



Financial Statements
June 30, 2011 and 2010

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

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Palo Alto County Hospital
d/b/a Palo Alto County Health System
Board of Trustees and Health System Officials

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
<hr/> <p style="text-align: center;">Board of Trustees</p> <hr/>		
Kris Ausborn	Chair	December 31, 2014
Pat Joyce	Treasurer	December 31, 2012
Tammy Naig	Secretary	December 31, 2012
Dawn Schmidt	Trustee	December 31, 2016
James Hobart	Trustee	December 31, 2016
Charles S. Wirtz	Trustee	December 31, 2012
Dean Newlon	Trustee	December 31, 2014
<hr/> <p style="text-align: center;">Health System Officials</p> <hr/>		
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

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

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, 2011 and 2010, and its discretely presented component unit, Palo Alto County Health Care Foundation (Foundation), as of December 31, 2010 and 2009, 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, 2011 and 2010, and the financial statements of its discretely presented component unit as of December 31, 2010 and 2009, 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 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 6, 2011, 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.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 4 through 9 and the Budgetary Comparison Information on pages 34 and 35 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statement in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Eide Bailly LLP

Dubuque, Iowa
September 6, 2011

This discussion and analysis of the financial performance of Palo Alto County Hospital, d/b/a Palo Alto County Health System (Health System), provides an overall review of the Health System's financial activities and balances as of and for the years ended June 30, 2011, 2010, and 2009. The intent of this discussion is to provide further information on the Health System's performance as a whole. We encourage readers to consider the information presented here in conjunction with the Health System's financial statements, including the notes thereto to enhance their understanding of the Health System's financial status.

Overview of the Financial Statements

The financial statements are composed of the balance sheets, statements of revenues, expenses, and changes in net assets, and the statements of cash flows. The financial statements also include notes that explain in more detail some of the information in the financial statements. The financial statements are designed to provide readers with a broad overview of the Health System's finances.

The Health System's financial statements offer short and long term information about its activities. The balance sheets include all of the Health System's assets and liabilities, as well as the Palo Alto County Health Care Foundation's net assets, and provide information about the nature and amounts of investments in resources (assets) and the obligations to Health System creditors (liabilities). The balance sheets also provide the basis for evaluating the capital structure of the Health System and assessing the liquidity and financial flexibility of the Health System.

All of the current year's revenues and expenses are accounted for in the statements of revenues, expenses, and changes in net assets. These statements measure the success of the Health System's operations over the past year and can be used to determine whether the Health System has successfully recovered all of its costs through its patient and resident service revenue and other revenue sources. Revenues and expenses are reported on an accrual basis, which means the related cash could be received or paid in a subsequent period.

The final statement is the statement of cash flows. These statements report cash receipts, cash payments and net changes in cash resulting from operations, investing and financing activities. They also provide answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

Financial Highlights

The Balance Sheet and the Statement of Revenues, Expenses, and Changes in Net Assets report the net assets of the Health System and Foundation and the changes in them. The Health System's net assets - the difference between assets and liabilities - is a way to measure financial health or financial position. Over time, sustained increases or decreases in the Health System's net assets are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors such as changes in economic condition, population growth and new or changed governmental legislation should also be considered.

- The Balance Sheet at June 30, 2011, indicates total assets of \$41,301,673, total liabilities of \$18,496,735, and net assets of \$ 22,804,938.
- The Statements of Revenues, Expenses and Changes in Net Assets indicate total net operating revenue of \$22,141,209 an increase of 8.8% over the previous fiscal year, total operating expenses of \$21,379,803 an increase 5.2% resulting in a gain from operations of \$761,406 or 3.4% compared to 0.1% from the previous year. The health system had a non-operating gain of \$1,209,675.

- The Health System's current assets exceeded its current liabilities by \$11,236,824 at June 30, 2011, providing a 3.4 current ratio.
- The Health System recorded an excess of revenues over expenses for fiscal year ending June 30, 2011, amounting to \$ 1,971,081.
- Gross outpatient charges increased 17.7% during fiscal year 2011.
- Total operating expenses increased 6.1% from the previous fiscal year.
- Gross days in accounts receivable continue to be very favorable at 47 on June 30, 2011.
- Total acute patient days total 1,499 a 17.4% increase from prior year
 - Skilled care days 820 (6.4% decline)
 - Long term care days 7,728 (2.5% decline)
 - Surgeries 1,084 (15.4% increase)
 - Physical Therapy visits unchanged at 6,549

Organization Highlights

The organization continued to make many positive changes over this last fiscal year, including:

- Implemented ePay system for patients and staff to manage their payments and balances
- Implemented Eprescribing in the clinics
- Converted all current medical records to electronic format via scanning
- Installed a GeneXpert analyzer in lab for faster results of highly infectious diseases
- Landscaped the hospital grounds following construction
- Purchased Acute Track system to monitor Providers exact unduplicated time with patient

