

**FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006**

HILLCREST FAMILY SERVICES, INC.

HILLCREST FAMILY SERVICES, INC.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Hillcrest Family Services, Inc.
Dubuque, Iowa

We have audited the accompanying statement of financial position of Hillcrest Family Services, Inc., as of October 31, 2007, and the related statements of activities, functional expenses and cash flows for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Hillcrest Family Services, Inc. as of October 31, 2006, were audited by other auditors whose report dated May 16, 2007, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. 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 audit provides 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 Hillcrest Family Services, Inc., as of October 31, 2007, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated May 15, 2008, on our consideration of Hillcrest Family Services, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

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Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary schedules are presented for purposes of additional analysis and are not a required part of the financial statements of the Organization. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is also not a required part of the financial statements of the Organization. Such information has been subjected to the auditing procedures applied in the audit 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.

The accompanying financial statements for 2006 have been restated to correct certain errors. Furthermore, net assets at the beginning of 2006 have also been adjusted to correct errors made during prior years. The effect of these retroactive adjustments is disclosed in Note 15.

Hillcrest Family Services, Inc. adopted Statement of Financial Accounting Standard No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132R" during 2007. The effect of this Standard on the 2007 financial statements is disclosed in Note 8.

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

Dubuque, Iowa
May 15, 2008

HILLCREST FAMILY SERVICES, INC.
STATEMENTS OF FINANCIAL POSITION
OCTOBER 31, 2007 AND 2006

	2007	(As restated) 2006
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 73,857	\$ 2,629,840
Receivables		
Program service, net of allowances of \$235,390 in 2007 and \$73,392 in 2006	2,618,329	2,357,663
Accrued interest receivable	-	24,624
Promises to give – Note 5	111,035	168,611
Inventory	31,995	10,120
Prepaid expenses	<u>37,887</u>	<u>73,459</u>
 Total current assets	 <u>2,873,103</u>	 <u>5,264,317</u>
 LAND, BUILDINGS AND EQUIPMENT, net – Note 4	 <u>4,179,899</u>	 <u>4,486,468</u>
 OTHER ASSETS		
Promises to give – Note 5	40,163	11,455
Investments – Note 2	3,333,570	3,197,232
Beneficial interest in net assets of community foundation – Note 3	<u>12,881</u>	<u>12,377</u>
 Total other assets	 <u>3,386,614</u>	 <u>3,221,064</u>
 Total assets	 <u>\$ 10,439,616</u>	 <u>\$ 12,971,849</u>

See notes to financial statements.

HILLCREST FAMILY SERVICES, INC.
STATEMENTS OF FINANCIAL POSITION
OCTOBER 31, 2007 AND 2006

	2007	(As restated) 2006
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Bank overdraft	\$ 55,040	\$ 2,748,028
Current maturities of long-term debt – Note 6	73,068	81,427
Line of credit – Note 6	259,224	354,450
Accounts payable	433,768	291,763
Accrued expenses		
Salaries and wages	389,476	72,251
Vacation	367,964	335,260
Payroll taxes and other	113,203	73,638
Deferred revenue – Note 7	156,604	151,834
Total current liabilities	1,848,347	4,108,651
PENSION LIABILITY – Note 8	20,591	328,408
LONG-TERM DEBT, less current maturities – Note 6	203,591	242,010
Total liabilities	2,072,529	4,679,069
NET ASSETS		
Unrestricted		
Undesignated	4,866,466	4,924,375
Designated by board – Note 2	3,141,514	2,997,339
Temporarily restricted – Note 9	168,107	180,066
Permanently restricted – Note 9	191,000	191,000
Total net assets	8,367,087	8,292,780
Total liabilities and net assets	\$ 10,439,616	\$ 12,971,849

HILLCREST FAMILY SERVICES, INC.
STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
YEARS ENDED OCTOBER 31, 2007 AND 2006

	2007			Total Net Assets
	Unrestricted Net Assets	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	
SUPPORT AND REVENUE				
Public support				
Direct:				
Contributions	\$ 239,605	\$ 56,909	\$ -	\$ 296,514
Bequests - trusts/estates	2,109	-	-	2,109
Bowl for Kids Sake	31,944	-	-	31,944
The Big Event	6,987	-	-	6,987
Special events - lights	188,112	-	-	188,112
Indirect:				
Grants - federal awards	1,319,901	-	-	1,319,901
Grants - other	136,269	-	-	136,269
United Way	13,709	92,000	-	105,709
Total public support	<u>1,938,636</u>	<u>148,909</u>	<u>-</u>	<u>2,087,545</u>
Revenue				
Program service fees, net	12,944,613	-	-	12,944,613
Less: administrative adjustment - Note 13	(133,728)	-	-	(133,728)
Investment income	271,163	-	-	271,163
Miscellaneous	15,183	-	-	15,183
Net assets released from restrictions	160,868	(160,868)	-	-
Total revenues	<u>13,258,099</u>	<u>(160,868)</u>	<u>-</u>	<u>13,097,231</u>
Total public support and revenue	<u>15,196,735</u>	<u>(11,959)</u>	<u>-</u>	<u>15,184,776</u>
EXPENSES				
Program services	15,121,447	-	-	15,121,447
Supporting services				
Development	303,704	-	-	303,704
Special event - lights	130,362	-	-	130,362
Total expenses	<u>15,555,513</u>	<u>-</u>	<u>-</u>	<u>15,555,513</u>
PUBLIC SUPPORT AND REVENUE IN EXCESS OF (LESS THAN) EXPENSES	(358,778)	(11,959)	-	(370,737)
OTHER CHANGES IN NET ASSETS				
Change in unrealized gains and losses - Note 2	4,717	-	-	4,717
Pledge forgiven - Note 9	-	-	-	-
Pension liability adjustment - Note 8	440,327	-	-	440,327
INCREASE (DECREASE) IN NET ASSETS	<u>\$ 86,266</u>	<u>\$ (11,959)</u>	<u>\$ -</u>	<u>\$ 74,307</u>

See notes to financial statements.

2006 (As restated)			
Unrestricted Net Assets	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	Total Net Assets
\$ 305,229	\$ -	\$ 10,000	\$ 315,229
15,645	-	-	15,645
31,059	-	-	31,059
14,633	-	-	14,633
159,661	-	-	159,661
1,220,443	-	-	1,220,443
170,562	-	-	170,562
16,308	92,000	-	108,308
<u>1,933,540</u>	<u>92,000</u>	<u>10,000</u>	<u>2,035,540</u>
12,181,820	-	-	12,181,820
-	-	-	-
256,842	-	-	256,842
109,721	-	-	109,721
210,328	(210,328)	-	-
<u>12,758,711</u>	<u>(210,328)</u>	<u>-</u>	<u>12,548,383</u>
<u>14,692,251</u>	<u>(118,328)</u>	<u>10,000</u>	<u>14,583,923</u>
14,203,729	-	-	14,203,729
303,340	-	-	303,340
97,483	-	-	97,483
<u>14,604,552</u>	<u>-</u>	<u>-</u>	<u>14,604,552</u>
87,699	(118,328)	10,000	(20,629)
147,161	-	-	147,161
-	(20,000)	-	(20,000)
<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<u>\$ 234,860</u>	<u>\$ (138,328)</u>	<u>\$ 10,000</u>	<u>\$ 106,532</u>

(continued)

HILLCREST FAMILY SERVICES, INC.
STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS (continued)
YEARS ENDED OCTOBER 31, 2007 AND 2006

	<u>2007</u>			<u>Total</u> <u>Net Assets</u>
	<u>Unrestricted</u> <u>Net Assets</u>	<u>Temporarily</u> <u>Restricted</u> <u>Net Assets</u>	<u>Permanently</u> <u>Restricted</u> <u>Net Assets</u>	
INCREASE (DECREASE) IN NET ASSETS	<u>\$ 86,266</u>	<u>\$ (11,959)</u>	<u>\$ -</u>	<u>\$ 74,307</u>
NET ASSETS, BEGINNING OF YEAR, AS PREVIOUSLY REPORTED	-	-	-	-
PRIOR PERIOD ADJUSTMENTS - Note 15	-	-	-	-
NET ASSETS, BEGINNING OF YEAR, AS RESTATED	<u>7,921,714</u>	<u>180,066</u>	<u>191,000</u>	<u>8,292,780</u>
NET ASSETS, END OF YEAR	<u>\$ 8,007,980</u>	<u>\$ 168,107</u>	<u>\$ 191,000</u>	<u>\$ 8,367,087</u>

See notes to financial statements.

