

**FINANCIAL STATEMENTS**  
**JUNE 30, 2009 AND 2008**



**PALO ALTO COUNTY**  

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**HEALTH SYSTEM**

 AFFILIATED WITH  
MERCY HEALTH NETWORK

**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**

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<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	Trustee	December 31, 2010
Tammy Naig	Trustee	December 31, 2012
Kris Ausborn	Trustee	December 31, 2014
Dean Newlon	Trustee	December 31, 2014
<u>Health System Officials</u>		
Thomas J. Lee	Chief Executive Officer	
Renay Hauswirth	Director of Finance	
Coleen Ruddy	Director of Patient Billing	
Joann Higgen	Director of Nursing	



CPAs & BUSINESS ADVISORS

## INDEPENDENT AUDITOR'S REPORT

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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, 2009 and 2008, and its discretely presented component unit, Palo Alto County Health Care Foundation (Foundation), as of December 31, 2008 and 2007, 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 the Health System, as of June 30, 2009 and 2008, and the financial statements for its discretely presented component unit as of December 31, 2008 and 2007, 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 10, 2009, 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 Bailly LLP". The signature is written in black ink and is positioned above the typed name and date.

Dubuque, Iowa  
September 10, 2009

# 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, 2009. 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 \$1,429,899 or 4.0%. This increase represents investments in capital equipment and buildings.
- The Health System's assets exceeded liabilities by \$18,674,977 at June 30, 2009.
- During the year, the Health System's total operating revenues increased 11.0% to \$19,758,812, while the operating expenses increased 10.6% to \$19,630,235. The Health System had income from operations of \$128,577, which is 0.7% of total operating revenues.
- The Health System made capital equipment and building investments totaling \$3,744,122 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, 2009, reports total assets of \$37,264,779, total liabilities of \$18,589,802, and net assets of \$18,674,977.

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 \$19,758,812 and total operating expenses of \$19,630,235 during fiscal year 2009. The operating income was \$128,577 in 2009, compared to an operating income of \$24,672 in 2008.

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 \$14,640,633 in short-term and long-term debt. The debt was incurred for improvements of the Health System's acute, long-term care, business office, specialty clinic, community health 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 specialists, 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 electronic medical records 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 1<sup>st</sup> Street  
Emmetsburg, IA 50536

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**BALANCE SHEETS**  
**JUNE 30, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 5,738,703	\$ 5,317,652
Restricted under bond agreement - Note 4	456,752	450,660
Receivables		
Patient and resident, net of estimated uncollectibles		
of \$1,760,000 in 2009 and \$1,737,000 in 2008	2,547,888	2,328,884
Estimated third-party payor settlements	151,345	380,000
Succeeding year property tax	981,097	956,799
Other	73,025	119,522
Supplies	296,881	305,096
Prepaid expense	63,086	115,713
Total current assets	<u>10,308,777</u>	<u>9,974,326</u>
<b>ASSETS LIMITED AS TO USE OR RESTRICTED - Note 4</b>		
Internally designated for capital improvements	2,912,763	2,689,090
Restricted under bond agreement	<u>2,600,629</u>	<u>3,889,617</u>
Total assets limited as to use or restricted	<u>5,513,392</u>	<u>6,578,707</u>
<b>LAND, BUILDINGS, AND EQUIPMENT, net - Note 5</b>	<u>21,131,701</u>	<u>18,955,427</u>
<b>OTHER ASSETS</b>		
Bond issuance costs, net of accumulated amortization	<u>310,909</u>	<u>326,420</u>
Total assets	<u>\$ 37,264,779</u>	<u>\$ 35,834,880</u>

See notes to financial statements.

	<u>2009</u>	<u>2008</u>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Current maturities of long-term debt - Note 7	\$ 270,000	\$ 180,000
Accounts payable		
Trade	823,620	687,562
Construction	400,725	462,587
Accrued expenses		
Salaries and wages	385,768	335,611
Paid time-off	513,210	440,475
Interest	305,166	307,491
Payroll taxes and employee benefits	189,303	160,389
Estimated health claims payable	320,000	362,900
Deferred revenue for succeeding year property tax receivable	<u>981,097</u>	<u>956,799</u>
 Total current liabilities	 <b>4,188,889</b>	 3,893,814
<b>OTHER LIABILITIES</b>		
Security deposits	30,280	25,180
 LONG-TERM DEBT, less current maturities - Note 7	 <u>14,370,633</u>	 <u>14,629,062</u>
 Total liabilities	 <u><b>18,589,802</b></u>	 <u>18,548,056</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	7,560,647	6,841,187
Restricted under bond agreement	2,298,711	1,971,875
Unrestricted	<u>8,815,619</u>	<u>8,473,762</u>
 Total net assets	 <u><b>18,674,977</b></u>	 <u>17,286,824</u>
 Total liabilities and net assets	 <u><b>\$ 37,264,779</b></u>	 <u>\$ 35,834,880</u>

