

FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

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

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

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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
Dawn Schmidt	Member	December 31, 2010
Tammy Naig	Member	December 31, 2012
Kris Ausborn	Member	December 31, 2008
Dean Newlon	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, 2008 and 2007, and its discretely presented component unit, Palo Alto County Health Care Foundation, as of December 31, 2007 and 2006, 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, 2008 and 2007, and the financial statements for its discretely presented component unit as of December 31, 2007 and 2006, 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 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.

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In accordance with *Government Auditing Standards*, we have also issued our report dated September 11, 2008, 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 audits.

Management's Discussion and Analysis on pages 4 and 5 and the Budgetary Comparison Information on pages 27 and 28 are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion on it.

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

Dubuque, Iowa
September 11, 2008

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, 2008. 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 \$1,125,236 or 3.2%. This increase represents investments in capital equipment and buildings.
- The Health System's assets exceeded liabilities by \$17,286,824 at June 30, 2008.
- During the year, the Health System's total operating revenues increased 5.7% to \$17,803,892, while the operating expenses increased 6.8% to \$17,754,548. The Health System had income from operations of \$24,672, which is 0.1% of total operating revenues.
- The Health System made capital equipment and building investments totaling \$5,337,264 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, 2008, reports total assets of \$35,834,880, total liabilities of \$18,548,056 and net assets of \$17,286,824.

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 \$17,803,892 and total operating expenses of \$17,754,548 during fiscal year 2008. The operating income was \$24,672 in 2008, compared to an operating income of \$110,421 in 2007.

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 \$14,809,062 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, Specialty Clinic, and Business Office areas. The estimated completion date is August of 2009. 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. There will also be additional Specialty Clinic space renovated for visiting Specialist, and the Business Office will be remodeled to improve patient privacy and allow for additional staff to accommodate the return of the Family Practice Clinic's billing. 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, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 5,317,652	\$ 4,190,089
Restricted under bond agreement - Note 4	450,660	436,838
Receivables		
Patient and resident, net of estimated uncollectibles of \$1,737,000 in 2008 and \$1,418,000 in 2007	2,328,884	2,161,410
Estimated third-party payor settlements	380,000	140,000
Succeeding year property tax	956,799	877,132
Other	119,522	107,001
Supplies	305,096	303,261
Prepaid expense	115,713	121,774
Total current assets	<u>9,974,326</u>	<u>8,337,505</u>
ASSETS LIMITED AS TO USE OR RESTRICTED - Note 4		
Internally designated for capital improvements	2,689,090	2,579,546
Restricted under bond agreement	3,889,617	8,814,351
Total assets limited as to use or restricted	<u>6,578,707</u>	<u>11,393,897</u>
LAND, BUILDINGS, AND EQUIPMENT, net - Note 5	<u>18,955,427</u>	<u>14,636,311</u>
OTHER ASSETS		
Bond issuance costs, net of accumulated amortization	<u>326,420</u>	<u>341,931</u>
Total assets	<u>\$ 35,834,880</u>	<u>\$ 34,709,644</u>

See notes to financial statements.

	<u>2008</u>	<u>2007</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current maturities of long-term debt - Note 7	\$ 180,000	\$ 175,000
Accounts payable		
Trade	687,562	325,239
Construction	462,587	1,134,356
Accrued expenses		
Salaries and wages	335,611	272,717
Paid time-off	440,475	416,794
Interest	307,491	309,532
Payroll taxes and employee benefits	160,389	95,409
Estimated health claims payable	362,900	278,295
Deferred revenue for succeeding year property tax receivable	<u>956,799</u>	<u>877,132</u>
Total current liabilities	3,893,814	3,884,474
OTHER LIABILITIES		
Security deposits	25,180	23,100
LONG-TERM DEBT, less current maturities - Note 7	<u>14,629,062</u>	<u>14,797,491</u>
Total liabilities	<u>18,548,056</u>	<u>18,705,065</u>
NET ASSETS		
Invested in capital assets, net of related debt	4,472,785	4,073,291
Restricted under bond agreement	4,340,277	9,251,189
Unrestricted	<u>8,473,762</u>	<u>2,680,099</u>
Total net assets	<u>17,286,824</u>	<u>16,004,579</u>
Total liabilities and net assets	<u>\$ 35,834,880</u>	<u>\$ 34,709,644</u>