Condensed Financial Statements

Balance Sheets

	June 30, 2011	June 30, 2010	June 30, 2009
Assets			
Current Assets			
Cash and cash equivalents	\$ 11,416,442	\$ 8,044,084	\$ 5,738,703
Restricted under bond agreement	337,445	460,311	456,752
Receivables			
Patient and resident, net of estimated uncollectibles	2,446,850	2,176,085	2,547,888
Estimated third-party payor settlements	-	-	151,345
Succeeding year property tax	1,165,193	1,112,548	981,097
Other	88,752	305,849	72,785
Other assets	419,805	364,659	359,967
Total current assets	15,874,487	12,463,536	10,308,537
Assets Limited as to Use or Restricted	4,812,847	4,904,639	5,513,632
Capital Assets, Net	20,334,331	21,260,760	21,131,701
Other Assets	280,008	295,428	310,909
Total assets	\$ 41,301,673	\$ 38,924,363	\$ 37,264,779

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Management's Discussion and Analysis
June 30, 2011 and 2010

Condensed Financial Statements

Balance Sheets (continued)

	June 30, 2011	June 30, 2010	June 30, 2009
Liabilities and Net Assets			
Current Liabilities			
Current maturities of long-term debt	\$ 290,000	\$ 275,000	\$ 270,000
Accounts payable			
Trade	450,593	480,219	602,111
Construction	-	363,255	400,725
Affiliated organization	236,488	146,502	221,509
Estimated health claims payable	285,000	285,000	320,000
Estimated third-party payor settlements	690,000	16,635	-
Accrued expenses	1,520,389	1,463,673	1,393,447
Deferred revenue for succeeding year property tax receivable	1,165,193	1,112,548	981,097
Total current liabilities	4,637,663	4,142,832	4,188,889
Other Liabilities			
Security deposits	30,367	28,606	30,280
Long-term Debt, less current maturities	13,828,705	14,107,186	14,370,633
Total liabilities	18,496,735	18,278,624	18,589,802
Net Assets			
Invested in capital assets, net of related debt	6,495,634	7,174,002	7,560,647
Restricted	2,044,301	2,320,092	2,298,711
Unrestricted	14,265,003	11,151,645	8,815,619
Total net assets	22,804,938	20,645,739	18,674,977
Total liabilities and net assets	\$ 41,301,673	\$ 38,924,363	\$ 37,264,779

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Management's Discussion and Analysis
June 30, 2011 and 2010

Statements of Revenues, Expenses, and Changes in Net Assets

	Year Ended June 30,		
	2011	2010	2009
Operating Revenues			
Net patient and resident service revenue	\$ 21,210,779	\$ 19,417,229	\$ 18,884,190
Apartment revenue	405,195	379,651	371,041
Other operating revenues	525,235	553,136	503,581
Total Operating Revenues	<u>22,141,209</u>	<u>20,350,016</u>	<u>19,758,812</u>
Operating Expenses			
Salaries, wages and employee benefits	10,395,341	9,782,575	9,139,780
Supplies and other expenses	8,309,946	8,050,798	8,272,994
Depreciation, interest and amortization	2,674,516	2,491,195	2,217,461
Total Operating Expenses	<u>21,379,803</u>	<u>20,324,568</u>	<u>19,630,235</u>
Operating Income	<u>761,406</u>	<u>25,448</u>	<u>128,577</u>
Nonoperating Revenues (Expenses)			
Investment income	107,252	103,897	315,777
County tax revenue	1,114,606	983,463	941,094
Noncapital contributions and grants	13,033	11,485	6,715
Loss on sale of capital assets	(25,216)	(6,031)	(24,010)
Net Nonoperating Revenues	<u>1,209,675</u>	<u>1,092,814</u>	<u>1,239,576</u>
Revenues in Excess of Expenses	1,971,081	1,118,262	1,368,153
Capital Contributions and Grants	<u>188,118</u>	<u>852,500</u>	<u>20,000</u>
Increase in Net Assets	2,159,199	1,970,762	1,388,153
Net Assets Beginning of Year	<u>20,645,739</u>	<u>18,674,977</u>	<u>17,286,824</u>
Net Assets End of Year	<u>\$ 22,804,938</u>	<u>\$ 20,645,739</u>	<u>\$ 18,674,977</u>

Long-Term Debt

Palo Alto County Health System had \$290,000 and \$14,118,705 in short-term and long-term debt, respectively, for the year ended June 30, 2011, and \$275,000 and \$14,107,186 in short-term and long-term debt, respectively, for the year ended June 30, 2010. The debt was incurred to update the facility and continue to invest in new equipment and technology.

Economic and Other Factors and Next Year's Budget

The Health System's Board and management considered many factors when preparing the fiscal year 2012 budget. Of primary consideration in the 2012 budget are the unknowns of health care reform and the continued difficulty in the status of the economy.

Items listed below were also considered.