**PALO ALTO COUNTY HEALTH CARE FOUNDATION**  
**BALANCE SHEETS**  
**DECEMBER 31, 2008 AND 2007**

	<u>2008</u>	<u>2007</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 104,328	\$ 209,369
Accrued interest receivable	<u>10,284</u>	<u>10,920</u>
Total current assets	114,612	220,289
<b>NONCURRENT CASH AND INVESTMENTS</b>	2,302,441	1,624,967
<b>LAND, BUILDINGS, AND EQUIPMENT, NET</b>	<u>37,687</u>	<u>40,222</u>
Total assets	<u>\$ 2,454,740</u>	<u>\$ 1,885,478</u>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Property tax payable	\$ 796	\$ 758
<b>NET ASSETS, unrestricted</b>	<u>2,453,944</u>	<u>1,884,720</u>
Total liabilities and net assets	<u>\$ 2,454,740</u>	<u>\$ 1,885,478</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, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
<b>OPERATING REVENUES</b>		
Net patient and resident service revenue (net of provision for bad debts of \$602,804 in 2009 and \$595,913 in 2008) - Notes 2 and 3	\$ 18,879,216	\$ 16,869,776
Apartment revenue	371,041	365,024
Other operating revenues	<u>508,555</u>	<u>569,092</u>
<b>TOTAL OPERATING REVENUES</b>	<u><b>19,758,812</b></u>	<u>17,803,892</u>
<b>OPERATING EXPENSES</b>		
Salaries and wages	7,271,796	6,707,393
Employee benefits	1,902,034	2,057,694
Supplies and other expenses	8,238,944	7,583,957
Depreciation	1,538,592	999,707
Interest and amortization	<u>678,869</u>	<u>405,797</u>
<b>TOTAL OPERATING EXPENSES</b>	<u><b>19,630,235</b></u>	<u>17,754,548</u>
<b>OPERATING INCOME BEFORE AFFILIATION AGREEMENT</b>	<b>128,577</b>	49,344
<b>AFFILIATION AGREEMENT EXPENSE</b>	<u>-</u>	<u>(24,672)</u>
<b>OPERATING INCOME</b>	<u><b>128,577</b></u>	<u>24,672</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Investment income	315,777	273,506
County tax revenue	941,094	875,888
Noncapital grants and contributions	6,715	15,682
Loss on sale of property and equipment	<u>(24,010)</u>	<u>(7,503)</u>
<b>NET NONOPERATING REVENUES</b>	<u><b>1,239,576</b></u>	<u>1,157,573</u>
<b>REVENUES IN EXCESS OF EXPENSES BEFORE CAPITAL CONTRIBUTIONS AND GRANTS</b>		
	<b>1,368,153</b>	1,182,245
Capital contributions and grants	<u>20,000</u>	<u>100,000</u>
<b>INCREASE IN NET ASSETS</b>	<b>1,388,153</b>	1,282,245
<b>NET ASSETS, BEGINNING OF YEAR</b>	<u><b>17,286,824</b></u>	<u>16,004,579</u>
<b>NET ASSETS, END OF YEAR</b>	<u><b>\$ 18,674,977</b></u>	<u>\$ 17,286,824</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, 2008 AND 2007**

	<u>2008</u>	<u>2007</u>
OPERATING REVENUES		
Investment Income	\$ 76,141	\$ 78,205
Rental income	7,500	7,500
Contributions	<u>515,034</u>	<u>244,198</u>
 TOTAL OPERATING REVENUES	 <u>598,675</u>	 <u>329,903</u>
EXPENSES		
Depreciation	2,535	2,535
Property taxes	1,619	1,516
Supplies and other expenses	297	462
Contributions to health system	<u>25,000</u>	<u>137,038</u>
 TOTAL EXPENSES	 <u>29,451</u>	 <u>141,551</u>
 INCREASE IN UNRESTRICTED NET ASSETS	 <u>569,224</u>	 188,352
 NET ASSETS, BEGINNING OF YEAR	 <u>1,884,720</u>	 <u>1,696,368</u>
 NET ASSETS, END OF YEAR	 <u>\$ 2,453,944</u>	 <u>\$ 1,884,720</u>

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED JUNE 30, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts of patient and resident service revenue	\$ 19,306,405	\$ 16,814,805
Payments of salaries and wages	(7,148,904)	(6,620,818)
Payments of supplies and other expenses	(10,019,926)	(9,821,958)
Other receipts and payments, net	<u>508,555</u>	<u>569,092</u>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<u>2,646,130</u>	<u>941,121</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Noncapital grants and contributions received	6,715	15,682
County tax revenue received	<u>941,094</u>	<u>875,888</u>
<b>NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES</b>	<u>947,809</u>	<u>891,570</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Principal payments on long-term debt	(180,000)	(175,000)
Purchase of property and equipment	(3,664,947)	(5,139,656)
Proceeds from sale of property and equipment	100	5,500
Interest payments on long-term debt	(735,188)	(740,426)
Net security deposits received	5,100	2,080
Capital contributions and grants	<u>20,000</u>	<u>100,000</u>
<b>NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES</b>	<u>(4,554,935)</u>	<u>(5,947,502)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Sale and transfer of investments	1,100,790	4,822,616
Investment income	<u>281,257</u>	<u>419,758</u>
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<u>1,382,047</u>	<u>5,242,374</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>421,051</b>	1,127,563
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<u>5,317,652</u>	<u>4,190,089</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<u>\$ 5,738,703</u>	<u>\$ 5,317,652</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, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
RECONCILIATION OF OPERATING INCOME TO		
NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 128,577	\$ 24,672
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	1,538,592	999,707
Interest and amortization expense considered capital and related financing activity	678,869	405,797
Provision for bad debts	602,804	595,913
Changes in assets and liabilities		
Patient and resident receivables	(821,808)	(763,387)
Estimated third-party payor settlements	228,655	(240,000)
Other receivables	46,497	(12,521)
Supplies	8,215	(1,835)
Prepaid expense	52,627	6,061
Accounts payable	74,196	(309,446)
Accrued expenses	151,806	151,555
Estimated health claims payable	(42,900)	84,605
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 2,646,130</u>	<u>\$ 941,121</u>

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION**

Cash paid for interest (including amounts capitalized) in 2009 and 2008 was \$735,181 and \$740,426, respectively.

