of the following “Fund”:

DEBT SERVICE RESERVE FUND – into which the Health System was required to deposit an amount equal to the sum of \$821,323.

A summary of interest cost and investment income on borrowed funds during the year ended June 30, 2007, is as follows:

Interest cost:	
Capitalized as part of construction project	\$ 295,542
Recognized as interest expense	<u>303,663</u>
Total	<u>\$ 599,205</u>
Investment income:	
Capitalized as part of construction project	<u>\$ 320,632</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

NOTE 7 - PENSION AND RETIREMENT BENEFITS

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

Plan members are required to contribute 3.70% of their annual salary and the Health System is required to contribute 5.75% of annual covered payroll for the years ended June 30, 2007, 2006, and 2005. Contribution requirements are established by State statute. The Health System's contribution to IPERS for the years ended June 30, 2007, 2006, and 2005, were \$384,800, \$331,761, and \$301,048, respectively, equal to the required contributions for each year.

NOTE 8 - RELATED ORGANIZATIONS

Master Affiliation Agreement

The Health System has a Master Affiliation Agreement with Mercy Medical Center – North Iowa (MMC-NI) to provide hospital, physician, and other health care services in Palo Alto County and surrounding counties in central Iowa. As a part of this Master Affiliation Agreement, the Health System entered into a Professional Service Agreement with MMC-NI whereby MMC-NI provides professional medical services for the Health System. Amounts paid to MMC-NI for the provision of these services amounted to \$1,431,992 and \$1,700,223 for the years ended June 30, 2007 and 2006, respectively.

Operating gains and losses from the consolidated operation of the Health System and MMC-NI services are shared equally in accordance with the formulas outlined in the Master Affiliation Agreement. Total operating gains to be allocated to MMC-NI amounted to \$110,422 and \$37,845, respectively, for the years ended June 30, 2007 and 2006, for the various services and distributions related to these agreements.

Management Services Agreement

The Health System has a contractual arrangement with MMC-NI under which MMC-NI provides administrative staff, management consultation, and other services to the Health System. The arrangement does not alter the authority or responsibility of the Board of Trustees of the Health System. Expenses for the administrative and management services for the years ended June 30, 2007 and 2006, were \$118,325 and \$111,467, respectively.

Due to and from Affiliated Organization

As of June 30, 2007 and 2006, the Health System's records reflect an amount due to MMC-NI of \$148,388 and \$165,158, respectively, for the various services and distributions related to these agreements.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

NOTE 9 - CONTINGENCIES

Malpractice Insurance

The Health System has 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.

Self-Funded Employee Health Insurance Plan

The Health System has a self-funded employee health insurance plan covering substantially all employees. The plan is responsible to pay all administration expenses and benefits up to the reinsurance limits. Liabilities of \$278,295 and \$175,037 have been established to record the incurred but not reported claims outstanding at June 30, 2007 and 2006, respectively.

Health Care Legislation and Regulation

The health care 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 and resident 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 health care providers. Violation of these laws and regulations could result in expulsion from government health care programs together with imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

Management believes that the Health System 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 regulation is subject to government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

NOTE 10 - RISK MANAGEMENT

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

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2007 AND 2006

NOTE 11 - CONCENTRATION OF CREDIT RISK

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

	<u>2007</u>	<u>2006</u>
Medicare	37.1%	35.8%
Medicaid	5.2%	7.5%
Blue Cross	17.2%	14.6%
Other third-party payors, patients, and residents	<u>40.5%</u>	<u>42.1%</u>
	<u><u>100.0%</u></u>	<u><u>100.0%</u></u>

NOTE 12 - HEALTH SYSTEM COMMITMENT

Palo Alto County Hospital, d/b/a Palo Alto County Health System, entered into an agreement with Mercy Medical Center – North Iowa regarding electronic hospital records for which the Health System’s share will be approximately \$1,500,000.

NOTE 13 - FOUNDATION COMMITMENTS

The Palo Alto County Health Care Foundation has committed to donating \$500,000 over a five year period to the Health System’s construction and renovation project.

The Foundation has also agreed to contribute up to a maximum of \$100,000 to assist the Health Center with construction costs related to a fluoroscopic room.

