

**FINANCIAL STATEMENTS  
OCTOBER 31, 2008 AND 2007**

**HILLCREST FAMILY SERVICES, INC.**

## HILLCREST FAMILY SERVICES, INC.

### Table of Contents

---

|  | <u>Page</u> |
|--|-------------|
| <b>INDEPENDENT AUDITOR’S REPORT</b>  | 1-2         |
| <b>FINANCIAL STATEMENTS</b>  |             |
| Statements of Financial Position   | 3           |
| Statements of Activities and Changes in Net Assets   | 4-5         |
| Statement of Functional Expenses - October 31, 2008  | 6-7         |
| Statement of Functional Expenses - October 31, 2007  | 8-9         |
| Statements of Cash Flows   | 10          |
| Notes to Financial Statements  | 11-25       |
| <b>SUPPLEMENTARY INFORMATION</b>   |             |
| Schedule(s)  |             |
| Program Service Fees, net  | 26          |
| Mental Health Center Expenses  | 27          |
| Revenues and Expenses:   |             |
| WIC – Contract # 5888AO35  | 28          |
| Maternal Health – Contract # 5888MH13  | 28          |
| <b>SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS</b>  | 29          |
| <b>REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING<br/>AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN<br/>AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE<br/>WITH <i>GOVERNMENT AUDITING STANDARDS</i></b> | 30-31       |
| <b>REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE<br/>TO ITS MAJOR PROGRAM AND ON INTERNAL CONTROL OVER<br/>COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133</b>  | 32-33       |
| <b>SCHEDULE OF FINDINGS AND QUESTIONED COSTS</b>   | 34-37       |



CPAs & BUSINESS ADVISORS

## INDEPENDENT AUDITOR'S REPORT

---

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

We have audited the accompanying statements of financial position of Hillcrest Family Services, Inc., as of October 31, 2008 and 2007, and the related statements of activities and changes in net assets, functional expenses, and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our 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 Hillcrest Family Services, Inc., as of October 31, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with Government Auditing Standards, we have also issued our report dated March 20, 2009, on our consideration of Hillcrest Family Services, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

PEOPLE. PRINCIPLES. POSSIBILITIES.

[www.eidebailly.com](http://www.eidebailly.com)

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

The image shows a handwritten signature in cursive script that reads "Eide Bailly LLP". The signature is written in black ink and is positioned above the typed text of the firm's name.

Dubuque, Iowa  
March 20, 2009



|  | <u>2008</u>                 | <u>2007</u>          |
|--|-----------------------------|----------------------|
| <b>LIABILITIES AND NET ASSETS</b>                |                             |                      |
| <b>CURRENT LIABILITIES</b>                       |                             |                      |
| Bank overdraft                                   | \$ -                        | \$ 55,040            |
| Current maturities of long-term debt – Note 8    | <b>133,418</b>              | 73,068               |
| Line of credit – Note 8                          | -                           | 259,224              |
| County payable - Note 7                          | <b>187,625</b>              | -                    |
| Custodial funds                                  | <b>45,862</b>               | -                    |
| Accounts payable                                 | <b>298,857</b>              | 358,679              |
| Accrued expenses                                 |                             |                      |
| Salaries and wages                               | <b>178,009</b>              | 389,476              |
| Vacation   | <b>389,892</b>              | 367,964              |
| Payroll taxes and other                          | <b>262,530</b>              | 181,992              |
| Pension liability – Note 10                      | <b>1,568,783</b>            | -                    |
| Deferred revenue – Note 9                        | <b>222,935</b>              | 162,904              |
|  | <u>3,287,911</u>            | <u>1,848,347</u>     |
| Total current liabilities                        | <b>3,287,911</b>            | 1,848,347            |
| PENSION LIABILITY – Note 10                      | -                           | 20,591               |
| LONG-TERM DEBT, less current maturities – Note 8 | <u>76,203</u>               | <u>203,591</u>       |
| Total liabilities                                | <u><b>3,364,114</b></u>     | <u>2,072,529</u>     |
| <b>NET ASSETS</b>                                |                             |                      |
| Unrestricted                                     |                             |                      |
| Undesignated                                     | <b>4,180,619</b>            | 4,866,466            |
| Designated by board – Note 3                     | <b>2,227,410</b>            | 3,141,514            |
| Temporarily restricted – Note 11                 | <b>347,880</b>              | 168,107              |
| Permanently restricted – Note 11                 | <b>313,320</b>              | 191,000              |
|  | <u>7,069,229</u>            | <u>8,367,087</u>     |
| Total net assets                                 | <u><b>7,069,229</b></u>     | <u>8,367,087</u>     |
| Total liabilities and net assets                 | <u><b>\$ 10,433,343</b></u> | <u>\$ 10,439,616</u> |

**HILLCREST FAMILY SERVICES, INC.**  
**STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS**  
**YEARS ENDED OCTOBER 31, 2008 AND 2007**

|  | 2008                       |   |   | Total<br>Net Assets   |
|--|----------------------------|---|---|-----------------------|
|  | Unrestricted<br>Net Assets | Temporarily<br>Restricted<br>Net Assets | Permanently<br>Restricted<br>Net Assets |                       |
| <b>SUPPORT AND REVENUE</b>   |                            |   |   |                       |
| Public support   |                            |   |   |                       |
| Direct:  |                            |   |   |                       |
| Contributions  | \$ 244,793                 | \$ 154,773                              | \$ 102,320                              | \$ 501,886            |
| Bequests - trusts/estates  | 4,181                      | -                                       | -                                       | 4,181                 |
| Bowl for Kids Sake   | 28,092                     | -                                       | -                                       | 28,092                |
| The Big Event  | 2,671                      | -                                       | -                                       | 2,671                 |
| Special events - lights  | 221,335                    | -                                       | -                                       | 221,335               |
| Indirect:  |                            |   |   |                       |
| Grants - federal awards  | 1,142,791                  | -                                       | -                                       | 1,142,791             |
| Grants - other   | 351,177                    | -                                       | -                                       | 351,177               |
| United Way - Note 6  | 44,919                     | 117,000                                 | -                                       | 161,919               |
| Total public support   | <u>2,039,959</u>           | <u>271,773</u>                          | <u>102,320</u>                          | <u>2,414,052</u>      |
| Revenue  |                            |   |   |                       |
| Program service fees, net - Note 2   | 14,846,382                 | -                                       | -                                       | 14,846,382            |
| Investment income (loss) - Note 3  | (210,014)                  | -                                       | -                                       | (210,014)             |
| Miscellaneous  | 40,813                     | -                                       | -                                       | 40,813                |
| Net assets released from restrictions  | 92,000                     | (92,000)                                | -                                       | -                     |
| Total revenue  | <u>14,769,181</u>          | <u>(92,000)</u>                         | <u>-</u>                                | <u>14,677,181</u>     |
| Total public support and revenue   | <u>16,809,140</u>          | <u>179,773</u>                          | <u>102,320</u>                          | <u>17,091,233</u>     |
| <b>EXPENSES</b>  |                            |   |   |                       |
| Program services   | 13,660,128                 | -                                       | -                                       | 13,660,128            |
| Supporting services  |                            |   |   |                       |
| General and administrative   | 2,485,915                  | -                                       | -                                       | 2,485,915             |
| Development  | 288,468                    | -                                       | -                                       | 288,468               |
| Special event - lights   | 118,210                    | -                                       | -                                       | 118,210               |
| Total expenses   | <u>16,552,721</u>          | <u>-</u>                                | <u>-</u>                                | <u>16,552,721</u>     |
| PUBLIC SUPPORT AND REVENUE IN EXCESS<br>OF (LESS THAN) EXPENSES              | 256,419                    | 179,773                                 | 102,320                                 | 538,512               |
| <b>OTHER CHANGES IN NET ASSETS</b>   |                            |   |   |                       |
| Change in unrealized gains and losses on<br>investments - Note 3             | (563,434)                  | -                                       | -                                       | (563,434)             |
| Gain on disposal of assets   | 130,394                    | -                                       | -                                       | 130,394               |
| Net asset reclassification   | (20,000)                   | -                                       | 20,000                                  | -                     |
| Pension - related changes other than net<br>periodic pension costs - Note 10 | (1,403,330)                | -                                       | -                                       | (1,403,330)           |
| INCREASE (DECREASE) IN NET ASSETS  | <u>\$ (1,599,951)</u>      | <u>\$ 179,773</u>                       | <u>\$ 122,320</u>                       | <u>\$ (1,297,858)</u> |

See notes to financial statements.

2007

| Unrestricted<br>Net Assets | Temporarily<br>Restricted<br>Net Assets | Permanently<br>Restricted<br>Net Assets | Total<br>Net Assets |
|----------------------------|---|---|---------------------|
| \$ 239,605                 | \$ 56,909                               | \$ -                                    | \$ 296,514          |
| 2,109                      | -                                       | -                                       | 2,109               |
| 31,944                     | -                                       | -                                       | 31,944              |
| 6,987                      | -                                       | -                                       | 6,987               |
| 188,112                    | -                                       | -                                       | 188,112             |
| 1,319,901                  | -                                       | -                                       | 1,319,901           |
| 136,269                    | -                                       | -                                       | 136,269             |
| 13,709                     | 92,000                                  | -                                       | 105,709             |
| <u>1,938,636</u>           | <u>148,909</u>                          | <u>-</u>                                | <u>2,087,545</u>    |
| 12,810,885                 | -                                       | -                                       | 12,810,885          |
| 271,163                    | -                                       | -                                       | 271,163             |
| 15,183                     | -                                       | -                                       | 15,183              |
| 160,868                    | (160,868)                               | -                                       | -                   |
| <u>13,258,099</u>          | <u>(160,868)</u>                        | <u>-</u>                                | <u>13,097,231</u>   |
| <u>15,196,735</u>          | <u>(11,959)</u>                         | <u>-</u>                                | <u>15,184,776</u>   |
| 12,973,682                 | -                                       | -                                       | 12,973,682          |
| 2,252,213                  | -                                       | -                                       | 2,252,213           |
| 196,507                    | -                                       | -                                       | 196,507             |
| 133,111                    | -                                       | -                                       | 133,111             |
| <u>15,555,513</u>          | <u>-</u>                                | <u>-</u>                                | <u>15,555,513</u>   |
| (358,778)                  | (11,959)                                | -                                       | (370,737)           |
| 4,717                      | -                                       | -                                       | 4,717               |
| -                          | -                                       | -                                       | -                   |
| -                          | -                                       | -                                       | -                   |
| <u>440,327</u>             | <u>-</u>                                | <u>-</u>                                | <u>440,327</u>      |
| <u>\$ 86,266</u>           | <u>\$ (11,959)</u>                      | <u>\$ -</u>                             | <u>\$ 74,307</u>    |

(continued)

**HILLCREST FAMILY SERVICES, INC.**  
**STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS (continued)**  
**YEARS ENDED OCTOBER 31, 2008 AND 2007**

|                                   | <b>2008</b>                        |  |  | <b>Total<br/>Net Assets</b> |
|-----------------------------------|------------------------------------|--|--|-----------------------------|
|                                   | <b>Unrestricted<br/>Net Assets</b> | <b>Temporarily<br/>Restricted<br/>Net Assets</b> | <b>Permanently<br/>Restricted<br/>Net Assets</b> |                             |
| INCREASE (DECREASE) IN NET ASSETS | <u>\$ (1,599,951)</u>              | <u>\$ 179,773</u>                                | <u>\$ 122,320</u>                                | <u>\$ (1,297,858)</u>       |
| NET ASSETS, BEGINNING OF YEAR     | <u>8,007,980</u>                   | <u>168,107</u>                                   | <u>191,000</u>                                   | <u>8,367,087</u>            |
| NET ASSETS, END OF YEAR           | <u>\$ 6,408,029</u>                | <u>\$ 347,880</u>                                | <u>\$ 313,320</u>                                | <u>\$ 7,069,229</u>         |

See notes to financial statements.