- Medicare and Medicaid reimbursement rates
- Managed Care contracts
- Increase in self-pay accounts receivable due to uninsured and underinsured
- Nursing Home reimbursement
- Staffing benchmarks
- Increased expectations for quality at a lower price
- Salary and benefit costs
- Increasing supply costs
- Energy costs
- Patient safety initiatives
- Pay-for-performance and quality indicators
- Technology advances
- Medical Staff issues
- Lower return on investments

Summary

The Health System's Board of Trustees and Administrative Team continue to be extremely proud of the excellent patient care, dedication, commitment and support each of our 280 employees provides to every person they serve. We would also like to thank each member of the Health System's Medical Staff for their dedication and support provided.

Contacting the Health System's Finance Department

The Health System's financial statements are designed to present users with a general overview of the Health System's finances and to demonstrate the Health System's accountability. If you have questions about the report or need additional financial information, please contact the finance department at the following address:

Palo Alto County Health System
Attn: Renay Hauswirth, CFO
3201 1st Street
Emmetsburg, IA 50536

	<u>2011</u>	<u>2010</u>
Assets		
Current Assets		
Cash and cash equivalents	\$ 11,416,442	\$ 8,044,084
Restricted under bond agreement - Note 4	337,445	460,311
Receivables		
Patient and resident, net of estimated uncollectibles of \$1,826,000 in 2011 and \$1,540,000 in 2010	2,446,850	2,176,085
Succeeding year property tax	1,165,193	1,112,548
Other	88,752	305,849
Supplies	302,411	284,559
Prepaid expense	117,394	80,100
Total current assets	<u>15,874,487</u>	<u>12,463,536</u>
Assets Limited as to Use or Restricted - Note 4		
Internally designated for capital improvements	3,105,991	3,044,858
Restricted under bond agreement	<u>1,706,856</u>	<u>1,859,781</u>
Total assets limited as to use or restricted	<u>4,812,847</u>	<u>4,904,639</u>
Capital Assets - Note 5		
Capital assets not being depreciated	140,365	146,965
Depreciable capital assets, net of accumulated depreciation	<u>20,193,966</u>	<u>21,113,795</u>
Total capital assets, net	<u>20,334,331</u>	<u>21,260,760</u>
Other Assets		
Bond issuance costs, net of accumulated amortization	<u>280,008</u>	<u>295,428</u>
Total assets	<u>\$ 41,301,673</u>	<u>\$ 38,924,363</u>

See Notes to Financial Statements

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Balance Sheets
June 30, 2011 and 2010

	2011	2010
Liabilities and Net Assets		
Current Liabilities		
Current maturities of long-term debt - Note 7	\$ 290,000	\$ 275,000
Accounts payable		
Trade	450,593	480,219
Construction	-	363,255
Affiliated organization - Note 9	236,488	146,502
Estimated health claims payable - Note 10	285,000	285,000
Estimated third-party payor settlements	690,000	16,635
Accrued expenses		
Salaries and wages	477,488	423,645
Paid time-off	592,144	532,782
Interest	296,636	301,099
Payroll taxes and employee benefits	154,121	206,147
Deferred revenue for succeeding year property tax receivable	1,165,193	1,112,548
Total current liabilities	4,637,663	4,142,832
Other Liabilities		
Security deposits	30,367	28,606
Long-Term Debt, Less Current Maturities - Note 7	13,828,705	14,107,186
Total liabilities	18,496,735	18,278,624
Net Assets		
Invested in capital assets, net of related debt	6,495,634	7,174,002
Restricted		
Expendable under bond agreement	2,044,301	2,320,092
Unrestricted	14,265,003	11,151,645
Total net assets	22,804,938	20,645,739
Total liabilities and net assets	\$ 41,301,673	\$ 38,924,363

Palo Alto County Health Care Foundation

Balance Sheets

December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Assets		
Current Assets		
Cash and cash equivalents	\$ 183,769	\$ 82,928
Accrued interest receivable	<u>6,834</u>	<u>10,462</u>
Total current assets	190,603	93,390
Noncurrent Cash and Investments - Note 4	1,876,521	2,451,083
Capital Assets, Net	<u>-</u>	<u>35,152</u>
Total assets	<u>\$ 2,067,124</u>	<u>\$ 2,579,625</u>
Liabilities and Net Assets		
Current Liabilities		
Property tax payable	\$ 965	\$ 832
Commitment to Health System - Note 13	<u>245,000</u>	<u>845,000</u>
Total current liabilities	245,965	845,832
Net Assets, Unrestricted	<u>1,821,159</u>	<u>1,733,793</u>
Total liabilities and net assets	<u>\$ 2,067,124</u>	<u>\$ 2,579,625</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, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Operating Revenues		
Net patient and resident service revenue (net of provision for bad debts of \$713,070 in 2011 and \$548,685 in 2010) - Notes 2 and 3	\$ 21,210,779	\$ 19,417,229
Apartment revenue	405,195	379,651
Other operating revenues	<u>525,235</u>	<u>553,136</u>
Total Operating Revenues	<u>22,141,209</u>	<u>20,350,016</u>
Operating Expenses		
Salaries and wages	7,953,440	7,470,887
Employee benefits	2,441,901	2,311,688
Supplies and other expenses	8,309,946	8,050,798
Depreciation	1,934,759	1,762,441
Interest and amortization	<u>739,757</u>	<u>728,754</u>
Total Operating Expenses	<u>21,379,803</u>	<u>20,324,568</u>
Operating Income	<u>761,406</u>	<u>25,448</u>
Nonoperating Revenues (Expenses)		
Investment income	107,252	103,897
County tax revenue	1,114,606	983,463
Noncapital contributions and grants	13,033	11,485
Loss on sale of capital assets	<u>(25,216)</u>	<u>(6,031)</u>
Net Nonoperating Revenues	<u>1,209,675</u>	<u>1,092,814</u>
Revenues in Excess of Expenses	1,971,081	1,118,262
Other Changes in Net Assets		
Capital contributions and grants	<u>188,118</u>	<u>852,500</u>
Increase in Net Assets	2,159,199	1,970,762
Net Assets, Beginning of Year	<u>20,645,739</u>	<u>18,674,977</u>
Net Assets, End of Year	<u>\$ 22,804,938</u>	<u>\$ 20,645,739</u>