**PALO ALTO COUNTY HEALTH CARE FOUNDATION**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2008 AND 2007**

	<u>2008</u>	<u>2007</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Increase in unrestricted net assets	\$ 569,224	\$ 188,352
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	2,510	3,090
Changes in assets and liabilities		
Accrued interest receivable	636	1,147
Property tax payable	38	(23)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<u>574,943</u>	<u>195,101</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investments	(1,100,000)	(150,000)
Sale of investments	450,000	125,000
Interest earned on certificates of deposit	(29,984)	(29,952)
<b>NET CASH USED FOR INVESTING ACTIVITIES</b>	<u>(679,984)</u>	<u>(54,952)</u>
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>(105,041)</b>	140,149
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<u>209,369</u>	<u>69,220</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<u>\$ 104,328</u>	<u>\$ 209,369</u>

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2009 AND 2008**

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**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 (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 sheets display 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, 2009 AND 2008**

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*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, resident, 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.

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*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, 2009 and 2008, accumulated amortization was \$18,538, and \$10,227, 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, 2009 and 2008, accumulated amortization was \$42,300 and \$35,100, respectively. Total amortization expense of the bond issuance costs was \$15,511 for both of the years ended June 30, 2009 and 2008.

*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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*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, 2009.

*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 statements of revenues, expenses, and changes in net assets distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange and nonexchange 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.

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*Investment Income*

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

*Charity Care*

To fulfill its mission of community service, the Health System provides care to patients and residents 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 and residents 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.

*Subsequent Events*

The Health System has evaluated subsequent events through September 10, 2009, the date which the financial statements were available to be issued.

*Reclassification*

Certain items from the 2008 financial statements have been reclassified to conform to the current year presentation.

*Other Significant Accounting Policies*

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

**NOTE 2 - CHARITY CARE AND COMMUNITY BENEFITS**

The Health System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The amounts of charges foregone were \$150,556 and \$203,256 for the years ended June 30, 2009 and 2008, respectively. The estimated costs of the charges foregone, based upon an overall cost to charge ratio calculation, for the years ended June 30, 2009 and 2008 were \$104,000, and \$137,000, respectively.

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In addition, the Health System provides services to other medically indigent patients under certain government-reimbursed public aid programs. Such programs pay providers amounts which are less than established charges for the services provided to the recipients and for some services the payments are less than the cost of rendering the services provided.

The Health System also commits significant time and resources to endeavors and critical services which meet otherwise unfulfilled community needs. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable.

**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, 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, 2006.

**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 payment to the Health System under these agreements may include prospectively determined rates and discounts from established charges.

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Revenue from the Medicare and Medicaid programs accounted for approximately 33% and 8%, respectively, of the Health System's net patient and resident service revenue for the year ended June 30, 2009, and 34% and 5%, respectively, of the Health System's net patient and resident service revenue for the year ended June 30, 2008. The 2009 net patient service revenue increased approximately \$63,000 due to the removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to audits, reviews, and investigations. The 2009 net patient and resident service revenue increased approximately \$273,000 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, 2009 and 2008, is as follows:

	<u>2009</u>	<u>2008</u>
Total patient and resident service revenue	<u>\$ 26,490,641</u>	<u>\$ 24,701,441</u>
Contractual adjustments:		
Medicare	(4,537,736)	(4,252,119)
Medicaid	(766,524)	(670,454)
Other	<u>(1,704,361)</u>	<u>(2,313,179)</u>
Total contractual adjustments	<u>(7,008,621)</u>	<u>(7,235,752)</u>
Net patient and resident service revenue	<b>19,482,020</b>	17,465,689
Provision for bad debts	<u>(602,804)</u>	<u>(595,913)</u>
Net patient and resident service revenue (net of provision for bad debts)	<u><b>\$ 18,879,216</b></u>	<u>\$ 16,869,776</u>

**NOTE 4 - DEPOSITS AND INVESTMENTS**

The Health System's deposits in banks at June 30, 2009 and 2008, 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.

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At June 30, 2009 and 2008, the Health System's carrying amounts of deposits and investments are as follows:

	<u>2009</u>	<u>2008</u>
Checking and savings accounts	\$ 5,738,703	\$ 5,333,309
Certificates of deposit	327,605	317,211
Money market accounts	5,642,539	4,023,066
Fixed income securities	-	2,673,433
Total deposits	<u>\$ 11,708,847</u>	<u>\$ 12,347,019</u>

Included in the following balance sheet captions

Cash and cash equivalents	\$ 5,738,703	\$ 5,317,652
Assets limited as to use or restricted	<u>5,970,144</u>	<u>7,029,367</u>
	<u>\$ 11,708,847</u>	<u>\$ 12,347,019</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.