---

2007

| <u>Unrestricted<br/>Net Assets</u> | <u>Temporarily<br/>Restricted<br/>Net Assets</u> | <u>Permanently<br/>Restricted<br/>Net Assets</u> | <u>Total<br/>Net Assets</u> |
|------------------------------------|--|--|-----------------------------|
| \$ 86,266                          | \$ (11,959)                                      | \$ -   | \$ 74,307                   |
| <u>7,921,714</u>                   | <u>180,066</u>                                   | <u>191,000</u>                                   | <u>8,292,780</u>            |
| <u>\$ 8,007,980</u>                | <u>\$ 168,107</u>                                | <u>\$ 191,000</u>                                | <u>\$ 8,367,087</u>         |

**HILLCREST FAMILY SERVICES, INC.**  
**STATEMENT OF FUNCTIONAL EXPENSES**  
**YEAR ENDED OCTOBER 31, 2008**

|                                       | Program Services         |                       |                     |                     |                   |                                |                  |
|---------------------------------------|--------------------------|-----------------------|---------------------|---------------------|-------------------|--------------------------------|------------------|
|                                       | Residential<br>Treatment | CMI<br>Group<br>Homes | Health<br>Services  | Schools             | Shelter           | Family<br>Centered<br>Services | Counseling       |
| Salaries                              | \$ 1,670,568             | \$ 1,311,917          | \$ 872,276          | \$ 2,003,585        | \$ 268,078        | \$ 201,336                     | \$ 28,254        |
| Fringe benefits                       | 297,203                  | 233,396               | 155,183             | 356,448             | 47,693            | 35,819                         | 5,027            |
| Payroll taxes and other               | <u>121,302</u>           | <u>95,260</u>         | <u>63,337</u>       | <u>145,483</u>      | <u>19,466</u>     | <u>14,619</u>                  | <u>2,052</u>     |
| Total personnel expenses              | 2,089,073                | 1,640,573             | 1,090,796           | 2,505,516           | 335,237           | 251,774                        | 35,333           |
| Contracted services                   | 62,290                   | 32,965                | 47,481              | 15,978              | 3,669             | 2,612                          | 1,770            |
| Supplies & equipment maintenance      | 199,436                  | 147,041               | 159,121             | 111,575             | 36,167            | 4,070                          | 368              |
| Telephone                             | 12,706                   | 21,506                | 16,625              | 16,117              | 4,547             | 2,976                          | 953              |
| Postage and shipping                  | 505                      | 1,234                 | 2,962               | 377                 | 109               | 108                            | 5                |
| Occupancy                             | 97,562                   | 178,300               | 76,592              | 129,796             | 46,460            | 4,849                          | 4,835            |
| Outside printing                      | 112                      | 127                   | 1,116               | -                   | -                 | -                              | -                |
| Professional insurance                | 31,052                   | 22,938                | 13,328              | 32,468              | 5,783             | 2,998                          | 384              |
| Travel                                | 28,864                   | 26,943                | 32,511              | 36,624              | 7,638             | 5,426                          | 511              |
| Conferences and meetings              | 5,830                    | 2,123                 | 8,551               | 10,864              | 565               | 4,954                          | 3                |
| Subscriptions                         | 13                       | 15                    | 135                 | 25                  | 1                 | 1                              | 10               |
| Client assistance                     | 15,980                   | 5,475                 | 19,402              | 3,438               | 5,038             | 73                             | -                |
| Dues                                  | 3,155                    | 1,673                 | 613                 | 1,240               | 429               | 295                            | 57               |
| Miscellaneous                         | 9,798                    | 2,485                 | 2,465               | 4,239               | 519               | 294                            | 22               |
| Interest                              | 7,158                    | 618                   | 119                 | 306                 | 67                | 65                             | 1                |
| Bad debts                             | <u>6,620</u>             | <u>6,756</u>          | <u>9,826</u>        | <u>-</u>            | <u>-</u>          | <u>-</u>                       | <u>142</u>       |
| Total expenses before<br>depreciation | 2,570,154                | 2,090,772             | 1,481,643           | 2,868,563           | 446,229           | 280,495                        | 44,394           |
| Depreciation                          | <u>56,903</u>            | <u>24,809</u>         | <u>8,254</u>        | <u>25,014</u>       | <u>4,791</u>      | <u>2,026</u>                   | <u>241</u>       |
| Total expenses                        | <u>\$ 2,627,057</u>      | <u>\$ 2,115,581</u>   | <u>\$ 1,489,897</u> | <u>\$ 2,893,577</u> | <u>\$ 451,020</u> | <u>\$ 282,521</u>              | <u>\$ 44,635</u> |

See notes to financial statements.

Program Services

| Adoption         | Hillcrest<br>Supported<br>Living<br>IPRS/Voc | Family<br>Empowerment<br>Center | Transitional<br>Housing | PATH<br>Grant    | WRAP/<br>Recovery<br>Grant | Mental<br>Health<br>Centers | Big Brothers/<br>Big Sisters | Total<br>Program<br>Services |
|------------------|--|---------------------------------|-------------------------|------------------|----------------------------|-----------------------------|------------------------------|------------------------------|
| \$ 41,301        | \$ 839,039                                   | \$ -                            | \$ 30,794               | \$ 25,324        | \$ 69,939                  | \$ 898,690                  | \$ 66,429                    | \$ 8,327,530                 |
| 7,348            | 149,269                                      | -                               | 5,478                   | 4,505            | 12,442                     | 159,882                     | 11,818                       | 1,481,511                    |
| 2,999            | 60,924                                       | -                               | 2,236                   | 1,839            | 5,078                      | 65,255                      | 4,824                        | 604,674                      |
| 51,648           | 1,049,232                                    | -                               | 38,508                  | 31,668           | 87,459                     | 1,123,827                   | 83,071                       | 10,413,715                   |
| 13,928           | 7,348  | -                               | 2,991                   | -                | 461                        | 628,545                     | 1,658                        | 821,696                      |
| 499              | 9,772  | -                               | 8,668                   | 52               | 3,641                      | 36,588                      | 1,106                        | 718,104                      |
| 2,144            | 14,439                                       | -                               | 3,120                   | 622              | 2,121                      | 17,382                      | 308                          | 115,566                      |
| 67               | 530  | -                               | -                       | 1                | 73                         | 1,108                       | 62                           | 7,141                        |
| 4,896            | 42,348                                       | 3,286                           | 14,403                  | 8,554            | 25,429                     | 62,080                      | 223                          | 699,613                      |
| -                | -  | -                               | -                       | 5                | -                          | 283                         | 179                          | 1,822                        |
| 651              | 12,600                                       | -                               | -                       | -                | 1,325                      | 20,682                      | 1,164                        | 145,373                      |
| 3,705            | 40,721                                       | -                               | 841                     | 809              | 4,102                      | 21,821                      | 1,457                        | 211,973                      |
| 777              | 2,131  | -                               | 23                      | 97               | 1,245                      | 3,211                       | 193                          | 40,567                       |
| 10               | 19   | -                               | -                       | -                | 24                         | 5                           | -                            | 258                          |
| -                | 1,492  | -                               | 80                      | 9                | 5                          | 23                          | 483                          | 51,498                       |
| 83               | 1,126  | -                               | 25                      | 12               | 25                         | 1,566                       | 3,916                        | 14,215                       |
| 26               | 1,215  | -                               | 2                       | 30               | 217                        | 4,470                       | 33                           | 25,815                       |
| 2                | 191  | 792                             | -                       | -                | 13                         | 196                         | 14                           | 9,542                        |
| 500              | 2,000  | -                               | -                       | -                | -                          | 196,462                     | -                            | 222,306                      |
| 78,936           | 1,185,164                                    | 4,078                           | 68,661                  | 41,859           | 126,140                    | 2,118,249                   | 93,867                       | 13,499,204                   |
| 885              | 11,489                                       | 855                             | 9,800                   | 240              | 1,430                      | 13,572                      | 615                          | 160,924                      |
| <u>\$ 79,821</u> | <u>\$ 1,196,653</u>                          | <u>\$ 4,933</u>                 | <u>\$ 78,461</u>        | <u>\$ 42,099</u> | <u>\$ 127,570</u>          | <u>\$ 2,131,821</u>         | <u>\$ 94,482</u>             | <u>\$ 13,660,128</u>         |

(continued)