PALO ALTO COUNTY HEALTH CARE FOUNDATION
BALANCE SHEETS
DECEMBER 31, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 209,369	\$ 69,220
Accrued interest receivable	<u>10,920</u>	<u>12,067</u>
Total current assets	220,289	81,287
NONCURRENT CASH AND INVESTMENTS	1,624,967	1,573,105
LAND, BUILDINGS, AND EQUIPMENT, NET	<u>40,222</u>	<u>42,757</u>
Total assets	<u>\$ 1,885,478</u>	<u>\$ 1,697,149</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Property tax payable	\$ 758	\$ 781
NET ASSETS, unrestricted	<u>1,884,720</u>	<u>1,696,368</u>
Total liabilities and net assets	<u>\$ 1,885,478</u>	<u>\$ 1,697,149</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, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
OPERATING REVENUES		
Net patient and resident service revenue (net of provision for bad debts of \$595,913 in 2008 and \$520,296 in 2007) - Notes 2 and 3	\$ 16,936,080	\$ 15,994,815
Apartment revenue	365,024	366,382
Other operating revenues	<u>502,788</u>	<u>477,943</u>
TOTAL OPERATING REVENUES	<u>17,803,892</u>	<u>16,839,140</u>
OPERATING EXPENSES		
Salaries and wages	6,658,765	6,356,774
Employee benefits	2,062,173	2,080,777
Supplies and other expenses	7,628,106	6,973,829
Depreciation	999,707	903,254
Interest and amortization	<u>405,797</u>	<u>303,663</u>
TOTAL OPERATING EXPENSES	<u>17,754,548</u>	<u>16,618,297</u>
OPERATING INCOME BEFORE AFFILIATION AGREEMENT	49,344	220,843
AFFILIATION AGREEMENT EXPENSE	<u>(24,672)</u>	<u>(110,422)</u>
OPERATING INCOME	<u>24,672</u>	<u>110,421</u>
NONOPERATING REVENUES (EXPENSES)		
Investment income	273,506	403,095
County tax revenue	875,888	846,662
Noncapital grants and contributions	15,682	6,230
Gain (loss) on sale of property and equipment	<u>(7,503)</u>	<u>8,068</u>
NET NONOPERATING REVENUES	<u>1,157,573</u>	<u>1,264,055</u>
REVENUES IN EXCESS OF EXPENSES BEFORE CAPITAL CONTRIBUTIONS AND GRANTS	1,182,245	1,374,476
Capital contributions and grants	<u>100,000</u>	<u>-</u>
INCREASE IN NET ASSETS	1,282,245	1,374,476
NET ASSETS BEGINNING OF YEAR	<u>16,004,579</u>	<u>14,630,103</u>
NET ASSETS END OF YEAR	<u>\$ 17,286,824</u>	<u>\$ 16,004,579</u>

See notes to financial statements.

PALO ALTO COUNTY HEALTH CARE FOUNDATION
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
OPERATING REVENUES		
Investment Income	\$ 78,205	\$ 38,681
Rental income	7,500	6,875
Contributions	<u>244,198</u>	<u>100,969</u>
 TOTAL OPERATING REVENUES	 <u>329,903</u>	 <u>146,525</u>
EXPENSES		
Depreciation	2,535	2,535
Property taxes	1,516	1,549
Supplies and other expenses	462	4,348
Contributions to health system	<u>137,038</u>	<u>1,166</u>
 TOTAL EXPENSES	 <u>141,551</u>	 <u>9,598</u>
 INCREASE IN UNRESTRICTED NET ASSETS	 188,352	 136,927
 NET ASSETS BEGINNING OF YEAR	 <u>1,696,368</u>	 <u>1,559,441</u>
 NET ASSETS END OF YEAR	 <u>\$ 1,884,720</u>	 <u>\$ 1,696,368</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts of patient and resident service revenue	\$ 16,881,109	\$ 15,348,311
Payments of salaries and wages	(6,572,190)	(6,268,628)
Payments of supplies and other expenses	(9,870,586)	(8,197,194)
Other receipts and payments, net	<u>502,788</u>	<u>477,943</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>941,121</u>	<u>1,360,432</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Noncapital grants and contributions received	15,682	6,230
County tax revenue received	<u>875,888</u>	<u>846,662</u>
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	<u>891,570</u>	<u>852,892</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Principal payments on long-term debt	(175,000)	(175,000)
Proceeds from issuance of long-term debt	-	8,891,463
Bond issuance and deferred financing costs paid	-	(191,736)
Purchase of property and equipment	(5,139,656)	(4,973,618)
Proceeds from sale of property and equipment	5,500	-
Interest payments on long-term debt	(740,426)	(393,625)
Net security deposits paid (received)	2,080	(86)
Capital contributions and grants	<u>100,000</u>	<u>-</u>
NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(5,947,502)</u>	<u>3,157,398</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	-	(11,368,392)
Sale and transfer of investments	4,822,616	4,552,200
Investment income	<u>419,758</u>	<u>659,869</u>
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES	<u>5,242,374</u>	<u>(6,156,323)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	1,127,563	(785,601)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>4,190,089</u>	<u>4,975,690</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 5,317,652</u>	<u>\$ 4,190,089</u>

(continued on next page)

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
RECONCILIATION OF OPERATING INCOME TO		
NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 24,672	\$ 110,421
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	999,707	903,254
Interest and amortization expense considered capital and related financing activity	405,797	303,663
Provision for bad debts	595,913	520,296
Changes in assets and liabilities		
Patient and resident receivables	(763,387)	(660,765)
Estimated third-party payor settlements receivable	(240,000)	(140,000)
Other receivables	(12,521)	584
Supplies	(1,835)	(22,519)
Prepaid expense	6,061	(22,822)
Accounts payable	(309,446)	848,702
Accrued expenses	151,555	149,361
Estimated health claims payable	84,605	103,258
Estimated third-party payor settlements payable	<u>-</u>	<u>(733,001)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 941,121</u>	<u>\$ 1,360,432</u>

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash paid for interest (net of amount capitalized) in 2008 and 2007 was \$740,426 and \$393,625, respectively.