**NOTE 5 - LAND, BUILDINGS, AND EQUIPMENT**

Summaries of land, buildings, and equipment at June 30, 2009 and 2008, are as follows:

	June 30, 2008				June 30, 2009
	<u>Balance</u>	<u>Additions</u>	<u>Deductions</u>	<u>Transfers</u>	<u>Balance</u>
Cost					
Land and land improvements	\$ 379,466	\$ 37,476	\$ -	\$ -	\$ 416,942
Building	14,220,309	-	(48,298)	6,529,723	20,701,734
Fixed equipment	2,094,450	6,726	(38,799)	-	2,062,377
Major movable equipment	4,899,097	1,059,061	(634,996)	412,566	5,735,728
Construction in progress	5,932,931	2,640,859	-	(6,942,289)	1,631,501
	<u>27,526,253</u>	<u>\$ 3,744,122</u>	<u>\$ (722,093)</u>	<u>\$ -</u>	<u>30,548,282</u>
Accumulated depreciation					
Land improvements	163,695	\$ 15,939	\$ -	\$ -	179,634
Building	3,703,600	763,862	(43,736)	-	4,423,726
Fixed equipment	1,395,819	84,652	(33,388)	-	1,447,083
Major movable equipment	3,307,712	674,138	(615,712)	-	3,366,138
	<u>8,570,826</u>	<u>\$ 1,538,591</u>	<u>\$ (692,836)</u>	<u>\$ -</u>	<u>9,416,581</u>
Land, buildings, and equipment, net	<u>\$ 18,955,427</u>				<u>\$ 21,131,701</u>

(continued on next page)

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	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>

Projects related to the PARC Hall, acute care, administrative, and community health addition/renovation were completed and capitalized at approximately \$6,530,000 during fiscal year 2009.

Construction in progress at June 30, 2009, consists of additional costs related to the surgery remodeling project. The project is expected to be completed during fiscal year 2010. The total remaining cost to complete these projects is estimated to be approximately \$1,000,000, which will be funded through tax exempt bond financing obtained during fiscal year 2007 and Health System 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, 2009 and 2008, was \$324,865 and \$299,178 respectively.

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

<u>Year Ending June 30,</u>	<u>Amount</u>
2010	\$ 36,939
2011	3,360
2012	3,360
2013	<u>1,680</u>
Total	<u>\$ 45,339</u>

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**NOTE 7 - LONG-TERM DEBT**

A schedule of changes in long-term debt for 2009 and 2008, is as follows:

	Balance		Payments	Balance	Amounts Due
	June 30, 2008	Additions	(Amortization)	June 30, 2009	Within
					One Year
Hospital Revenue Bonds, Series 2003	\$ 6,050,000	\$ -	\$ (180,000)	\$ 5,870,000	\$ 190,000
Hospital Revenue Bonds, Series 2006	9,000,000	-	-	9,000,000	80,000
	15,050,000	-	(180,000)	14,870,000	270,000
Bond discount	(18,752)	-	932	(17,820)	-
Deferred loss on bond refinancing	(119,438)	-	5,934	(113,504)	-
Bond OID less premium 2006	(102,748)	-	4,705	(98,043)	-
Total long-term debt	<u>\$ 14,809,062</u>	<u>\$ -</u>	<u>\$ (168,429)</u>	<u>14,640,633</u>	<u>\$ 270,000</u>
Less current maturities				(270,000)	
Long-term debt, less current maturities				<u>\$ 14,370,633</u>	

	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	-
	15,225,000	-	(175,000)	15,050,000	180,000
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)	-
Total long-term debt	<u>\$ 14,972,491</u>	<u>\$ -</u>	<u>\$ (163,429)</u>	14,809,062	<u>\$ 180,000</u>
Less current maturities				(180,000)	
Long-term debt, less current maturities				<u>\$ 14,629,062</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, 2009 and 2008.

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

<u>Year Ending June 30,</u>	<u>Long-term Debt</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
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	315,000	680,195	995,195
2015 to 2019	1,785,000	3,166,023	4,951,023
2020 to 2024	2,285,000	2,652,638	4,937,638
2025 to 2029	2,920,000	2,010,106	4,930,106
2030 to 2034	3,715,000	1,190,922	4,905,922
2035 to 2036	2,715,000	213,328	2,928,328
	<u>\$ 14,870,000</u>	<u>\$ 12,757,520</u>	<u>\$ 27,627,520</u>

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

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

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

The bond resolution of the Series 2006 bonds requires the establishment of the following “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 sum of \$821,323, to fund final debt payment on August 1, 2036.

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A summary of interest cost and investment income on borrowed funds during the years ended June 30, 2009 and 2008, is as follows:

	<u>2009</u>	<u>2008</u>
Interest cost:		
Capitalized as part of construction project	\$ 81,075	\$ 359,669
Recognized as interest expense	<u>651,788</u>	<u>378,716</u>
 Total	 <u>\$ 732,863</u>	 <u>\$ 738,385</u>
Investment income:		
Capitalized as part of construction project	<u>\$ 7,046</u>	<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 4.10% of their annual covered salary, and the Health System is required to contribute 6.35% of annual covered payroll for the year ended June 30, 2009. Plan members were required to contribute 3.90% and 3.70% of their annual covered salary, and the Health System was required to contribute 6.05% and 5.75% of annual covered payroll for the years ended June 30, 2008 and 2007, respectively. Contribution requirements are established by state statute. The Health System's contributions to IPERS for the years ended June 30, 2009, 2008, and 2007, were \$459,837, \$400,245, and \$384,800, respectively, equal to the required contributions for each year.

**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 \$2,689,629 and \$2,575,274 for the years ended June 30, 2009 and 2008, respectively.

Through June 30, 2008, operating gains and losses from the consolidated operation of the Health System and MMC-NI services were shared equally in accordance with the formulas outlined in the Master Affiliation Agreement. Total operating gains allocated to MMC-NI amounted to \$24,672 for the year ended June 30, 2008, for the various services and distributions related to these agreements.

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*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, 2009 and 2008, were \$617,530 and \$369,495, respectively.

*Due to and from Affiliated Organization*

As of June 30, 2009 and 2008, the Health System's records reflect an amount due to MMC-NI of \$20,654 and \$183,667, 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.