**HILLCREST FAMILY SERVICES, INC.**  
**STATEMENT OF FUNCTIONAL EXPENSES (continued)**  
**YEAR ENDED OCTOBER 31, 2008**

|                                       | Supporting Services          |                               |                     |                          |                                 | <b>Total<br/>Expenses</b>   |
|---------------------------------------|------------------------------|-------------------------------|---------------------|--------------------------|---------------------------------|-----------------------------|
|                                       | Total<br>Program<br>Services | General and<br>Administrative | Development<br>Fund | Event-<br>Lights<br>Fund | Total<br>Supporting<br>Services |                             |
| Salaries                              | \$ 8,327,530                 | \$ 1,113,500                  | \$ 98,651           | \$ -                     | \$ 1,212,151                    | <b>\$ 9,539,681</b>         |
| Fringe benefits                       | 1,481,511                    | 195,813                       | 17,551              | -                        | 213,364                         | <b>1,694,875</b>            |
| Payroll taxes and other               | <u>604,674</u>               | <u>80,851</u>                 | <u>7,163</u>        | <u>-</u>                 | <u>88,014</u>                   | <b><u>692,688</u></b>       |
| Total personnel expenses              | 10,413,715                   | 1,390,164                     | 123,365             | -                        | 1,513,529                       | <b>11,927,244</b>           |
| Contracted services                   | 821,696                      | 137,411                       | 79,422              | -                        | 216,833                         | <b>1,038,529</b>            |
| Supplies & equipment maintenance      | 718,104                      | 204,579                       | 8,176               | -                        | 212,755                         | <b>930,859</b>              |
| Telephone                             | 115,566                      | 5,359                         | 2,298               | -                        | 7,657                           | <b>123,223</b>              |
| Postage and shipping                  | 7,141                        | 22,156                        | 322                 | -                        | 22,478                          | <b>29,619</b>               |
| Occupancy                             | 699,613                      | 237,039                       | 1,448               | -                        | 238,487                         | <b>938,100</b>              |
| Outside printing                      | 1,822                        | 9,241                         | 46,134              | -                        | 55,375                          | <b>57,197</b>               |
| Professional insurance                | 145,373                      | -                             | 2,974               | -                        | 2,974                           | <b>148,347</b>              |
| Travel                                | 211,973                      | 41,142                        | 9,943               | -                        | 51,085                          | <b>263,058</b>              |
| Conferences and meetings              | 40,567                       | 17,953                        | 5,643               | -                        | 23,596                          | <b>64,163</b>               |
| Subscriptions                         | 258                          | 3,568                         | 173                 | -                        | 3,741                           | <b>3,999</b>                |
| Client assistance                     | 51,498                       | 40,447                        | -                   | -                        | 40,447                          | <b>91,945</b>               |
| Dues                                  | 14,215                       | 16,999                        | 418                 | -                        | 17,417                          | <b>31,632</b>               |
| Miscellaneous                         | 25,815                       | 60,077                        | 3,933               | 118,210                  | 182,220                         | <b>208,035</b>              |
| Interest                              | 9,542                        | 12,646                        | 471                 | -                        | 13,117                          | <b>22,659</b>               |
| Bad debts                             | <u>222,306</u>               | <u>-</u>                      | <u>-</u>            | <u>-</u>                 | <u>-</u>                        | <b><u>222,306</u></b>       |
| Total expenses before<br>depreciation | 13,499,204                   | 2,198,781                     | 284,720             | 118,210                  | 2,601,711                       | <b>16,100,915</b>           |
| Depreciation                          | <u>160,924</u>               | <u>287,134</u>                | <u>3,748</u>        | <u>-</u>                 | <u>290,882</u>                  | <b><u>451,806</u></b>       |
| Total expenses                        | <u>\$ 13,660,128</u>         | <u>\$ 2,485,915</u>           | <u>\$ 288,468</u>   | <u>\$ 118,210</u>        | <u>\$ 2,892,593</u>             | <b><u>\$ 16,552,721</u></b> |

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

|                                    | Program Services    |                     |                     |                     |                   |                      |                  |
|------------------------------------|---------------------|---------------------|---------------------|---------------------|-------------------|----------------------|------------------|
|                                    | Residential         | CMI                 | Health              |                     |                   | Family               |                  |
|                                    | Treatment           | Group<br>Homes      | Services            | Schools             | Shelter           | Centered<br>Services | Counseling       |
| Salaries                           | \$ 1,708,983        | \$ 1,215,412        | \$ 724,316          | \$ 1,762,247        | \$ 244,670        | \$ 402,971           | \$ 48,435        |
| Fringe benefits                    | 304,509             | 216,564             | 129,060             | 313,999             | 43,596            | 71,802               | 8,630            |
| Payroll taxes and other            | <u>130,737</u>      | <u>92,979</u>       | <u>55,410</u>       | <u>134,812</u>      | <u>18,717</u>     | <u>30,827</u>        | <u>3,705</u>     |
| Total personnel expenses           | 2,144,229           | 1,524,955           | 908,786             | 2,211,058           | 306,983           | 505,600              | 60,770           |
| Contracted services                | 72,021              | 45,477              | 150,713             | 10,950              | 4,373             | 3,072                | 6,459            |
| Supplies & equipment maintenance   | 203,904             | 157,902             | 102,578             | 86,663              | 39,291            | 979                  | 7,418            |
| Telephone                          | 12,690              | 17,856              | 14,039              | 14,710              | 4,724             | 2,819                | 1,003            |
| Postage and shipping               | 396                 | 1,093               | 1,311               | 791                 | 104               | 113                  | 394              |
| Occupancy                          | 89,344              | 208,575             | 64,152              | 121,854             | 36,483            | 5,718                | 372              |
| Outside printing                   | -                   | 318                 | 707                 | -                   | -                 | -                    | -                |
| Professional insurance             | 36,459              | 25,722              | 15,637              | 27,561              | 6,415             | 8,753                | 1,870            |
| Travel                             | 24,045              | 26,410              | 26,200              | 33,532              | 5,832             | 8,714                | 570              |
| Conferences and meetings           | 7,943               | 1,654               | 14,798              | 14,635              | 574               | 885                  | 602              |
| Subscriptions                      | 6                   | 153                 | (347)               | -                   | -                 | 1                    | 83               |
| Client assistance                  | 21,822              | 6,200               | 18,185              | 4,321               | 4,937             | -                    | -                |
| Dues                               | 2,295               | 1,279               | 167                 | 655                 | 210               | 309                  | -                |
| Miscellaneous                      | 5,314               | 5,198               | 6,131               | 5,717               | 734               | 1,030                | 177              |
| Interest                           | 8,642               | 67                  | -                   | -                   | -                 | -                    | -                |
| Bad debts                          | <u>-</u>            | <u>-</u>            | <u>110</u>          | <u>-</u>            | <u>-</u>          | <u>-</u>             | <u>622</u>       |
| Total expenses before depreciation | 2,629,110           | 2,022,859           | 1,323,167           | 2,532,447           | 410,660           | 537,993              | 80,340           |
| Depreciation                       | <u>74,749</u>       | <u>20,678</u>       | <u>5,298</u>        | <u>9,654</u>        | <u>1,954</u>      | <u>1,388</u>         | <u>-</u>         |
| Total expenses                     | <u>\$ 2,703,859</u> | <u>\$ 2,043,537</u> | <u>\$ 1,328,465</u> | <u>\$ 2,542,101</u> | <u>\$ 412,614</u> | <u>\$ 539,381</u>    | <u>\$ 80,340</u> |

See notes to financial statements.

Program Services

| Adoption          | Hillcrest<br>Supported<br>Living<br>IPRS/Voc | Family<br>Empowerment<br>Center | Transitional<br>Housing | PATH<br>Grant    | WRAP/<br>Recovery<br>Grant | Mental<br>Health<br>Centers | Big Brothers/<br>Big Sisters | Total<br>Program<br>Services |
|-------------------|--|---------------------------------|-------------------------|------------------|----------------------------|-----------------------------|------------------------------|------------------------------|
| \$ 64,229         | \$ 841,622                                   | \$ 38,240                       | \$ 29,444               | \$ 19,049        | \$ 25,689                  | \$ 770,073                  | \$ 121,527                   | \$ 8,016,907                 |
| 11,444            | 149,961                                      | 6,814                           | 5,246                   | 3,394            | 4,577                      | 137,213                     | 21,654                       | 1,428,463                    |
| 4,914             | 64,384                                       | 2,925                           | 2,252                   | 1,457            | 1,965                      | 58,911                      | 9,297                        | 613,292                      |
| 80,587            | 1,055,967                                    | 47,979                          | 36,942                  | 23,900           | 32,231                     | 966,197                     | 152,478                      | 10,058,662                   |
| 13,045            | 6,687  | 226                             | 127                     | -                | -                          | 499,288                     | 5,726                        | 818,164                      |
| 1,534             | 5,584  | 237                             | 2,885                   | 5                | 1,842                      | 22,710                      | 3,514                        | 637,046                      |
| 1,636             | 16,826                                       | 2,937                           | 2,878                   | -                | 272                        | 17,239                      | 512                          | 110,141                      |
| 159               | 609  | 16                              | 36                      | -                | -                          | 1,632                       | 171                          | 6,825                        |
| 778               | 19,416                                       | 12,672                          | 15,282                  | 1,263            | 2,051                      | 75,894                      | 332                          | 654,186                      |
| -                 | -  | -                               | -                       | -                | -                          | -                           | (127)                        | 898                          |
| 1,327             | 10,988                                       | 1,293                           | 918                     | -                | -                          | 17,163                      | 2,950                        | 157,056                      |
| 8,805             | 40,042                                       | 144                             | 584                     | 353              | 1,645                      | 11,940                      | 2,911                        | 191,727                      |
| 2,326             | 2,322  | 94                              | -                       | 75               | 855                        | 6,803                       | 3,131                        | 56,697                       |
| 750               | 205  | 1                               | -                       | -                | -                          | 103                         | -                            | 955                          |
| -                 | 879  | -                               | 863                     | (25)             | (1)                        | -                           | -                            | 57,181                       |
| 17                | 1,037  | 50                              | -                       | -                | -                          | 514                         | 3,588                        | 10,121                       |
| 2,264             | 2,303  | 76                              | -                       | 25               | 110                        | 2,237                       | 605                          | 31,921                       |
| -                 | -  | 225                             | -                       | -                | -                          | -                           | -                            | 8,934                        |
| -                 | -  | -                               | -                       | -                | -                          | 15,158                      | -                            | 15,890                       |
| 113,228           | 1,162,865                                    | 65,950                          | 60,515                  | 25,596           | 39,005                     | 1,636,878                   | 175,791                      | 12,816,404                   |
| 975               | 6,582  | 5,244                           | 23,740                  | -                | -                          | 7,016                       | -                            | 157,278                      |
| <u>\$ 114,203</u> | <u>\$ 1,169,447</u>                          | <u>\$ 71,194</u>                | <u>\$ 84,255</u>        | <u>\$ 25,596</u> | <u>\$ 39,005</u>           | <u>\$ 1,643,894</u>         | <u>\$ 175,791</u>            | <u>\$ 12,973,682</u>         |

(continued)