PALO ALTO COUNTY HEALTH CARE FOUNDATION
STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in unrestricted net assets	\$ 188,352	\$ 136,927
Adjustments to reconcile increase in unrestricted net assets to net cash provided by operating activities		
Depreciation	2,535	2,535
Amortization of premiums on investments	3,090	23,110
Changes in assets and liabilities		
Accrued interest receivable	1,147	604
Property tax payable	<u>(23)</u>	<u>13</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>195,101</u>	<u>163,189</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(150,000)	(200,000)
Sale of investments	125,000	100,000
Interest capitalized to CDs	<u>(29,952)</u>	<u>(13,164)</u>
NET CASH USED FOR INVESTING ACTIVITIES	<u>(54,952)</u>	<u>(113,164)</u>
INCREASE IN CASH AND CASH EQUIVALENTS	140,149	50,025
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>69,220</u>	<u>19,195</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u><u>\$ 209,369</u></u>	<u><u>\$ 69,220</u></u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

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 9. 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, 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.

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

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

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 patient 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.

The carrying amount of patient and resident receivables is reduced by a valuation allowance that reflects management's 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.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

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, 2008 and 2007, accumulated amortization was \$10,227, and \$1,916, respectively. 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, 2008 and 2007, accumulated amortization was \$35,100 and \$27,900, respectively. Total amortization expense of the bond issuance costs for the years ended June 30, 2008 and 2007, was \$15,511 and \$9,116, respectively.

Land, Buildings, and Equipment

Land, buildings, and equipment acquisitions in excess of \$5,000 are capitalized and are recorded at cost. Land, buildings, and equipment 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 class of depreciable asset and is computed using the straight-line method. Interest cost incurred on borrowed funds during the period of construction of land, buildings, and equipment is capitalized as a component of the cost of acquiring those assets. The estimated useful lives of property and equipment are as follows:

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

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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

Compensated Absences

The Health System 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, 2008.

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 and assets which are restricted by bond agreements.

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 System 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 System has agreements with third-party payors that provide for payments to the Health System 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.

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.

Investment Income

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

PALO ALTO COUNTY HOSPITAL
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

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 System 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.

Reclassification

Certain items from the 2007 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, 2008 and 2007, were \$203,256 and \$153,460, respectively. The estimated costs of the charges foregone, based on an overall cost to charge ratio calculation, for the years ended June 30, 2008 and 2007 were \$140,000, and \$103,000, 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:

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, 2006. 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.

PALO ALTO COUNTY HOSPITAL
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

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, 2005.

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.

Revenue from the Medicare and Medicaid programs accounted for approximately 51% and 8%, respectively, of the Health System's net patient and resident service revenue for the year ended June 30, 2008, and 43% and 9%, respectively, of the Health System's net patient and resident service revenue for the year ended June 30, 2007. The 2008 net patient and resident service revenue increased approximately \$160,000 due to prior-year retroactive adjustments in excess of amounts previously estimated.

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.

A summary of patient and resident service revenue, contractual adjustments, and provision for bad debts for the years ended June 30, 2008 and 2007, is as follows:

	<u>2008</u>	<u>2007</u>
Total patient and resident service revenue	<u>\$ 24,767,745</u>	<u>\$ 23,709,625</u>
Contractual adjustments:		
Medicare	(4,252,119)	(4,532,532)
Medicaid	(670,454)	(673,646)
Other	<u>(2,313,179)</u>	<u>(1,988,336)</u>
Total contractual adjustments	<u>(7,235,752)</u>	<u>(7,194,514)</u>
Net patient and resident service revenue	17,531,993	16,515,111
Provision for bad debts	<u>(595,913)</u>	<u>(520,296)</u>
Net patient and resident service revenue (net of provision for bad debts)	<u>\$ 16,936,080</u>	<u>\$ 15,994,815</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 4 - DEPOSITS AND INVESTMENTS

The Health System's deposits in banks at June 30, 2008 and 2007, 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, 2008 and 2007, the Health System's carrying amounts of deposits and investments are as follows:

	<u>2008</u>	<u>2007</u>
Checking and savings accounts	\$ 5,333,309	\$ 4,292,654
Certificates of deposit	317,211	303,457
Money market accounts	4,023,066	8,947,731
Fixed income securities	<u>2,673,433</u>	<u>2,476,982</u>
Total deposits	<u>\$ 12,347,019</u>	<u>\$ 16,020,824</u>
Included in the following balance sheet captions:		
Cash and cash equivalents	\$ 5,317,652	\$ 4,190,089
Assets limited as to use or restricted	<u>7,029,367</u>	<u>11,830,735</u>
	<u>\$ 12,347,019</u>	<u>\$ 16,020,824</u>

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.

