



Financial Statements  
June 30, 2010 and 2009

**Palo Alto County Hospital**  
**d/b/a Palo Alto County Health**  
**System**

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

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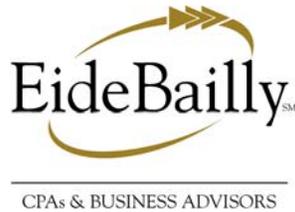
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**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**BOARD OF TRUSTEES AND HEALTH SYSTEM OFFICIALS**

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<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
<u>Board of Trustees</u>		
Kris Ausborn	Chair	December 31, 2014
Pat Joyce	Treasurer	December 31, 2012
Tammy Naig	Secretary	December 31, 2012
Dawn Schmidt	Trustee	December 31, 2010
James Hobart	Trustee	December 31, 2010
Charles S. Wirtz	Trustee	December 31, 2012
Dean Newlon	Trustee	December 31, 2014
<u>Health System Officials</u>		
Thomas J. Lee	Chief Executive Officer	
Renay Hauswirth	Director of Finance	
Coleen Ruddy	Director of Patient Billing	
Joann Higgins	Director of Nursing	



## INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying balance sheets of Palo Alto County Hospital, d/b/a Palo Alto County Health System (Health System), as of June 30, 2010 and 2009, and its discretely presented component unit, Palo Alto County Health Care Foundation (Foundation), as of December 31, 2009 and 2008, as listed in the table of contents, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Health System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Health System as of June 30, 2010 and 2009, and the financial statements of its discretely presented component unit as of December 31, 2009 and 2008, and the respective changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As indicated in the Health System's Summary of Significant Accounting Policies in Note 1 to the financial statements, management has elected to report interest expense as an operating expense in the Statement of Revenues, Expenses, and Changes in Net Assets. Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, does not establish a definition of operating revenues and expenses versus nonoperating revenues and expenses. Rather, governments are required to establish their own policy defining operating revenues and expenses and apply the policy consistently. The common practice for governmental health care entities is to include interest expense in nonoperating revenues and expenses.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 10, 2010, on our consideration of the Health System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Management's Discussion and Analysis on pages 4 and 5 and the Budgetary Comparison Information on pages 28 and 29 are not required parts of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion on it.

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

Dubuque, Iowa  
September 10, 2010

# **PALO ALTO COUNTY HEALTH SYSTEM**

## **Management's Discussion and Analysis**

This section of Palo Alto County Health System's annual financial report presents background information and management's analysis of the financial performance during the fiscal year that ended June 30, 2010. We encourage readers to read this analysis in conjunction with the financial statements in this report.

### **Financial Highlights**

- The Health System's total assets increased by \$1,659,584 or 4.5%. This increase represents investments in capital equipment and buildings.
- The Health System's assets exceeded liabilities by \$20,645,739 at June 30, 2010.
- During the year, the Health System's total operating revenues increased 3.0% to \$20,350,016, while the operating expenses increased 3.5% to \$20,324,568. The Health System had income from operations of \$25,448, which is 0.1% of total operating revenues.
- The Health System made capital equipment and building investments totaling \$1,898,491 during the fiscal year. The source of funding for these items was derived from operations and notes payable.

### **Overview of the Financial Statements**

The basic financial statements of the Health System report information using Governmental Accounting Standards Board (GASB) accounting principles. These statements offer short-term and long-term information about its activities.

The balance sheets provide information about the nature and amounts of the Health System's assets and liabilities. The balance sheet at June 30, 2010, reports total assets of \$38,924,363, total liabilities of \$18,278,624, and net assets of \$20,645,739.

The statements of revenues, expenses, and changes in net assets provide information on the Health System's revenues and expenses. These statements indicate total operating revenues of \$20,350,016 and total operating expenses of \$20,324,568 during fiscal year 2010. The operating income was \$25,448 in 2010, compared to an operating income of \$128,577 in 2009.

There are notes to the financial statements included in the audit report. All of the notes are consistent with and similar to audit reports from prior years. There are also several supplementary schedules that provide the reader detail about the source of the Health System's revenues and expenses. The reader is encouraged to examine these notes and schedules for additional information.

### **Long-term Debt**

At year-end, the Health System had \$14,382,186 in short-term and long-term debt. The debt was incurred for improvements of the Health System's acute care, long-term care, business office, specialty clinic, community health and surgery areas.

## **Factors Bearing on Financial Future**

Palo Alto County Health System completed a significant building renovation project that updated the Acute Care, Long-term Care, Obstetrics, Surgical, Specialty Clinic, and Business Office areas. The completion date was June 2010. There are currently no major construction projects on the horizon, but we are planning an update to the Emergency Room.

The past fiscal year showed a decrease in some statistics, mainly due to the down trend in the economy. This was also seen to some degree across the Mercy North Iowa Network and the rest of the state. We are in the process of implementing Process Excellence (LEAN) and we hope to see some improvements to the organization in time.

## **Requests for Information**

Questions regarding the information provided in this report or requests for additional financial information should be addressed to the office of the Chief Financial Officer at the following address:

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

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**BALANCE SHEETS**  
**JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 8,044,084	\$ 5,738,703
Restricted under bond agreement - Note 4	460,311	456,752
Receivables		
Patient and resident, net of estimated uncollectibles		
of \$1,540,000 in 2010 and \$1,760,000 in 2009	2,176,085	2,547,888
Estimated third-party payor settlements	-	151,345
Succeeding year property tax	1,112,548	981,097
Other	320,789	73,025
Supplies	284,559	296,881
Prepaid expense	80,100	63,086
Total current assets	<u>12,478,476</u>	<u>10,308,777</u>
<b>ASSETS LIMITED AS TO USE OR RESTRICTED - Note 4</b>		
Internally designated for capital improvements	3,029,918	2,912,763
Restricted under bond agreement	<u>1,859,781</u>	<u>2,600,629</u>
Total assets limited as to use or restricted	<u>4,889,699</u>	<u>5,513,392</u>
<b>CAPITAL ASSETS, net - Note 5</b>	<u>21,260,760</u>	<u>21,131,701</u>
<b>OTHER ASSETS</b>		
Bond issuance costs, net of accumulated amortization	<u>295,428</u>	<u>310,909</u>
Total assets	<u>\$ 38,924,363</u>	<u>\$ 37,264,779</u>

See notes to financial statements.

	<u>2010</u>	<u>2009</u>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Current maturities of long-term debt - Note 7	\$ 275,000	\$ 270,000
Accounts payable		
Trade	480,219	602,111
Construction	363,255	400,725
Affiliated organization - Note 9	146,502	221,509
Estimated health claims payable - Note 10	285,000	320,000
Estimated third-party payor settlements	16,635	-
Accrued expenses		
Salaries and wages	423,645	385,768
Paid time-off	532,782	513,210
Interest	301,099	305,166
Payroll taxes and employee benefits	206,147	189,303
Deferred revenue for succeeding year property tax receivable	<u>1,112,548</u>	<u>981,097</u>
 Total current liabilities	 <b>4,142,832</b>	 4,188,889
<b>OTHER LIABILITIES</b>		
Security deposits	28,606	30,280
 LONG-TERM DEBT, less current maturities - Note 7	 <u>14,107,186</u>	 <u>14,370,633</u>
 Total liabilities	 <u>18,278,624</u>	 <u>18,589,802</u>
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	7,174,002	7,560,647
Restricted		
Expendable under bond agreement	2,320,092	2,298,711
Unrestricted	<u>11,151,645</u>	<u>8,815,619</u>
 Total net assets	 <u>20,645,739</u>	 <u>18,674,977</u>
 Total liabilities and net assets	 <u>\$ 38,924,363</u>	 <u>\$ 37,264,779</u>