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

|                                       | Supporting Services          |                               |                     |                          |                                 |                      |
|---------------------------------------|------------------------------|-------------------------------|---------------------|--------------------------|---------------------------------|----------------------|
|                                       | Total<br>Program<br>Services | General and<br>Administrative | Development<br>Fund | Event-<br>Lights<br>Fund | Total<br>Supporting<br>Services | Total<br>Expenses    |
| Salaries                              | \$ 8,016,907                 | \$ 1,039,816                  | \$ 78,667           | \$ -                     | \$ 1,118,483                    | \$ 9,135,390         |
| Fringe benefits                       | 1,428,463                    | 178,201                       | 14,017              | -                        | 192,218                         | 1,620,681            |
| Payroll taxes and other               | <u>613,292</u>               | <u>48,299</u>                 | <u>6,018</u>        | <u>-</u>                 | <u>54,317</u>                   | <u>667,609</u>       |
| Total personnel expenses              | 10,058,662                   | 1,266,316                     | 98,702              | -                        | 1,365,018                       | 11,423,680           |
| Contracted services                   | 818,164                      | 77,587                        | 14,460              | -                        | 92,047                          | 910,211              |
| Supplies & equipment maintenance      | 637,046                      | 170,493                       | 9,136               | -                        | 179,629                         | 816,675              |
| Telephone                             | 110,141                      | 5,660                         | 1,246               | -                        | 6,906                           | 117,047              |
| Postage and shipping                  | 6,825                        | 24,821                        | 1,470               | -                        | 26,291                          | 33,116               |
| Occupancy                             | 654,186                      | 222,575                       | 328                 | -                        | 222,903                         | 877,089              |
| Outside printing                      | 898                          | 10,304                        | 48,405              | -                        | 58,709                          | 59,607               |
| Professional insurance                | 157,056                      | -                             | 2,679               | -                        | 2,679                           | 159,735              |
| Travel                                | 191,727                      | 32,204                        | 7,197               | -                        | 39,401                          | 231,128              |
| Conferences and meetings              | 56,697                       | 21,853                        | 2,738               | -                        | 24,591                          | 81,288               |
| Subscriptions                         | 955                          | 2,227                         | 393                 | -                        | 2,620                           | 3,575                |
| Client assistance                     | 57,181                       | 40,051                        | -                   | -                        | 40,051                          | 97,232               |
| Dues                                  | 10,121                       | 12,773                        | 672                 | -                        | 13,445                          | 23,566               |
| Miscellaneous                         | 31,921                       | 47,657                        | 4,393               | 133,111                  | 185,161                         | 217,082              |
| Interest                              | 8,934                        | 48,762                        | -                   | -                        | 48,762                          | 57,696               |
| Bad debts                             | <u>15,890</u>                | <u>-</u>                      | <u>-</u>            | <u>-</u>                 | <u>-</u>                        | <u>15,890</u>        |
| Total expenses before<br>depreciation | 12,816,404                   | 1,983,283                     | 191,819             | 133,111                  | 2,308,213                       | 15,124,617           |
| Depreciation                          | <u>157,278</u>               | <u>268,930</u>                | <u>4,688</u>        | <u>-</u>                 | <u>273,618</u>                  | <u>430,896</u>       |
| Total expenses                        | <u>\$ 12,973,682</u>         | <u>\$ 2,252,213</u>           | <u>\$ 196,507</u>   | <u>\$ 133,111</u>        | <u>\$ 2,581,831</u>             | <u>\$ 15,555,513</u> |

**HILLCREST FAMILY SERVICES, INC.**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED OCTOBER 31, 2008 AND 2007**

|   | <u>2008</u>      | <u>2007</u>        |
|---|------------------|--------------------|
| <b>OPERATING ACTIVITIES</b>   |                  |                    |
| Increase (decrease) in net assets   | \$ (1,297,858)   | \$ 74,307          |
| Adjustments to reconcile increase (decrease) in net assets<br>to net cash used for operating activities |                  |                    |
| Depreciation  | 451,806          | 430,896            |
| Gain on disposal of assets  | (130,394)        | -                  |
| Bad debts   | 222,306          | 15,890             |
| Changes in assets and liabilities   |                  |                    |
| Receivables   | (998,605)        | (223,064)          |
| Inventory   | 9,872            | (21,875)           |
| Prepaid expenses  | (87,625)         | 35,572             |
| Bank overdraft  | (55,040)         | (2,692,988)        |
| Accounts/County payable   | 127,803          | 66,916             |
| Accrued expenses  | (109,001)        | 460,695            |
| Deferred revenue  | 60,031           | 8,658              |
| Pension liability   | 1,548,192        | (307,817)          |
| <b>NET CASH USED FOR OPERATING ACTIVITIES</b>   | <u>(258,513)</u> | <u>(2,152,810)</u> |
| <b>INVESTING ACTIVITIES</b>   |                  |                    |
| Purchase of property and equipment  | (217,129)        | (87,627)           |
| (Increase) decrease in investments  | 638,131          | (136,842)          |
| Proceeds from sale of assets  | 164,414          | -                  |
| <b>NET CASH FROM (USED FOR) INVESTING ACTIVITIES</b>  | <u>585,416</u>   | <u>(224,469)</u>   |
| <b>FINANCING ACTIVITIES</b>   |                  |                    |
| Net payments on line of credit  | (259,224)        | (95,226)           |
| Proceeds from issuance of long-term debt  | 58,969           | -                  |
| Principal payments on long-term debt  | (126,006)        | (83,478)           |
| <b>NET CASH USED FOR FINANCING ACTIVITIES</b>   | <u>(326,261)</u> | <u>(178,704)</u>   |
| <b>NET INCREASE (DECREASE) IN CASH AND<br/>CASH EQUIVALENTS</b>   | <b>642</b>       | <b>(2,555,983)</b> |
| <b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>   | <u>73,857</u>    | <u>2,629,840</u>   |
| <b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>   | <u>\$ 74,499</u> | <u>\$ 73,857</u>   |
| <b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>   |                  |                    |
| Cash paid during the year for interest  | <u>\$ 22,659</u> | <u>\$ 57,696</u>   |
| <b>SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING<br/>AND FINANCING ACTIVITIES</b>                        |                  |                    |
| Equipment financed through long-term debt   | <u>\$ 58,969</u> | <u>\$ 36,700</u>   |

See notes to financial statements.

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

---

**NOTE 1 – ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES**

*Organization*

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

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

*Use of Estimates*

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

*Cash and Cash Equivalents*

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

*Accounts Receivable*

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

Payments of client 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 client receivables is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from clients and third-party payors. Management reviews client 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 clients due to bad debts. Management considers historical write off and recovery information in determining the estimated bad debt provision.

*Inventory*

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

*Assets Limited as to Use*

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

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

---

*Property and Equipment*

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

*Pension Liability*

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

*Temporarily and Permanently Restricted Net Assets*

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

*Public Support and Revenue in Excess of (Less Than) Expenses*

Public support and revenue in excess of (less than) expenses excludes change in unrealized gains and losses on investments, gain on disposal of assets and pension-related changes other than net periodic pension costs.

*Program Service Revenue*

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

*Investments and Investment Income (Loss)*

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

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

---

*Donated Goods and Services*

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

*Promises to Give*

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

*Advertising Costs*

The Organization expenses advertising costs as incurred.

*Reclassification*

Certain items from the 2007 financial statements have been reclassified to conform to the current year presentation.

*New Accounting Standards*

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement No. 157, *Fair Value Measurements* (SFAS No. 157), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles (GAAP). SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, except for non-financial assets and non-financial liabilities of which the effective date has been delayed for one year.

In August 2008, FASB Staff Position No. FAS 117-1, *Endowments of Not-for-Profit Organizations: Net asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA) and Enhanced Disclosures for All Endowment Funds (FSP)*, was issued, and its guidance is effective for fiscal years ending after December 15, 2008. A key component of that FSP is a requirement to classify the portion of a donor-restricted endowment fund that is not classified as permanently restricted net assets as temporarily restricted net assets until appropriated for expenditure. The state of Iowa has adopted UPMIFA so the Organization will be required to adopt the complete standard.

The Organization is currently evaluating the impact the aforementioned statements will have on the financial statements. It does not believe that the adoption of SFAS No. 157 and FASB Staff Position No. FAS 117-1 will have a material impact on its financial position and changes in net assets.

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

---

**NOTE 2 – NET PROGRAM SERVICE FEES**

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

**Medicaid (IME/T19)**

The Medicaid program reimburses the Organization for services as defined in various agreements. The basis for reimbursement under these agreements may include discounts from established charges and prospectively determined rates, or may be based on a cost reimbursement methodology. Under this methodology, the Organization is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports.

**Grants**

Hillcrest Family Services, Inc. has several grant agreements with various governmental organizations. These grants are administered by the various government agencies and grant awards are determined based on availability of funds and need. The Organization is required to submit documentation to the various grantors to verify allowable expenditures that will be reimbursed under the grant.

**MBC of Iowa – an Affiliate of Magellan Behavioral Health**

The basis for reimbursement under agreements with Magellan is based on a cost reimbursement methodology. Under this methodology, the Organization is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports.

**County Board of Supervisors**

The Organization has also entered into payment agreements with several county Board of Supervisors. The basis for reimbursement under these agreements may include discounts from established charges and prospectively determined rates. Rates are negotiated based on annual cost report information.

**Medicare**

The Medicare program reimburses the Organization for services under agreements that may include discounts from established charges and prospectively determined rates.

**Other Payors**

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

Revenue from the various payors accounted for approximately:

|                                      | <b>2008</b> | <b>2007</b> |
|--------------------------------------|-------------|-------------|
| Medicaid                             | <b>44%</b>  | 49%         |
| Grants                               | <b>31</b>   | 28          |
| MBC of Iowa                          | <b>10</b>   | 8           |
| County Board of Supervisors          | <b>6</b>    | 6           |
| Commercial insurance                 | <b>5</b>    | 4           |
| Other third-party payors and clients | <b>4</b>    | 5           |
|                                      | <b>100%</b> | 100%        |

(continued on next page)

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

The 2008 net program service revenue increased approximately \$310,000 due to prior-year retroactive adjustments in excess of amounts previously estimated.

**NOTE 3 – INVESTMENTS AND INVESTMENT INCOME (LOSS)**

*Investments*

Investments are stated at fair value and include the following at October 31, 2008 and 2007:

|                         | <u>2008</u>         |                     | <u>2007</u>         |                     |
|-------------------------|---------------------|---------------------|---------------------|---------------------|
|                         | <u>Market</u>       |                     | <u>Market</u>       |                     |
|                         | <u>Value</u>        | <u>Cost</u>         | <u>Value</u>        | <u>Cost</u>         |
| Certificates of deposit | \$ 113,437          | \$ 113,437          | \$ 229,080          | \$ 229,080          |
| Money market            | 39,891              | 39,891              | 187,714             | 187,714             |
| Government agencies     | 165,251             | 164,111             | 508,992             | 514,287             |
| Common stocks           | 1,107,669           | 1,253,713           | 1,790,818           | 1,469,732           |
| Mutual/bond funds       | 1,271,831           | 1,374,762           | 615,916             | 616,108             |
| Land - Arizona          | 1,050               | 1,050               | 1,050               | 1,050               |
|                         | <u>\$ 2,699,129</u> | <u>\$ 2,946,964</u> | <u>\$ 3,333,570</u> | <u>\$ 3,017,971</u> |

*Assets Limited as to Use*

Included in investments are funds that have been designated by the Board of Trustees to supplement future operations totaling \$2,227,410 and \$3,141,514 at October 31, 2008 and 2007, respectively.