*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 \$320,000 and \$362,900 have been established to record the incurred but not reported claims outstanding at June 30, 2009 and 2008, 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 and resident services previously billed.

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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, 2009 and 2008, was as follows:

	<u>2009</u>	<u>2008</u>
Medicare	32%	39%
Medicaid	14%	5%
Blue Cross	19%	19%
Other third-party payors, patients, and residents	<u>35%</u>	<u>37%</u>
	<u><u>100%</u></u>	<u><u>100%</u></u>

**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**  

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**HEALTH SYSTEM**

 AFFILIATED WITH  
MERCY HEALTH NETWORK

**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, 2009**

	Actual Accrual Basis	Accrual Adjustments	Actual Cash Basis	Amended Budget	Variance Favorable (Unfavorable)
Estimated amount to be raised by taxation	\$ 941,094	\$ -	\$ 941,094	\$ 956,799	\$ (15,705)
Estimated other revenues/receipts	<u>20,101,304</u>	<u>26,828</u>	<u>20,128,132</u>	<u>20,710,663</u>	<u>(582,531)</u>
	21,042,398	26,828	21,069,226	21,667,462	(598,236)
Expenses/disbursements	<u>19,654,245</u>	<u>2,053,153</u>	<u>21,707,398</u>	<u>24,000,000</u>	<u>2,292,602</u>
Net	1,388,153	(2,026,325)	(638,172)	(2,332,538)	<u>\$ 1,694,366</u>
Balance, beginning of year	<u>17,286,824</u>	<u>(4,939,805)</u>	<u>12,347,019</u>	<u>11,876,050</u>	
Balance, end of year	<u>\$18,674,977</u>	<u>\$ (6,966,130)</u>	<u>\$ 11,708,847</u>	<u>\$ 9,543,512</u>	

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**NOTES TO REQUIRED SUPPLEMENTARY INFORMATION - BUDGETARY REPORTING**  
**YEAR ENDED JUNE 30, 2009**

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**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 perspective differences resulting from the Health System preparing a budget on the cash basis of accounting.

The Board of Trustees annually prepares and adopts a budget designating the amount necessary for the improvement and maintenance of the Health Center on the cash basis following required public notice and hearing in accordance with Chapters 24 and 347 of the Code of Iowa. The Board of Trustees certifies the approved budget to the appropriate county auditors. The budget may be amended during the year utilizing similar statutorily prescribed procedures. Formal and legal budgetary control is based on total expenditures. The budget was amended during the year ended June 30, 2009.

For the year ended June 30, 2009, the Health System's expenditures did not exceed the amount of the amended budget.

**OTHER SUPPLEMENTARY INFORMATION**



**PALO ALTO COUNTY**  

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**HEALTH SYSTEM**

 AFFILIATED WITH  
MERCY HEALTH NETWORK



CPAs & BUSINESS ADVISORS

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

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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 Schedules of Comparative Statistics on page 38 marked "unaudited," on which we express no opinion, has been subjected to the auditing procedures applied in the audits of the basic financial statements; and, in our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

*Eide Bailly LLP*

Dubuque, Iowa  
September 10, 2009

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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, 2009 AND 2008**

	TOTAL	
	2009	2008
PATIENT AND RESIDENT SERVICE REVENUE		
Medical and surgical	\$ 1,247,218	\$ 1,232,193
Nursery	126,617	110,733
Long-term care	970,321	607,551
Subtotal	<u>2,344,156</u>	<u>1,950,477</u>
OTHER PROFESSIONAL SERVICES		
Operating room	2,518,533	2,237,934
Labor and delivery room	78,631	58,427
Anesthesiology	687,203	580,995
Radiology	4,096,170	4,034,014
Laboratory	3,043,531	3,290,688
Respiratory therapy	767,765	863,437
Physical therapy	809,532	772,434
Occupational therapy	92,216	125,902
Speech therapy	14,228	4,529
Electrocardiography	491,086	540,964
Medical and surgical supplies	529,471	491,287
Pharmacy	2,352,665	1,770,283
Graettinger Clinic	450,640	402,434
Emmetsburg Clinic	4,009,520	3,506,781
West Bend Clinic	766,813	658,068
Emergency room	2,102,382	2,226,980
Ambulance	622,100	652,259
Home health	579,023	504,574
Hospice	285,532	232,230
Subtotal	<u>24,297,041</u>	<u>22,954,220</u>
Total	26,641,197	24,904,697
Charity care	<u>(150,556)</u>	<u>(203,256)</u>
Total patient and resident service revenue	26,490,641	24,701,441
Adjustments to patient and resident service revenue	<u>(7,611,425)</u>	<u>(7,831,665)</u>
NET PATIENT AND RESIDENT SERVICE REVENUE	<u>\$ 18,879,216</u>	<u>\$ 16,869,776</u>

INPATIENT		OUTPATIENT	
2009	2008	2009	2008
\$ 1,247,218	\$ 1,232,193	\$ -	\$ -
126,617	110,733	-	-
970,321	607,551	-	-
<b>2,344,156</b>	1,950,477	-	-
<b>341,430</b>	292,734	<b>2,177,103</b>	1,945,200
78,631	58,427	-	-
78,153	67,240	609,050	513,755
232,683	259,417	3,863,487	3,774,597
384,386	420,967	2,659,145	2,869,721
452,849	555,628	314,916	307,809
111,267	110,825	698,265	661,609
35,729	35,088	56,487	90,814
3,005	1,581	11,223	2,948
28,811	39,939	462,275	501,025
107,570	88,925	421,901	402,362
732,512	657,005	1,620,153	1,113,278
-	-	450,640	402,434
-	-	4,009,520	3,506,781
-	-	766,813	658,068
133,781	162,416	1,968,601	2,064,564
-	-	622,100	652,259
-	-	579,023	504,574
19,440	12,464	266,092	219,766
<b>2,740,247</b>	2,762,656	<b>21,556,794</b>	20,191,564
<b>\$ 5,084,403</b>	\$ 4,713,133	<b>\$ 21,556,794</b>	\$ 20,191,564