**PALO ALTO COUNTY HEALTH CARE FOUNDATION**  
**BALANCE SHEETS**  
**DECEMBER 31, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
<b>ASSETS</b>		
CURRENT ASSETS		
Cash and cash equivalents	\$ 82,928	\$ 104,328
Accrued interest receivable	<u>10,462</u>	<u>10,284</u>
Total current assets	93,390	114,612
NONCURRENT CASH AND INVESTMENTS - Note 4	2,451,083	2,302,441
CAPITAL ASSETS, net	<u>35,152</u>	<u>37,687</u>
Total assets	<u>\$ 2,579,625</u>	<u>\$ 2,454,740</u>
<b>LIABILITIES AND NET ASSETS</b>		
CURRENT LIABILITIES		
Property tax payable	\$ 832	\$ 796
Commitment to Health System - Note 13	<u>845,000</u>	<u>-</u>
Total current liabilities	845,832	796
NET ASSETS, unrestricted	<u>1,733,793</u>	<u>2,453,944</u>
Total liabilities and net assets	<u>\$ 2,579,625</u>	<u>\$ 2,454,740</u>

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**  
**YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
<b>OPERATING REVENUES</b>		
Net patient and resident service revenue (net of provision for bad debts of \$548,685 in 2010 and \$602,804 in 2009) - Notes 2 and 3	\$ 19,417,229	\$ 18,884,190
Apartment revenue	379,651	371,041
Other operating revenues	<u>553,136</u>	<u>503,581</u>
<b>TOTAL OPERATING REVENUES</b>	<u><b>20,350,016</b></u>	<u>19,758,812</u>
<b>OPERATING EXPENSES</b>		
Salaries and wages	7,470,887	7,237,746
Employee benefits	2,311,688	1,902,034
Supplies and other expenses	8,050,798	8,272,994
Depreciation	1,762,441	1,538,592
Interest and amortization	<u>728,754</u>	<u>678,869</u>
<b>TOTAL OPERATING EXPENSES</b>	<u><b>20,324,568</b></u>	<u>19,630,235</u>
<b>OPERATING INCOME</b>	<u><b>25,448</b></u>	<u>128,577</u>
<b>NONOPERATING REVENUES (EXPENSES)</b>		
Investment income	103,897	315,777
County tax revenue	983,463	941,094
Noncapital contributions and grants	11,485	6,715
Loss on sale of capital assets	<u>(6,031)</u>	<u>(24,010)</u>
<b>NET NONOPERATING REVENUES</b>	<u><b>1,092,814</b></u>	<u>1,239,576</u>
<b>REVENUES IN EXCESS OF EXPENSES BEFORE CAPITAL CONTRIBUTIONS AND GRANTS</b>		
	<b>1,118,262</b>	1,368,153
Capital contributions and grants	<u>852,500</u>	<u>20,000</u>
<b>INCREASE IN NET ASSETS</b>	<b>1,970,762</b>	1,388,153
<b>NET ASSETS, BEGINNING OF YEAR</b>	<u><b>18,674,977</b></u>	<u>17,286,824</u>
<b>NET ASSETS, END OF YEAR</b>	<u><b>\$ 20,645,739</b></u>	<u>\$ 18,674,977</u>

See notes to financial statements.

**PALO ALTO COUNTY HEALTH CARE FOUNDATION**  
**STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**  
**YEARS ENDED DECEMBER 31, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
OPERATING REVENUES		
Investment income	\$ 78,804	\$ 76,141
Rental income	7,500	7,500
Contributions	<u>43,383</u>	<u>515,034</u>
 TOTAL OPERATING REVENUES	 <u>129,687</u>	 <u>598,675</u>
EXPENSES		
Depreciation	2,535	2,535
Property taxes	1,640	1,619
Supplies and other expenses	663	297
Contributions to Health System - Note 13	<u>845,000</u>	<u>25,000</u>
 TOTAL EXPENSES	 <u>849,838</u>	 <u>29,451</u>
 INCREASE (DECREASE) IN UNRESTRICTED NET ASSETS	 (720,151)	 569,224
 NET ASSETS, BEGINNING OF YEAR	 <u>2,453,944</u>	 <u>1,884,720</u>
 NET ASSETS, END OF YEAR	 <u>\$ 1,733,793</u>	 <u>\$ 2,453,944</u>

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts of patient and resident service revenue	\$ 20,085,198	\$ 19,309,210
Payments of salaries and wages	(7,413,438)	(7,114,854)
Payments of supplies and other expenses	(10,582,233)	(9,992,114)
Other receipts and payments, net	<u>553,136</u>	<u>503,581</u>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<u>2,642,663</u>	<u>2,705,823</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
Noncapital contributions and grants received	11,485	6,715
County tax revenue received	<u>987,164</u>	<u>943,263</u>
<b>NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES</b>	<u>998,649</u>	<u>949,978</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Principal payments on long-term debt	(270,000)	(180,000)
Purchase of capital assets	(1,876,888)	(3,664,947)
Proceeds from sale of capital assets	960	100
Interest payments on long-term debt, excluding amounts capitalized	(727,517)	(735,188)
Decrease in construction payable	(37,470)	(61,862)
Net security deposits received (paid)	(1,674)	5,100
Capital contributions and grants	<u>852,500</u>	<u>20,000</u>
<b>NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES</b>	<u>(2,060,089)</u>	<u>(4,616,797)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Sale and transfer of investments	620,134	1,100,790
Investment income	<u>104,024</u>	<u>281,257</u>
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<u>724,158</u>	<u>1,382,047</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>2,305,381</b>	421,051
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<u>5,738,703</u>	<u>5,317,652</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<u>\$ 8,044,084</u>	<u>\$ 5,738,703</u>

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**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
RECONCILIATION OF OPERATING INCOME TO		
NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating income	\$ 25,448	\$ 128,577
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	1,762,441	1,538,592
Interest and amortization expense considered capital and related financing activity	728,754	678,869
Provision for bad debts	548,685	602,804
Changes in assets and liabilities		
Patient and resident receivables	(176,882)	(821,808)
Estimated third-party payor settlements	167,980	228,655
Other receivables	(251,465)	44,328
Supplies	12,322	8,215
Prepaid expense	(17,014)	52,627
Accounts payable - trade and affiliated organization	(196,899)	136,058
Accrued expenses	74,293	151,806
Estimated health claims payable	(35,000)	(42,900)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 2,642,663</u>	<u>\$ 2,705,823</u>

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION**

Cash paid for interest (including amounts capitalized) in 2010 and 2009 was \$727,518 and \$735,181, respectively.