Palo Alto County Health Care Foundation
Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended December 31, 2010 and 2009

	2010	2009
Operating Revenues		
Investment income	\$ 55,713	\$ 78,804
Rental income	5,625	7,500
Contributions	73,872	43,383
Total Operating Revenues	135,210	129,687
Expenses		
Depreciation	-	2,535
Property taxes	1,930	1,640
Supplies and other expenses	5,863	663
Contributions to Health System - Note 13	27,418	845,000
Total Expenses	35,211	849,838
Operating Income (Loss)	99,999	(720,151)
Nonoperating Revenues (Expenses)		
Loss on sale of capital assets	(12,633)	-
Increase (Decrease) in Unrestricted Net Assets	87,366	(720,151)
Net Assets, Beginning of Year	1,733,793	2,453,944
Net Assets, End of Year	\$ 1,821,159	\$ 1,733,793

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Statements of Cash Flows
Years Ended June 30, 2011 and 2010

	2011	2010
Cash Flows from Operating Activities		
Receipts of patient and resident service revenue	\$ 22,018,574	\$ 20,336,663
Payments of salaries and wages	(7,840,235)	(7,413,438)
Payments of supplies and other expenses	(10,798,659)	(10,582,233)
Other receipts and payments, net	744,932	316,371
Net Cash Provided by Operating Activities	4,124,612	2,657,363
Cash Flows from Noncapital Financing Activities		
Noncapital contributions and grants received	13,033	11,485
County tax revenue received	1,112,006	987,164
Net Cash Provided by Noncapital Financing Activities	1,125,039	998,649
Cash Flows from Capital and Related Financing Activities		
Principal payments on long-term debt	(275,000)	(270,000)
Purchase of capital assets	(1,034,397)	(1,876,888)
Proceeds from sale of capital assets	850	960
Interest payments on long-term debt, excluding amounts capitalized	(717,281)	(727,517)
Decrease in construction payable	(363,255)	(37,470)
Net security deposits received (paid)	1,762	(1,674)
Capital contributions and grants	188,118	852,500
Net Cash used for Capital and Related Financing Activities	(2,199,203)	(2,060,089)
Cash Flows from Investing Activities		
Sale and transfer of investments	214,658	605,434
Investment income	107,252	104,024
Net Cash Provided by Investing Activities	321,910	709,458
Net Increase in Cash and Cash Equivalents	3,372,358	2,305,381
Cash and Cash Equivalents at Beginning of Year	8,044,084	5,738,703
Cash and Cash Equivalents at End of Year	\$ 11,416,442	\$ 8,044,084

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Statements of Cash Flows
Years Ended June 30, 2011 and 2010

	2011	2010
Reconciliation of Operating Income to Net Cash		
Provided by Operating Activities		
Operating income	\$ 761,406	\$ 25,448
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	1,934,759	1,762,441
Interest and amortization expense considered capital and related financing activity	739,757	728,754
Provision for bad debts	713,070	548,685
Changes in assets and liabilities		
Patient and resident receivables	(983,835)	(176,882)
Estimated third-party payor settlements	673,365	167,980
Other receivables	219,697	(236,765)
Supplies	(17,852)	12,322
Prepaid expense	(37,294)	(17,014)
Accounts payable - trade and affiliated organization	60,360	(196,899)
Accrued expenses	61,179	74,293
Estimated health claims payable	-	(35,000)
	\$ 4,124,612	\$ 2,657,363
Net Cash Provided by Operating Activities		

Supplemental Disclosure of Cash Flow Information

Cash paid for interest (including amounts capitalized) in 2011 and 2010 was \$717,281 and \$727,518, respectively.