PALO ALTO COUNTY HOSPITAL
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 5 - LAND, BUILDINGS, AND EQUIPMENT

Summaries of land, buildings, and equipment at June 30, 2008 and 2007, are as follows:

	June 30, 2007				June 30, 2008
	Balance	Additions	Deductions	Transfers	Balance
Cost					
Land and land improvements	\$ 379,466	\$ -	\$ -	\$ -	\$ 379,466
Building	10,732,584	14,924	-	3,472,801	14,220,309
Fixed equipment	2,104,570	-	(10,120)	-	2,094,450
Major movable equipment	4,406,889	699,290	(248,325)	41,243	4,899,097
Construction in progress	4,823,925	4,623,050	-	(3,514,044)	5,932,931
	<u>22,447,434</u>	<u>\$ 5,337,264</u>	<u>\$ (258,445)</u>	<u>\$ -</u>	<u>27,526,253</u>
Accumulated depreciation					
Land improvements	145,607	\$ 18,088	\$ -	\$ -	163,695
Building	3,245,865	457,735	-	-	3,703,600
Fixed equipment	1,324,377	81,562	(10,120)	-	1,395,819
Major movable equipment	3,095,274	442,321	(229,883)	-	3,307,712
	<u>7,811,123</u>	<u>\$ 999,706</u>	<u>\$ (240,003)</u>	<u>\$ -</u>	<u>8,570,826</u>
Land, buildings, and equipment, net	<u>\$ 14,636,311</u>				<u>\$ 18,955,427</u>
	June 30, 2006				June 30, 2007
	Balance	Additions	Deductions	Transfers	Balance
Cost					
Land and land improvements	\$ 351,581	\$ 27,885	\$ -	\$ -	\$ 379,466
Building	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
Building	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>
Land, buildings, and equipment, net	<u>\$ 10,604,592</u>				<u>\$ 14,636,311</u>

Projects related to the acute care/OB remodel and dietary addition/renovation were completed and capitalized at approximately \$3,400,000 during fiscal year 2008.

(continued on next page)

PALO ALTO COUNTY HOSPITAL
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

Construction in progress at June 30, 2008, consists of the remaining costs incurred for projects related to the renovation and addition of space to the acute, long-term care, and surgery areas. These projects are expected to be completed during fiscal year 2009. The total remaining cost to complete these projects is estimated to be approximately \$7,500,000, which will be funded through tax exempt bond financing obtained during fiscal year 2007 and hospital operations.

NOTE 6 - LEASES

The Health System leases certain equipment under noncancelable long-term lease agreements. The leases have been recorded as operating leases. Total equipment rental expense for all operating leases for the years ended June 30, 2008 and 2007, was \$299,178 and \$207,432, respectively.

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

<u>Year Ending June 30,</u>	<u>Amount</u>
2009	\$ 47,658
2010	36,939
2011	3,360
2012	3,360
2013	<u>1,680</u>
Total	<u>\$ 92,997</u>

NOTE 7 - LONG-TERM DEBT

A schedule of changes in long-term debt for 2008 and 2007, is as follows:

	Balance		Payments	Balance	Amounts Due
	June 30, 2007	Additions	(Amortization)	June 30, 2008	Within
					One Year
Hospital Revenue Bonds, Series 2003	\$ 6,225,000	\$ -	\$ (175,000)	\$ 6,050,000	\$ 180,000
Hospital Revenue Bonds, Series 2006	9,000,000	-	-	9,000,000	-
	<u>15,225,000</u>	<u>-</u>	<u>(175,000)</u>	<u>15,050,000</u>	<u>180,000</u>
Bond discount	(19,684)	-	932	(18,752)	-
Deferred loss on bond refinancing	(125,372)	-	5,934	(119,438)	-
Bond OID less premium 2006	(107,453)	-	4,705	(102,748)	-
	<u>\$ 14,972,491</u>	<u>\$ -</u>	<u>\$ (163,429)</u>	<u>14,809,062</u>	<u>\$ 180,000</u>
Less current maturities				<u>(180,000)</u>	
Long-term debt, less current maturities				<u>\$ 14,629,062</u>	

PALO ALTO COUNTY HOSPITAL
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

	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>	14,972,491	<u>\$ 175,000</u>
Less current maturities				<u>(175,000)</u>	
Long-term debt, less current maturities				<u><u>\$ 14,797,491</u></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, 2008 and 2007.

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
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	300,000	693,553	993,553
2014 to 2018	1,710,000	3,247,979	4,957,979
2019 to 2023	2,170,000	2,769,392	4,939,392
2024 to 2028	2,785,000	2,146,728	4,931,728
2029 to 2033	3,535,000	1,375,628	4,910,628
2034 to 2036	3,535,000	373,484	3,908,484
	<u>\$ 15,050,000</u>	<u>\$ 13,492,706</u>	<u>\$ 28,542,706</u>

PALO ALTO COUNTY HOSPITAL
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

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, 2008, is as follows:

Interest cost:	
Capitalized as part of construction project	\$ 359,669
Recognized as interest expense	<u>405,797</u>
Total	<u>\$ 765,466</u>
Investment income:	
Capitalized as part of construction project	<u>\$ 167,500</u>

NOTE 8 - 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 3.90% of their annual covered salary, and the Health System is required to contribute 6.05% of annual covered payroll for the year ended June 30, 2008. Plan members were required to contribute 3.70% of their annual covered salary, and the Health System was required to contribute 5.75% of annual covered payroll for the years ended June 30, 2007 and 2006. Contribution requirements are established by state statute. The Health System’s contributions to IPERS for the years ended June 30, 2008, 2007, and 2006, were \$400,245, \$384,800, and \$331,761, respectively, equal to the required contributions for each year.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 9 - 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 \$1,498,913 and \$1,431,992 for the years ended June 30, 2008 and 2007, 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 \$24,672 and \$110,422, respectively, for the years ended June 30, 2008 and 2007, 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, 2008 and 2007, were \$102,164 and \$118,325, respectively.