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF OTHER OPERATING REVENUES**  
**YEARS ENDED JUNE 30, 2009 AND 2008**

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	<u>2009</u>	<u>2008</u>
OTHER OPERATING REVENUES		
Home health support	\$ 230,611	\$ 308,689
Meals sold	65,478	57,280
Lifeline	55,805	56,445
Business health	82,514	70,429
Willow Ridge	29,265	3,235
Specialty clinic	23,100	24,672
Grants	6,513	32,801
Other	15,269	15,541
TOTAL OTHER OPERATING REVENUES	<u>\$ 508,555</u>	<u>\$ 569,092</u>

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF OPERATING EXPENSES**  
**YEARS ENDED JUNE 30, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
<b>MEDICAL AND SURGICAL</b>		
Salaries and wages	\$ 836,391	\$ 801,204
Supplies and other	198,395	285,522
	<u>1,034,786</u>	<u>1,086,726</u>
<b>NURSERY</b>		
Salaries and wages	41,539	41,417
Supplies and other	4,042	6,243
	<u>45,581</u>	<u>47,660</u>
<b>LONG-TERM CARE</b>		
Salaries and wages	586,343	506,091
Supplies and other	57,607	85,016
	<u>643,950</u>	<u>591,107</u>
<b>NURSING ADMINISTRATION</b>		
Salaries and wages	209,628	164,194
Supplies and other	9,457	14,734
	<u>219,085</u>	<u>178,928</u>
<b>OPERATING ROOM</b>		
Salaries and wages	364,720	324,806
Supplies and other	145,527	120,117
	<u>510,247</u>	<u>444,923</u>
<b>LABOR AND DELIVERY ROOM</b>		
Salaries and wages	9,525	14,700
Supplies and other	6,085	6,648
	<u>15,610</u>	<u>21,348</u>
<b>ANESTHESIOLOGY</b>		
Supplies and other	<u>272,365</u>	<u>254,584</u>
<b>RADIOLOGY</b>		
Salaries and wages	327,857	339,782
Supplies and other	659,540	639,557
	<u>987,397</u>	<u>979,339</u>
<b>LABORATORY</b>		
Salaries and wages	335,954	301,008
Supplies and other	553,851	541,214
	<u>889,805</u>	<u>842,222</u>
<b>RESPIRATORY THERAPY</b>		
Salaries and wages	41,544	44,581
Supplies and other	33,054	25,280
	<u>74,598</u>	<u>69,861</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, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
PHYSICAL THERAPY		
Salaries and wages	\$ 277,678	\$ 262,597
Supplies and other	27,076	33,184
	<u>304,754</u>	<u>295,781</u>
OCCUPATIONAL THERAPY		
Salaries and wages	113,612	103,084
Supplies and other	41,489	36,222
	<u>155,101</u>	<u>139,306</u>
SPEECH THERAPY		
Supplies and other	11,849	5,280
ELECTROCARDIOGRAPHY		
Salaries and wages	83,673	81,214
Supplies and other	60,737	69,342
	<u>144,410</u>	<u>150,556</u>
MEDICAL AND SURGICAL SUPPLIES		
Salaries and wages	21,148	21,197
Supplies and other	282,993	226,149
	<u>304,141</u>	<u>247,346</u>
PHARMACY		
Supplies and other	593,320	526,898
GRAETTINGER CLINIC		
Salaries and wages	212,348	204,759
Supplies and other	108,324	105,496
	<u>320,672</u>	<u>310,255</u>
EMMETSBURG CLINIC		
Salaries and wages	858,091	758,344
Supplies and other	1,661,724	1,611,021
	<u>2,519,815</u>	<u>2,369,365</u>
WEST BEND CLINIC		
Salaries and wages	270,647	250,780
Supplies and other	214,802	236,827
	<u>485,449</u>	<u>487,607</u>
EMERGENCY ROOM		
Salaries and wages	317,751	320,216
Supplies and other	597,393	576,286
	<u>915,144</u>	<u>896,502</u>