**PALO ALTO COUNTY HEALTH CARE FOUNDATION**  
**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED DECEMBER 31, 2009 AND 2008**

	<u>2009</u>	<u>2008</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Increase (decrease) in unrestricted net assets	\$ (720,151)	\$ 569,224
Adjustments to reconcile increase (decrease) in unrestricted net assets to net cash provided by operating activities		
Depreciation	2,535	2,535
Amortization of premiums on investments	2,057	2,510
Changes in assets and liabilities		
Accrued interest receivable	(178)	636
Commitment to health system	845,000	-
Property tax payable	36	38
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<u>129,299</u>	<u>574,943</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of investments	(927,685)	(1,100,000)
Sale of investments	750,000	450,000
Interest earned (capitalized) on certificates of deposit	26,986	(29,984)
<b>NET CASH USED FOR INVESTING ACTIVITIES</b>	<u>(150,699)</u>	<u>(679,984)</u>
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(21,400)</b>	<b>(105,041)</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<u>104,328</u>	<u>209,369</u>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<u>\$ 82,928</u>	<u>\$ 104,328</u>

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2010 AND 2009**

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

*Organization*

Palo Alto County Hospital, d/b/a Palo Alto County Health System (Health System), consists of a 25-bed acute care hospital and a 22-bed skilled nursing/long-term care facility, located in Emmetsburg, Iowa. The Health System provides health care services in accordance with a Master Affiliation Agreement discussed further in Note 9. Services are provided to residents of Palo Alto County and surrounding counties in Iowa. The Health System is organized under Chapter 347 of the Code of Iowa. It is also organized as an Iowa nonprofit corporation and has been recognized by the Internal Revenue Service as exempt from federal income taxes under Internal Revenue Code Section 501(c)(3). The Health System is exempt from income taxes as a political subdivision. However, the Health System would be subject to federal income tax on any unrelated business taxable income.

*Reporting Entity*

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

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

*Basis of Presentation*

The balance sheets display the Health System's assets and liabilities, with the difference reported as net assets. Net assets are reported in the following categories/components:

*Invested in capital assets, net of related debt* consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt attributable to the acquisition, construction, or improvement of those assets.

*Restricted net assets*

*Nonexpendable* – Nonexpendable net assets are subject to externally imposed stipulations which require them to be maintained permanently by the Health System.

*Expendable* – Expendable net assets result when constraints placed on net asset use are either externally imposed or imposed by law through constitutional provisions or enabling legislation.

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2010 AND 2009**

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*Unrestricted net assets* consist of net assets not meeting the definition of the preceding categories. Unrestricted net assets often have constraints on resources imposed by management which can be removed or modified.

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

*Measurement Focus and Basis of Accounting*

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied.

The Health System reports in accordance with accounting principles generally accepted in the United States of America as specified by the American Institute of Certified Public Accountants' *Audit and Accounting Guide for Health Care Organizations* and, as a governmental entity, also provides certain disclosures required by the Governmental Accounting Standards Board (GASB). The accompanying financial statements have been prepared on the accrual basis of accounting. Revenues are recognized when earned, and expenses are recorded when the liability is incurred.

In reporting its financial activity, the Health System applies all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure.

*Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Cash and Cash Equivalents*

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

*Patient and Resident Receivables*

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

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

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The carrying amount of patient and resident receivables is reduced by a valuation allowance that reflects management's estimate of amounts that will not be collected from patients, residents, and third-party payors. Management reviews patient and resident receivables by payor class and applies percentages to determine estimated amounts that will not be collected from third parties under contractual agreements and amounts that will not be collected from patients and residents due to bad debts. Management considers historical write off and recovery information in determining the estimated bad debt provision. Management also reviews accounts to determine if classification as charity care is appropriate.

*Property Tax Receivable*

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

*Deferred Revenue*

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

*Supplies*

Supplies are stated at lower of average cost or market.

*Assets Limited as to Use or Restricted*

Assets limited as to use or restricted include assets set aside by the Board of Trustees for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes; and assets which are restricted by bond agreements. Assets limited as to use or restricted that are available for obligations classified as current liabilities are reported in current assets.

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

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*Capital Assets*

Capital asset acquisitions in excess of \$5,000 are capitalized and are recorded at cost. Capital assets donated for the Health System's operations are recorded as additions to net assets at fair value at the date of receipt. Depreciation is provided over the estimated useful life of each class of depreciable asset and is computed using the straight-line method. Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. The estimated useful lives of capital assets are as follows:

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

*Unamortized Bond Issuance Costs and Expense*

Bond issuance costs of \$191,736 from the Series 2006 Hospital Revenue Bonds are being amortized over the life of the bonds using the straight-line method. As of June 30, 2010 and 2009, accumulated amortization was \$26,819, and \$18,538, respectively. In addition, bond issuances costs of \$180,011 from the Series 2003 Hospital Revenue Bonds are being amortized over the life of the bonds using the straight-line method. As of June 30, 2010 and 2009, accumulated amortization was \$49,500 and \$42,300, respectively. Total amortization expense of the bond issuance costs was \$15,481, and \$15,511 for the years ended June 30, 2010 and 2009, respectively.

*Compensated Absences*

Health System employees accumulate a limited amount of earned but unused paid time-off for subsequent use or for payment upon termination, death, or retirement. The cost of paid time-off is recorded as a current liability on the balance sheet. The compensated absences liability has been computed based on rates of pay in effect at June 30, 2010 and 2009.

*Operating Revenues and Expenses*

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

*Net Patient and Resident Service Revenue*

The Health System has agreements with third-party payors that provide for payments to the Health System at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs, discounted charges, and per diem payments. Patient and resident service revenue is reported at the estimated net realizable amounts from patients, residents, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors and a provision for uncollectible accounts. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

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*Grants and Contributions*

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

*Investment Income*

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

*Asset Retirement Obligation*

The Health System recognizes an asset retirement obligation in the period in which it incurs a legal obligation associated with the retirement of a tangible long-lived asset, including leased premises, resulting from the acquisition, construction, development, and/or normal use of the asset. The fair value of the asset retirement cost is capitalized as part of the carrying value of the related long-lived asset and is depreciated over the life of the asset. The liability may be changed to reflect the passage of time and changes in the fair value assessment of the retirement obligation.

*Charity Care*

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

*Advertising Costs*

The Health System expenses advertising costs as incurred.

*County Tax Revenue*

Taxes are included in nonoperating revenues when received and distributed by the County Treasurer. No provision is made in the financial statements for taxes levied in the current year to be collected in a subsequent year.

*Accounting for Uncertainty in Taxes*

The Health System has adopted the provisions of FASB Accounting Standards Codification Topic 740-10 (previously Financial Interpretation No. 48, *Accounting for the Uncertainty in Income Taxes*), on July 1, 2009. The implementation of this standard had no impact on the financial statements. As of both the date of adoption, and as of June 30, 2010, the unrecognized tax benefit accrual was zero.

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The Health System will recognize future accrued interest and penalties related to unrecognized tax benefits in income tax expense if incurred.

*Subsequent Events*

The Health System has evaluated subsequent events through September 10, 2010, the date which the financial statements were available to be issued.

*Reclassifications*

Certain items from the 2009 financial statements have been reclassified to conform to the current year presentation. The reclassifications had no impact on increase in net assets.

*Other Significant Accounting Policies*

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

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

The Health System maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The amounts of charges foregone were \$159,179 and \$150,556 for the years ended June 30, 2010 and 2009, respectively. The estimated costs of the charges foregone, based upon an overall cost-to-charge ratio calculation, for the years ended June 30, 2010 and 2009 were \$111,000, and \$106,000, respectively.

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

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

**NOTE 3 - NET PATIENT AND RESIDENT SERVICE REVENUE**

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

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**Medicare**

The Health System is licensed as a Critical Access Hospital (CAH). The Health System is reimbursed for most inpatient and outpatient services at cost with final settlement determined after submission of annual cost reports by the Health System and are subject to audits thereof by the Medicare fiscal intermediary. The Health System's Medicare cost reports have been settled by the Medicare fiscal intermediary through the year ended June 30, 2008.