2006 (As restated)			
<u>Unrestricted Net Assets</u>	<u>Temporarily Restricted Net Assets</u>	<u>Permanently Restricted Net Assets</u>	<u>Total Net Assets</u>
\$ 234,860	\$ (138,328)	\$ 10,000	\$ 106,532
8,108,644	203,180	130,920	8,442,744
(421,790)	115,214	50,080	(256,496)
7,686,854	318,394	181,000	8,186,248
<u>\$ 7,921,714</u>	<u>\$ 180,066</u>	<u>\$ 191,000</u>	<u>\$ 8,292,780</u>

HILLCREST FAMILY SERVICES, INC.
STATEMENT OF FUNCTIONAL EXPENSES
YEAR ENDED OCTOBER 31, 2007

	Program Services						
	Residential Treatment	CMI Group Homes	Health Services	Schools	Shelter	Family Centered Services	Counseling
Salaries	\$ 1,962,705	\$ 1,315,267	\$ 778,896	\$ 1,898,080	\$ 274,640	\$ 436,139	\$ 71,475
Fringe benefits	339,302	244,876	145,263	377,735	48,937	49,585	11,413
Payroll taxes and other	142,390	97,598	57,459	137,421	20,231	32,497	4,488
Total personnel expenses	2,444,397	1,657,741	981,618	2,413,236	343,808	518,221	87,376
Contracted services	109,559	55,019	57,714	17,226	7,376	6,679	6,772
Supplies & equipment maintenance	246,897	171,895	128,457	113,922	48,294	7,495	7,870
Telephone	12,986	18,274	16,166	14,921	4,780	2,939	1,003
Postage and shipping	6,049	4,770	3,628	4,288	1,304	1,469	394
Occupancy	111,953	227,461	111,398	139,949	55,762	9,101	7,329
Outside printing	-	185	707	-	-	486	-
Travel	28,753	27,627	37,007	40,151	6,430	9,914	873
Conferences and meetings	10,466	5,026	20,763	18,144	1,263	2,057	750
Subscriptions	140	345	646	44	-	23	83
Client assistance	50,099	6,429	21,407	5,076	9,115	-	-
Dues	5,217	3,929	1,594	1,026	761	1,109	696
Miscellaneous	53,656	37,576	26,559	44,253	8,150	11,877	2,439
Interest	21,613	10,718	1,853	611	2,152	2,965	28
Bad debts	6,408	-	110	-	-	-	2,705
Total expenses before depreciation	3,108,193	2,226,995	1,409,627	2,812,847	489,195	574,335	118,318
Depreciation	140,110	63,590	20,934	51,032	12,297	17,195	2,821
Total expenses	\$ 3,248,303	\$ 2,290,585	\$ 1,430,561	\$ 2,863,879	\$ 501,492	\$ 591,530	\$ 121,139

See notes to financial statements.

Program Services

Adoption	Hillcrest Supported Living IPRS/Voc	Family Empowerment Center	Transitional Housing	PATH Grant	WRAP/ Recovery Grant	Mental Health Centers	Big Brothers/ Big Sisters	Total Program Services
\$ 66,098	\$ 906,274	\$ 48,906	\$ 32,365	\$ 19,049	\$ 33,156	\$ 1,028,975	\$ 132,566	\$ 9,004,591
8,903	132,931	7,593	7,758	2,337	3,535	174,923	33,775	1,588,866
5,031	67,229	3,596	2,207	1,278	2,379	76,917	9,575	660,296
80,032	1,106,434	60,095	42,330	22,664	39,070	1,280,815	175,916	11,253,753
15,004	12,264	681	140	-	385	540,947	50,228	879,994
1,682	23,515	1,889	2,974	5	3,546	39,666	6,615	804,722
1,636	17,004	3,274	2,878	-	272	18,996	612	115,741
159	3,129	262	36	-	-	4,852	658	30,998
7,633	73,212	11,458	15,491	4,210	2,129	98,347	566	875,999
713	-	-	-	-	-	-	1,713	3,804
9,228	42,836	299	1,438	389	1,674	13,636	3,439	223,694
2,465	3,068	242	295	121	929	8,714	3,564	77,867
750	248	118	-	-	-	781	4	3,182
-	1,624	-	270	25	1	186	3,000	97,232
91	2,375	147	-	-	-	1,663	3,705	22,313
4,033	16,425	1,620	1,459	-	109	25,614	4,341	238,111
4	5,403	3,440	4	-	(1)	7,702	50	56,542
-	-	-	-	-	-	6,667	-	15,890
123,430	1,307,537	83,525	67,315	27,414	48,114	2,048,586	254,411	14,699,842
3,433	26,371	6,754	26,912	-	664	44,837	4,655	421,605
\$ 126,863	\$ 1,333,908	\$ 90,279	\$ 94,227	\$ 27,414	\$ 48,778	\$ 2,093,423	\$ 259,066	\$ 15,121,447

(continued)

HILLCREST FAMILY SERVICES, INC.
STATEMENT OF FUNCTIONAL EXPENSES (continued)
YEAR ENDED OCTOBER 31, 2007

	Supporting Services				Total Expenses
	Total Program Services	Development Fund	Event- Lights Fund	Supporting Services Total	
Salaries	\$ 9,004,591	\$ 130,799	\$ -	\$ 130,799	\$ 9,135,390
Fringe benefits	1,588,866	31,815	-	31,815	1,620,681
Payroll taxes, etc.	<u>660,296</u>	<u>7,313</u>	-	<u>7,313</u>	667,609
Total personnel expenses	11,253,753	169,927	-	169,927	11,423,680
Contracted services	879,994	30,217	-	30,217	910,211
Supplies & equipment maintenance	804,722	11,953	-	11,953	816,675
Telephone	115,741	1,306	-	1,306	117,047
Postage and shipping	30,998	2,118	-	2,118	33,116
Occupancy	875,999	1,090	-	1,090	877,089
Outside printing	3,804	55,803	-	55,803	59,607
Travel	223,694	7,558	-	7,558	231,252
Conferences and meetings	77,867	3,421	-	3,421	81,288
Subscriptions	3,182	393	-	393	3,575
Client assistance	97,232	-	-	-	97,232
Dues	22,313	1,267	-	1,267	23,580
Miscellaneous	238,111	8,206	130,362	138,568	376,679
Interest	56,542	1,154	-	1,154	57,696
Bad debts	<u>15,890</u>	-	-	-	15,890
Total expenses before depreciation	14,699,842	294,413	130,362	424,775	15,124,617
Depreciation	<u>421,605</u>	<u>9,291</u>	-	<u>9,291</u>	430,896
Total expenses	<u>\$ 15,121,447</u>	<u>\$ 303,704</u>	<u>\$ 130,362</u>	<u>\$ 434,066</u>	\$ 15,555,513

HILLCREST FAMILY SERVICES, INC.
STATEMENT OF FUNCTIONAL EXPENSES
YEAR ENDED OCTOBER 31, 2006 (AS RESTATED)

	Program Services						
	Residential	CMI	Health			Family	
	Treatment	Group Homes	Services	Schools	Shelter	Centered Services	Counseling
Salaries	\$ 1,863,587	\$ 1,271,028	\$ 732,063	\$ 1,630,092	\$ 267,200	\$ 538,495	\$ 170,925
Fringe benefits	343,103	240,196	128,235	373,040	51,156	56,602	24,130
Payroll taxes and other	<u>133,752</u>	<u>93,959</u>	<u>53,195</u>	<u>118,776</u>	<u>20,075</u>	<u>40,010</u>	<u>12,476</u>
Total personnel expenses	2,340,442	1,605,183	913,493	2,121,908	338,431	635,107	207,531
Contracted services	90,625	43,555	95,229	35,008	3,425	13,734	8,704
Supplies & equipment maintenance	253,601	167,103	89,119	103,800	56,955	9,011	5,215
Telephone	11,069	16,924	14,928	13,185	4,654	6,255	844
Postage and shipping	5,711	5,287	3,205	4,636	908	1,486	541
Occupancy	108,746	251,115	117,709	159,082	63,858	22,197	4,422
Outside printing	851	356	1,478	69	15	19	315
Travel	23,511	35,058	26,916	26,458	5,798	12,721	876
Conferences and meetings	9,388	8,772	13,140	11,834	1,045	1,106	6,155
Subscriptions	673	722	1,138	207	103	555	450
Client assistance	44,220	45,504	2,929	4,545	7,155	29	-
Dues	3,567	4,177	444	998	520	675	1,220
Miscellaneous	43,346	34,290	19,382	38,793	7,803	11,027	4,383
Interest	13,756	5,842	690	1,579	752	991	72
Bad debts	<u>7,156</u>	<u>29,224</u>	<u>10</u>	<u>-</u>	<u>34,661</u>	<u>91,662</u>	<u>4,477</u>
Total expenses before depreciation	2,956,662	2,253,112	1,299,810	2,522,102	526,083	806,575	245,205
Depreciation	<u>151,171</u>	<u>67,455</u>	<u>20,835</u>	<u>50,117</u>	<u>15,818</u>	<u>19,965</u>	<u>2,963</u>
Total expenses	<u>\$ 3,107,833</u>	<u>\$ 2,320,567</u>	<u>\$ 1,320,645</u>	<u>\$ 2,572,219</u>	<u>\$ 541,901</u>	<u>\$ 826,540</u>	<u>\$ 248,168</u>

See notes to financial statements.