Due to and from Affiliated Organization

As of June 30, 2008 and 2007, the Health System's records reflect an amount due to MMC-NI of \$183,667 and \$148,388, respectively, for the various services and distributions related to these agreements.

NOTE 10 - 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.

Excess Liability Umbrella Insurance

The Health System also has excess liability umbrella coverage on a claims-made basis subject to a limit of \$5,000,000 per occurrence and an annual aggregate limit of \$5,000,000. 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.

PALO ALTO COUNTY HOSPITAL
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NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

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 \$362,900 and \$278,295 have been established to record the incurred but not reported claims outstanding at June 30, 2008 and 2007, 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 health care 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 11 - 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.

NOTE 12 - 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, 2008 and 2007, was as follows:

	<u>2008</u>	<u>2007</u>
Medicare	39%	37%
Medicaid	5%	5%
Blue Cross	19%	17%
Other third-party payors, patients, and residents	<u>37%</u>	<u>41%</u>
	<u>100%</u>	<u>100%</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

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.

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, 2008

	Actual Accrual Basis	Accrual Adjustments	Actual Cash Basis	Budget	Variance Favorable (Unfavorable)
Estimated amount to be raised by taxation	\$ 875,888	\$ -	\$ 875,888	\$ 877,132	\$ (1,244)
Estimated other revenues/receipts	<u>18,193,080</u>	<u>(266,163)</u>	<u>17,926,917</u>	<u>21,051,280</u>	<u>(3,124,363)</u>
	19,068,968	(266,163)	18,802,805	21,928,412	(3,125,607)
Expenses/disbursements	<u>17,786,723</u>	<u>4,689,887</u>	<u>22,476,610</u>	<u>25,070,831</u>	<u>2,594,221</u>
Net	1,282,245	(4,956,050)	(3,673,805)	(3,142,419)	<u>\$ (531,386)</u>
Balance beginning of year	<u>16,004,579</u>	<u>16,245</u>	<u>16,020,824</u>	<u>15,615,719</u>	
Balance end of year	<u>\$17,286,824</u>	<u>\$ (4,939,805)</u>	<u>\$ 12,347,019</u>	<u>\$12,473,300</u>	

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION - BUDGETARY REPORTING
YEAR ENDED JUNE 30, 2008

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 not amended during the year ended June 30, 2008.

For the year ended June 30, 2008, 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 38 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.

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

Dubuque, Iowa
September 11, 2008

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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, 2008 AND 2007

	TOTAL	
	2008	2007
PATIENT AND RESIDENT SERVICE REVENUE		
Medical and surgical	\$ 1,232,193	\$ 1,274,055
Intensive care unit	-	4,222
Nursery	110,733	98,915
Long-term care	607,551	721,988
Subtotal	<u>1,950,477</u>	<u>2,099,180</u>
OTHER PROFESSIONAL SERVICES		
Operating room	2,237,934	2,208,838
Labor and delivery room	58,427	71,512
Anesthesiology	580,995	597,431
Radiology	4,034,014	3,766,160
Laboratory	2,773,800	2,699,836
Respiratory therapy	826,569	906,251
Physical therapy	772,434	794,122
Audiology	42,982	29,485
Occupational therapy	192,206	180,060
Speech therapy	4,529	8,662
Electrocardiography	577,832	509,887
Medical and surgical supplies	491,287	460,563
Pharmacy	1,770,283	1,628,678
Graettinger Clinic	452,572	454,365
Emmetsburg Clinic	3,875,331	3,528,567
West Bend Clinic	756,268	737,556
Emergency room	2,174,992	1,865,567
Ambulance	661,265	534,953
Home health	504,574	515,249
Hospice	232,230	266,163
Subtotal	<u>23,020,524</u>	<u>21,763,905</u>
Total	<u>24,971,001</u>	23,863,085
Charity care	<u>(203,256)</u>	<u>(153,460)</u>
Total patient and resident service revenue	<u>24,767,745</u>	23,709,625
Adjustments to patient and resident service revenue	<u>(7,831,665)</u>	<u>(7,714,810)</u>
NET PATIENT AND RESIDENT SERVICE REVENUE	<u>\$ 16,936,080</u>	<u>\$ 15,994,815</u>

INPATIENT		OUTPATIENT	
2008	2007	2008	2007
\$ 1,232,193	\$ 1,274,055	\$ -	\$ -
-	4,222	-	-
110,733	98,915	-	-
607,551	721,988	-	-
1,950,477	2,099,180	-	-
288,771	265,787	1,949,163	1,943,051
58,427	71,512	-	-
67,240	67,792	513,755	529,639
259,417	276,264	3,774,597	3,489,896
420,967	470,820	2,352,833	2,229,016
555,628	640,735	270,941	265,516
146,513	163,001	625,921	631,121
-	-	42,982	29,485
35,088	51,076	157,118	128,984
1,581	5,142	2,948	3,520
39,939	33,285	537,893	476,602
88,925	80,683	402,362	379,880
496,055	463,978	1,274,228	1,164,700
-	-	452,572	454,365
-	-	3,875,331	3,528,567
-	-	756,268	737,556
83,601	81,952	2,091,391	1,783,615
-	-	661,265	534,953
-	-	504,574	515,249
12,464	13,667	219,766	252,496
2,554,616	2,685,694	20,465,908	19,078,211
\$ 4,505,093	\$ 4,784,874	\$ 20,465,908	\$ 19,078,211