**Medicaid**

**Hospital**

Inpatient and outpatient services rendered to Medicaid program beneficiaries are paid based on a cost reimbursement methodology. The Health System is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Health System and audits thereof by the Medicaid fiscal intermediary. The Health System's Medicaid cost reports have been processed by the Medicaid fiscal intermediary through June 30, 2007.

**Nursing Home**

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

**Other Payors**

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

Revenue from the Medicare and Medicaid programs accounted for approximately 45% and 11%, respectively, of the Health System's net patient and resident service revenue for the year ended June 30, 2010, and 33% and 8%, respectively, of the Health System's net patient and resident service revenue for the year ended June 30, 2009. The 2009 net patient and resident service revenue increased approximately \$63,000 due to the removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to audits, reviews, and investigations. The 2010 and 2009 net patient and resident service revenue increased approximately \$185,000 and \$273,000, respectively, due to prior-year retroactive adjustments in excess of amounts previously estimated.

Laws and regulations governing the Medicare, Medicaid, and other programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

The Centers for Medicare and Medicaid Services (CMS) has implemented a Recovery Audit Contractor (RAC) program under which claims subsequent to October 1, 2007, are reviewed by contractors for validity, accuracy, and proper documentation. A demonstration project completed in several other states resulted in the identification of potential overpayments, some being significant. If selected for audit, the potential exists that the Health System may incur a liability for a claims overpayment at a future date. The Health System is unable to determine if it will be audited and, if so, the extent of liability of overpayments, if any. As the outcome of such potential reviews is unknown and cannot be reasonably estimated, it is the Health System's policy to adjust revenue for deductions from overpayment amounts or additions from underpayment amounts determined under the RAC audits at the time a change in reimbursement is agreed upon between the Health System and CMS.

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A summary of patient and resident service revenue, contractual adjustments, and provision for bad debts for the years ended June 30, 2010 and 2009, is as follows:

	<u>2010</u>	<u>2009</u>
Total patient and resident service revenue	<u>\$ 27,684,560</u>	<u>\$ 26,495,615</u>
Contractual adjustments:		
Medicare	(3,477,888)	(3,621,766)
Medicaid	(761,649)	(766,524)
Other	<u>(3,479,109)</u>	<u>(2,620,331)</u>
Total contractual adjustments	<u>(7,718,646)</u>	<u>(7,008,621)</u>
Net patient and resident service revenue	<b>19,965,914</b>	19,486,994
Provision for bad debts	<u>(548,685)</u>	<u>(602,804)</u>
Net patient and resident service revenue (net of provision for bad debts)	<u><b>\$ 19,417,229</b></u>	<u>\$ 18,884,190</u>

**NOTE 4 - DEPOSITS AND INVESTMENTS**

The Health System's deposits in banks at June 30, 2010 and 2009, were entirely covered by federal depository insurance or the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

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

At June 30, 2010 and 2009, the Health System's carrying amounts of deposits and investments are as follows:

	<u>2010</u>	<u>2009</u>
Checking and savings accounts	<u>\$ 8,044,084</u>	<u>\$ 5,738,703</u>
Certificates of deposit	<u>3,363,697</u>	<u>327,605</u>
Money market accounts	<u>1,986,313</u>	<u>5,642,539</u>
Total deposits	<u><b>\$ 13,394,094</b></u>	<u><b>\$ 11,708,847</b></u>
Included in the following balance sheet captions		
Cash and cash equivalents	<u>\$ 8,044,084</u>	<u>\$ 5,738,703</u>
Assets limited as to use or restricted	<u>5,350,010</u>	<u>5,970,144</u>
	<u><b>\$ 13,394,094</b></u>	<u><b>\$ 11,708,847</b></u>

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

At December 31, 2009 and 2008, the Foundation's carrying amounts of deposits and investments are as follows:

	<u>2009</u>	<u>2008</u>
Certificates of deposit	<u>\$ 2,451,083</u>	<u>\$ 2,302,441</u>

**NOTE 5 - CAPITAL ASSETS**

Capital assets activity for the years ended June 30, 2010 and 2009, was as follows:

	June 30, 2009				June 30, 2010
	<u>Balance</u>	<u>Additions</u>	<u>Deductions</u>	<u>Transfers</u>	<u>Balance</u>
Capital assets					
Land and land improvements	\$ 416,942	\$ -	\$ -	\$ -	\$ 416,942
Building	20,701,734	8,097	-	2,496,910	23,206,741
Fixed equipment	2,062,377	6,421	-	-	2,068,798
Major movable equipment	5,735,728	661,544	(172,884)	350,420	6,574,808
Construction in progress	<u>1,631,501</u>	<u>1,222,429</u>	<u>-</u>	<u>(2,847,330)</u>	<u>6,600</u>
	<u>30,548,282</u>	<u>\$ 1,898,491</u>	<u>\$ (172,884)</u>	<u>\$ -</u>	<u>32,273,889</u>
Accumulated depreciation					
Land improvements	179,634	\$ 11,907	\$ -	\$ -	191,541
Building	4,423,726	902,328	-	-	5,326,054
Fixed equipment	1,447,083	83,361	-	-	1,530,444
Major movable equipment	<u>3,366,138</u>	<u>764,846</u>	<u>(165,894)</u>	<u>-</u>	<u>3,965,090</u>
	<u>9,416,581</u>	<u>\$ 1,762,442</u>	<u>\$ (165,894)</u>	<u>\$ -</u>	<u>11,013,129</u>
Total capital assets, net	<u>\$ 21,131,701</u>				<u>\$ 21,260,760</u>

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

The surgery addition and renovation was capitalized at approximately \$2,540,000 during 2010. The surgery component was the final stage in the Health System's major addition/renovation project that started in 2006, funded through tax exempt financing and Health System operations.

**NOTE 6 - LEASES**

The Health System leases certain equipment under noncancelable long-term lease agreements. The leases have been recorded as operating leases. Total equipment rental expense for all operating leases for the years ended June 30, 2010 and 2009, was \$290,982 and \$324,865 respectively.

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

<u>Year Ending June 30,</u>	<u>Amount</u>
2011	\$ 3,360
2012	3,360
2013	<u>1,680</u>
Total	<u>\$ 8,400</u>

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**NOTE 7 - LONG-TERM DEBT**

A schedule of changes in long-term debt for 2010 and 2009, is as follows:

	Balance		Payments	Balance	Amounts Due
	June 30, 2009	Additions	(Amortization)	June 30, 2010	Within
					One Year
Hospital Revenue Bonds, Series 2003	\$ 5,870,000	\$ -	\$ (190,000)	\$ 5,680,000	\$ 195,000
Hospital Revenue Bonds, Series 2006	9,000,000	-	(80,000)	8,920,000	80,000
	14,870,000	-	(270,000)	14,600,000	275,000
Bond discount	(17,820)	-	932	(16,888)	-
Deferred loss on bond refinancing	(113,504)	-	5,934	(107,570)	-
Bond OID less premium 2006	(98,043)	-	4,687	(93,356)	-
Total long-term debt	<u>\$ 14,640,633</u>	<u>\$ -</u>	<u>\$ (258,447)</u>	<u>14,382,186</u>	<u>\$ 275,000</u>
Less current maturities				<u>(275,000)</u>	
Long-term debt, less current maturities				<u>\$ 14,107,186</u>	

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

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

<u>Year Ending June 30,</u>	<u>Long-term Debt</u>		
	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 275,000	\$ 717,281	\$ 992,281
2012	290,000	705,956	995,956
2013	300,000	693,553	993,553
2014	315,000	680,195	995,195
2015	325,000	665,897	990,897
2016 to 2020	1,870,000	3,077,934	4,947,934
2021 to 2025	2,405,000	2,531,411	4,936,411
2026 to 2030	3,060,000	1,865,894	4,925,894
2031 to 2035	3,905,000	995,659	4,900,659
2036	1,855,000	96,222	1,951,222
	<u>\$ 14,600,000</u>	<u>\$ 12,030,002</u>	<u>\$ 26,630,002</u>

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

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

The Health System is subject to certain covenants under the bond agreement regarding the funding of debt service reserve and sinking fund accounts. The Health System was in compliance with these covenants for the years ended June 30, 2010 and 2009.