Program Services						
Adoption	Hillcrest Supported Living IPRS/Voc	Family Empowerment Center	Transitional Housing	Mental Health Centers	Big Brothers/ Big Sisters	Total Program Services
\$ 111,209	\$ 808,543	\$ 57,551	\$ 33,496	\$ 649,286	\$ 126,572	\$ 8,260,047
16,275	105,172	9,480	6,897	56,724	29,105	1,440,115
<u>8,316</u>	<u>58,233</u>	<u>4,205</u>	<u>2,209</u>	<u>46,983</u>	<u>9,072</u>	<u>601,261</u>
135,800	971,948	71,236	42,602	752,993	164,749	10,301,423
9,738	7,721	394	1,593	394,288	84,619	788,633
3,865	19,742	2,276	6,212	32,702	3,982	753,583
1,703	14,812	3,894	3,316	15,992	622	108,198
904	3,207	229	322	1,800	592	28,828
13,016	72,491	11,750	15,655	59,129	8,147	907,317
9	36	4	4	1,409	1,196	5,761
10,549	36,899	394	1,371	9,855	4,378	194,784
2,038	4,710	307	442	7,743	3,187	69,867
29	380	8	6	252	214	4,737
132	2,389	20	2,712	226	4,399	114,260
183	2,671	94	31	4,383	2,986	21,949
2,600	20,152	1,539	1,376	58,757	4,581	248,029
36	1,731	3,805	36	2,045	72	31,407
-	<u>15,005</u>	<u>2,549</u>	-	<u>29,426</u>	-	<u>214,170</u>
180,602	1,173,894	98,499	75,678	1,371,000	283,724	13,792,946
<u>2,604</u>	<u>26,612</u>	<u>8,288</u>	<u>27,427</u>	<u>12,403</u>	<u>5,125</u>	<u>410,783</u>
<u>\$ 183,206</u>	<u>\$ 1,200,506</u>	<u>\$ 106,787</u>	<u>\$ 103,105</u>	<u>\$ 1,383,403</u>	<u>\$ 288,849</u>	<u>\$ 14,203,729</u>

(continued)

HILLCREST FAMILY SERVICES, INC.
STATEMENT OF FUNCTIONAL EXPENSES (continued)
YEAR ENDED OCTOBER 31, 2006 (AS RESTATED)

	Supporting Services				
	Total Program Services	Development Fund	Event- Lights Fund	Supporting Services Total	Total Expenses
Salaries	\$ 8,260,047	\$ 124,661	\$ -	\$ 124,661	\$ 8,384,708
Fringe benefits	1,440,115	21,685	-	21,685	1,461,800
Payroll taxes, etc.	<u>601,261</u>	<u>9,408</u>	<u>-</u>	<u>9,408</u>	<u>610,669</u>
Total personnel expenses	10,301,423	155,754	-	155,754	10,457,177
Contracted services	788,633	59,927	-	59,927	848,560
Supplies & equipment maintenance	753,583	9,929	-	9,929	763,512
Telephone	108,198	1,486	-	1,486	109,684
Postage and shipping	28,828	2,249	-	2,249	31,077
Occupancy	907,317	1,090	-	1,090	908,407
Outside printing	5,761	40,863	-	40,863	46,624
Travel	194,784	5,228	-	5,228	200,012
Conferences and meetings	69,867	1,787	-	1,787	71,654
Subscriptions	4,737	745	-	745	5,482
Client assistance	114,260	-	-	-	114,260
Dues	21,949	860	-	860	22,809
Miscellaneous	248,029	16,243	97,483	113,726	361,755
Interest	31,407	314	-	314	31,721
Bad debts	<u>214,170</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>214,170</u>
Total expenses before depreciation	13,792,946	296,475	97,483	393,958	14,186,904
Depreciation	<u>410,783</u>	<u>6,865</u>	<u>-</u>	<u>6,865</u>	<u>417,648</u>
Total expenses	<u>\$ 14,203,729</u>	<u>\$ 303,340</u>	<u>\$ 97,483</u>	<u>\$ 400,823</u>	<u>\$ 14,604,552</u>

HILLCREST FAMILY SERVICES, INC.
STATEMENTS OF CASH FLOWS
YEARS ENDED OCTOBER 31, 2007 AND 2006

	<u>2007</u>	(As restated) <u>2006</u>
OPERATING ACTIVITIES		
Increase in net assets	\$ 74,307	\$ 106,532
Adjustments to reconcile increase in net assets to net cash from (used for) operating activities		
Depreciation	430,896	417,648
Gain on sale of equipment	-	(8,978)
Receipt of land donation	-	(1,050)
Bad debts	15,890	214,170
Changes in assets and liabilities		
Receivables	(223,064)	(941,610)
Inventory	(21,875)	(600)
Prepaid expenses	35,572	4,247
Bank overdraft	(2,692,988)	440,467
Accounts payable	142,005	83,781
Accrued expenses	389,494	111,690
Deferred revenue	4,770	27,690
Pension liability	(307,817)	107,168
NET CASH FROM (USED FOR) OPERATING ACTIVITIES	<u>(2,152,810)</u>	<u>561,155</u>
INVESTING ACTIVITIES		
Purchase of property and equipment	(87,627)	(313,658)
Increase in investments	(136,842)	(777,061)
Proceeds from sale of equipment	-	14,000
NET CASH USED FOR INVESTING ACTIVITIES	<u>(224,469)</u>	<u>(1,076,719)</u>
FINANCING ACTIVITIES		
Net proceeds (payments) on line of credit	(95,226)	354,450
Principal payments on long-term debt	(83,478)	(134,265)
NET CASH FROM (USED FOR) FINANCING ACTIVITIES	<u>(178,704)</u>	<u>220,185</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(2,555,983)	(295,379)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>2,629,840</u>	<u>2,925,219</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 73,857</u>	<u>\$ 2,629,840</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for interest	<u>\$ 57,696</u>	<u>\$ 31,721</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Property and equipment financed through long-term debt	<u>\$ 36,700</u>	<u>\$ -</u>

See notes to financial statements.

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Organization

Hillcrest Family Services, Inc. (the Organization), located in Dubuque, Iowa, is organized as an Iowa nonprofit corporation and has been recognized by the Internal Revenue Service as exempt from federal income taxes under Internal Revenue Code Section 501(c)(3). However, the Organization would be subject to federal income tax on any unrelated business taxable income.

The purpose of the Organization is to provide a range of educational, counseling, and health services to individuals and families in an effort to improve the welfare of their clients.

Accounting Basis

Assets and liabilities and revenue and expenses are reported on the accrual basis of accounting.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

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

Accounts Receivable

Accounts receivables are uncollateralized individual and third-party payor obligations. Unpaid accounts receivable are not charged interest on amounts owed.

Payments of 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 the receivables is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from third-party payors.

Inventory

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

Assets Limited as to Use

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

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

Property and Equipment

Property and equipment acquisitions are capitalized and recorded at cost. Donated property and equipment are recorded at fair value at the date of receipt. Depreciation is provided over the estimated useful life of each class of depreciable asset, generally 3 to 15 years for equipment, vehicles and leasehold improvements, and up to 40 years for buildings and improvements, and is computed using the straight-line method.

Pension Liability

Effective October 31, 2007, Hillcrest Family Services, Inc. recorded an accrued pension liability for its defined benefit retirement plan in accordance with Statement of Financial Accounting Standard No. 158 (SFAS 158), "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132R". The accrued liability represents the underfunded status of the defined benefit plan which is the difference between the plan's projected benefit obligation and fair value of the plan assets as of the October 31 measurement date. Adjustments for the difference between the projected benefit obligation and fair value of the plan assets are reported under Other Changes in the Statement of Activities and Changes in Net Assets.

Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets are those whose use by the Organization has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Organization in perpetuity.

Net Program Service Fees

Hillcrest Family Services, Inc. has agreements with third-party payors that provide for payments to the Organization at amounts different from its established rates. The Organization is reimbursed at prospective rates by some payors. Certain other payors reimburse at interim rates which are final settled after submission of an annual cost report. Any difference between interim rates and final rates are recorded in the period that the cost reports are settled.

Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value, and other investments are reported at the lower of cost or fair value. Investment income or loss (including realized gains and losses on investments, interest, and dividends) is included in public support and revenue in excess of (less than) expenses unless the income or loss is restricted by donor or law. Change in unrealized gains and losses on investments is excluded from public support and revenue in excess of (less than) expenses unless the investments are trading securities.

Donated Goods and Services

Donated materials and equipment are reflected as contributions in the accompanying statements at their estimated fair market values at the date of receipt. No amounts have been reflected in the statements for donated services, inasmuch as no objective basis is available to measure the value of such services.

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

Promises to Give

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. Conditional promises to give and indications of intentions to give are reported at fair value at the date the gift is received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When donor stipulated time restrictions or purpose restrictions are met or accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statement of activities and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in the statement of activities and changes in net assets.

Advertising Costs

The Organization expenses advertising costs as incurred.

Reclassification

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

Recently Issued Accounting Pronouncement

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard No. 158 (SFAS 158), "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132R". The provisions of this Standard have been implemented in 2007. Refer to Note 8 concerning this Standard.

NOTE 2 – INVESTMENTS AND INVESTMENT INCOME

Investments

Investments are stated at fair value and include the following at October 31, 2007 and 2006:

	2007		2006	
	Market Value	Cost	Market Value	Cost
Certificates of deposit	\$ 229,080	\$ 229,080	\$ 322,734	\$ 322,734
Money market	187,714	187,714	77,659	77,659
Government agencies	508,992	514,287	769,061	790,225
Common stocks	1,790,818	1,469,732	1,784,816	1,450,835
Mutual/bond funds	615,916	616,108	241,912	243,847
Land - Arizona	1,050	1,050	1,050	1,050
	\$ 3,333,570	\$ 3,017,971	\$ 3,197,232	\$ 2,886,350

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HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

Assets Limited as to Use

Included in investments are funds that have been designated by the Board of Trustees to supplement future operations totaling \$3,141,514 and \$2,997,339 at October 31, 2007 and 2006, respectively.

Investment Income

Investment income and gains and losses on cash equivalents and other investments consist of the following for the years ended October 31, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Investment income		
Interest and dividend income	\$ 96,285	\$ 85,489
Realized gains and losses on sales of investments	<u>174,878</u>	<u>171,353</u>
Total investment income	<u>\$ 271,163</u>	<u>\$ 256,842</u>
Other changes in net assets		
Change in unrealized gains and losses	<u>\$ 4,717</u>	<u>\$ 147,161</u>

NOTE 3 – BENEFICIAL INTEREST IN NET ASSETS OF COMMUNITY FOUNDATION

The Organization is a beneficiary of a community foundation maintained by an independent trustee. The assets maintained by the community foundation are to be held in perpetuity. The Organization expects to receive annual distributions of its share of the community foundation's income. These distributions will be recorded in the financial statements as investment income. The funds which have been invested directly by the Organization are recognized in the financial statements as a beneficial interest in net assets of the community foundation at the fair market value of the Organization's interest in the foundation. These funds amounted to \$12,881 and \$12,377 at October 31, 2007 and 2006, respectively.

The community foundation also holds funds contributed by individual donors for the benefit of Hillcrest Family Services, Inc. It should be noted, however, that the community foundation has variance power, which allows them to modify the donor's stipulations under certain circumstances as they monitor the changing needs of the community. These funds will not be recorded as an asset on the financial statements of the Organization. They total \$117,993 and \$82,801 at October 31, 2007 and 2006, respectively, and are held by the community foundation as permanently endowed for the support of Hillcrest Family Services, Inc.

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

NOTE 4 – LAND, BUILDINGS AND EQUIPMENT

A summary of net property and equipment at October 31, 2007 and 2006, follows:

	2007		2006	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Land	\$ 40,000	\$ -	\$ 40,000	\$ -
Land improvements	141,362	27,837	140,480	18,428
Buildings	6,267,808	2,861,641	6,267,035	2,659,905
Vehicles	548,661	389,509	512,009	325,352
Furniture, fixtures, and equipment	1,653,726	1,228,341	1,593,396	1,077,204
Leasehold improvements	40,755	20,123	30,130	15,693
Construction in progress	15,038	-	-	-
	\$ 8,707,350	\$ 4,527,451	\$ 8,583,050	\$ 4,096,582
Net land, buildings and equipment		\$ 4,179,899		\$ 4,486,468

Construction in progress consists of architect fees associated with the Family Life Center project which is expected for construction to begin in 2010. The estimated total cost to complete the project is \$10 million and will be funded through a capital campaign and operations.

NOTE 5 – UNCONDITIONAL PROMISES

Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using a risk free interest rate of 5%. Amortization of the discounts is included in contribution revenue. Included in amounts due in less than one year are United Way contributions, totaling \$92,000 at October 31, 2007 and 2006. Promises to give are due as follows:

	2007	2006
Less than one year	\$ 111,035	\$ 168,611
One to five years	40,163	11,455
	\$ 151,198	\$ 180,066

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

NOTE 6 – NOTE PAYABLE AND LONG-TERM DEBT

The Organization has a line of credit available of up to \$750,000 with U.S. Bank in Dubuque, Iowa. Interest is paid monthly at a rate of LIBOR plus 2.75% (7.88% at October 31, 2007). The line matures in June 2008, and is secured by substantially all assets of the Organization. As of October 31, 2007 and 2006, the balance outstanding on the line of credit was \$259,224 and \$354,450, respectively.

Long-term debt consists of:

	<u>2007</u>	<u>2006</u>
5.33% note payable to bank, due in monthly installments of \$1,850 including interest, due in December 2008, secured by real estate.	\$ 114,102	\$ 129,680
6.49% note payable to bank, due in monthly installments of \$720 including interest, due in July 2012, secured by vehicles.	35,127	-
7.61% mortgage payable to bank, due in monthly installments of \$937 including interest, due in May 2011, secured by real estate.	34,494	42,730
5.49% note payable to bank, due in monthly installments of \$864 including interest, due in September 2010, secured by equipment.	27,904	36,496
7.61% mortgage payable to bank, due in monthly installments of \$740 including interest, due in May 2011, secured by real estate.	26,087	32,677
5.24% note payable to bank, due in monthly installments of \$724 including interest, due in September 2010, secured by vehicles.	20,308	27,723
4.65% note payable to bank, due in monthly installments of \$1,362 including interest, due in September 2008, secured by vehicles.	14,637	29,907
Interest free note payable to Iowa Finance Authority, due in monthly payments of \$1,333.	4,000	9,334
4.99% note payable to bank, due in monthly installments of \$947 including interest, due in September 2007, secured by vehicles.	-	10,160
7.25% mortgage payable to bank, due in monthly installments of \$706 including interest, due in March 2007, secured by real estate.	-	2,654
7.25% mortgage payable to bank, due in monthly installments of \$630 including interest, due in March 2007, secured by real estate.	-	2,076
	<u>\$ 276,659</u>	<u>\$ 323,437</u>
Less current maturities	<u>(73,068)</u>	<u>(81,427)</u>
Long-term debt, less current maturities	<u>\$ 203,591</u>	<u>\$ 242,010</u>

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HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

Future principal payments on the above loan are as follows:

<u>Year Ending October 31</u>	
2008	\$ 73,068
2009	141,220
2010	34,695
2011	21,475
2012	<u>6,201</u>
Total	<u>\$ 276,659</u>

NOTE 7 – DEFERRED REVENUE

Deferred revenue includes an advance from the Iowa Department of Public Health earmarked for future periods. The advance totaled \$43,666 for the years ended October 31, 2007 and 2006.

NOTE 8 – EMPLOYEE BENEFIT PLANS

Self-Insured Health Plan

Starting in fiscal year 2007, Hillcrest Family Services, Inc. self-insures for losses related to employee health benefits. Reinsurance coverage is maintained for specific individual and aggregate liability losses over specified amounts. A provision for estimated health claims outstanding of \$61,000 is included in accounts payable at October 31, 2007.