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF OPERATING EXPENSES**  
**YEARS ENDED JUNE 30, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
<b>SPECIALTY CLINIC</b>		
Salaries and wages	\$ 5,699	\$ -
Supplies and other	34,307	-
	<u>40,006</u>	<u>-</u>
<b>AMBULANCE</b>		
Salaries and wages	199,871	208,370
Supplies and other	72,896	61,015
	<u>272,767</u>	<u>269,385</u>
<b>HOME HEALTH</b>		
Salaries and wages	461,612	442,771
Supplies and other	172,007	131,088
	<u>633,619</u>	<u>573,859</u>
<b>HOSPICE</b>		
Salaries and wages	68,818	58,701
Supplies and other	37,135	47,376
	<u>105,953</u>	<u>106,077</u>
<b>MEDICAL RECORDS</b>		
Salaries and wages	190,884	172,266
Supplies and other	39,346	45,233
	<u>230,230</u>	<u>217,499</u>
<b>DIETARY</b>		
Salaries and wages	279,255	270,086
Supplies and other	172,224	175,816
	<u>451,479</u>	<u>445,902</u>
<b>OPERATION OF PLANT</b>		
Salaries and wages	249,910	222,455
Supplies and other	490,843	448,575
	<u>740,753</u>	<u>671,030</u>
<b>HOUSEKEEPING</b>		
Salaries and wages	178,075	146,309
Supplies and other	21,516	20,570
	<u>199,591</u>	<u>166,879</u>
<b>LAUNDRY</b>		
Salaries and wages	126	5,706
Supplies and other	79,808	77,831
	<u>79,934</u>	<u>83,537</u>
<b>BLOOD</b>		
Salaries and wages	3,738	4,240
Supplies and other	52,881	61,196
	<u>56,619</u>	<u>65,436</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, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
ADMINISTRATIVE SERVICES		
Salaries and wages	\$ 667,341	\$ 584,611
Supplies and other	<u>1,488,671</u>	<u>1,079,326</u>
	<u>2,156,012</u>	<u>1,663,937</u>
DIABETIC EDUCATION		
Salaries and wages	10,585	8,810
Supplies and other	<u>328</u>	<u>941</u>
	<u>10,913</u>	<u>9,751</u>
APARTMENTS		
Salaries and wages	47,433	43,094
Supplies and other	<u>37,352</u>	<u>29,370</u>
	<u>84,785</u>	<u>72,464</u>
UNASSIGNED EXPENSES		
Depreciation	1,538,592	999,707
Interest and amortization	678,869	405,797
Employee benefits	<u>1,902,034</u>	<u>2,057,694</u>
	<u>4,119,495</u>	<u>3,463,198</u>
TOTAL OPERATING EXPENSES	<u>\$ 19,630,235</u>	<u>\$ 17,754,548</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, 2009 AND 2008**

**ANALYSIS OF AGING**

Age of Accounts (Days Since Discharge)	2009		2008	
	Amount	Percent to Total	Amount	Percent to Total
30 days or less	\$ 2,352,505	54.60%	\$ 2,033,886	50.02%
31 to 60 days	598,971	13.90%	963,752	23.70%
61 to 90 days	316,454	7.35%	326,186	8.02%
91 days and over	1,040,260	24.15%	742,252	18.26%
	<b>4,308,190</b>	<b>100.00%</b>	4,066,076	100.00%
Less: Allowance for doubtful accounts	660,268		559,013	
Allowance for contractual adjustments	1,100,034		1,178,179	
Net	<b>\$ 2,547,888</b>		<b>\$ 2,328,884</b>	
Net patient and resident service revenue per calendar day	<b>\$ 51,724</b>		<b>\$ 46,219</b>	
Days of net revenue in net accounts receivable at year end	<b>49</b>		<b>50</b>	

**ANALYSIS OF ALLOWANCE FOR DOUBTFUL ACCOUNTS**

	2009		2008	
	Amount	Percent of Net Patient and Resident Service Revenue	Amount	Percent of Net Patient and Resident Service Revenue
Beginning balance	\$ 559,013		\$ 477,045	
Add:				
Provision for bad debts	602,804	3.19%	595,913	3.53%
Recoveries previously written off	351,919	1.86%	309,683	1.84%
	<b>954,723</b>		<b>905,596</b>	
Less:				
Accounts written off	(853,468)	4.52%	(823,628)	4.88%
Ending balance	<b>\$ 660,268</b>		<b>\$ 559,013</b>	

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF SUPPLIES AND PREPAID EXPENSES**  
**JUNE 30, 2009 AND 2008**

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	<u>2009</u>	<u>2008</u>
SUPPLIES		
Pharmacy	\$ 96,748	\$ 99,216
Central supply	41,529	43,360
Dietary	12,040	11,352
Other	<u>146,564</u>	<u>151,168</u>
 Total supplies	 <u>\$ 296,881</u>	 <u>\$ 305,096</u>
 PREPAID EXPENSE		
Dues and other	\$ 63,086	\$ 62,105
Insurance	<u>-</u>	<u>53,608</u>
 Total prepaid expense	 <u>\$ 63,086</u>	 <u>\$ 115,713</u>

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF COMPARATIVE STATISTICS**  
**YEARS ENDED JUNE 30, 2009 AND 2008 (UNAUDITED)**

	<u>2009</u>	<u>2008</u>
<b>PATIENT DAYS</b>		
Acute	1,390	1,463
Swing-bed	572	687
Long-term care	7,650	5,630
Nursery	256	246
Totals	<u>9,868</u>	<u>8,026</u>
<b>ADMISSIONS</b>		
Acute	461	473
Swing-bed	74	98
Long-term care	25	9
Totals	<u>560</u>	<u>580</u>
<b>DISCHARGES</b>		
Acute	461	480
Swing-bed	87	99
Long-term care	17	13
Totals	<u>565</u>	<u>592</u>
<b>ACUTE AVERAGE LENGTH OF STAY</b>	<u>3.0</u>	<u>3.0</u>
<b>SWING-BED AVERAGE LENGTH OF STAY</b>	<u>6.6</u>	<u>6.9</u>
<b>ACUTE BEDS</b>	<u>25</u>	<u>25</u>
<b>LONG-TERM CARE BEDS</b>	<u>22</u>	<u>22</u>
<b>PERCENTAGE OF OCCUPANCY</b>		
Acute and swing-bed (based on 25 beds)	21.5%	23.6%
Long-term care (based on 22 beds)	95.3%	70.1%
<b>OUTPATIENT VISITS</b>	<u>22,126</u>	<u>23,089</u>
<b>CLINIC VISITS</b>		
Graettinger	3,338	3,526
Emmetsburg	26,459	26,633
West Bend	4,839	4,805



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**

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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, 2009 and 2008, and its discretely presented component unit, Palo Alto County Health Care Foundation, as of December 31, 2008 and 2007, 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 10, 2009. 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 opinions 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 that 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.