Palo Alto County Health Care Foundation

Statements of Cash Flows

Years Ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Cash Flows from Operating Activities		
Increase (decrease) in unrestricted net assets	\$ 87,366	\$ (720,151)
Adjustments to reconcile increase (decrease) in unrestricted net assets to net cash (used for) provided by operating activities		
Depreciation	-	2,535
Amortization of premiums on investments	1,787	2,057
Loss on the sale of capital assets	12,633	-
Changes in assets and liabilities		
Accrued interest receivable	3,628	(178)
Commitment to health system	(600,000)	845,000
Property tax payable	133	36
Net Cash Provided by (used for) Operating Activities	<u>(494,453)</u>	<u>129,299</u>
Cash Flows from Capital and Financing Activities		
Proceeds from the sale of capital assets	<u>22,519</u>	<u>-</u>
Cash Flows from Investing Activities		
Purchase of investments	(700,000)	(927,685)
Sale of investments	1,250,000	750,000
Interest earned on certificates of deposit	<u>22,775</u>	<u>26,986</u>
Net Cash Provided by (used for) Investing Activities	<u>572,775</u>	<u>(150,699)</u>
Increase (Decrease) in Cash and Cash Equivalents	100,841	(21,400)
Cash and Cash Equivalents at Beginning of Year	<u>82,928</u>	<u>104,328</u>
Cash and Cash Equivalents at End of Year	<u>\$ 183,769</u>	<u>\$ 82,928</u>

Note 1 - Organization and Significant Accounting Policies

Organization

Palo Alto County Hospital, d/b/a Palo Alto County Health System (Health System), consists of a 25-bed acute care hospital and a 22-bed skilled nursing/long-term care facility, located in Emmetsburg, Iowa. It is organized under Chapter 347 of the Code of Iowa. The Health System provides health care services in accordance with a Master Affiliation Agreement discussed further in Note 9. Services are provided to residents of Palo Alto County and surrounding counties in Iowa.

Tax Exempt Status

The Health System is 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). The Health System is subject to income tax on net income that is derived from business activities that are unrelated to its exempt purpose, as applicable.

The Health System believes that it has appropriate support for any tax positions taken affecting its annual filing requirements, and as such, does not have any uncertain tax positions that are material to the financial statements. The Health System would recognize future accrued interest and penalties related to unrecognized tax benefits and liabilities in income tax expense if such interest and penalties are incurred.

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.

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's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America as prescribed 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.

The Health System uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis, using the economic resources measurement focus. Based on GASB Codification Topic 1600, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Health System has elected not to apply provisions of any pronouncements of the Financial Accounting Standards Board (FASB) issued after November 30, 1989.

Use of Estimates

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

Cash and Cash Equivalents

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

Patient and Resident Receivables

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

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

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

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.

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, 2011 and 2010, accumulated amortization was \$35,038, and \$26,819, 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, 2011 and 2010, accumulated amortization was \$56,700 and \$49,500, respectively. Total amortization expense of the bond issuance costs was \$15,419, and \$15,481 for the years ended June 30, 2011 and 2010, 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 projected paid time-off payouts is recorded as a current liability on the balance sheet based on rates that are in effect at June 30, 2011 and 2010.

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 transactions associated with providing health care services – the Health System's principal activity. Nonexchange revenues, including interest income, 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.

Contributions and Grants

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 would recognize 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 would be 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.

Subsequent Events

The Health System has evaluated subsequent events through September 6, 2011, the date which the financial statements were available to be issued.

Reclassifications

Certain items from the 2010 financial statements have been reclassified to conform to the current year presentation. The reclassifications had no impact on increase in net assets.

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 \$264,400 and \$159,179 for the years ended June 30, 2011 and 2010, respectively. The estimated costs of the charges foregone, based upon an overall cost-to-charge ratio calculation, for the years ended June 30, 2011 and 2010 were \$167,000, and \$111,000, 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:

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, 2009.

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, 2008.

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, 2011, and 45% and 11%, respectively, of the Health System's net patient and resident service revenue for the year ended June 30, 2010. The 2011 net patient and resident service revenue increased approximately \$145,000 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 2011 and 2010 net patient and resident service revenue increased approximately \$191,000 and \$185,000, 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 the 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.

A summary of patient and resident service revenue, contractual adjustments, and provision for bad debts for the years ended June 30, 2011 and 2010, is as follows:

	2011	2010
Total Patient and Resident Service Revenue	\$ 32,163,008	\$ 27,684,560
Contractual Adjustments:		
Medicare	(5,311,901)	(3,477,888)
Medicaid	(740,620)	(761,649)
Other	(4,186,638)	(3,479,109)
Total contractual adjustments	(10,239,159)	(7,718,646)
Net Patient and Resident Service Revenue	21,923,849	19,965,914
Provision for Bad Debts	(713,070)	(548,685)
Net Patient and Resident Service Revenue (Net of Provision for Bad Debts)	\$ 21,210,779	\$ 19,417,229

Note 4 - Deposits and Investments

The Health System's deposits in banks at June 30, 2011 and 2010, 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.