Defined Contribution Pension Plan

Hillcrest Family Services, Inc. had a defined contribution pension plan covering substantially all bargaining employees. The Organization contributed six percent of the eligible compensation of each employee until August 31, 2006. The Organization's contributions for the year ended October 31, 2006 were \$33,408.

401(k) Retirement Plans

Effective September 1, 2006, the Organization adopted a qualified 401(k) retirement plan. The plan covers all bargaining employees who have completed two years of service and are 21 years of age or older. The Organization makes discretionary contributions of 3% of eligible compensation. The Organization also matches 50% of employee contributions up to 2% of eligible compensation. Effective November 1, 2008, the Organization will match 50% of employee contributions up to 4% of eligible compensation. The employer contributions for the years ended October 31, 2007 and 2006, were \$39,225 and \$1,057, respectively.

Subsequent to year end, the Organization also adopted a qualified 401(k) retirement plan that covers all non-bargaining employees who have completed one year of service and are 21 years of age or older. The Organization makes discretionary contributions of 3% of eligible compensation. The Organization also matches 50% of employee contributions up to 4% of eligible compensation.

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HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

Defined Benefit Pension Plan

Hillcrest Family Services, Inc. has a defined benefit pension plan covering substantially all non-bargaining employees. Plan benefits are based primarily on years of service and employee's compensation near retirement. Plan assets consist primarily of mutual funds and common stock.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132R". This standard requires employers to recognize the underfunded or overfunded status of defined benefit pension and postretirement plans as an asset or liability in its statement of financial position, and recognize changes in the funded status (such as actuarial gains and losses, prior service costs or credits and net transition assets or obligations) in the year in which the changes occur as a non operating-item in changes in net assets. This standard requires the liability to be calculated using the plan's projected benefit obligation which takes into consideration expected future changes in compensation rather than using the accumulated benefit obligation, which does not take into account future changes in compensation. This Standard also eliminates the requirement for an Additional Minimum Pension Liability (AML) required under SFAS No. 87. As a result of the application of SFAS No. 158 as of October 31, 2007, the Organization decreased its pension liability by \$440,327. This resulted in an increase in unrestricted net assets reported as a pension plan adjustment under Other Changes in the Statement of Activities and Changes in Net Assets.

The following table discloses the adjustments to the balance sheet to record the funded status of the defined benefit pension plan as of October 31, 2007:

	Pre SFAS No. 158	SFAS No. 158 Adoption Adjustments	Post SFAS No. 158
Accrued pension liability	\$ (460,918)	\$ 440,327	\$ (20,591)
Unrestricted net assets	\$ -	\$ 440,327	\$ 440,327

The plan's measurement date is October 31.

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

The following table sets forth the plan's funded status at October 31:

	<u>2007</u>	<u>2006</u>
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 4,258,931	\$ 3,833,296
Service cost	333,061	350,332
Interest cost	237,713	232,588
Experience (gain)/loss due to participant changes	(870,483)	47,899
Benefits paid	<u>(60,812)</u>	<u>(205,184)</u>
Benefit obligation at end of year	<u>\$ 3,898,410</u>	<u>\$ 4,258,931</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$ 3,685,579	\$ 3,284,827
Actual return on plan assets	37,052	320,806
Employer contribution	216,000	285,130
Benefits paid	<u>(60,812)</u>	<u>(205,184)</u>
Fair value of plan assets at end of year	<u>\$ 3,877,819</u>	<u>\$ 3,685,579</u>
Funded status	\$ (20,591)	\$ (573,352)
Unrecognized net actuarial loss	-	(133,329)
Unrecognized transition (asset) obligation	<u>-</u>	<u>378,273</u>
Accrued benefit cost liability	<u>\$ (20,591)</u>	<u>\$ (328,408)</u>

Amounts recognized in the financial statements under SFAS 158:

	<u>Pension Benefits</u>	
	<u>2007</u>	<u>2006</u>
Noncurrent liabilities	<u>\$ 20,591</u>	<u>\$ -</u>
Net gain	\$ 744,429	\$ -
Net transition obligation	<u>(304,102)</u>	<u>-</u>
Total	<u>\$ 440,327</u>	<u>\$ -</u>

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

The accumulated benefit obligation for the defined benefit pension plan was \$3,842,429 and \$3,597,013 at October 31, 2007 and 2006, respectively.

	<u>2007</u>	<u>2006</u>
Weighted-average assumptions as of October 31		
Discounted rate	6.00%	5.75%
Rate of total compensation increase	4.50%	4.50%
Expected return on plan assets	8.00%	8.00%

The net periodic pension cost for the years ended October 31, includes the following components:

	<u>2007</u>	<u>2006</u>
Components on net periodic benefit cost		
Service cost	\$ 333,061	\$ 350,332
Interest cost	237,713	232,588
Expected return on plan assets	(296,435)	(264,793)
Amortization of transition obligation	74,171	74,171
Net periodic benefit cost	<u>\$ 348,510</u>	<u>\$ 392,298</u>

The Organization's pension plan weighted-average asset allocation at October 31, by asset category is as follows:

	<u>2007</u>	<u>2006</u>
Equity securities	58%	64%
Debt securities	36	34
Other	6	2
Total	<u>100%</u>	<u>100%</u>

Management's investment philosophy to achieve acceptable returns with reasonable risks involves diversification into different investment asset classes, which in turn, mitigates an over exposure to any one segment of investment alternatives, avoids market timing, and controls fees.

The Organization expects to contribute approximately \$40,542 to the plan during the fiscal year ended October 31, 2008.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

<u>Year Ending October 31</u>	
2008	\$ 359,000
2009	256,000
2010	185,000
2011	336,000
2012	204,000
Thereafter, through 2017	1,823,000

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

Plan Termination

Subsequent to year end, Hillcrest Family Services, Inc. made the decision to terminate the preceding defined benefit pension plan. The assets of the plan were frozen on December 31, 2007, and the plan is currently in the termination process. According to the plan document, participants become 100% vested in their accrued benefit upon plan termination. Benefits will be distributed to the participants in the manner and priorities allowed by the plan, as soon as practicable. The above calculations did not consider the plan termination.

NOTE 9 – TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS

Temporarily restricted net assets are available for the following purposes at October 31, 2007 and 2006:

	<u>2007</u>	<u>2006</u>
Time restriction - United Way contributions	\$ 92,000	\$ 92,000
Time restriction - other pledges	59,198	88,066
Family Life Center	<u>16,909</u>	<u>-</u>
	<u>\$ 168,107</u>	<u>\$ 180,066</u>

During the fiscal year ended October 31, 2006, the Organization released a donor from a pledge commitment totaling \$20,000. In lieu of this pledge, the donor made a \$20,000 contribution to the Organization's endowment fund under the Community Foundation of Greater Dubuque.

Permanently restricted net assets at October 31, 2007 and 2006, are held in perpetuity with the income to be used for:

	<u>2007</u>	<u>2006</u>
Unrestricted support for programs	\$ 110,000	\$ 110,000
Educational programs	80,000	80,000
Family counseling	<u>1,000</u>	<u>1,000</u>
	<u>\$ 191,000</u>	<u>\$ 191,000</u>

NOTE 10 – OPERATING LEASES

The Organization leases certain property and equipment under noncancellable long-term operating lease agreements. Total lease expense for the years ended October 31, 2007 and 2006, was \$353,156 and \$369,639, respectively.

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

Minimum future lease payments are as follows:

<u>Year Ending October 31</u>	
2008	\$ 191,986
2009	175,134
2010	171,005
2011	61,493
2012	<u>40,085</u>
Total	<u>\$ 639,703</u>

NOTE 11 – RELATED PARTY TRANSACTIONS

The Organization had transactions with a company owned by a member of the Board of Trustees related to the purchase of an automobile and repairs. The total payments for the years ended October 31, 2007 and 2006, were \$0 and \$15,281, respectively.

NOTE 12 – CONTINGENCY

A civil lawsuit has been filed on behalf of the estate of a former client. No specific amount of monetary damages is being sought. A trial is set to begin on September 9, 2008. At this point, the case is in its early stages and is being vigorously contested by the Organization's insurer. Management feels that any damages sought should be covered by their insurance policy. Available policy limits are \$1 million.

NOTE 13 – ADMINISTRATIVE ADJUSTMENT

The Iowa Department of Human Services (DHS) had performed three billing audits of the Organization pertaining to certain youth treatment services. The results of these audits showed that DHS had overpaid the Organization for these services in the amount of \$421,197. Hillcrest appealed the audits and the result of the appeals was a settlement of \$133,728 which was paid during the year ending October 31, 2007.