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

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

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

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

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

**DEBT SERVICE RESERVE FUND** – into which the Health System was required to deposit an amount equal to the sum of \$821,323, to fund final debt payment on August 1, 2036.

A summary of interest cost and investment income on borrowed funds during the years ended June 30, 2010 and 2009, is as follows:

	<u>2010</u>	<u>2009</u>
Interest cost:		
Capitalized as part of construction project	\$ 21,730	\$ 81,075
Recognized as interest expense	<u>701,720</u>	<u>651,788</u>
Total	<u>\$ 723,450</u>	<u>\$ 732,863</u>
Investment income:		
Capitalized as part of construction project	<u>\$ 127</u>	<u>\$ 7,046</u>

**NOTE 8 - PENSION AND RETIREMENT BENEFITS**

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

Plan members are required to contribute 4.30% of their annual covered salary, and the Health System is required to contribute 6.65% of annual covered payroll for the year ended June 30, 2010. Plan members were required to contribute 4.10% and 3.90% of their annual covered salary, and the Health System was required to contribute 6.35% and 6.05% of annual covered payroll for the years ended June 30, 2009 and 2008, respectively. Contribution requirements are established by state statute. The Health System’s contributions to IPERS for the years ended June 30, 2010, 2009, and 2008, were \$500,694, \$459,837, and \$400,245, respectively, equal to the required contributions for each year.

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**NOTE 9 - RELATED ORGANIZATIONS**

*Master Affiliation Agreement*

The Health System has a Master Affiliation Agreement with Mercy Medical Center – North Iowa (MMC-NI) to provide hospital, physician, and other health care services in Palo Alto County and surrounding counties in central Iowa. As a part of this Master Affiliation Agreement, the Health System entered into a Professional Service Agreement with MMC-NI whereby MMC-NI provides professional medical services for the Health System. Amounts paid to MMC-NI for the provision of these services amounted to \$2,355,476 and \$2,689,629 for the years ended June 30, 2010 and 2009, respectively.

*Management Services Agreement*

The Health System has a contractual arrangement with MMC-NI under which MMC-NI provides administrative staff, management consultation, and other services to the Health System. The arrangement does not alter the authority or responsibility of the Board of Trustees of the Health System. Expenses for the administrative and management services for the years ended June 30, 2010 and 2009, were \$668,618 and \$617,530, respectively.

*Due to Affiliated Organization*

As of June 30, 2010 and 2009, the Health System's records reflect an amount due to MMC-NI of \$146,502 and \$221,509, respectively, for the various services and distributions related to these agreements.

**NOTE 10 - CONTINGENCIES**

*Malpractice Insurance*

The Health System has insurance coverage to provide protection for professional liability losses on a claims-made basis subject to a limit of \$1 million per claim and an aggregate limit of \$3 million. The Health System also has directors' and officers' insurance coverage to provide protection for losses on a claims-made basis subject to a limit of \$2 million per claim and an aggregate limit of \$2 million. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, will be uninsured.

*Excess Liability Umbrella Insurance*

The Health System also has excess liability umbrella coverage on a claims-made basis subject to a limit of \$5 million per occurrence and an annual aggregate limit of \$5 million. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during its term, but reported subsequently, will be uninsured.

*Self-Funded Employee Health Insurance Plan*

The Health System has a self-funded employee health insurance plan covering substantially all employees. The plan is responsible to pay all administration expenses and benefits up to the reinsurance limits. Liabilities of \$285,000 and \$320,000 have been established to record the incurred but not reported claims outstanding at June 30, 2010 and 2009, respectively.

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2010 AND 2009**

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*Health Care Legislation and Regulation*

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient and resident services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violation of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient and resident services previously billed.

Management believes that the Health System is in substantial compliance with fraud and abuse as well as other applicable government laws and regulations. While no regulatory inquiries have been made, compliance with such laws and regulations is subject to government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

**NOTE 11 - RISK MANAGEMENT**

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

**NOTE 12 - CONCENTRATION OF CREDIT RISK**

The Health System grants credit without collateral to its patients and residents, most of whom are insured under third-party payor agreements. The mix of receivables from third-party payors, patients, and residents at June 30, 2010 and 2009, was as follows:

	<u>2010</u>	<u>2009</u>
Medicare	34%	32%
Medicaid	10%	14%
Blue Cross	17%	19%
Other third-party payors, patients, and residents	<u>39%</u>	<u>35%</u>
	<u>100%</u>	<u>100%</u>

**NOTE 13 - FOUNDATION COMMITMENT**

The Palo Alto County Health Care Foundation committed \$845,000 to the Health System's construction and renovation project. During June 2010, the Foundation paid \$600,000 of the pledged balance to the Health System. The remaining balance of \$245,000 has been recorded as a receivable on the Health System's financial statements as of June 30, 2010. Accordingly, the Foundation's December 31, 2009, financial statements show a commitment to the Health System for the entire \$845,000.



Required Supplementary Information  
June 30, 2010 and 2009

**Palo Alto County Hospital**  
**d/b/a Palo Alto County Health**  
**System**

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**BUDGETARY COMPARISON SCHEDULE OF REVENUES, EXPENSES, AND CHANGES IN NET**  
**ASSETS – BUDGET AND ACTUAL (CASH BASIS)**  
**REQUIRED SUPPLEMENTARY INFORMATION**  
**YEAR ENDED JUNE 30, 2010**

	Actual Accrual Basis	Accrual Adjustments	Actual Cash Basis	Budget	Variance Favorable (Unfavorable)
Estimated amount to be raised by taxation	\$ 983,463	\$ 3,701	\$ 987,164	\$ 981,097	\$ 6,067
Estimated other revenues/receipts	<u>21,317,898</u>	<u>287,731</u>	<u>21,605,629</u>	<u>21,536,211</u>	<u>69,418</u>
	22,301,361	291,432	22,592,793	22,517,308	75,485
Expenses/disbursements	<u>20,330,599</u>	<u>576,947</u>	<u>20,907,546</u>	<u>21,241,008</u>	<u>333,462</u>
Net	1,970,762	(285,515)	1,685,247	1,276,300	<u>\$ 408,947</u>
Balance, beginning of year	<u>18,674,977</u>	<u>(6,966,130)</u>	<u>11,708,847</u>	<u>6,617,173</u>	
Balance, end of year	<u>\$20,645,739</u>	<u>\$ (7,251,645)</u>	<u>\$ 13,394,094</u>	<u>\$ 7,893,473</u>	

**PALO ALTO COUNTY HOSPITAL  
d/b/a PALO ALTO COUNTY HEALTH SYSTEM  
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION – BUDGETARY REPORTING  
JUNE 30, 2010**

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This budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary perspective differences resulting from the Health System preparing a budget on the cash basis of accounting.

The Board of Trustees annually prepares and adopts a budget designating the amount necessary for the improvement and maintenance of the Health Center on the cash basis following required public notice and hearing in accordance with Chapters 24 and 347 of the Code of Iowa. The Board of Trustees certifies the approved budget to the appropriate county auditors. The budget may be amended during the year utilizing similar statutorily prescribed procedures. Formal and legal budgetary control is based on total expenditures. The Health System did not amend its original budget during the year ended June 30, 2010.