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF OTHER OPERATING REVENUES
YEARS ENDED JUNE 30, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
OTHER OPERATING REVENUES		
Home health support	\$ 333,361	\$ 275,117
Meals sold	57,280	59,832
Lifeline	56,445	44,610
Grants	32,801	87,312
Other	<u>22,901</u>	<u>11,072</u>
TOTAL OTHER OPERATING REVENUES	<u>\$ 502,788</u>	<u>\$ 477,943</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF OPERATING EXPENSES
YEARS ENDED JUNE 30, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
MEDICAL AND SURGICAL		
Salaries and wages	\$ 770,801	\$ 691,159
Supplies and other	314,402	103,367
	<u>1,085,203</u>	<u>794,526</u>
INTENSIVE CARE UNIT		
Salaries and wages	-	4,369
Supplies and other	-	1,961
	<u>-</u>	<u>6,330</u>
NURSERY		
Salaries and wages	41,417	55,389
Supplies and other	6,243	17,397
	<u>47,660</u>	<u>72,786</u>
LONG-TERM CARE		
Salaries and wages	506,091	505,220
Supplies and other	101,241	49,942
	<u>607,332</u>	<u>555,162</u>
NURSING ADMINISTRATION		
Salaries and wages	167,928	140,734
Supplies and other	10,718	7,930
	<u>178,646</u>	<u>148,664</u>
OPERATING ROOM		
Salaries and wages	324,806	291,967
Supplies and other	126,613	181,009
	<u>451,419</u>	<u>472,976</u>
LABOR AND DELIVERY ROOM		
Salaries and wages	14,700	21,551
Supplies and other	6,684	6,380
	<u>21,384</u>	<u>27,931</u>
ANESTHESIOLOGY		
Supplies and other	262,458	268,801
	<u>262,458</u>	<u>268,801</u>
RADIOLOGY		
Salaries and wages	339,782	334,763
Supplies and other	644,599	606,674
	<u>984,381</u>	<u>941,437</u>
LABORATORY		
Salaries and wages	301,008	281,442
Supplies and other	465,178	474,891
	<u>766,186</u>	<u>756,333</u>
RESPIRATORY THERAPY		
Salaries and wages	23,304	18,772
Supplies and other	37,313	45,964
	<u>60,617</u>	<u>64,736</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, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
PHYSICAL THERAPY		
Salaries and wages	\$ 262,597	\$ 262,469
Supplies and other	38,448	41,563
	<u>301,045</u>	<u>304,032</u>
AUDIOLOGY		
Supplies and other	<u>18,186</u>	<u>9,152</u>
OCCUPATIONAL THERAPY		
Salaries and wages	103,084	98,459
Supplies and other	37,058	37,703
	<u>140,142</u>	<u>136,162</u>
SPEECH THERAPY		
Supplies and other	<u>6,547</u>	<u>6,891</u>
ELECTROCARDIOGRAPHY		
Salaries and wages	102,491	94,446
Supplies and other	69,918	64,319
	<u>172,409</u>	<u>158,765</u>
MEDICAL AND SURGICAL SUPPLIES		
Salaries and wages	21,197	28,721
Supplies and other	213,314	261,730
	<u>234,511</u>	<u>290,451</u>
PHARMACY		
Supplies and other	<u>518,509</u>	<u>436,580</u>
GRAETTINGER CLINIC		
Salaries and wages	204,759	192,016
Supplies and other	124,956	129,113
	<u>329,715</u>	<u>321,129</u>
EMMETSBURG CLINIC		
Salaries and wages	756,558	714,459
Supplies and other	1,743,745	1,575,282
	<u>2,500,303</u>	<u>2,289,741</u>
WEST BEND CLINIC		
Salaries and wages	248,994	237,752
Supplies and other	275,961	261,100
	<u>524,955</u>	<u>498,852</u>
EMERGENCY ROOM		
Salaries and wages	320,216	361,048
Supplies and other	564,084	484,840
	<u>884,300</u>	<u>845,888</u>
AMBULANCE		
Salaries and wages	208,325	179,213
Supplies and other	63,710	63,697
	<u>272,035</u>	<u>242,910</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, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
HOME HEALTH		
Salaries and wages	\$ 445,404	\$ 426,013
Supplies and other	202,082	187,744
	<u>647,486</u>	<u>613,757</u>
HOSPICE		
Salaries and wages	55,304	48,438
Supplies and other	46,909	47,793
	<u>102,213</u>	<u>96,231</u>
MEDICAL RECORDS		
Salaries and wages	172,266	176,921
Supplies and other	45,233	33,864
	<u>217,499</u>	<u>210,785</u>
DIETARY		
Salaries and wages	270,264	258,327
Supplies and other	178,107	144,315
	<u>448,371</u>	<u>402,642</u>
OPERATION OF PLANT		
Salaries and wages	226,027	203,017
Supplies and other	341,880	292,650
	<u>567,907</u>	<u>495,667</u>
HOUSEKEEPING		
Salaries and wages	146,309	132,557
Supplies and other	21,846	34,523
	<u>168,155</u>	<u>167,080</u>
LAUNDRY		
Salaries and wages	5,706	21,585
Supplies and other	1,498	891
	<u>7,204</u>	<u>22,476</u>
BLOOD		
Salaries and wages	4,240	5,560
Supplies and other	61,196	67,072
	<u>65,436</u>	<u>72,632</u>
ADMINISTRATIVE SERVICES		
Salaries and wages	563,283	532,134
Supplies and other	1,016,746	936,552
	<u>1,580,029</u>	<u>1,468,686</u>
DIABETIC EDUCATION		
Salaries and wages	8,810	8,538
APARTMENTS		
Salaries and wages	43,094	29,735
Supplies and other	62,724	92,139
	<u>105,818</u>	<u>121,874</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, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
UNASSIGNED EXPENSES		
Depreciation	\$ 999,707	\$ 903,254
Interest and amortization	405,797	303,663
Employee benefits	<u>2,062,173</u>	<u>2,080,777</u>
	<u>3,467,677</u>	<u>3,287,694</u>
 TOTAL OPERATING EXPENSES	 <u>\$ 17,754,548</u>	 <u>\$ 16,618,297</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, 2008 AND 2007