REQUIRED SUPPLEMENTARY INFORMATION

**PALO ALTO COUNTY HOSPITAL
d/b/a
PALO ALTO COUNTY HEALTH SYSTEM**

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
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	Amended Budget	Variance Favorable (Unfavorable)
Estimated amount to be raised by taxation	\$ 846,662	\$ -	\$ 846,662	\$ 845,787	\$ 875
Estimated other revenues/receipts	<u>17,256,533</u>	<u>8,127,283</u>	<u>25,383,816</u>	<u>17,266,641</u>	<u>8,117,175</u>
	18,103,195	8,127,283	26,230,478	18,112,428	8,118,050
Expenses/disbursements	<u>16,728,719</u>	<u>3,385,688</u>	<u>20,114,407</u>	<u>22,310,000</u>	<u>2,195,593</u>
Net	1,374,476	4,741,595	6,116,071	(4,197,572)	<u>\$ 10,313,643</u>
Balance beginning of year	<u>14,630,103</u>	<u>(4,725,350)</u>	<u>9,904,753</u>	<u>10,916,190</u>	
Balance end of year	<u>\$16,004,579</u>	<u>\$ 16,245</u>	<u>\$ 16,020,824</u>	<u>\$ 6,718,618</u>	

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTE 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 the Health System 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 the Health Center 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. The budget was amended during the year ended June 30, 2007.

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

OTHER SUPPLEMENTARY INFORMATION

**PALO ALTO COUNTY HOSPITAL
d/b/a
PALO ALTO COUNTY HEALTH SYSTEM**



CPAs & BUSINESS ADVISORS

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

The Board of Trustees
Palo Alto County Hospital
d/b/a Palo Alto County Health System
Emmetsburg, 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 Comparative Statistics on page 37 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
September 14, 2007

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PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF NET PATIENT AND RESIDENT SERVICE REVENUE
YEARS ENDED JUNE 30, 2007 AND 2006

	TOTAL	
	2007	2006
PATIENT AND RESIDENT SERVICE REVENUE		
Medical and surgical	\$ 1,274,055	\$ 1,456,054
Intensive care unit	4,222	9,498
Nursery	98,915	71,424
Long-term care	721,988	737,589
Total	2,099,180	2,274,565
OTHER PROFESSIONAL SERVICES		
Operating room	2,208,838	1,859,893
Labor and delivery room	71,512	48,699
Anesthesiology	597,431	514,200
Radiology	3,766,160	3,041,475
Laboratory	2,699,836	2,722,058
Respiratory therapy	906,251	918,098
Physical therapy	794,122	742,313
Audiology	29,485	23,133
Occupational therapy	180,060	178,574
Speech therapy	8,662	5,111
Electrocardiography	509,887	459,556
Medical and surgical supplies	460,563	420,786
Pharmacy	1,628,678	1,498,154
Graettinger Clinic	454,365	463,498
Emmetsburg Clinic	3,528,567	3,305,641
West Bend Clinic	737,556	677,151
Emergency room	1,865,567	1,577,537
Ambulance	534,953	415,536
Home health	515,249	450,694
Hospice	266,163	190,121
Total	21,763,905	19,512,228
Total	23,863,085	21,786,793
Charity care	(153,460)	(147,743)
Total patient and resident service revenue	23,709,625	21,639,050
Adjustments to patient and resident service revenue	(7,714,810)	(7,254,739)
NET PATIENT AND RESIDENT SERVICE REVENUE	\$ 15,994,815	\$ 14,384,311

INPATIENT		OUTPATIENT	
2007	2006	2007	2006
\$ 1,274,055	\$ 1,456,054	\$ -	\$ -
4,222	9,498	-	-
98,915	71,424	-	-
721,988	737,589	-	-
2,099,180	2,274,565	-	-
265,787	346,613	1,943,051	1,513,280
71,512	48,699	-	-
67,792	83,673	529,639	430,527
276,264	340,496	3,489,896	2,700,979
470,820	581,034	2,229,016	2,141,024
640,735	726,102	265,516	191,996
163,001	172,787	631,121	569,526
-	-	29,485	23,133
51,076	55,219	128,984	123,355
5,142	2,974	3,520	2,137
33,285	37,079	476,602	422,477
80,683	119,070	379,880	301,716
463,978	497,702	1,164,700	1,000,452
-	-	454,365	463,498
-	-	3,528,567	3,305,641
-	-	737,556	677,151
81,952	96,683	1,783,615	1,480,854
-	-	534,953	415,536
-	-	515,249	450,694
13,667	27,077	252,496	163,044
2,685,694	3,135,208	19,078,211	16,377,020
\$ 4,784,874	\$ 5,409,773	\$ 19,078,211	\$ 16,377,020