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, 2009, 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 Finance Committee, Board of Trustees, management 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 10, 2009

**PALO ALTO COUNTY HOSPITAL  
d/b/a PALO ALTO COUNTY HEALTH SYSTEM  
SCHEDULE OF FINDINGS AND RESPONSES  
YEAR ENDED JUNE 30, 2009**

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**Part I: Findings Related to the Financial Statements:**

**SIGNIFICANT DEFICIENCIES:**

I-A-09      Segregation of Duties

Criteria – One important aspect of internal controls is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible.

Condition – Certain employees perform duties that are incompatible.

Cause – A 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.

Effect – Limited segregation of duties could result in misstatements that may not be prevented or detected on a timely basis in the normal course of operations.

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.

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULE OF FINDINGS AND RESPONSES**  
**YEAR ENDED JUNE 30, 2009**

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

I-B-09 Preparation of Financial Statements

Criteria – A properly designed system of internal control over financial reporting includes the preparation of an entity's financial statements and accompanying notes to the financial statements by internal personnel of the entity. 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).

Condition – 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 statements of cash flows, as required by GAAP. 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.

Cause – We realize that obtaining the expertise necessary to prepare the financial statements, including all necessary disclosures, in accordance with GAAP can be considered costly and ineffective.

Effect – The effect of this condition is that the financial reporting is prepared by a party outside of the Health System. The outside party does not have the constant contact with ongoing financial transactions that internal staff have. Furthermore, it is possible that new standards may not be adopted and applied timely to the interim financial reporting. It is the responsibility of Health System 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.

Recommendation – We recommend that management continue reviewing operating procedures in order to obtain the maximum internal control over financial reporting possible under the circumstances to enable staff to draft the financial statements internally.

Response – This finding and recommendation is not a result of any change in the Health System's procedures, rather it is due to an auditing standard implemented by the American Institute of Certified Public Accountants. 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.

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULE OF FINDINGS AND RESPONSES**  
**YEAR ENDED JUNE 30, 2009**

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**Part II: Other Findings Related to Required Statutory Reporting:**

- II-A-09 Certified Budget – Disbursements during the year ended June 30, 2009, did not exceed the amount budgeted.
- II-B-09 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-09 Travel Expense – No expenditures of Health System money for travel expenses of spouses of Health System officials and/or employees were noted.
- II-D-09 Business Transactions – We noted no material business transactions between the Health System and Health System officials and/or employees.
- II-E-09 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.
- II-F-09 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-09 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.
- II-H-09 Publication of Sale of Real and Personal Property – Chapter 347.30 of the Code of Iowa states “A county or city hospital shall serve notice and hold a public hearing before selling or leasing any real (or personal) property. The notice shall definitely describe the property, indicate the date and location of the hearing, and shall be published by at least one insertion each week for two consecutive weeks in a newspaper having general circulation in the county where the property is located. The hearing shall not take place prior to two weeks after the second publication.” The Health Center sold personal property during the year without proper notice of publication prior to the sale.

Recommendation – In the future it is recommended that the Health Center publish proper notice in accordance with Chapter 347.30 of the Code of Iowa prior to the sale of personal property.

Response – Going forward the Health Center will publish proper notice in accordance with Chapter 347.30 of the Code of Iowa prior to the sale of personal property that has use to the general public. Therefore, if the item is equipment that is strictly for medical use, the Health Center will continue to find an appropriate “purchaser” of this equipment at a fair price.

Conclusion – Response accepted.



CPAs & BUSINESS ADVISORS

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

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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, 2009, and have issued our report thereon dated September 10, 2009. Professional standards require that we provide you with information about our responsibilities under generally accepted auditing standards and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated June 4, 2009. Professional standards also require that we communicate to you the following information related to our audit.

### **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, 2009. We noted no transactions entered into by the Health System during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

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

Collectibility of Patient and Resident Receivables – Management's estimate of the collectibility of patient and resident receivables is based on historical trends for uncollectible accounts and contractual adjustments.

Estimated Third-Party Payor Settlements – Management's estimate of the amounts either owed to or receivable from third-party payors is based on both final and tentatively settled cost reports. 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 that 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.

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Self-Funded Health Insurance Liability – Management’s estimate of self-funded health insurance liability is based on the timing and amounts of historical payments.

Depreciation Expense – Management’s estimate of depreciation expense is based on the estimated useful lives assigned using industry recommended averages and historical experience. Depreciation is calculated using the straight-line method.

We evaluated the key factors and assumptions used to develop these estimates related to the collectibility of patient receivables, amounts either owed to or receivable from third-party payors, self-funded health insurance liability, and depreciation expense in determining that they are reasonable in relation to the financial statements taken as a whole.

*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 2009 audit:

Revenue in excess of expenses, prior to audit adjustments	\$ 1,398,799
To adjust estimated third-party payor settlements	(50,000)
To reduce estimated health claims liability	30,000
Other adjustments	<u>(10,646)</u>
Revenue in excess of expenses as reported	<u>\$ 1,368,153</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 10, 2009.

*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.

This information is intended solely for the use of the Finance Committee, Board of Trustees, and management of Palo Alto County Hospital, d/b/a Palo Alto County Health System, and is not intended to be and should not be used by anyone other than these specified parties.

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

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

Dubuque, Iowa  
September 10, 2009

xc: Mr. Thomas J. Lee