NOTE 14 – CONCENTRATION OF CREDIT RISK

Hillcrest Family Services, Inc. is reimbursed for substantially all program services under third-party payor agreements with various government programs. Substantially all program services are paid at prospectively determined rates.

The Organization's cash balances are maintained in various bank deposit accounts. At times these deposits may be in excess of federally insured limits. Management believes these financial institutions have strong credit ratings and that credit risk related to these deposits is minimal.

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

NOTE 15 – PRIOR PERIOD ADJUSTMENTS

The accompanying financial statements for 2006 have been restated to correct certain errors. Furthermore, net assets at the beginning of 2006 have also been adjusted to correct errors made in prior years.

Accrued Pension Liability

Statement of Financial Accounting Standards Nos. 87 and 132R “Employers’ Accounting for Pensions” and “Employers’ Disclosures about Pensions and Other Postretirement Benefits” (Standards) require plan sponsors to recognize an accrued or prepaid balance related to the status of defined benefit pension and postretirement plans as an asset or liability in its Statement of Financial Position. The asset or liability represents the difference between the plan sponsor contributions to the plan and the net periodic pension cost of the plan as computed by an actuary. Furthermore, an additional minimum liability is accrued if the plan’s accumulated benefit obligation is less than the fair value of plan assets as of the measurement date.

An accrued pension liability should have been recorded in prior years under these Standards but was not. As a result, unrestricted net assets as of the beginning of 2006 have been restated (decreased) to record an accrued pension liability of \$221,240 as of October 31, 2005. Furthermore, the accompanying financial statements for 2006 have been restated to record an accrued pension liability of \$328,408 as of October 31, 2006. The effect of this restatement was a decrease to change in net assets of \$107,168 in 2006.

Net Asset Restrictions

Net asset classifications for donor restricted contributions and promises to give were incorrectly reported in the past. As a result, net assets as of the beginning of 2006 have been restated to reclassify the restrictions as follows: unrestricted net assets decreased by \$165,294, temporarily restricted net assets increased by \$115,214 and permanently restricted net assets increased by \$50,080. Furthermore, the accompanying financial statements for 2006 have been restated to reflect the proper reporting of the activity associated with donor-restrictions and promises to give. The effect of this restatement was a reclassification of net assets as follows: increase unrestricted net assets by \$152,465, decrease temporarily restricted net assets by \$133,175 and decrease permanently restricted net assets by \$19,290 in 2006.

Deferred Revenue and Prepaid Expenses

The Organization hosts a holiday lights display (Reflections in the Park) from Thanksgiving through New Years Day. Financial activity for this event has been recorded on a cash basis in the past. Most of the sponsor revenue and display expenses for the event are received/incurred prior to October 31st each year. Recognition of revenues collected and expenses paid prior to the Organization’s fiscal year end should be deferred until the event takes place. As a result, unrestricted net assets as of the beginning of 2006 have been restated (decreased by \$35,256) to record deferred revenue of \$80,478 and prepaid expenses of \$45,222 as of October 31, 2005. Furthermore, the accompanying financial statements for 2006 have been restated to record deferred revenue of \$105,640 and prepaid expenses of \$46,934 as of October 31, 2006. The October 31, 2005 deferred revenue and prepaid expenses were recognized as revenue and expense for 2006. The effect of this restatement was a decrease to unrestricted net assets of \$23,450 in 2006.

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

The financial statement line items for 2006 were affected by the aforementioned restatements as follows:

	As Originally Reported	As Restated for Cumulative Effect of 2005 Adjustments	Effect of Accrued Pension Liability Restatement	Effect of Net Asset Restrictions Restatement	Effect of Deferred Revenue and Prepaid Expense Restatement	As Restated
STATEMENT OF FINANCIAL POSITION						
ASSETS						
CURRENT ASSETS						
Cash and cash equivalents	\$ 2,629,840	\$ 2,629,840	\$ -	\$ -	\$ -	\$ 2,629,840
Receivables	2,357,663	2,357,663	-	-	-	2,357,663
Accrued interest receivable	24,624	24,624	-	-	-	24,624
Promises to give	168,611	168,611	-	-	-	168,611
Inventory	10,120	10,120	-	-	-	10,120
Prepaid expenses	26,525	71,747	-	-	1,712	73,459
Total current assets	<u>5,217,383</u>	<u>5,262,605</u>	<u>-</u>	<u>-</u>	<u>1,712</u>	<u>5,264,317</u>
LAND, BUILDINGS AND EQUIPMENT	<u>4,486,468</u>	<u>4,486,468</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,486,468</u>
OTHER ASSETS						
Promises to give	11,455	11,455	-	-	-	11,455
Investments	3,197,232	3,197,232	-	-	-	3,197,232
Beneficial interest in net assets of community foundation	12,377	12,377	-	-	-	12,377
Total other assets	<u>3,221,064</u>	<u>3,221,064</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,221,064</u>
Total assets	<u>\$ 12,924,915</u>	<u>\$ 12,970,137</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,712</u>	<u>\$ 12,971,849</u>
LIABILITIES AND NET ASSETS						
CURRENT LIABILITIES						
Bank overdraft	\$ 2,748,028	\$ 2,748,028	\$ -	\$ -	\$ -	\$ 2,748,028
Current maturities of long-term debt	81,427	81,427	-	-	-	81,427
Line of credit	354,450	354,450	-	-	-	354,450
Accounts payable	291,763	291,763	-	-	-	291,763
Accrued expenses						
Salaries and wages	72,251	72,251	-	-	-	72,251
Vacation	335,260	335,260	-	-	-	335,260
Payroll taxes and other	73,638	73,638	-	-	-	73,638
Deferred revenue	46,194	126,672	-	-	25,162	151,834
Total current liabilities	<u>4,003,011</u>	<u>4,083,489</u>	<u>-</u>	<u>-</u>	<u>25,162</u>	<u>4,108,651</u>
PENSION LIABILITY	-	221,240	107,168	-	-	328,408
LONG-TERM DEBT, less current maturities	<u>242,010</u>	<u>242,010</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>242,010</u>
Total liabilities	<u>4,245,021</u>	<u>4,546,739</u>	<u>107,168</u>	<u>-</u>	<u>25,162</u>	<u>4,679,069</u>
NET ASSETS						
Unrestricted						
Undesignated	5,324,318	4,902,528	(107,168)	152,465	(23,450)	4,924,375
Designated by board	2,997,339	2,997,339	-	-	-	2,997,339
Temporarily restricted	198,027	313,241	-	(133,175)	-	180,066
Permanently restricted	160,210	210,290	-	(19,290)	-	191,000
Total net assets	<u>8,679,894</u>	<u>8,423,398</u>	<u>(107,168)</u>	<u>-</u>	<u>(23,450)</u>	<u>8,292,780</u>
Total liabilities and net assets	<u>\$ 12,924,915</u>	<u>\$ 12,970,137</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,712</u>	<u>\$ 12,971,849</u>

(continued on next page)