ANALYSIS OF AGING

Age of Accounts (Days Since Discharge)	2008		2007	
	Amount	Percent to Total	Amount	Percent to Total
30 days or less	\$ 2,033,886	50.02%	\$ 2,055,427	57.42%
31 to 60 days	963,752	23.70%	602,811	16.84%
61 to 90 days	326,186	8.02%	182,561	5.10%
91 days and over	742,252	18.26%	738,838	20.64%
	4,066,076	100.00%	3,579,637	100.00%
Less: Allowance for doubtful accounts	559,013		477,045	
Allowance for contractual adjustments	1,178,179		941,182	
Net	\$ 2,328,884		\$ 2,161,410	
Net patient and resident service revenue per calendar day	\$ 46,400		\$ 43,821	
Days of net revenue in net accounts receivable at year end	50		49	

ANALYSIS OF ALLOWANCE FOR DOUBTFUL ACCOUNTS

	2008		2007	
	Amount	Percent of Net Patient and Resident Service Revenue	Amount	Percent of Net Patient and Resident Service Revenue
Beginning balance	\$ 477,045		\$ 421,367	
Add:				
Provision for bad debts	595,913	3.52%	520,296	3.25%
Recoveries previously written off	309,683	1.83%	264,961	1.66%
	905,596		785,257	
Less:				
Accounts written off	(823,628)	4.86%	(729,579)	4.56%
Ending balance	\$ 559,013		\$ 477,045	

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF SUPPLIES AND PREPAID EXPENSES
JUNE 30, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
SUPPLIES		
Pharmacy	\$ 99,216	\$ 100,782
Central supply	43,360	48,071
Dietary	11,352	6,532
Other	<u>151,168</u>	<u>147,876</u>
 Total supplies	 <u>\$ 305,096</u>	 <u>\$ 303,261</u>
PREPAID EXPENSE		
Dues and other	\$ 62,105	\$ 68,499
Insurance	<u>53,608</u>	<u>53,275</u>
 Total prepaid expense	 <u>\$ 115,713</u>	 <u>\$ 121,774</u>

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULES OF COMPARATIVE STATISTICS
YEARS ENDED JUNE 30, 2008 AND 2007 (UNAUDITED)

	<u>2008</u>	<u>2007</u>
PATIENT DAYS		
Acute	1,234	1,333
Long-term care	5,630	6,763
Swing-bed	687	862
Nursery	246	254
Totals	<u>7,797</u>	<u>9,212</u>
ADMISSIONS		
Acute	479	513
Swing-bed	98	127
Long-term care	9	11
Totals	<u>586</u>	<u>651</u>
DISCHARGES		
Acute	480	516
Swing-bed	99	125
Long-term care	13	14
Totals	<u>592</u>	<u>655</u>
ACUTE AVERAGE LENGTH OF STAY	<u>2.6</u>	<u>2.6</u>
SWING-BED AVERAGE LENGTH OF STAY	<u>6.9</u>	<u>6.9</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)	21.1%	24.1%
Long-term care (based on 22 beds)	<u>70.1%</u>	<u>84.2%</u>
OUTPATIENT VISITS	<u>23,069</u>	<u>22,069</u>
CLINIC VISITS		
Graettinger	<u>3,972</u>	<u>4,170</u>
Emmetsburg	<u>28,291</u>	<u>27,601</u>
West Bend	<u>6,195</u>	<u>6,282</u>



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**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, 2008 and 2007, and its discretely presented component unit, Palo Alto County Health Care Foundation, as of December 31, 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 September 11, 2008. 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 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 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 and Responses 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, 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 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, 2008, 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 and Responses. 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 and Responses. 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.