*Investments in an Unrealized Gain (Loss) Position*

Investments in an unrealized gain (loss) position at October 31, 2008, are shown in the following table:

|                     | <u>Fair Value</u>   | <u>Unrealized Losses</u> | <u>Fair Value</u> | <u>Unrealized Gains</u> |
|---------------------|---------------------|--------------------------|-------------------|-------------------------|
| Government agencies | \$ -                | \$ -                     | \$ 165,251        | \$ 1,137                |
| Common stocks       | 521,761             | (182,130)                | 275,905           | 36,706                  |
| Bond funds          | 1,271,830           | (103,548)                | -                 | -                       |
|                     | <u>\$ 1,793,591</u> | <u>\$ (285,678)</u>      | <u>\$ 441,156</u> | <u>\$ 37,843</u>        |

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

The duration of the investments in an unrealized loss position at October 31, 2008, is shown in the following table:

|                     | <u>Greater than 12 months</u> |                          | <u>Less than 12 months</u> |                          |
|---------------------|-------------------------------|--------------------------|----------------------------|--------------------------|
|                     | <u>Fair Value</u>             | <u>Unrealized Losses</u> | <u>Fair Value</u>          | <u>Unrealized Losses</u> |
| Government agencies | \$ -                          | \$ -                     | \$ -                       | \$ -                     |
| Common stocks       | 73,316                        | (145,235)                | 448,445                    | (36,895)                 |
| Bond funds          | 490,725                       | (35,387)                 | 781,105                    | (68,161)                 |
|                     | <u>\$ 564,041</u>             | <u>\$ (180,622)</u>      | <u>\$ 1,229,550</u>        | <u>\$ (105,056)</u>      |

The unrealized losses on the Organization's investments in common stocks were caused by numerous changes in market factors. The Organization evaluated the near-term prospects of the issuers for common stock in relation to the severity and duration of the impairment. Based on that evaluation and the Organization's ability and intent to hold those investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Organization does not consider the investments in common stocks to be other-than-temporarily impaired at October 31, 2008.

The unrealized losses on the Organization's investments in bond funds were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than amortized cost of the investment. Because the Organization has the ability and the intent to hold those investments until a recovery of fair value, which may be maturity, the Organization does not consider those investments to be other-than-temporarily impaired at October 31, 2008.

The Organization invests in various investment securities which are exposed to risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported on the statement of financial position.

*Investment Income (Loss)*

Investment income (loss) is recorded net of investment fees of \$22,687 and \$22,916 for the years ended October 31, 2008 and 2007. Investment income and gains and losses on cash equivalents and other investments consist of the following for the years ended October 31, 2008 and 2007:

|  | <u>2008</u>         | <u>2007</u>       |
|--|---------------------|-------------------|
| Investment income (loss)                             |                     |                   |
| Interest and dividend income                         | \$ 138,563          | \$ 96,285         |
| Realized gains and losses on sale of investments     | <u>(348,577)</u>    | <u>174,878</u>    |
| Total investment income (loss)                       | <u>\$ (210,014)</u> | <u>\$ 271,163</u> |
| Other changes in net assets                          |                     |                   |
| Change in unrealized gains and losses on investments | <u>\$ (563,434)</u> | <u>\$ 4,717</u>   |

Included in realized gains and losses on sale of investments for 2008 are investment impairments that were recognized due to a less than temporary decline in value. See Note 17 for additional information.

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

**NOTE 4 – BENEFICIAL INTEREST IN NET ASSETS OF COMMUNITY FOUNDATION**

The Organization is a beneficiary of a community foundation maintained by an independent trustee. The assets maintained by the community foundation are to be held in perpetuity. The Organization expects to receive annual distributions of its share of the community foundation's income. These distributions will be recorded in the financial statements as investment income. The funds which have been invested directly by the Organization are recognized in the financial statements as a beneficial interest in net assets of the community foundation at the fair market value of the Organization's interest in the foundation. These funds amounted to \$9,191 and \$12,881 at October 31, 2008 and 2007, respectively.

The community foundation also holds funds contributed by individual donors for the benefit of Hillcrest Family Services, Inc. It should be noted, however, that the community foundation has variance power, which allows them to modify the donor's stipulations under certain circumstances as they monitor the changing needs of the community. These funds will not be recorded as an asset on the financial statements of the Organization. They total \$109,626 and \$117,993 at October 31, 2008 and 2007, respectively, and are held by the community foundation as permanently endowed for the support of Hillcrest Family Services, Inc.

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

A summary of property and equipment at October 31, 2008 and 2007, follows:

|                                    | 2008                |                             | 2007                |                             |
|------------------------------------|---------------------|-----------------------------|---------------------|-----------------------------|
|                                    | Cost                | Accumulated<br>Depreciation | Cost                | Accumulated<br>Depreciation |
| Land                               | \$ 40,000           | \$ -                        | \$ 40,000           | \$ -                        |
| Land improvements                  | 141,362             | 37,575                      | 141,362             | 27,837                      |
| Buildings                          | 6,229,647           | 2,978,527                   | 6,267,808           | 2,861,641                   |
| Vehicles                           | 513,578             | 367,554                     | 548,661             | 389,509                     |
| Furniture, fixtures, and equipment | 1,751,531           | 1,406,954                   | 1,653,726           | 1,228,341                   |
| Leasehold improvements             | 42,934              | 25,829                      | 40,755              | 20,123                      |
| Construction in progress           | <u>8,588</u>        | -                           | <u>15,038</u>       | -                           |
|                                    | <u>\$ 8,727,640</u> | <u>\$ 4,816,439</u>         | <u>\$ 8,707,350</u> | <u>\$ 4,527,451</u>         |
| Net land, buildings and equipment  | <u>\$ 3,911,201</u> |                             | <u>\$ 4,179,899</u> |                             |

Construction in progress consists of three projects at year end. The largest portion of construction in progress consists of architect fees associated with the Family Life Center project which is expected to begin construction in 2010. The estimated total cost to complete this project is \$10 million and will be funded through a capital campaign and operations. The other projects in progress at year end are remodeling projects for New Pathways and Marywood. The estimated total costs of these remodeling projects total \$14,000 and will be funded through grants received. These remodeling projects are expected to be completed in early 2009.

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

**NOTE 6 – UNCONDITIONAL PROMISES**

Unconditional promises to give that are expected to be collected within one year are recorded at net realizable value. Unconditional promises to give that are expected to be collected in future years are recorded at the present value of their estimated future cash flows. The discounts on those amounts are computed using a risk free interest rate of 5%. No allowance has been recorded at October 31, 2008 and 2007, due to management's belief that all amounts will be collected. No discount has been recorded due to the timing of expected collections. Included in amounts due in less than one year are United Way contributions, totaling \$117,000 and \$92,000 at October 31, 2008 and 2007, respectively. Promises to give are due as follows:

|                    | <u>2008</u>       | <u>2007</u>       |
|--------------------|-------------------|-------------------|
| Less than one year | \$ 131,450        | \$ 111,035        |
| One to five years  | <u>109,081</u>    | <u>40,163</u>     |
|                    | <u>\$ 240,531</u> | <u>\$ 151,198</u> |

**NOTE 7 – COUNTY PAYABLE**

The County payable accrual consists of \$28,327 due to Jackson County and \$159,298 due to Dubuque County. These amounts represent funds to be refunded to the counties for fiscal years 2008 and 2007 financial assistance provided by the counties for Medicaid reimbursement losses experienced by Hillcrest related to mental health services. There is an understanding that Hillcrest will reimburse the counties for their risk-sharing assistance if a cost settlement is paid by Medicaid to correct the rate reimbursement. Hillcrest received a corrected rate from Medicaid and, therefore, will refund the financial assistance to the counties.

**NOTE 8 – LINE OF CREDIT AND LONG-TERM DEBT**

The Organization has a line of credit available of up to \$750,000 with U.S. Bank in Dubuque, Iowa. Interest is paid monthly at a rate of LIBOR plus 2.75% (6.71% at October 31, 2008). The line matures in June 2009, and is secured by substantially all assets of the Organization. At October 31, 2008, there was no balance outstanding on the line of credit. At October 31, 2007, the outstanding balance on the line of credit was \$259,224.

Long-term debt consists of:

|  | <u>2008</u> | <u>2007</u> |
|--|-------------|-------------|
| 5.33% note payable to bank, due in monthly installments of \$1,850 including interest, due in December 2008, secured by real estate. | \$ 97,676   | \$ 114,102  |
| 5.54% note payable to bank, due in monthly installments of \$1,130 including interest, due in February 2013, secured by vehicles.    | 52,005      | -           |
| 6.49% note payable to bank, due in monthly installments of \$720 including interest, due in July 2012, secured by vehicles.          | 28,602      | 35,127      |
| 5.49% note payable to bank, due in monthly installments of \$864 including interest, due in September 2010, secured by equipment.    | 18,828      | 27,904      |

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

|  | <u>2008</u>      | <u>2007</u>       |
|--|------------------|-------------------|
| 5.24% note payable to bank, due in monthly installments of \$724 including interest, due in September 2010, secured by vehicles.   | \$ 12,510        | \$ 20,308         |
| 7.61% mortgage payable to bank, due in monthly installments of \$937 including interest, due in May 2011, secured by real estate.  | -                | 34,494            |
| 7.61% mortgage payable to bank, due in monthly installments of \$740 including interest, due in May 2011, secured by real estate.  | -                | 26,087            |
| 4.65% note payable to bank, due in monthly installments of \$1,362 including interest, due in September 2008, secured by vehicles. | -                | 14,637            |
| Interest free note payable to Iowa Finance Authority, due in monthly payments of \$1,333.  | -                | 4,000             |
|  | <u>209,621</u>   | 276,659           |
| Less current maturities  | <u>(133,418)</u> | <u>(73,068)</u>   |
| Long-term debt, less current maturities  | <u>\$ 76,203</u> | <u>\$ 203,591</u> |

Future principal payments on the above loans are as follows:

| <u>Year Ending October 31</u> |                   |
|-------------------------------|-------------------|
| 2009                          | \$ 133,418        |
| 2010                          | 32,552            |
| 2011                          | 20,178            |
| 2012                          | 19,139            |
| 2013                          | <u>4,334</u>      |
| Total                         | <u>\$ 209,621</u> |

**NOTE 9 – DEFERRED REVENUE**

Deferred revenue includes an advance from the Iowa Department of Public Health earmarked for future periods. The advance was \$43,666 at October 31, 2008 and 2007.

**NOTE 10 – EMPLOYEE BENEFIT PLANS**

*Self-Insured Health Plan*

Starting in fiscal year 2007, Hillcrest Family Services, Inc. self-insures for losses related to employee health benefits. Reinsurance coverage is maintained for specific individual and aggregate liability losses over specified amounts. A provision for estimated health claims outstanding of \$40,000 and \$61,000 is included in payroll taxes and other accrued expenses at October 31, 2008 and 2007, respectively.

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

---

*401(k) Retirement Plans*

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

Effective January 1, 2008, the Organization also adopted a qualified 401(k) retirement plan that covers all non-bargaining employees who have completed one year of service and are 21 years of age or older. The Organization makes discretionary contributions of 3% of eligible compensation. The Organization also matches 50% of employee contributions up to 4% of eligible compensation.

The employer contributions for the 401k plans for the years ended October 31, 2008 and 2007, were \$257,016 and \$39,225, respectively.