For the year ended June 30, 2010, the Health System's expenditures did not exceed the amount budgeted.



Other Supplementary Information  
June 30, 2010 and 2009

**Palo Alto County Hospital**  
**d/b/a Palo Alto County Health**  
**System**



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

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

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information, except for the Schedules of Comparative Statistics on page 39 marked "unaudited," on which we express no opinion, has been subjected to the auditing procedures applied in the audits of the basic financial statements; and, in our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink that reads "Eide Bailly LLP".

Dubuque, Iowa  
September 10, 2010

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF NET PATIENT AND RESIDENT SERVICE REVENUE**  
**YEARS ENDED JUNE 30, 2010 AND 2009**

	TOTAL	
	2010	2009
<b>PATIENT AND RESIDENT SERVICE REVENUE</b>		
Medical and surgical	\$ 1,304,006	\$ 1,247,218
Nursery	127,276	126,617
Long-term care	1,116,857	970,321
Subtotal	<u>2,548,139</u>	<u>2,344,156</u>
<b>OTHER PROFESSIONAL SERVICES</b>		
Operating room	2,403,748	2,518,533
Labor and delivery room	81,598	78,631
Anesthesiology	653,175	687,203
Radiology	4,294,148	4,096,170
Laboratory	2,963,334	3,048,505
Respiratory therapy	961,956	767,765
Physical therapy	880,099	809,532
Occupational therapy	139,783	92,216
Speech therapy	18,252	14,228
Electrocardiography	592,459	491,086
Medical and surgical supplies	478,844	529,471
Pharmacy	2,894,629	2,352,665
Graettinger Clinic	432,128	450,640
Emmetsburg Clinic	3,911,891	4,009,520
West Bend Clinic	785,084	766,813
Emergency room	2,198,521	2,102,382
Ambulance	696,477	622,100
Home health	548,569	579,023
Hospice	360,905	285,532
Subtotal	<u>25,295,600</u>	<u>24,302,015</u>
Total	<u>27,843,739</u>	<u>26,646,171</u>
Charity care	<u>(159,179)</u>	<u>(150,556)</u>
Total patient and resident service revenue	<u>27,684,560</u>	<u>26,495,615</u>
<b>CONTRACTUAL ADJUSTMENTS</b>		
Medicare	(3,477,888)	(3,621,766)
Medicaid	(761,649)	(766,524)
Other	(3,479,109)	(2,620,331)
Total contractual adjustments	<u>(7,718,646)</u>	<u>(7,008,621)</u>
<b>NET PATIENT AND RESIDENT SERVICE REVENUE</b>	<b>19,965,914</b>	19,486,994
<b>PROVISION FOR BAD DEBTS</b>	<b>(548,685)</b>	(602,804)
<b>NET PATIENT AND RESIDENT SERVICE REVENUE</b> <b>(NET OF PROVISION FOR BAD DEBTS)</b>	<b><u>\$ 19,417,229</u></b>	<b><u>\$ 18,884,190</u></b>

INPATIENT		OUTPATIENT	
2010	2009	2010	2009
\$ 1,304,006	\$ 1,247,218	\$ -	\$ -
127,276	126,617	-	-
1,116,857	970,321	-	-
<b>2,548,139</b>	<b>2,344,156</b>	<b>-</b>	<b>-</b>
263,771	341,430	<b>2,139,977</b>	2,177,103
81,598	78,631	-	-
55,685	78,153	<b>597,490</b>	609,050
229,512	232,683	<b>4,064,636</b>	3,863,487
340,350	384,386	<b>2,622,984</b>	2,664,119
522,647	452,849	<b>439,309</b>	314,916
154,698	111,267	<b>725,401</b>	698,265
61,293	35,729	<b>78,490</b>	56,487
3,415	3,005	<b>14,837</b>	11,223
38,669	28,811	<b>553,790</b>	462,275
95,584	107,570	<b>383,260</b>	421,901
718,975	732,512	<b>2,175,654</b>	1,620,153
-	-	<b>432,128</b>	450,640
-	-	<b>3,911,891</b>	4,009,520
-	-	<b>785,084</b>	766,813
150,851	133,781	<b>2,047,670</b>	1,968,601
-	-	<b>696,477</b>	622,100
-	-	<b>548,569</b>	579,023
26,047	19,440	<b>334,858</b>	266,092
<b>2,743,095</b>	<b>2,740,247</b>	<b>22,552,505</b>	21,561,768
<b>\$ 5,291,234</b>	<b>\$ 5,084,403</b>	<b>\$ 22,552,505</b>	<b>\$ 21,561,768</b>

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF OTHER OPERATING REVENUES**  
**YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
OTHER OPERATING REVENUES		
Home health support	\$ 308,759	\$ 230,611
Business health	77,985	82,514
Meals sold	63,978	65,478
Lifeline	50,405	55,805
Specialty clinic	29,829	23,100
Willow Ridge	3,085	29,265
Grants	-	6,513
Other	19,095	10,295
TOTAL OTHER OPERATING REVENUES	<u>\$ 553,136</u>	<u>\$ 503,581</u>

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF OPERATING EXPENSES**  
**YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
<b>MEDICAL AND SURGICAL</b>		
Salaries and wages	\$ 864,303	\$ 836,391
Supplies and other	79,655	198,395
	<u>943,958</u>	<u>1,034,786</u>
<b>NURSERY</b>		
Salaries and wages	41,985	41,539
Supplies and other	3,744	4,042
	<u>45,729</u>	<u>45,581</u>
<b>LONG-TERM CARE</b>		
Salaries and wages	632,475	586,343
Supplies and other	47,994	57,607
	<u>680,469</u>	<u>643,950</u>
<b>NURSING ADMINISTRATION</b>		
Salaries and wages	210,731	209,628
Supplies and other	9,886	9,457
	<u>220,617</u>	<u>219,085</u>
<b>OPERATING ROOM</b>		
Salaries and wages	382,127	364,720
Supplies and other	219,989	145,527
	<u>602,116</u>	<u>510,247</u>
<b>LABOR AND DELIVERY ROOM</b>		
Salaries and wages	6,568	9,525
Supplies and other	9,136	6,085
	<u>15,704</u>	<u>15,610</u>
<b>ANESTHESIOLOGY</b>		
Supplies and other	<u>264,630</u>	<u>272,365</u>
<b>RADIOLOGY</b>		
Salaries and wages	330,226	327,857
Supplies and other	623,369	659,540
	<u>953,595</u>	<u>987,397</u>
<b>LABORATORY</b>		
Salaries and wages	331,822	335,954
Supplies and other	464,088	553,851
	<u>795,910</u>	<u>889,805</u>
<b>BLOOD</b>		
Salaries and wages	2,450	3,738
Supplies and other	56,735	52,881
	<u>59,185</u>	<u>56,619</u>