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF OTHER OPERATING REVENUES
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
OTHER OPERATING REVENUES		
Meals sold	\$ 59,832	\$ 68,166
Lifeline	44,610	45,537
Rural transition grant	87,312	65,643
Home health support	275,117	391,675
Miscellaneous	<u>11,072</u>	<u>6,663</u>
 TOTAL OTHER OPERATING REVENUES	 <u><u>\$ 477,943</u></u>	 <u><u>\$ 577,684</u></u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
MEDICAL AND SURGICAL		
Salaries and wages	\$ 691,159	\$ 711,480
Supplies and other	103,367	92,808
	<u>794,526</u>	<u>804,288</u>
INTENSIVE CARE UNIT		
Salaries and wages	4,369	3,975
Supplies and other	1,961	1,273
	<u>6,330</u>	<u>5,248</u>
NURSERY		
Salaries and wages	55,389	32,239
Supplies and other	17,397	4,936
	<u>72,786</u>	<u>37,175</u>
LONG-TERM CARE		
Salaries and wages	505,220	472,878
Supplies and other	49,942	53,690
	<u>555,162</u>	<u>526,568</u>
NURSING ADMINISTRATION		
Salaries and wages	140,734	128,253
Supplies and other	7,930	13,272
	<u>148,664</u>	<u>141,525</u>
OPERATING ROOM		
Salaries and wages	291,967	262,800
Supplies and other	181,009	154,653
	<u>472,976</u>	<u>417,453</u>
LABOR AND DELIVERY ROOM		
Salaries and wages	21,551	14,783
Supplies and other	6,380	4,337
	<u>27,931</u>	<u>19,120</u>
ANESTHESIOLOGY		
Supplies and other	268,801	242,750
RADIOLOGY		
Salaries and wages	334,763	264,656
Supplies and other	606,674	387,821
	<u>941,437</u>	<u>652,477</u>
LABORATORY		
Salaries and wages	281,442	283,801
Supplies and other	474,891	440,719
	<u>756,333</u>	<u>724,520</u>
RESPIRATORY THERAPY		
Salaries and wages	18,772	16,906
Supplies and other	45,964	49,306
	<u>64,736</u>	<u>66,212</u>

(continued on next page)

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
PHYSICAL THERAPY		
Salaries and wages	\$ 262,469	\$ 228,528
Supplies and other	41,563	35,256
	<u>304,032</u>	<u>263,784</u>
AUDIOLOGY		
Supplies and other	<u>9,152</u>	<u>6,508</u>
OCCUPATIONAL THERAPY		
Salaries and wages	98,459	97,460
Supplies and other	37,703	46,071
	<u>136,162</u>	<u>143,531</u>
SPEECH THERAPY		
Supplies and other	<u>6,891</u>	<u>5,974</u>
ELECTROCARDIOGRAPHY		
Salaries and wages	94,446	86,488
Supplies and other	64,319	73,956
	<u>158,765</u>	<u>160,444</u>
MEDICAL AND SURGICAL SUPPLIES		
Salaries and wages	28,721	19,675
Supplies and other	261,730	181,877
	<u>290,451</u>	<u>201,552</u>
PHARMACY		
Supplies and other	<u>436,580</u>	<u>390,378</u>
GRAETTINGER CLINIC		
Salaries and wages	192,016	172,420
Supplies and other	129,113	145,342
	<u>321,129</u>	<u>317,762</u>
EMMETSBURG CLINIC		
Salaries and wages	714,459	566,854
Supplies and other	1,575,282	1,728,721
	<u>2,289,741</u>	<u>2,295,575</u>
WEST BEND CLINIC		
Salaries and wages	237,752	204,170
Supplies and other	261,100	273,649
	<u>498,852</u>	<u>477,819</u>
EMERGENCY ROOM		
Salaries and wages	361,048	318,742
Supplies and other	484,840	426,745
	<u>845,888</u>	<u>745,487</u>
AMBULANCE		
Salaries and wages	179,213	175,990
Supplies and other	63,697	67,145
	<u>242,910</u>	<u>243,135</u>

(continued on next page)

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
HOME HEALTH		
Salaries and wages	\$ 426,013	\$ 368,154
Supplies and other	187,744	226,271
	<u>613,757</u>	<u>594,425</u>
HOSPICE		
Salaries and wages	48,438	44,462
Supplies and other	47,793	36,292
	<u>96,231</u>	<u>80,754</u>
MEDICAL RECORDS		
Salaries and wages	176,921	162,436
Supplies and other	33,864	38,156
	<u>210,785</u>	<u>200,592</u>
DIETARY		
Salaries and wages	258,327	228,838
Supplies and other	144,315	149,348
	<u>402,642</u>	<u>378,186</u>
OPERATION OF PLANT		
Salaries and wages	203,017	181,695
Supplies and other	292,650	345,886
	<u>495,667</u>	<u>527,581</u>
HOUSEKEEPING		
Salaries and wages	132,557	119,944
Supplies and other	34,523	18,748
	<u>167,080</u>	<u>138,692</u>
LAUNDRY		
Salaries and wages	21,585	15,145
Supplies and other	891	890
	<u>22,476</u>	<u>16,035</u>
BLOOD		
Salaries and wages	5,560	3,447
Supplies and other	67,072	79,641
	<u>72,632</u>	<u>83,088</u>
ADMINISTRATIVE SERVICES		
Salaries and wages	532,134	414,077
Supplies and other	936,552	876,632
	<u>1,468,686</u>	<u>1,290,709</u>
DIABETIC EDUCATION		
Salaries and wages	8,538	7,484
APARTMENTS		
Salaries and wages	29,735	25,721
Supplies and other	92,139	120,783
	<u>121,874</u>	<u>146,504</u>