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

	As Originally Reported	As Restated for Cumulative Effect of 2005 Adjustments	Effect of Accrued Pension Liability Restatement	Effect of Net Asset Restrictions Restatement	Effect of Deferred Revenue and Prepaid Expense Restatement	As Restated
STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS						
SUPPORT AND REVENUE						
Public support						
Direct:						
Contributions	\$ 315,229	\$ 315,229	\$ -	\$ -	\$ -	\$ 315,229
Bequests - trusts/estates	15,645	15,645	-	-	-	15,645
Bowl for Kids Sake	31,059	31,059	-	-	-	31,059
The Big Event	14,633	14,633	-	-	-	14,633
Special events - lights	184,823	184,823	-	-	(25,162)	159,661
Indirect:						
Grants - federal awards	1,220,443	1,220,443	-	-	-	1,220,443
Grants - other	170,562	170,562	-	-	-	170,562
United Way	108,308	108,308	-	-	-	108,308
Total public support	<u>2,060,702</u>	<u>2,060,702</u>	<u>-</u>	<u>-</u>	<u>(25,162)</u>	<u>2,035,540</u>
Revenue						
Program service fees, net	12,181,820	12,181,820	-	-	-	12,181,820
Less: administrative adjustment	-	-	-	-	-	-
Investment income	256,842	256,842	-	-	-	256,842
Miscellaneous	109,721	109,721	-	-	-	109,721
Net assets released from restrictions	-	-	-	-	-	-
Total revenues	<u>12,548,383</u>	<u>12,548,383</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>12,548,383</u>
Total public support and revenue	<u>14,609,085</u>	<u>14,609,085</u>	<u>-</u>	<u>-</u>	<u>(25,162)</u>	<u>14,583,923</u>
EXPENSES						
Program services	14,098,881	14,098,881	104,848	-	-	14,203,729
Supporting services						
Development	301,020	301,020	2,320	-	-	303,340
Special event - lights	99,195	99,195	-	-	(1,712)	97,483
Total expenses	<u>14,499,096</u>	<u>14,499,096</u>	<u>107,168</u>	<u>-</u>	<u>(1,712)</u>	<u>14,604,552</u>
PUBLIC SUPPORT AND REVENUE IN EXCESS OF (LESS THAN) EXPENSES	109,989	109,989	(107,168)	-	(23,450)	(20,629)
OTHER CHANGES IN NET ASSETS						
Change in unrealized gains and losses	147,161	147,161	-	-	-	147,161
Pledge forgiven	(20,000)	(20,000)	-	-	-	(20,000)
Pension liability adjustment	-	-	-	-	-	-
INCREASE (DECREASE) IN NET ASSETS	<u>\$ 237,150</u>	<u>\$ 237,150</u>	<u>\$ (107,168)</u>	<u>\$ -</u>	<u>\$ (23,450)</u>	<u>\$ 106,532</u>
NET ASSETS, BEGINNING OF YEAR, AS PREVIOUSLY REPORTED	8,442,744	8,442,744	-	-	-	8,442,744
PRIOR PERIOD ADJUSTMENTS	-	(256,496)	-	-	-	(256,496)
NET ASSETS, BEGINNING OF YEAR, AS RESTATED	<u>8,442,744</u>	<u>8,186,248</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,186,248</u>
NET ASSETS, END OF YEAR	<u>\$ 8,679,894</u>	<u>\$ 8,423,398</u>	<u>\$ (107,168)</u>	<u>\$ -</u>	<u>\$ (23,450)</u>	<u>\$ 8,292,780</u>

(continued on next page)

HILLCREST FAMILY SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
OCTOBER 31, 2007 AND 2006

	As Originally Reported	As Restated for Cumulative Effect of 2005 Adjustments	Effect of Accrued Pension Liability Restatement	Effect of Net Asset Restrictions Restatement	Effect of Deferred Revenue and Prepaid Expense Restatement	As Restated
STATEMENT OF CASH FLOWS						
OPERATING ACTIVITIES						
Increase (decrease) in net assets	\$ 237,150	\$ 237,150	\$ (107,168)	\$ -	\$ (23,450)	\$ 106,532
Adjustments to reconcile increase (decrease) in net assets to net cash from (used for) operating activities						
Depreciation	417,648	417,648	-	-	-	417,648
Gain on sale of equipment	(8,978)	(8,978)	-	-	-	(8,978)
Receipt of land donation	(1,050)	(1,050)	-	-	-	(1,050)
Bad debts	214,170	214,170	-	-	-	214,170
Changes in assets and liabilities						
Receivables	(941,610)	(941,610)	-	-	-	(941,610)
Inventory	(600)	(600)	-	-	-	(600)
Prepaid expenses	5,959	5,959	-	-	(1,712)	4,247
Bank overdraft	440,467	440,467	-	-	-	440,467
Accounts payable	83,781	83,781	-	-	-	83,781
Accrued expenses	111,690	111,690	-	-	-	111,690
Deferred revenue	2,528	2,528	-	-	25,162	27,690
Pension liability	-	-	107,168	-	-	107,168
NET CASH FROM OPERATING ACTIVITIES	561,155	561,155	-	-	-	561,155
INVESTING ACTIVITIES						
Purchase of property and equipment	(313,658)	(313,658)	-	-	-	(313,658)
Increase in investments	(777,061)	(777,061)	-	-	-	(777,061)
Proceeds from sale of equipment	14,000	14,000	-	-	-	14,000
NET CASH USED FOR INVESTING ACTIVITIES	(1,076,719)	(1,076,719)	-	-	-	(1,076,719)
FINANCING ACTIVITIES						
Net proceeds (payments) on line of credit	354,450	354,450	-	-	-	354,450
Principal payments on long-term debt	(134,265)	(134,265)	-	-	-	(134,265)
NET CASH FROM FINANCING ACTIVITIES	220,185	220,185	-	-	-	220,185
NET DECREASE IN CASH AND CASH EQUIVALENTS	(295,379)	(295,379)	-	-	-	(295,379)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	2,925,219	2,925,219	-	-	-	2,925,219
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 2,629,840	\$ 2,629,840	\$ -	\$ -	\$ -	\$ 2,629,840

NOTE 16 - SUBSEQUENT EVENT – RETIREMENT PLANS

Subsequent to year end, Hillcrest Family Services, Inc. made the decision to terminate its defined benefit pension plan. The assets of the plan were frozen on December 31, 2007, and the plan is currently in the termination process. According to the plan document, participants become 100% vested in their accrued benefit upon plan termination. Benefits will be distributed to the participants in the manner and priorities allowed by the plan, as soon as practicable.

Subsequent to year end, the Hillcrest Family Services, Inc. adopted a qualified 401(k) retirement plan. The plan covers all non-bargaining employees who have completed one year of service and are 21 years of age or older. The Organization makes discretionary contributions of 3% of eligible compensation. The Organization also matches 50% of employee contributions up to 4% of eligible compensation.

**SUPPLEMENTARY INFORMATION
OCTOBER 31, 2007 AND 2006**

HILLCREST FAMILY SERVICES, INC.

HILLCREST FAMILY SERVICES, INC.
SCHEDULES OF PROGRAM SERVICE FEES, NET
OCTOBER 31, 2007 AND 2006

	<u>2007</u>	<u>2006</u>
Program service fees, net		
Residential treatment	\$ 3,038,009	\$ 3,027,738
CMI group homes	2,161,914	2,292,740
Health services	403,014	470,008
Schools	2,850,244	2,536,815
Shelter	494,234	502,639
Family Centered Services	430,264	557,835
Counseling	75,658	173,145
Adoption	142,992	186,247
Hillcrest supported living/IPRS/VOC	1,263,144	1,141,609
Family Empowerment Center	58,428	99,310
Transitional housing	3,259	860
Washington County mental health center	246,322	260,928
Dubuque County mental health center	1,520,343	795,035
Jackson County mental health center	255,598	136,911
Path Grant	1,171	-
WRAP/Recovery Center	<u>19</u>	<u>-</u>
 Total program service fees	 <u>\$ 12,944,613</u>	 <u>\$ 12,181,820</u>

HILLCREST FAMILY SERVICES, INC.
SCHEDULE OF REVENUES AND EXPENSES
WIC – CONTRACT # 5887AO35
MATERNAL HEALTH – CONTRACT # 5887MH13
ABSTINENCE ONLY – CONTRACT # 5886AB48 AND 5887AB48
CONTRACT PERIOD: OCTOBER 1, 2006 THROUGH SEPTEMBER 30, 2007

	<u>WIC</u>	<u>Maternal Health</u>	<u>Abstinence Only</u>
Revenues			
Iowa Department of Public Health	\$ 593,962	\$ 66,412	\$ -
Title XIX	-	123,986	-
United Way	-	7,226	-
Miscellaneous	<u>1,726</u>	<u>4,861</u>	<u>8,148</u>
 Total revenues	 <u>595,688</u>	 <u>202,485</u>	 <u>8,148</u>
Expenses			
Salaries	339,697	131,595	4,883
Fringe benefits	61,685	16,397	907
Payroll taxes, etc.	25,355	9,590	368
Contracted services	3,157	32,861	1,747
Supplies & equipment maintenance	32,157	4,373	(3)
Telephone	10,497	562	24
Postage and shipping	1,758	558	25
Occupancy	69,511	6,144	7
Outside printing	90	-	-
Travel	20,505	3,843	239
Conferences and meetings	5,259	1,233	53
Subscriptions	769	9	-
Client assistance	16,157	489	41
Dues	1,238	140	-
Miscellaneous	10,022	4,502	-
Interest	67	53	-
Depreciation	<u>-</u>	<u>4,993</u>	<u>-</u>
 Total expenses	 <u>597,924</u>	 <u>217,342</u>	 <u>8,291</u>
 Revenues less than expenses	 <u>\$ (2,236)</u>	 <u>\$ (14,857)</u>	 <u>\$ (143)</u>

HILLCREST FAMILY SERVICES, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED OCTOBER 31, 2007