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**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF OPERATING EXPENSES**  
**YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
RESPIRATORY THERAPY		
Salaries and wages	\$ 43,080	\$ 41,544
Supplies and other	37,506	33,054
	<u>80,586</u>	<u>74,598</u>
PHYSICAL THERAPY		
Salaries and wages	251,887	277,678
Supplies and other	32,155	27,076
	<u>284,042</u>	<u>304,754</u>
OCCUPATIONAL THERAPY		
Salaries and wages	46,142	45,190
Supplies and other	1,314	6,429
	<u>47,456</u>	<u>51,619</u>
SPEECH THERAPY		
Supplies and other	12,469	11,849
	<u>12,469</u>	<u>11,849</u>
ELECTROCARDIOGRAPHY		
Salaries and wages	90,286	83,673
Supplies and other	75,867	60,737
	<u>166,153</u>	<u>144,410</u>
MEDICAL AND SURGICAL SUPPLIES		
Salaries and wages	22,721	21,148
Supplies and other	234,544	282,993
	<u>257,265</u>	<u>304,141</u>
PHARMACY		
Supplies and other	715,585	593,320
	<u>715,585</u>	<u>593,320</u>
GRAETTINGER CLINIC		
Salaries and wages	217,059	212,348
Supplies and other	96,339	108,324
	<u>313,398</u>	<u>320,672</u>
EMMETSBURG CLINIC		
Salaries and wages	876,379	858,091
Supplies and other	1,544,027	1,661,724
	<u>2,420,406</u>	<u>2,519,815</u>
WEST BEND CLINIC		
Salaries and wages	273,799	270,647
Supplies and other	185,044	214,802
	<u>458,843</u>	<u>485,449</u>

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**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF OPERATING EXPENSES**  
**YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
EMERGENCY ROOM		
Salaries and wages	\$ 294,252	\$ 317,751
Supplies and other	603,949	597,393
	<u>898,201</u>	<u>915,144</u>
SPECIALTY CLINIC		
Salaries and wages	11,783	5,699
Supplies and other	6,707	34,307
	<u>18,490</u>	<u>40,006</u>
BUSINESS HEALTH		
Salaries and wages	64,558	68,422
Supplies and other	22,573	35,060
	<u>87,131</u>	<u>103,482</u>
AMBULANCE		
Salaries and wages	211,690	199,871
Supplies and other	60,333	72,896
	<u>272,023</u>	<u>272,767</u>
HOME HEALTH		
Salaries and wages	468,463	461,612
Supplies and other	107,978	172,007
	<u>576,441</u>	<u>633,619</u>
HOSPICE		
Salaries and wages	70,218	68,818
Supplies and other	24,463	37,135
	<u>94,681</u>	<u>105,953</u>
MEDICAL RECORDS		
Salaries and wages	207,750	190,884
Supplies and other	40,358	39,346
	<u>248,108</u>	<u>230,230</u>
DIETARY		
Salaries and wages	299,507	279,255
Supplies and other	164,836	172,224
	<u>464,343</u>	<u>451,479</u>
OPERATION OF PLANT		
Salaries and wages	255,889	249,910
Supplies and other	494,613	490,843
	<u>750,502</u>	<u>740,753</u>
HOUSEKEEPING		
Salaries and wages	193,479	178,075
Supplies and other	35,879	21,516
	<u>229,358</u>	<u>199,591</u>

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**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF OPERATING EXPENSES**  
**YEARS ENDED JUNE 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
LAUNDRY		
Salaries and wages	\$ -	\$ 126
Supplies and other	72,602	79,808
	<u>72,602</u>	<u>79,934</u>
ADMINISTRATIVE SERVICES		
Salaries and wages	705,196	633,291
Supplies and other	1,657,831	1,522,721
	<u>2,363,027</u>	<u>2,156,012</u>
DIABETIC EDUCATION		
Salaries and wages	11,800	10,585
Supplies and other	1,961	328
	<u>13,761</u>	<u>10,913</u>
APARTMENTS		
Salaries and wages	52,262	47,433
Supplies and other	42,639	37,352
	<u>94,901</u>	<u>84,785</u>
UNASSIGNED EXPENSES		
Depreciation	1,762,441	1,538,592
Interest and amortization	728,754	678,869
Employee benefits	2,311,688	1,902,034
	<u>4,802,883</u>	<u>4,119,495</u>
TOTAL OPERATING EXPENSES	<u>\$ 20,324,568</u>	<u>\$ 19,630,235</u>

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF PATIENT AND RESIDENT RECEIVABLES,**  
**ALLOWANCE FOR DOUBTFUL ACCOUNTS, AND COLLECTION STATISTICS**  
**JUNE 30, 2010 AND 2009**

**ANALYSIS OF AGING**

Age of Accounts (Days Since Discharge)	June 30, 2010		June 30, 2009	
	Amount	Percent to Total	Amount	Percent to Total
30 days or less	\$ 2,321,404	62.47%	\$ 2,352,505	54.60%
31 to 60 days	488,812	13.15%	598,971	13.90%
61 to 90 days	259,473	6.98%	316,454	7.35%
91 days and over	646,565	17.40%	1,040,260	24.15%
	<u>3,716,254</u>	<u>100.00%</u>	<u>4,308,190</u>	<u>100.00%</u>
Less: Allowance for doubtful accounts	599,669		660,268	
Allowance for contractual adjustments	<u>940,500</u>		<u>1,100,034</u>	
Net	<u>\$ 2,176,085</u>		<u>\$ 2,547,888</u>	

**ANALYSIS OF ALLOWANCE FOR DOUBTFUL ACCOUNTS**  
**YEARS ENDED JUNE 30, 2010 AND 2009**

	2010	2009
Beginning balance	<u>\$ 660,268</u>	<u>\$ 559,013</u>
Add:		
Provision for bad debts	548,685	602,804
Recoveries previously written off	<u>386,304</u>	<u>351,919</u>
	<u>934,989</u>	<u>954,723</u>
Less:		
Accounts written off	<u>(995,588)</u>	<u>(853,468)</u>
Ending balance	<u>\$ 599,669</u>	<u>\$ 660,268</u>

**COLLECTION STATISTICS**

	2010	2009
Net accounts receivable - patients and residents	\$ 2,176,085	\$ 2,547,888
Number of days charges outstanding (1)	41	49
Uncollectible accounts (2)	721,229	769,460
Percentage of uncollectible accounts to total charges	2.6%	2.9%

(1) Based on average daily net patient and resident service revenue for April, May, and June.

(2) Includes provision for bad debts, charity care, and collection fees.

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF SUPPLIES AND PREPAID EXPENSE**  
**JUNE 30, 2010 AND 2009**

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	<u>2010</u>	<u>2009</u>
SUPPLIES		
Pharmacy	\$ 103,435	\$ 96,748
Central supply	44,893	41,529
Dietary	11,441	12,040
Other	<u>124,790</u>	<u>146,564</u>
 Total supplies	 <u>\$ 284,559</u>	 <u>\$ 296,881</u>
 PREPAID EXPENSE		
Dues and other	<u>\$ 80,100</u>	<u>\$ 63,086</u>

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULES OF COMPARATIVE STATISTICS**  
**YEARS ENDED JUNE 30, 2010 AND 2009 (UNAUDITED)**

	<u>2010</u>	<u>2009</u>
<b>PATIENT DAYS</b>		
Acute	1,277	1,390
Swing-bed	876	572
Long-term care	7,927	7,650
Nursery	241	256
Totals	<u>10,321</u>	<u>9,868</u>
<b>ADMISSIONS</b>		
Acute	437	461
Swing-bed	111	74
Long-term care	3	25
Totals	<u>551</u>	<u>560</u>
<b>DISCHARGES</b>		
Acute	435	461
Swing-bed	112	87
Long-term care	3	17
Totals	<u>550</u>	<u>565</u>
<b>ACUTE AVERAGE LENGTH OF STAY</b>	<u>2.9</u>	<u>3.0</u>
<b>SWING-BED AVERAGE LENGTH OF STAY</b>	<u>7.8</u>	<u>6.6</u>
<b>ACUTE BEDS</b>	<u>25</u>	<u>25</u>
<b>LONG-TERM CARE BEDS</b>	<u>22</u>	<u>22</u>
<b>PERCENTAGE OF OCCUPANCY</b>		
Acute and swing-bed (based on 25 beds)	23.6%	21.5%
Long-term care (based on 22 beds)	98.7%	95.3%
<b>OUTPATIENT VISITS</b>	<u>21,986</u>	<u>22,126</u>
<b>CLINIC VISITS</b>		
Graettinger	2,926	3,338
Emmetsburg	22,733	26,459
West Bend	4,140	4,839