(continued on next page)

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
UNASSIGNED EXPENSES		
Depreciation	\$ 903,254	\$ 945,633
Interest and amortization	303,663	304,796
Employee benefits	<u>2,080,777</u>	<u>1,638,007</u>
	<u>3,287,694</u>	<u>2,888,436</u>
 TOTAL OPERATING EXPENSES	 <u><u>\$ 16,618,297</u></u>	 <u><u>\$ 15,241,771</u></u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF PATIENT AND RESIDENT RECEIVABLES
AND ALLOWANCE FOR DOUBTFUL ACCOUNTS
JUNE 30, 2007 AND 2006

ANALYSIS OF AGING

Age of Accounts (Days Since Discharge)	2007		2006	
	Amount	Percent to Total	Amount	Percent to Total
30 days or less	\$ 2,055,427	57.42%	\$ 1,660,719	52.48%
31 to 60 days	602,811	16.84%	713,743	22.56%
61 to 90 days	182,561	5.10%	190,174	6.01%
91 days and over	738,838	20.64%	599,560	18.95%
	<u>3,579,637</u>	<u>100.00%</u>	<u>3,164,196</u>	<u>100.00%</u>
Less: Allowance for doubtful accounts	477,045		421,367	
Allowance for contractual adjustments	<u>941,182</u>		<u>721,888</u>	
Net	<u>\$ 2,161,410</u>		<u>\$ 2,020,941</u>	
Net patient and resident service revenue per calendar day (net of bad debts)	<u>\$ 43,821</u>		<u>\$ 39,409</u>	
Days of net revenue in net accounts receivable at year end	<u>49</u>		<u>51</u>	

ANALYSIS OF ALLOWANCE FOR DOUBTFUL ACCOUNTS

	2007		2006	
	Amount	Percent of Net Patient and Resident Service Revenue	Amount	Percent of Net Patient and Resident Service Revenue
Beginning balance	\$ 421,367		\$ 355,010	
Add:				
Provision for bad debts	520,296	3.25%	494,332	3.44%
Recoveries previously written off	264,961	1.66%	264,961	1.84%
	<u>785,257</u>		<u>759,293</u>	
Less:				
Accounts written off	<u>(729,579)</u>	4.56%	<u>(692,936)</u>	4.82%
Ending balance	<u>\$ 477,045</u>		<u>\$ 421,367</u>	

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF SUPPLIES AND PREPAID EXPENSES
JUNE 30, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
SUPPLIES		
Pharmacy	\$ 100,782	\$ 108,385
General	48,071	38,476
Dietary	6,532	8,329
Other	<u>147,876</u>	<u>125,552</u>
Total supplies	<u>\$ 303,261</u>	<u>\$ 280,742</u>
 PREPAID EXPENSE		
Prepaid insurance	\$ 53,275	\$ 52,846
Prepaid other	<u>68,499</u>	<u>46,106</u>
Total prepaid expense	<u>\$ 121,774</u>	<u>\$ 98,952</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF COMPARATIVE STATISTICS
YEARS ENDED JUNE 30, 2007 AND 2006 (UNAUDITED)

	<u>2007</u>	<u>2006</u>
PATIENT DAYS		
Acute	1,333	1,890
Long-term care	6,763	7,246
Swing-bed	862	829
Nursery	254	190
Totals	<u>9,212</u>	<u>10,155</u>
ADMISSIONS		
Acute	513	677
Swing-bed	127	146
Long-term care	11	21
Totals	<u>651</u>	<u>844</u>
DISCHARGES		
Acute	516	676
Swing-bed	125	147
Long-term care	14	21
Totals	<u>655</u>	<u>844</u>
ACUTE AVERAGE LENGTH OF STAY	<u>2.6</u>	<u>2.8</u>
SWING-BED AVERAGE LENGTH OF STAY	<u>6.9</u>	<u>5.6</u>
ACUTE BEDS	<u>25</u>	<u>25</u>
LONG-TERM CARE BEDS	<u>22</u>	<u>22</u>
PERCENTAGE OF OCCUPANCY		
Acute and swing-bed (based on 25 beds)	24.1%	29.8%
Long-term care (based on 22 beds)	84.2%	90.2%
OUTPATIENT VISITS	<u>22,069</u>	<u>21,269</u>
CLINIC VISITS		
Graettinger	<u>4,170</u>	<u>4,780</u>
Emmetsburg	<u>27,601</u>	<u>27,962</u>
West Bend	<u>6,282</u>	<u>6,275</u>