*Defined Benefit Pension Plan*

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

The following table sets forth the changes in projected benefit obligations, changes in plan assets and funded status for the plan for the years ended October 31, using a measurement date of October 31 also:

|   | <u>2008</u>         | <u>2007</u>         |
|---|---------------------|---------------------|
| <b>Change in benefit obligation</b>     |                     |                     |
| Benefit obligation at beginning of year | \$ 3,898,410        | \$ 4,258,931        |
| Service cost                            | 53,737              | 333,061             |
| Interest cost                           | 221,898             | 237,713             |
| Actuarial (gain)/loss                   | 928,875             | (870,483)           |
| Benefits paid                           | (651,619)           | (60,812)            |
| Settlements                             | 84,718              | -                   |
| Curtailments                            | <u>55,981</u>       | <u>-</u>            |
| Benefit obligation at end of year       | <u>\$ 4,592,000</u> | <u>\$ 3,898,410</u> |

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

|   | <u>2008</u>           | <u>2007</u>         |
|---|-----------------------|---------------------|
| <b>Change in plan assets</b>  |                       |                     |
| Fair value of plan assets at beginning of year                        | \$ 3,877,819          | \$ 3,685,579        |
| Actual net return on plan assets                                      | (243,525)             | 37,052              |
| Employer contribution   | 40,542                | 216,000             |
| Benefits paid   | (2,115)               | (60,812)            |
| Settlements   | <u>(649,504)</u>      | <u>-</u>            |
| Fair value of plan assets at end of year                              | <u>\$ 3,023,217</u>   | <u>\$ 3,877,819</u> |
| <br>  |                       |                     |
| Funded status   | \$ (1,568,783)        | \$ (20,591)         |
| Unrecognized net actuarial loss                                       | -                     | -                   |
| Unrecognized transition (asset) obligation                            | <u>-</u>              | <u>-</u>            |
| Accrued benefit cost liability  | <u>\$ (1,568,783)</u> | <u>\$ (20,591)</u>  |
| <br><b>Pension Benefits</b><br><br>                                   |                       |                     |
|   | <u>2008</u>           | <u>2007</u>         |
| Amounts recognized in the statement of financial position consist of: |                       |                     |
| <br>  |                       |                     |
| Liabilities - accrued benefit liability                               | <u>\$ (1,568,783)</u> | <u>\$ (20,591)</u>  |
| <br>  |                       |                     |
| Amounts recognized in unrestricted net assets consist of:             |                       |                     |
| <br>  |                       |                     |
| Net actuarial (gain) loss   | \$ 671,263            | \$ (744,429)        |
| Net transition obligation   | <u>229,931</u>        | <u>304,102</u>      |
| Total amounts included in unrestricted net assets                     | <u>\$ 901,194</u>     | <u>\$ (440,327)</u> |
| <br>  |                       |                     |
|   | <u>2008</u>           | <u>2007</u>         |
| <b>Weighted-average assumptions as of October 31</b>                  |                       |                     |
| Discounted rate   | 6.00%                 | 6.00%               |
| Rate of total compensation increase                                   | 4.50%                 | 4.50%               |
| Expected return on plan assets  | 5.00%                 | 8.00%               |

Historical market returns, risks, and peer data are examined as part of determining the assumption related to the expected return on plan assets. Current market factors, such as inflation and interest rates, are also evaluated.

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

The components of net periodic pension cost and other amounts recognized in changes in unrestricted net assets for the years ended October 31, include the following:

|  | <u>2008</u>         | <u>2007</u>       |
|--|---------------------|-------------------|
| <b>Net periodic benefit cost</b>   |                     |                   |
| Service cost   | \$ 53,737           | \$ 333,061        |
| Interest cost  | 221,898             | 237,713           |
| Expected return on plan assets   | (185,402)           | (296,435)         |
| Amortization of transition obligation  | 12,362              | 74,171            |
| Amortization of unrecognized net (gain) loss   | <u>(57,890)</u>     | <u>-</u>          |
| Net periodic benefit cost  | <u>\$ 44,705</u>    | <u>\$ 348,510</u> |
| <b>Other changes in plan assets and projected benefit obligations recognized in changes in unrestricted net assets</b> |                     |                   |
| Amortization of net transition (asset) obligation  | \$ (12,362)         | \$ N/A            |
| Net (gain) loss experienced during the year  | 1,357,802           | N/A               |
| Amortization of net (gain) loss  | <u>57,890</u>       | <u>N/A</u>        |
| Total recognized in changes in unrestricted net assets   | <u>\$ 1,403,330</u> | <u>\$ N/A</u>     |
| Total recognized in net periodic benefit cost and changes in unrestricted net assets                                   | <u>\$ 1,448,035</u> | <u>\$ 348,510</u> |
| <b>Other costs</b>   |                     |                   |
| Recognized loss due to settlement or curtailment   | <u>\$ 100,157</u>   | <u>\$ N/A</u>     |

The estimated net loss, prior service cost and transition obligation for the defined benefit pension plan that will be amortized from unrecognized net assets into net periodic benefit cost during the 2009 fiscal year are \$35,641, \$0 and \$0, respectively.

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

|                   | <u>2008</u> | <u>2007</u> |
|-------------------|-------------|-------------|
| Equity securities | 0%          | 58%         |
| Debt securities   | -           | 36          |
| Other             | <u>100</u>  | <u>6</u>    |
| Total             | <u>100%</u> | <u>100%</u> |

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

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

---

*Plan Termination*

The Organization notified its employees during 2008 of its intent to terminate the defined benefit pension plan. Plan benefits were frozen on December 31, 2007. According to the plan document, participants become 100% vested in their accrued benefit upon plan termination. Benefits will be distributed to the participants in the manner and priorities allowed by the plan, as soon as practicable. The exact date the plan will be paid out has not yet been determined due to pending Internal Revenue Service approval. The Organization expects to contribute \$1,568,783 to the plan during the fiscal year ended October 31, 2009.

The following is the expected timing of estimated future benefit payments which is based on the October 31, 2008, measurement date:

Fiscal Year End 2009 \$ 4,592,000

The final distribution which will be made in fiscal year end 2009, when the final plan distributions are settled, will vary from the amount above, which is based on the October 31, 2008, measurement date.

**NOTE 11 – TEMPORARILY AND PERMANENTLY RESTRICTED NET ASSETS**

Temporarily restricted net assets are available for the following purposes at October 31, 2008 and 2007:

|   | <u>2008</u>       | <u>2007</u>       |
|---|-------------------|-------------------|
| Time restriction - United Way contributions | \$ 117,000        | \$ 92,000         |
| Time restriction - other pledges            | 123,531           | 59,198            |
| Family Life Center                          | <u>107,349</u>    | <u>16,909</u>     |
|   | <u>\$ 347,880</u> | <u>\$ 168,107</u> |

Permanently restricted net assets at October 31, 2008 and 2007, are held in perpetuity with the income to be used for:

|                                   | <u>2008</u>       | <u>2007</u>       |
|-----------------------------------|-------------------|-------------------|
| Unrestricted support for programs | \$ 140,000        | \$ 110,000        |
| Family Life Center                | 92,320            | -                 |
| Educational programs              | 80,000            | 80,000            |
| Family counseling                 | <u>1,000</u>      | <u>1,000</u>      |
|                                   | <u>\$ 313,320</u> | <u>\$ 191,000</u> |

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

---

**NOTE 12 – OPERATING LEASES**

The Organization leases certain property and equipment under non-cancellable long-term operating lease agreements. Total lease expense for the years ended October 31, 2008 and 2007, was \$360,845 and \$353,156, respectively.

Minimum future lease payments are as follows:

| <u>Year Ending October 31</u> |                   |
|-------------------------------|-------------------|
| 2009                          | \$ 180,634        |
| 2010                          | 171,255           |
| 2011                          | 61,493            |
| 2012                          | <u>40,085</u>     |
| Total                         | <u>\$ 453,467</u> |

**NOTE 13 – RELATED PARTY TRANSACTIONS**

The Organization had transactions with a company owned by an employee and spouse related to the purchase of signs and banners. The total payments for the years ended October 31, 2008 and 2007, were \$1,392 and \$0, respectively. The Organization also had transactions with a company owned by the family of an employee related to the purchase and installation of flooring. The total payments for the years ended October 31, 2008 and 2007, were \$21,384 and \$0, respectively.

**NOTE 14 – CONTINGENCY**

A civil lawsuit has been filed on behalf of the estate of a former client. No specific amount of monetary damages is being sought. A trial is set to begin on August 11, 2009. At this point, the case is in its early stages and is being vigorously contested by the Organization's insurer. Management feels that any damages sought should be covered by their insurance policy. Available policy limits are \$1 million.

**NOTE 15 – ADMINISTRATIVE ADJUSTMENT**

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

**HILLCREST FAMILY SERVICES, INC.**  
**NOTES TO FINANCIAL STATEMENTS**  
**OCTOBER 31, 2008 AND 2007**

---

**NOTE 16 – CONCENTRATION OF CREDIT RISK**

Hillcrest Family Services, Inc. grants credit without collateral to its clients, most of whom are insured under third-party payor agreements. The mix of receivables from third-party payors and clients at October 31, 2008 and 2007, was as follows:

|                                      | <u>2008</u> | <u>2007</u> |
|--------------------------------------|-------------|-------------|
| Medicaid                             | 38%         | 41%         |
| Grants                               | 23          | 6           |
| MBC of Iowa                          | 14          | 19          |
| County Board of Supervisors          | 7           | 5           |
| Commercial insurance                 | 10          | 15          |
| Other third-party payors and clients | 8           | 14          |
|                                      | <u>100%</u> | <u>100%</u> |

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

**NOTE 17 – SUBSEQUENT EVENT**

Hillcrest Family Services, Inc. sold investments with a fair market value in excess of \$1,500,000 during January 2009. The majority of these investments were sold at prices less than amounts originally invested. An impairment on these investments was recorded at October 31, 2008, resulting in the recording of realized losses totaling \$310,003.