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

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

We have audited the accompanying balance sheets of Palo Alto County Hospital, d/b/a Palo Alto County Health System (Health System), as of June 30, 2010 and 2009, and its discretely presented component unit, Palo Alto County Health Care Foundation, as of December 31, 2009 and 2008, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended and have issued our report thereon dated September 10, 2010. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

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

*A deficiency in internal control* 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Health System’s financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying Schedule of Findings and Responses that we consider to be significant deficiencies in internal control over financial reporting. We consider the deficiencies in internal control described in Part I of the accompanying Schedule of Findings and Responses to be significant deficiencies in internal control over financial reporting. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of Palo Alto County Hospital, d/b/a Palo Alto County Health System, are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards*.

Comments involving statutory and other legal matters about the Health System's operations for the year ended June 30, 2010, are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Health System and are reported in Part II of the accompanying Schedule of Findings and Responses. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

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

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

We would like to acknowledge the many courtesies and assistance extended to us by personnel of Palo Alto County Hospital, d/b/a Palo Alto County Health System, during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

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

Dubuque, Iowa  
September 10, 2010

**PALO ALTO COUNTY HOSPITAL  
d/b/a PALO ALTO COUNTY HEALTH SYSTEM  
SCHEDULE OF FINDINGS AND RESPONSES  
YEAR ENDED JUNE 30, 2010**

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

**SIGNIFICANT DEFICIENCIES:**

**I-A-10      Segregation of Duties**

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

Condition – Certain employees perform duties that are incompatible.

Cause – A limited number of office personnel prevents a proper segregation of accounting functions necessary to assure optimal internal control. This is not an unusual condition in organizations of your size.

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

Recommendation – We realize that with a limited number of office employees, segregation of duties is difficult. We also recognize that in some instances it may not be cost effective to employ additional personnel for the purpose of segregating duties. However, the Health System should continually review its internal control procedures, other compensating controls and monitoring procedures to obtain the maximum internal control possible under the circumstances. Management involvement through the review of reconciliation procedures can be an effective control to ensure these procedures are being accurately completed on a timely basis. Furthermore, the Health System should periodically evaluate its procedures to identify potential areas where the benefits of further segregation of duties or addition of other compensating controls and monitoring procedures exceed the related costs.

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

Conclusion – Response accepted.

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULE OF FINDINGS AND RESPONSES**  
**YEAR ENDED JUNE 30, 2010**

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

I-B-10      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 control over financial reporting and procedures related to the fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles (GAAP).

Condition – Palo Alto County Health System does not have an internal control system designed to provide for the preparation of the financial statements, including the accompanying footnotes and statements of cash flows, as required by GAAP. As auditors, we were requested to draft the financial statements and accompanying notes to the financial statements. The outsourcing of these services is not unusual in an organization of your size.

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

Effect – The effect of this condition is that the year-end financial reporting is prepared by a party outside of the Health System. The outside party does not have the constant contact with ongoing financial transactions that internal staff have. Furthermore, it is possible that new standards may not be adopted and applied timely to the interim financial reporting. It is the responsibility of Health System management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations.

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

Response – This finding and recommendation is not a result of any change in the Health System's procedures, rather it is due to an auditing standard implemented by the American Institute of Certified Public Accountants. Management feels that committing the resources necessary to remain current on GAAP and GASB reporting requirements and corresponding footnote disclosures would lack benefit in relation to the cost, but will continue evaluating on a going forward basis.

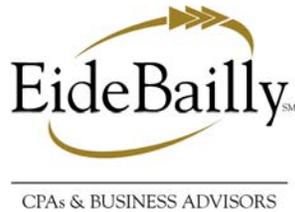
Conclusion – Response accepted.

**PALO ALTO COUNTY HOSPITAL**  
**d/b/a PALO ALTO COUNTY HEALTH SYSTEM**  
**SCHEDULE OF FINDINGS AND RESPONSES**  
**YEAR ENDED JUNE 30, 2010**

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

- II-A-10 Certified Budget – Disbursements during the year ended June 30, 2010, did not exceed the amount budgeted.
- II-B-10 Questionable Expenditures – We noted no expenditures that we believe would be in conflict with the requirements of public purpose as defined in an Attorney General’s opinion dated April 25, 1979.
- II-C-10 Travel Expense – No expenditures of Health System money for travel expenses of spouses of Health System officials and/or employees were noted.
- II-D-10 Business Transactions – We noted no material business transactions between the Health System and Health System officials and/or employees.
- II-E-10 Board Minutes – No transactions were found that we believe should have been approved in the Board minutes but were not.
- II-F-10 Deposits and Investments – No instances of non-compliance with the deposit and investment provisions of Chapter 12B and Chapter 12C of the Code of Iowa and the Health System’s investment policy were noted.
- II-G-10 Publication of Bills Allowed and Salaries – Chapter 347.13(11) of the Code of Iowa states “There shall be published quarterly in each of the official newspapers of the county as selected by the board of supervisors pursuant to section 349.1 the schedule of bills allowed and there shall be published annually in such newspapers the schedule of salaries paid by job classification and category...” The Health System published a schedule of bills allowed and a schedule of salaries paid as required by the Code of Iowa.



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

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Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Health System's financial statements will not be prevented, or detected and corrected on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the Health System's internal control to be significant deficiencies:

#### Preparation of Financial Statements

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 control over financial reporting and procedures related to the fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles (GAAP). Palo Alto County Hospital, d/b/a Palo Alto County Health System, does not have an internal control system designed to provide for the preparation of the financial statements, including the accompanying footnotes and statement of cash flows, as required by 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. 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. The effect of this condition is that the year-end financial reporting is prepared by a party outside of the Health System. The outside party does not have the constant contact with ongoing financial transactions that internal staff have. Furthermore, it is possible that new standards may not be adopted and applied timely to the interim financial reporting. It is the responsibility of Health System management and those charged with governance to make the decision whether to accept the degree of risk associated with this condition because of cost or other considerations.

#### Segregation of Duties

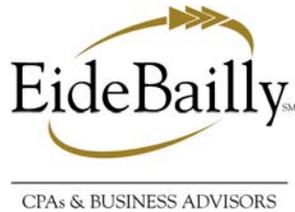
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We also recognize that in some instances it may not be cost effective to employ additional personnel for the purpose of segregating duties. However, the Health System should continually review its internal control procedures, other compensating controls and monitoring procedures to obtain the maximum internal control possible under the circumstances. Management involvement through the review of reconciliation procedures can be an effective control to ensure these procedures are being accurately completed on a timely basis. Furthermore, the Health System should periodically evaluate its procedures to identify potential areas where the benefits of further segregation of duties or addition of other compensating controls and monitoring procedures exceed the related costs.

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Dubuque, Iowa  
September 10, 2010



The Board of Trustees  
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d/b/a Palo Alto County Health System  
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September 10, 2010