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
Palo Alto County Hospital
d/b/a Palo Alto County Health System
Emmetsburg, Iowa

We have audited the accompanying balance sheets of Palo Alto County Hospital, d/b/a Palo Alto County Health System (Health System), as of June 30, 2007 and 2006, and its discretely presented component unit as of December 31, 2006 and 2005, 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 September 14, 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 the Health System'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 the Health System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Health System's internal control over financial reporting.

Our consideration of the 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 considered 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 the Health System'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 a misstatement of the Health System's financial statements that is more than inconsequential will not be prevented or detected by the Health System'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 the Health System's internal control.

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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, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of Palo Alto County Hospital, d/b/a Palo Alto County Health System, 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 Health System'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 the Health System and are reported in Part II of the accompanying Schedule of Findings. 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.

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

We also noted a certain additional matter that we reported to management of the Health System in a separate letter dated September 14, 2007.

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

We would like to acknowledge the many courtesies and assistance extended to us by personnel of Palo Alto County Hospital, d/b/a Palo Alto County Health System, 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 "Erik Sully LLP". The signature is written in a cursive, flowing style.

Dubuque, Iowa
September 14, 2007

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
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, the Health System should continually review its internal control procedures, other compensating controls and monitoring procedures to obtain the maximum internal control possible under the circumstances. Furthermore, the Health System 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 – The Health System does not have an internal control system designed to provide for the preparation of financial statements prepared in accordance with generally accepted accounting principles being audited. 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 in accordance with generally accepted accounting principles, including all necessary disclosures, can be considered costly and ineffective. However, the Health System's management and those charged with governance 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 the cost or other considerations.

Conclusion – Response accepted.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
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 Health System money for travel expenses of spouses of Health System officials and/or employees were noted.
- II-D-07 Business Transactions – We noted no material business transactions between the Health System and Health System 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 Chapter 12B and Chapter 12C of the Code of Iowa and the Health System’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...” The Health System did publish a schedule of bills allowed and a schedule of salaries paid as required by the Code of Iowa.



CPAs & BUSINESS ADVISORS

The Board of Trustees
Palo Alto County Hospital d/b/a Palo Alto County Health System
Emmetsburg, Iowa

We have audited the financial statements of Palo Alto County Hospital d/b/a Palo Alto County Health System (Health System) for the year ended June 30, 2007, and have issued our report thereon dated September 14, 2007. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards 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 U.S. generally accepted accounting principles. 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 the Health System. 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 the Health System'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 the Health System 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 the Health System 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.

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, the amounts either owed to or receivable from third-party payors, and the liability for self-insured employee medical insurance for claims incurred but not reported at year-end.

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Management's estimate of the collectibility of patient receivables is based on historical trends for uncollectible accounts and contractual adjustments. The estimate for the claims incurred but not reported at year-end related to the Health System's self-insured employee health plan is based on historical trends. 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 the Health System's financial reporting process (that is, cause future financial statements to be materially misstated). All of the adjustments we proposed were posted by the Health System.

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

Increase in net assets prior to audit adjustments	\$ 1,281,520
To adjust third-party payor settlements	173,006
To adjust income split agreement payable to Mercy	<u>(80,050)</u>
 Increase in net assets as reported	 <u>\$ 1,374,476</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 the Health System'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 the Health System'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 significant difficulties in dealing with management in performing and completing our audit.

Other Comment

We have included an additional comment regarding the Health System's operations.

This information is intended solely for the use of the officials, employees, and constituents of Palo Alto County Hospital d/b/a Palo Alto County Health System 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 Palo Alto County Hospital d/b/a Palo Alto County Health System.

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

Dubuque, Iowa
September 14, 2007

xc: Mr. Thomas J. Lee

**PALO ALTO COUNTY HOSPITAL d/b/a
PALO ALTO COUNTY HEALTH SYSTEM**

**YEAR ENDED JUNE 30, 2007
OTHER COMMENT**

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.

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 a significant impact on the Health System's audit.