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Notes to Financial Statements
June 30, 2011 and 2010

At June 30, 2011 and 2010, the Health System's carrying amounts of deposits and investments are as follows:

	<u>2011</u>	<u>2010</u>
Checking and Savings Accounts	\$ 11,416,442	\$ 8,044,084
Certificates of Deposit	3,444,790	3,378,637
Money Market Accounts	1,705,502	1,986,313
Total deposits	<u>\$ 16,566,734</u>	<u>\$ 13,409,034</u>
Included in the Following Balance Sheet Captions		
Cash and cash equivalents	\$ 11,416,442	\$ 8,044,084
Restricted under bond agreement - current	337,445	460,311
Assets limited as to use or restricted	4,812,847	4,904,639
	<u>\$ 16,566,734</u>	<u>\$ 13,409,034</u>

Interest rate risk is the exposure to fair value losses resulting from rising interest rates. The Health System's investment policy limits the investment of operating funds (funds expected to be expended in the current budget year or within 15 months of receipt) 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, 2010 and 2009, the Foundation's carrying amounts of deposits and investments are as follows:

	<u>2010</u>	<u>2009</u>
Certificates of Deposit	<u>\$ 1,876,521</u>	<u>\$ 2,451,083</u>

Note 5 - Capital Assets

Capital assets activity for the years ended June 30, 2011 and 2010, was as follows:

	June 30, 2010				June 30, 2011
	<u>Balance</u>	<u>Additions</u>	<u>Deductions</u>	<u>Transfers</u>	<u>Balance</u>
Capital Assets Not Being Depreciated					
Land	\$ 140,365	\$ -	\$ -	\$ -	\$ 140,365
Construction in progress	6,600	-	-	(6,600)	-
Total capital assets not being depreciated	<u>146,965</u>	<u>-</u>	<u>-</u>	<u>(6,600)</u>	<u>140,365</u>
Capital Assets Being Depreciated					
Land improvements	276,577	40,901	15,500	-	301,978
Buildings	23,206,741	38,343	19,856	-	23,225,228
Fixed equipment	2,068,798	123,847	131,758	-	2,060,887
Major movable equipment	6,574,808	831,306	202,613	6,600	7,210,101
Total capital assets being depreciated	<u>32,126,924</u>	<u>1,034,397</u>	<u>369,727</u>	<u>6,600</u>	<u>32,798,194</u>
Less Accumulated Depreciation for:					
Land improvements	191,541	10,914	-	-	202,455
Buildings	5,326,054	1,006,547	18,085	-	6,314,516
Fixed equipment	1,530,444	78,843	126,716	-	1,482,571
Major movable equipment	3,965,090	838,457	198,861	-	4,604,686
Total accumulated depreciation	<u>11,013,129</u>	<u>1,934,761</u>	<u>343,662</u>	<u>-</u>	<u>12,604,228</u>
Total Capital Assets Being Depreciated, Net	<u>21,113,795</u>	<u>(900,364)</u>	<u>26,065</u>	<u>-</u>	<u>20,193,966</u>
Total Capital Assets, Net	<u>\$ 21,260,760</u>	<u>\$ (900,364)</u>	<u>\$ 26,065</u>	<u>\$ -</u>	<u>\$ 20,334,331</u>

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Notes to Financial Statements
June 30, 2011 and 2010

	June 30, 2009				June 30, 2010
	Balance	Additions	Deductions	Transfers	Balance
Capital Assets Not Being Depreciated					
Land	\$ 140,365	\$ -	\$ -	\$ -	\$ 140,365
Construction in progress	1,631,501	1,222,429	-	(2,847,330)	6,600
Total capital assets not being depreciated	<u>1,771,866</u>	<u>1,222,429</u>	<u>-</u>	<u>(2,847,330)</u>	<u>146,965</u>
Capital Assets Being Depreciated					
Land improvements	276,577	-	-	-	276,577
Buildings	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
Total capital assets being depreciated	<u>28,776,416</u>	<u>676,062</u>	<u>172,884</u>	<u>2,847,330</u>	<u>32,126,924</u>
Less Accumulated Depreciation for:					
Land improvements	179,634	11,907	-	-	191,541
Buildings	4,423,726	902,328	-	-	5,326,054
Fixed equipment	1,447,083	83,361	-	-	1,530,444
Major movable equipment	3,366,138	764,846	165,894	-	3,965,090
Total accumulated depreciation	<u>9,416,581</u>	<u>1,762,442</u>	<u>165,894</u>	<u>-</u>	<u>11,013,129</u>
Total Capital Assets Being Depreciated, Net	<u>19,359,835</u>	<u>(1,086,380)</u>	<u>6,990</u>	<u>2,847,330</u>	<u>21,113,795</u>
Total Capital Assets, Net	<u>\$ 21,131,701</u>	<u>\$ 136,049</u>	<u>\$ 6,990</u>	<u>-</u>	<u>\$ 21,260,760</u>

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, 2011 and 2010, was \$175,531 and \$290,982 respectively.