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 "Eide Sully LLP". The signature is written in a cursive, flowing style.

Dubuque, Iowa
September 11, 2008

**PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2008**

Part I: Findings Related to the Financial Statements:

SIGNIFICANT DEFICIENCIES:

I-A-08 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. This is not an unusual condition in organizations of your size.

Recommendation – 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. Management involvement through the review of reconciliation procedures can be an effective control to ensure these procedures are being accurately completed on a timely basis. 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 agrees with the finding and has reviewed the operating procedures of Palo Alto County Health System. Due to the limited number of office employees, management will continue to monitor the Health System's operations and procedures. Furthermore, we will continually review the assignment of duties to obtain the maximum internal control possible under the circumstances.

Conclusion – Response accepted.

I-B-08 Preparation of Financial Statements – Management is responsible for establishing and maintaining internal controls over financial reporting and procedures related to the fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles (GAAP). Palo Alto County Health System does not have an internal control system designed to provide for the preparation of the financial statements, including the accompanying footnotes and statement of cash flows, as required by generally accepted accounting principles. The guidance in Statement of Auditing Standards No. 112, *Communicating Internal Control Related Matters Identified in an Audit*, requires us to communicate this matter to those charged with governance.

As auditors, we were requested to draft the financial statements and accompanying notes to the financial statements. The outsourcing of these services is not unusual in an organization of your size.

PALO ALTO COUNTY HOSPITAL
d/b/a PALO ALTO COUNTY HEALTH SYSTEM
SCHEDULE OF FINDINGS AND RESPONSES
YEAR ENDED JUNE 30, 2008

Part I: Findings Related to the Financial Statements: (continued)

Recommendation – We realize that obtaining the expertise necessary to prepare the financial statements, including all necessary disclosures, in accordance with generally accepted accounting principles can be considered costly and ineffective. However, it is the responsibility of the Health System’s management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations.

Response – Management feels that committing the resources necessary to remain current on GAAP and GASB reporting requirements and corresponding footnote disclosures would lack benefit in relation to the cost, but will continue evaluating on a going forward basis.

Conclusion – Response accepted.

Part II: Other Findings Related to Required Statutory Reporting:

- II-A-08 Certified Budget – Disbursements during the year ended June 30, 2008, did not exceed the amount budgeted.
- II-B-08 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-08 Travel Expense – No expenditures of Health System money for travel expenses of spouses of Health System officials and/or employees were noted.
- II-D-08 Business Transactions – We noted no material business transactions between the Health System and Health System officials and/or employees.
- II-E-08 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.
- II-F-08 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-08 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 published 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, 2008, and have issued our report thereon dated September 11, 2008. 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 4, 2008, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities.

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.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you and management on July 30, 2008, and in accordance to our engagement letter to you.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. 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, 2008. We noted no transactions entered into by the Health System during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

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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.

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. 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. 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.

The disclosures in the financial statements are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

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 2008 audit:

Revenue in excess of expenses, prior to audit adjustments	\$ 1,258,745
To adjust net capitalized interest	(72,214)
To adjust depreciation expense	(103,292)
To adjust income split agreement payable to Mercy	101,247
Other adjustments	<u>(2,241)</u>
Revenue in excess of expenses as reported	<u>\$ 1,182,245</u>

There were no significant passed adjustments.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, 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.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated September 11, 2008.

Management 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.

Other Audit Findings or Issues

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.

Other Comment

We have included an additional comment for informational purposes.

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.



Dubuque, Iowa
September 11, 2008

xc: Mr. Thomas J. Lee

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

**YEAR ENDED JUNE 30, 2008
OTHER COMMENT**

Revised Guidelines on Good Governance for Tax Exempt Entities

The issue of corporate governance of tax exempt organizations has emerged as a major focal point for the Internal Revenue Service (IRS) and is a key factor addressed in the newly revised Form 990, Return of Organization Exempt from Income Tax effective for 2008. These guidelines can be found in the IRS document “Governance and Related Topics – 501(c)(3) Organizations,” at the following link: http://www.irs.gov/pub/irs-tege/governance_practices.pdf. While tax law does not mandate the guidelines, they are a clear indication of the IRS’ strong commitment to monitoring governance practices of the tax-exempt community. The IRS has indicated its belief that a well-governed charity is more likely to obey the tax laws, safeguard charitable assets and serve charitable interests than one without some of the recommended guidelines. The IRS document is in line with the redesigned Form 990 governance questions and focuses on six specific topics:

- Mission
- Organizational Documents
- Governing Body
- Governance & Management Policies
- Financial Statements & Form 990 Reporting
- Transparency and Accountability

The IRS intends to monitor the organizations’ practices by utilizing primarily yes/no questions and detailed descriptions of policies and procedures on the new Form 990.

Although these guidelines are directed towards 501(c)(3) organizations, all tax-exempt entities should consider the same governance practices. We recommend all tax-exempt organizations review the guidelines in detail, as well as the specific questions in Part VI of the 2008 Form 990 and consider whether current practices should be modified or new practices adopted. By reviewing the Health System’s governance practices now, the Health System will be prepared to respond to the governance-related questions on the 2008 Form 990, if applicable, and portray a positive image to the IRS and the public.