**HILLCREST FAMILY SERVICES, INC.**

**HILLCREST FAMILY SERVICES, INC.**  
**SCHEDULES OF PROGRAM SERVICE FEES, NET**  
**OCTOBER 31, 2008 AND 2007**

|  | 2008                 |                              |                                  |                                  |                      |
|--|----------------------|------------------------------|----------------------------------|----------------------------------|----------------------|
|  | <u>Gross fees</u>    | <u>Contractual allowance</u> | <u>Estimated cost settlement</u> | <u>Administrative adjustment</u> | <u>Net fees</u>      |
| Program service fees, net              |                      |                              |                                  |                                  |                      |
| Residential treatment                  | \$ 3,045,673         | \$ 37,489                    | \$ 91,124                        | \$ (2,112)                       | \$ 3,172,174         |
| CMI group homes                        | 2,494,165            | (87,645)                     | (27,388)                         | (6,474)                          | 2,372,658            |
| Health services                        | 604,047              | (44,323)                     | -                                | (62,032)                         | 497,692              |
| Schools                                | 3,540,482            | -                            | -                                | -                                | 3,540,482            |
| Shelter                                | 564,956              | 25,600                       | -                                | (913)                            | 589,643              |
| Family Centered Services               | 244,510              | 4,117                        | 12,084                           | (366)                            | 260,345              |
| Counseling                             | 61,458               | (7,306)                      | -                                | (70)                             | 54,082               |
| Adoption                               | 67,670               | 6,209                        | -                                | -                                | 73,879               |
| Hillcrest supported living/IPRS/VOC    | 1,449,551            | (84,893)                     | (19,565)                         | (11,617)                         | 1,333,476            |
| Family Empowerment Center              | -                    | -                            | -                                | -                                | -                    |
| Transitional housing                   | 4,808                | -                            | -                                | -                                | 4,808                |
| Washington County Mental Health Center | 383,157              | (127,611)                    | 182,143                          | (7,982)                          | 429,707              |
| Dubuque County Mental Health Center    | 2,178,220            | (792,593)                    | 668,912                          | (31,502)                         | 2,023,037            |
| Jackson County Mental Health Center    | 485,870              | (257,448)                    | 280,010                          | (16,481)                         | 491,951              |
| PATH Grant                             | 2,445                | -                            | -                                | -                                | 2,445                |
| WRAP/Recovery Grant                    | <u>3</u>             | <u>-</u>                     | <u>-</u>                         | <u>-</u>                         | <u>3</u>             |
| Total program service fees, net        | <u>\$ 15,127,015</u> | <u>\$ (1,328,404)</u>        | <u>\$ 1,187,320</u>              | <u>\$ (139,549)</u>              | <u>\$ 14,846,382</u> |

| Program service fees, net              | 2007                 |                       |                           |                      |
|--|----------------------|-----------------------|---------------------------|----------------------|
|  | Gross fees           | Contractual allowance | Administrative adjustment | Net fees             |
| Residential treatment                  | \$ 3,116,902         | \$ (5,663)            | \$ (193,384)              | \$ 2,917,855         |
| CMI group homes                        | 2,386,064            | (34,751)              | (189,399)                 | 2,161,914            |
| Health services                        | 455,619              | -                     | (52,605)                  | 403,014              |
| Schools                                | 2,850,244            | -                     | -                         | 2,850,244            |
| Shelter                                | 494,234              | -                     | -                         | 494,234              |
| Family Centered Services               | 450,527              | -                     | (33,837)                  | 416,690              |
| Counseling                             | 114,836              | (28,416)              | (10,762)                  | 75,658               |
| Adoption                               | 142,992              | -                     | -                         | 142,992              |
| Hillcrest supported living/IPRS/VOC    | 1,390,421            | (102,527)             | (24,750)                  | 1,263,144            |
| Family Empowerment Center              | 68,297               | -                     | (9,869)                   | 58,428               |
| Transitional housing                   | 3,259                | -                     | -                         | 3,259                |
| Washington County Mental Health Center | 325,335              | (77,608)              | (1,405)                   | 246,322              |
| Dubuque County Mental Health Center    | 1,874,414            | (354,228)             | 157                       | 1,520,343            |
| Jackson County Mental Health Center    | 326,398              | (70,981)              | 181                       | 255,598              |
| PATH Grant                             | 1,171                | -                     | -                         | 1,171                |
| WRAP/Recovery Grant                    | 19                   | -                     | -                         | 19                   |
| Total program service fees, net        | <u>\$ 14,000,732</u> | <u>\$ (674,174)</u>   | <u>\$ (515,673)</u>       | <u>\$ 12,810,885</u> |

**HILLCREST FAMILY SERVICES, INC.**  
**SCHEDULES OF MENTAL HEALTH CENTER EXPENSES**  
**OCTOBER 31, 2008 AND 2007**

|                                       | 2008                        |                          |                          |                              |
|---------------------------------------|-----------------------------|--------------------------|--------------------------|------------------------------|
|                                       | Washington<br>County<br>MHC | Dubuque<br>County<br>MHC | Jackson<br>County<br>MHC | Total<br>Program<br>Services |
| Salaries                              | \$ 116,709                  | \$ 662,919               | \$ 119,062               | \$ 898,690                   |
| Fringe benefits                       | 20,763                      | 117,937                  | 21,182                   | 159,882                      |
| Payroll taxes and other               | 8,474                       | 48,136                   | 8,645                    | 65,255                       |
| Total personnel expenses              | <u>145,946</u>              | <u>828,992</u>           | <u>148,889</u>           | <u>1,123,827</u>             |
| Contracted services                   | 100,583                     | 449,401                  | 78,561                   | 628,545                      |
| Supplies & equipment maintenance      | 11,798                      | 21,443                   | 3,347                    | 36,588                       |
| Telephone                             | 3,783                       | 11,373                   | 2,226                    | 17,382                       |
| Postage and shipping                  | 663                         | 216                      | 229                      | 1,108                        |
| Occupancy                             | 2,388                       | 41,879                   | 17,813                   | 62,080                       |
| Outside printing                      | 283                         | -                        | -                        | 283                          |
| Professional insurance                | 2,874                       | 14,686                   | 3,122                    | 20,682                       |
| Travel                                | 3,495                       | 7,550                    | 10,776                   | 21,821                       |
| Conferences and meetings              | 135                         | 2,834                    | 242                      | 3,211                        |
| Subscriptions                         | -                           | 2                        | 3                        | 5                            |
| Client assistance                     | -                           | 23                       | -                        | 23                           |
| Dues                                  | 196                         | 1,155                    | 215                      | 1,566                        |
| Miscellaneous                         | 775                         | 3,407                    | 288                      | 4,470                        |
| Interest                              | 39                          | 129                      | 28                       | 196                          |
| Bad debts                             | 30,910                      | 128,355                  | 37,197                   | 196,462                      |
| Total expenses before<br>depreciation | <u>303,868</u>              | <u>1,511,445</u>         | <u>302,936</u>           | <u>2,118,249</u>             |
| Depreciation                          | <u>1,548</u>                | <u>9,958</u>             | <u>2,066</u>             | <u>13,572</u>                |
| Total expenses                        | <u>\$ 305,416</u>           | <u>\$ 1,521,403</u>      | <u>\$ 305,002</u>        | <u>\$ 2,131,821</u>          |

|                                       | 2007                        |                          |                          |                              |
|---------------------------------------|-----------------------------|--------------------------|--------------------------|------------------------------|
|                                       | Washington<br>County<br>MHC | Dubuque<br>County<br>MHC | Jackson<br>County<br>MHC | Total<br>Program<br>Services |
| Salaries                              | \$ 115,990                  | \$ 569,957               | \$ 84,126                | \$ 770,073                   |
| Fringe benefits                       | 20,667                      | 101,556                  | 14,990                   | 137,213                      |
| Payroll taxes and other               | <u>8,873</u>                | <u>43,602</u>            | <u>6,436</u>             | <u>58,911</u>                |
| Total personnel expenses              | 145,530                     | 715,115                  | 105,552                  | 966,197                      |
| Contracted services                   | 80,258                      | 367,732                  | 51,298                   | 499,288                      |
| Supplies & equipment maintenance      | 6,605                       | 13,790                   | 2,315                    | 22,710                       |
| Telephone                             | 2,498                       | 12,748                   | 1,993                    | 17,239                       |
| Postage and shipping                  | 1,079                       | 188                      | 365                      | 1,632                        |
| Occupancy                             | 1,780                       | 68,152                   | 5,962                    | 75,894                       |
| Outside printing                      | -                           | -                        | -                        | -                            |
| Professional insurance                | 1,270                       | 13,402                   | 2,491                    | 17,163                       |
| Travel                                | 5,429                       | 3,397                    | 3,114                    | 11,940                       |
| Conferences and meetings              | 569                         | 5,928                    | 306                      | 6,803                        |
| Subscriptions                         | 29                          | -                        | 74                       | 103                          |
| Client assistance                     | -                           | -                        | -                        | -                            |
| Dues                                  | 130                         | 323                      | 61                       | 514                          |
| Miscellaneous                         | 404                         | 1,533                    | 300                      | 2,237                        |
| Interest                              | -                           | -                        | -                        | -                            |
| Bad debts                             | <u>2,000</u>                | <u>11,514</u>            | <u>1,644</u>             | <u>15,158</u>                |
| Total expenses before<br>depreciation | 247,581                     | 1,213,822                | 175,475                  | 1,636,878                    |
| Depreciation                          | <u>-</u>                    | <u>5,742</u>             | <u>1,274</u>             | <u>7,016</u>                 |
| Total expenses                        | <u>\$ 247,581</u>           | <u>\$ 1,219,564</u>      | <u>\$ 176,749</u>        | <u>\$ 1,643,894</u>          |

**HILLCREST FAMILY SERVICES, INC.**  
**SCHEDULE OF REVENUES AND EXPENSES**  
**WIC – CONTRACT # 5888AO35**  
**MATERNAL HEALTH – CONTRACT # 5888MH13**  
**CONTRACT PERIOD: OCTOBER 1, 2007 THROUGH SEPTEMBER 30, 2008**

|  | <u>WIC</u>      | <u>Maternal<br/>Health</u> |
|--|-----------------|----------------------------|
| Revenues                                   |                 |                            |
| Iowa Department of Public Health           | \$ 604,161      | \$ 67,335                  |
| Title XIX                                  | -               | 126,715                    |
| United Way                                 | -               | 2,198                      |
| Miscellaneous                              | 2,417           | (28,041)                   |
|  | <u>606,578</u>  | <u>168,207</u>             |
| Total revenues                             |                 |                            |
| Expenses                                   |                 |                            |
| Salaries                                   | 358,950         | 151,474                    |
| Fringe benefits                            | 62,581          | 19,500                     |
| Payroll taxes, etc.                        | 27,347          | 11,366                     |
| Contracted services                        | 2,721           | 24,249                     |
| Supplies & equipment maintenance           | 35,097          | 6,824                      |
| Telephone                                  | 11,140          | 1,316                      |
| Postage and shipping                       | 2,381           | 634                        |
| Occupancy                                  | 61,805          | 6,773                      |
| Outside printing                           | 81              | 66                         |
| Travel                                     | 22,578          | 4,590                      |
| Conferences and meetings                   | 2,446           | 1,343                      |
| Subscriptions                              | 40              | 8                          |
| Client assistance                          | 6,959           | -                          |
| Dues                                       | 165             | 122                        |
| Miscellaneous                              | 9,196           | 2,820                      |
| Interest                                   | 111             | 63                         |
| Depreciation                               | 11              | 4,050                      |
|  | <u>603,609</u>  | <u>235,198</u>             |
| Total expenses                             |                 |                            |
| Revenues in excess of (less than) expenses | <u>\$ 2,969</u> | <u>\$ (66,991)</u>         |