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

Year Ending June 30,	Amount
2012	\$ 3,360
2013	1,680
Total	<u>\$ 5,040</u>

Note 7 - Long-Term Debt

A schedule of changes in long-term debt for 2011 and 2010, is as follows:

	Balance June 30, 2010	Additions	Payments (Amortization)	Balance June 30, 2011	Amounts Due Within One Year
Hospital Revenue Bonds, Series 2003	\$ 5,680,000	\$ -	\$ (195,000)	\$ 5,485,000	\$ 200,000
Hospital Revenue Bonds, Series 2006	8,920,000	-	(80,000)	8,840,000	90,000
	<u>14,600,000</u>	<u>-</u>	<u>(275,000)</u>	<u>14,325,000</u>	<u>290,000</u>
Bond Discount	(16,888)	-	932	(15,956)	-
Deferred Loss on Bond Refinancing	(107,570)	-	5,934	(101,636)	-
Bond OID Less Premium 2006	<u>(93,356)</u>	<u>-</u>	<u>4,653</u>	<u>(88,703)</u>	<u>-</u>
Total Long-Term Debt	<u>\$ 14,382,186</u>	<u>\$ -</u>	<u>\$ (263,481)</u>	14,118,705	<u>\$ 290,000</u>
Less Current Maturities				<u>(290,000)</u>	
Long-Term Debt, Less Current Maturities				<u>\$ 13,828,705</u>	

	Balance June 30, 2009	Additions	Payments (Amortization)	Balance June 30, 2010	Amounts Due 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
	<u>14,870,000</u>	<u>-</u>	<u>(270,000)</u>	<u>14,600,000</u>	<u>275,000</u>
Bond Discount	(17,820)	-	932	(16,888)	-
Deferred Loss on Bond Refinancing	(113,504)	-	5,934	(107,570)	-
Bond OID Less Premium 2006	<u>(98,043)</u>	<u>-</u>	<u>4,687</u>	<u>(93,356)</u>	<u>-</u>
Total Long-Term Debt	<u>\$ 14,640,633</u>	<u>\$ -</u>	<u>\$ (258,447)</u>	14,382,186	<u>\$ 275,000</u>
Less Current Maturities				<u>(275,000)</u>	
Long-Term Debt, Less Current Maturities				<u>\$ 14,107,186</u>	

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>
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	340,000	650,653	990,653
2017 to 2021	1,965,000	2,982,627	4,947,627
2022 to 2026	2,525,000	2,406,631	4,931,631
2027 to 2031	3,210,000	1,712,463	4,922,463
2032 to 2036	5,055,000	814,747	5,869,747
	<u>\$ 14,325,000</u>	<u>\$ 11,312,722</u>	<u>\$ 25,637,722</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. In July 2011, the Health System paid principal of \$1,240,000, which was due in 2022, and \$2,365,000, which was due in 2028. 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 5.250% 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, 2011 and 2010.

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

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

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

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

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

Debt Service Reserve Fund – into which the Health System was required to deposit an amount equal to the sum of \$821,323, to fund final debt payment on August 1, 2036.

A summary of interest cost and investment income on borrowed funds during the years ended June 30, 2011 and 2010, is as follows:

	2011	2010
Interest Cost:		
Capitalized as part of construction project	\$ -	\$ 21,730
Recognized as interest expense	712,818	701,720
Total	\$ 712,818	\$ 723,450
Investment Income:		
Capitalized as part of construction project	\$ -	\$ 127

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 4.50% of their annual covered salary, and the Health System is required to contribute 6.95% of annual covered payroll for the year ended June 30, 2011. Plan members were required to contribute 4.30% and 4.10% of their annual covered salary, and the Health System was required to contribute 6.65% and 6.35% of annual covered payroll for the years ended June 30, 2010 and 2009, respectively. Contribution requirements are established by state statute. The Health System’s contributions to IPERS for the years ended June 30, 2011, 2010, and 2009, were \$563,323, \$500,694, and \$459,837, respectively, equal to the required contributions for each year.

Note 9 - Related Organizations

Master Affiliation Agreement

The Health System has a Master Affiliation Agreement with Mercy Medical Center – North Iowa (MMC-NI) to provide hospital, physician, and other health care services in Palo Alto County and surrounding counties in central Iowa. As a part of this Master Affiliation Agreement, the Health System entered into a Professional Service Agreement with MMC-NI whereby MMC-NI provides professional medical services for the Health System. Amounts paid to MMC-NI for the provision of these services amounted to \$2,375,546 and \$2,355,476 for the years ended June 30, 2011 and 2010, 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, 2011 and 2010, were \$702,659 and \$668,618, respectively.

Due to Affiliated Organization

As of June 30, 2011 and 2010, the Health System's records reflect an amount due to MMC-NI of \$236,488 and \$146,502, 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. A liability of \$285,000 has been established to record the incurred but not reported claims outstanding at June 30, 2011 and 2010.

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.