Grantor/Program	CFDA Number	Agency or Pass- through Number	Program Expenditures
Indirect:			
U.S. Department of Agriculture			
Passed through Iowa Department of Public Health			
Special Supplemental Nutrition Program for Women, Infants, and Children	10.557	5887A035 5888A035	\$ 549,292 <u>45,748</u> <u>595,040</u>
Passed through Iowa Department of Education			
National School Lunch/Breakfast Programs	10.555/ 10.553	31-8014	<u>102,270</u>
U.S. Department of Health and Human Services			
Passed through Iowa Department of Human Services			
CMHS Mental Health Block Grant	93.958	07-0324-401- 6490-2349-84	15,566
		08-0324-401- 6490-2349-84	893
	93.958	07-0324-401- 6490-2349-83	66,488
		08-0324-401- 6490-2349-83	<u>14,421</u>
			<u>97,368</u>
Projects for Assistance in Transition from Homelessness	93.150	07-0444-401- 6890-2597-03 (2006-2007)	22,994
		08-0444-401- 6890-2597-03 (2007-2008)	<u>2,205</u>
			<u>25,199</u>
Passed through Iowa Department of Public Health			
Maternal and Child Health Services Block Grant	93.994	5887MH13 5888MH13	55,790 <u>12,742</u> <u>68,532</u>
Abstinence Only Education Grant	93.235	5887AB48	<u>7,358</u>
Childhood Immunization Grant	93.268	5886I435 5887I435	333 <u>1,387</u> <u>1,720</u>
HIV Prevention Project	93.940	5886-AP03	<u>772</u>

(continued)
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HILLCREST FAMILY SERVICES, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
YEAR ENDED OCTOBER 31, 2007

Grantor/Program	CFDA Number	Agency or Pass- through Number	Program Expenditures
Passed through State Department of Health and Human Services and Family Planning Council of Iowa			
Title X Family Planning	93.217	412/420-FY2007	\$ 88,311
		412/420-FY2008	<u>45,247</u>
			<u>133,558</u>
Direct:			
U.S. Department of Housing and Urban Development			
Supportive Housing Program	14.235	31-8014	<u>56,454</u>
U.S. Department of Education			
Mentoring Program Grants	84.184B	Q184B040951	<u>133,046</u>
Total			<u>\$ 1,221,317</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 Directors
Hillcrest Family Services, Inc.
Dubuque, Iowa

We have audited the financial statements of **Hillcrest Family Services, Inc. (Hillcrest)**, as of and for the year ended October 31, 2007, and have issued our report thereon dated May 15, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Hillcrest'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 an opinion on the effectiveness of Hillcrest's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Hillcrest'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 in Part II of the schedule of findings and questioned costs, 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 a 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 entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control over financial reporting. We consider the deficiencies described in Part II of the accompanying schedule of findings and questioned costs 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 that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies in Part II of the schedule of findings and questioned costs, we consider items II-A-07, II-B-07 and II-C-07 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Hillcrest's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance 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 noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Hillcrest's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit Hillcrest's responses, and accordingly, we express no opinion on them.

We also noted certain matters that we reported to management of Hillcrest Family Services, Inc. in a separate letter dated May 15, 2008.

This report is intended solely for the information and use of the board of directors, management, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

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

Dubuque, Iowa
May 15, 2008



CPAs & BUSINESS ADVISORS

**REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE
TO ITS MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

The Board of Directors
Hillcrest Family Services, Inc.
Dubuque, Iowa

Compliance

We have audited the compliance of Hillcrest Family Services, Inc. (Hillcrest), with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended October 31, 2007. Hillcrest's major federal program is identified in the summary of the independent auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grant agreements applicable to its major federal program is the responsibility of Hillcrest's management. Our responsibility is to express an opinion on Hillcrest's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Hillcrest's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Hillcrest's compliance with those requirements.

In our opinion, Hillcrest Family Services, Inc. complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended October 31, 2007.

Internal Control Over Compliance

The management of Hillcrest Family Services, Inc. is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grant agreements applicable to federal programs. In planning and performing our audit, we considered Hillcrest's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of Hillcrest's internal control over compliance with requirements that could have a direct and material effect on a major federal program. Accordingly, we do not express an opinion on the effectiveness of Hillcrest's internal control over compliance with requirements that could have a direct and material effect on a major federal program.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report on compliance with applicable requirements of laws, regulations, contracts, and grant agreements that would be material in relation to a major federal program being audited such that there is more than a remote likelihood that a noncompliance that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a noncompliance on a major federal program will not be prevented or detected by the entity's internal control.

Our consideration of internal control over compliance with requirements that could have a direct and material effect on a major federal program was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance with requirements that could have a direct and material effect on a major federal program that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the board of directors, management, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

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

Dubuque, Iowa
May 15, 2008

HILLCREST FAMILY SERVICES, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED OCTOBER 31, 2007

Part I: Summary of the Independent Auditor's Results

- (a) An unqualified opinion was issued on the financial statements of Hillcrest Family Services, Inc..
- (b) Significant deficiencies in internal control over financial reporting were disclosed by the audit of the financial statements, including material weaknesses.
- (c) The audit did not disclose any noncompliance which is material to the financial statements.
- (d) No material weaknesses in internal control over the major program were noted.
- (e) An unqualified opinion was issued on compliance with requirements applicable to the major program.
- (f) The audit disclosed no audit findings which were required to be reported in accordance with Office of Management and Budget Circular A-133, Section .510(a).
- (g) The major program was CFDA Number 10.557 – Special Nutrition Program for Women, Infants, and Children (WIC).
- (h) The dollar threshold used to distinguish between Type A and Type B programs was \$300,000.
- (i) Hillcrest Family Services, Inc. qualified as a low-risk auditee.

HILLCREST FAMILY SERVICES, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED OCTOBER 31, 2007

Part II: Findings - Financial Statements Audit

SIGNIFICANT DEFICIENCY/MATERIAL WEAKNESS

II-A-07 Preparation of Financial Statements

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

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 Organization'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 is willing to accept the risk associated with this condition. The cost of hiring and training additional staff to prepare the financial statements would not be financially beneficial to the Organization.

Conclusion

Response accepted.

II-B-07 Accounts Receivable Reconciliation

An important aspect of internal controls is the timely reconciliation of accounts receivable subsidiary information to the general ledger. Several accounts receivable balances were not reconciled to the general ledger when audit fieldwork was scheduled to take place.

Many third-party payors establish a limited timeframe for settling accounts. Accounts are disallowed for a variety of reasons which may include; incorrect diagnosis codes, errors in the billing dates, or no authorization for service on file for the consumer. Many of these issues can be addressed by correcting original input errors. Several accounts had exceeded the timeframe and needed to be written off.

Recommendation

Accounts receivable subsidiary information should be reconciled to the general ledger monthly. Timely reconciliation of this information allows management to analyze the collectibility of the accounts and to make appropriate financial decisions based on this analysis. Any disallowed charges should be followed up with the appropriate payor as soon as notification is received. This would give Hillcrest more time to provide information necessary to settle the account.

HILLCREST FAMILY SERVICES, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED OCTOBER 31, 2007

Part II: Findings - Financial Statements Audit (continued)

Response

Management agrees with the finding and has reviewed the accounts receivable reconciliation procedures of Hillcrest Family Services, Inc. Accounts receivable detail will be tied to the general ledger monthly and disallowed charges will be addressed when notification is received.

Conclusion

Response accepted.

II-C-07

Prior Period Adjustments

During the course of our audit we noted account balances that required prior period adjustments. These adjustments were made to ensure that the financial statements were prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Following is a summary of the adjustments:

- Net asset restrictions were adjusted to reflect the original donor intentions.
- Pension liability was adjusted to reflect reporting requirements based on applicable accounting standards.
- Reflections in the Park activity had been recorded on the cash basis of accounting and was adjusted to reflect the accrual basis of accounting.

Recommendation

Management should be aware of new accounting standards that have been issued to determine if they have an impact on their financial reporting. We encourage you to consult during the year with the auditors for assistance with the application of any new standards. Furthermore, all of the Organization's financial activity should be recorded consistently with GAAP.

Response

Management agrees with the finding and will address these issues with the auditors as new standards are adopted or when new activities are recorded.

Conclusion

Response accepted.

HILLCREST FAMILY SERVICES, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED OCTOBER 31, 2007

Part II: Findings - Financial Statements Audit (continued)

SIGNIFICANT DEFICIENCY

II-D-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. 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 Organization 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 Organization 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 Hillcrest Family Services, Inc.. Due to the limited number of office employees, management will continue to monitor the Organization'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.

Part III: Findings and Questioned Costs - Major Federal Award Program Audit

There are no findings and questioned costs to report.