**HILLCREST FAMILY SERVICES, INC.**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS**  
**YEAR ENDED OCTOBER 31, 2008**

| Grantor/Program  | CFDA<br>Number | Agency or Pass-<br>through Number           | Program<br>Expenditures |
|--|----------------|---|-------------------------|
| Indirect:  |                |   |                         |
| U.S. Department of Agriculture                               |                |   |                         |
| Passed through Iowa Department of Education                  |                |   |                         |
| School Breakfast Program                                     | 10.553/        |   |                         |
| National School Lunch Program                                | 10.555         | 31-8014                                     | <u>\$ 98,011</u>        |
| Passed through Iowa Department of Public Health              |                |   |                         |
| Special Supplemental Nutrition Program for                   |                |   |                         |
| Women, Infants, and Children                                 | 10.557         | 5888AO35                                    | 558,413                 |
|  |                | 5889AO35                                    | <u>38,168</u>           |
|  |                |   | <u>596,581</u>          |
| U.S. Department of Health and Human Services                 |                |   |                         |
| Passed through Iowa Department of Human Services             |                |   |                         |
| Projects for Assistance in Transition                        |                |   |                         |
| from Homelessness  | 93.150         | 08-0444-401-<br>6890-2597-03<br>(2007-2008) | 22,795                  |
|  |                | 09-0444-401-<br>6890-2597-03<br>(2008-2009) | <u>4,628</u>            |
|  |                |   | <u>27,423</u>           |
| Block Grants for Community Mental Health Services            | 93.958         | 09-0324-401-<br>6490-2349-83                | 737                     |
|  |                | 08-0324-401-<br>6490-2349-84                | 27,852                  |
|  |                | 09-0324-401-<br>6490-2349-84                | 35,634                  |
|  |                | 08-0324-401-<br>6490-2349-83                | <u>6,939</u>            |
|  |                |   | <u>71,162</u>           |
| Passed through Iowa Department of Public Health              |                |   |                         |
| Maternal and Child Health Services Block Grant to the States | 93.994         | 5888MH13                                    | 135,937                 |
|  |                | 5889MH13                                    | <u>15,611</u>           |
|  |                |   | <u>151,548</u>          |
| Passed through State Department of Health and                |                |   |                         |
| Human Services and Family Planning Council of Iowa           |                |   |                         |
| Family Planning Services                                     | 93.217         | 412/420-FY2008                              | 88,223                  |
|  |                | 412/420-FY2009                              | <u>47,698</u>           |
|  |                |   | <u>135,921</u>          |
| Total indirect   |                |   | 1,080,646               |
| Direct:  |                |   |                         |
| U.S. Department of Housing and Urban Development             |                |   |                         |
| Supportive Housing Program                                   | 14.235         | 31-8014                                     | <u>56,689</u>           |
| Total  |                |   | <u>\$ 1,137,335</u>     |

See notes to the Schedule of Expenditures of Federal Awards.



CPAs & BUSINESS ADVISORS

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF  
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE  
WITH GOVERNMENT AUDITING STANDARDS**

---

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

We have audited the financial statements of Hillcrest Family Services, Inc. (Hillcrest), as of and for the year ended October 31, 2008, and have issued our report thereon dated March 20, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Hillcrest'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 Hillcrest's financial statements that is more than inconsequential will not be prevented or detected by Hillcrest's internal control. We consider the deficiencies in internal control described in Part II of the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies in Part II of the schedule of findings and questioned costs, we consider items II-B-08 and II-C-08 to be material weaknesses.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether Hillcrest's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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*.

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

We also noted certain matters that we reported to management of Hillcrest Family Services, Inc. in a separate letter dated March 20, 2009.

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

The image shows 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  
March 20, 2009



CPAs & BUSINESS ADVISORS

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

---

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

Compliance

We have audited the compliance of Hillcrest Family Services, Inc. (Hillcrest), with the types of compliance requirements described in U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended October 31, 2008. Hillcrest's major federal program is identified in the summary of the independent auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grant agreements applicable to its major federal program is the responsibility of Hillcrest's management. Our responsibility is to express an opinion on Hillcrest's compliance based on our audit.

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

In our opinion, Hillcrest Family Services, Inc. complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended October 31, 2008.

Internal Control Over Compliance

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

A control deficiency in Hillcrest's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect non-compliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Hillcrest's ability to administer a federal program such that there is more than a remote likelihood non-compliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by Hillcrest's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood material non-compliance with a type of compliance requirement of a federal program will not be prevented or detected by Hillcrest's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

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

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

Dubuque, Iowa  
March 20, 2009

**HILLCREST FAMILY SERVICES, INC.**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**YEAR ENDED OCTOBER 31, 2008**

---

**Part I: Summary of the Independent Auditor's Results**

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

**HILLCREST FAMILY SERVICES, INC.**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**YEAR ENDED OCTOBER 31, 2008**

---

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

**SIGNIFICANT DEFICIENCY**

II-A-08     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 Organization 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 Organization should periodically evaluate its procedures to identify potential areas where the benefits of further segregation of duties or addition of other compensating controls and monitoring procedures exceed the related costs.

Response – Management agrees with the finding and has reviewed the operating procedures of Hillcrest Family Services, Inc. Due to the limited number of office employees, management will continue to monitor the Organization's operations and procedures. Furthermore, we will continually review the assignment of duties to obtain the maximum internal control possible under the circumstances.

Conclusion – Response accepted.

**SIGNIFICANT DEFICIENCIES/MATERIAL WEAKNESSES**

II-B-08     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 account principles (GAAP).

**HILLCREST FAMILY SERVICES, INC.**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**YEAR ENDED OCTOBER 31, 2008**

---

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

Condition – Hillcrest Family Services, Inc. does not have an internal control system designed to provide for the preparation of the financial statements, including the accompanying footnotes and statement of cash flows, as required by 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 entity. The outside party does not have the constant contact with ongoing financial transactions that internal staff have. It is the responsibility of Hillcrest's management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other consideration.

Recommendation – We recommend that management continue reviewing operating procedures in order to obtain the maximum internal control 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 Organization'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 FASB 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.

II-C-08 Material Audit Adjustments

Criteria – A properly designed system of internal control over financial reporting allows for the preparation of financial statements which are free from material misstatement.

Condition – As a result of our audit procedures, we proposed material audit adjustments and disclosures related to the accrual of the pension benefit obligation associated with the defined benefit pension plan.

Cause – The cause of the adjustments appears to be that internal staff are not familiar with the requirements relating to SFAS No. 158 *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

Effect – Had the proposed adjustments not been made, the financial statements would have been materially misstated.

**HILLCREST FAMILY SERVICES, INC.**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**YEAR ENDED OCTOBER 31, 2008**

---

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

Recommendation – We recommend that those responsible for financial reporting review the information to ensure that the financial statements are prepared in accordance with GAAP and that any new standards have been implemented.

Response – Financial information will be reviewed for appropriate GAAP reporting and staff will contact the auditors to discuss the impact new standards may have on the financial statements.

Conclusion – Response accepted.

**Part III: Findings and Questioned Costs For Federal Awards**

**INSTANCES OF NON-COMPLIANCE:**

No matters were noted.

**SIGNIFICANT DEFICIENCIES/MATERIAL WEAKNESSES:**

No material weaknesses in internal control over the major program were noted.



CPAs & BUSINESS ADVISORS

The Governing Board  
Hillcrest Family Services, Inc.  
Dubuque, Iowa

---

We have audited the financial statements of Hillcrest Family Services, Inc. (Hillcrest) for the year ended October 31, 2008, and have issued our report thereon dated March 20, 2009. Professional standards require that we provide you with the following information related to our audit.

## **Our Responsibilities under Auditing Standards Generally Accepted in the United States of America and OMB Circular A-133**

As stated in our engagement letter dated July 17, 2008, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities.

In planning and performing our audit, we considered Hillcrest's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether Hillcrest's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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. Also in accordance with OMB Circular A-133, we examined, on a test basis, evidence about Hillcrest's compliance with the types of compliance requirements described in the "U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement" applicable to its major federal program for the purpose of expressing an opinion on Hillcrest's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on Hillcrest's compliance with those requirements.

### **Planned Scope and Timing of the Audit**

We performed the audit according to the planned scope and timing previously communicated to you and management on December 11, 2008, in addition to our engagement letter to you dated July 17, 2008.

PEOPLE. PRINCIPLES. POSSIBILITIES.

[www.eidebailly.com](http://www.eidebailly.com)

## **Significant Audit Findings and Other Considerations**

### ***Qualitative Aspects of Accounting Practices***

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by Hillcrest 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 October 31, 2008. We noted no transactions entered into by the Organization during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

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 relates to the estimated claims payable as of October 31, 2008, for the self-insured health plan, the collectibility of amounts receivable from consumers and third-party payors, and depreciation expense. We evaluated the key factors and assumptions used to develop these estimates in determining that they are reasonable in relation to the financial statements taken as a whole.

Management's estimate of the self-insured health plan claims payable is based on an analysis of claims paid after year end.

Management's estimate of the collectibility of consumer and third-party receivables is based on historical trends for uncollectible accounts and contractual adjustments.

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.

### ***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. We discussed all adjustments to the financial statements with management during the audit. The following material misstatements detected as a result of audit procedures were corrected by management:

|   |                |
|---|----------------|
| To record defined benefit pension activity to other changes in net assets | \$ (1,403,330) |
| To adjust investments to current market value                             | (880,594)      |
| To record defined benefit pension activity to pension expense             | (144,862)      |
| To adjust promises to give  | 64,333         |

***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 March 20, 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 Organization'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 Organization's auditors. However, these discussions occurred in the normal course of our professional relationship, and our responses were not a condition to our retention.

***Other Comments***

We have included additional comments regarding Hillcrest's operations.

This information is intended solely for the use of the Governing Board and management of Hillcrest Family Services, Inc. and is not intended to be and should not be used by anyone other than these specified parties.

The Governing Board  
Hillcrest Family Services, Inc.  
Page 4

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 Hillcrest Family Services, Inc.

Sincerely,

EIDE BAILLY LLP  
CPAs & Business Advisors

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

Dubuque, Iowa  
March 20, 2009

**HILLCREST FAMILY SERVICES, INC.**  
**YEAR ENDED OCTOBER 31, 2008**  
**OTHER COMMENTS**

---

During our audit, we identified some areas where compensating controls or monitoring procedures could be implemented to obtain the maximum internal control possible under the circumstances and improve internal financial reporting. Those recommendations are as follows:

**Capitalization Policy**

We understand that a capitalization policy has been drafted, but not approved at October 31, 2008. We recommend that the Organization adopt a capitalization policy related to fixed asset purchases. Such a policy would provide guidance for consistent capitalization of fixed assets.

**Payroll**

Payroll hours are manually entered into the accounting system by the payroll clerk. Another individual should double-check the hours to ensure the accuracy of the information prior to paychecks being processed. Management has the ability to run a query to review for changes to pay rates on processed paychecks. As an additional control over payroll disbursements, we recommend that this query be generated randomly to review any changes made and to verify that changes were approved.

**Journal Entries**

Journal entries are currently entered and posted by all finance staff. Management is transitioning to a process where all journal entries will be entered by staff as pending with electronic backup attached to the entries. The information will be reviewed by the Director of Finance for approval and posting. This process will improve the segregation of duties and should also reduce the errors associated with posting.