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, 2011 and 2010, was as follows:

	2011	2010
Medicare	31%	34%
Medicaid	6%	10%
Blue Cross	22%	17%
Other Third-Party Payors, Patients, and Residents	41%	39%
	100%	100%

Note 13 - Foundation Commitment

The Palo Alto County Health Care Foundation committed \$845,000 to the Health System's construction and renovation project in fiscal year 2009. During the year ended June 30, 2010, the Foundation paid \$600,000 of the pledged balance to the Health System. The remaining pledged balance of \$245,000 was paid to the Health System during March 2011.



Required Supplementary Information
June 30, 2011

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, 2011

	Actual Accrual Basis	Accrual Adjustments	Actual Cash Basis	Budget	Variance Favorable (Unfavorable)
Estimated Amount to be Raised by Taxation	\$ 1,114,606	\$ (2,600)	\$ 1,112,006	\$ 1,112,548	\$ (542)
Estimated Other Revenues/ Receipts	<u>22,449,612</u>	<u>624,909</u>	<u>23,074,521</u>	<u>21,961,454</u>	<u>1,113,067</u>
	23,564,218	622,309	24,186,527	23,074,002	1,112,525
Expenses/Disbursements	<u>21,405,019</u>	<u>(376,192)</u>	<u>21,028,827</u>	<u>21,135,035</u>	<u>106,208</u>
Net	2,159,199	998,501	3,157,700	1,938,967	<u>\$ 1,218,733</u>
Balance, Beginning of Year	<u>20,645,739</u>	<u>(7,236,705)</u>	<u>13,409,034</u>	<u>12,692,586</u>	
Balance, End of Year	<u>\$ 22,804,938</u>	<u>\$ (6,238,204)</u>	<u>\$ 16,566,734</u>	<u>\$ 14,631,553</u>	

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 System 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, 2011.

For the year ended June 30, 2011, the Health System's expenditures did not exceed the amount budgeted.



Other Supplementary Information
June 30, 2011 and 2010

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



Independent Auditor's Report on Supplementary Information

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

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedules of net patient and resident service revenue, other operating revenues, operating expenses, patient and resident receivables, allowance for doubtful accounts, collection statistics, supplies and prepaid expense, and comparative statistics, are presented for the purposes of additional analysis and are not a required part of the basic financial statements. The schedules of net patient and resident service revenue, other operating revenues, operating expenses, and supplies and prepaid expense are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole. The schedules of patient and resident receivables, allowance for doubtful accounts, collection statistics, and comparative statistics have not been subjected to the auditing procedures applied in the audits of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

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

Dubuque, Iowa
September 6, 2011

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	Total	
	2011	2010
Patient and Resident Service Revenue		
Medical and surgical	\$ 1,690,368	\$ 1,304,006
Nursery	147,245	127,276
Long-term care	1,149,029	1,116,857
Subtotal	<u>2,986,642</u>	<u>2,548,139</u>
Other Professional Services		
Operating room	3,003,101	2,403,748
Labor and delivery room	92,582	81,598
Anesthesiology	768,797	653,175
Radiology	4,692,031	4,294,148
Laboratory	3,312,493	2,963,334
Respiratory therapy	1,187,140	961,956
Physical therapy	1,005,913	880,099
Occupational therapy	138,496	139,783
Speech therapy	39,931	18,252
Electrocardiography	736,335	592,459
Medical and surgical supplies	563,881	478,844
Pharmacy	3,533,215	2,894,629
Graettinger Clinic	451,040	432,128
Emmetsburg Clinic	4,320,358	3,911,891
West Bend Clinic	911,030	785,084
Emergency room	2,647,962	2,198,521
Ambulance	946,661	696,477
Home health	634,831	548,569
Hospice	454,969	360,905
Subtotal	<u>29,440,766</u>	<u>25,295,600</u>
Total	<u>32,427,408</u>	<u>27,843,739</u>
Charity care	(264,400)	(159,179)
Total patient and resident service revenue	<u>32,163,008</u>	<u>27,684,560</u>
Contractual Adjustments		
Medicare	(5,311,901)	(3,477,888)
Medicaid	(740,620)	(761,649)
Other	(4,186,638)	(3,479,109)
Total contractual adjustments	<u>(10,239,159)</u>	<u>(7,718,646)</u>
Net Patient and Resident Service Revenue	21,923,849	19,965,914
Provision for Bad Debts	(713,070)	(548,685)
Net Patient and Resident Service Revenue (Net of Provision for Bad Debts)	<u>\$ 21,210,779</u>	<u>\$ 19,417,229</u>

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Schedules of Net Patient and Resident Service Revenue
Years Ended June 30, 2011 and 2010

Inpatient		Outpatient	
2011	2010	2011	2010
\$ 1,690,368	\$ 1,304,006	\$ -	\$ -
147,245	127,276	-	-
1,149,029	1,116,857	-	-
<u>2,986,642</u>	<u>2,548,139</u>	<u>-</u>	<u>-</u>
332,915	263,771	2,670,186	2,139,977
92,582	81,598	-	-
70,194	55,685	698,603	597,490
271,309	229,512	4,420,722	4,064,636
377,527	340,350	2,934,966	2,622,984
705,005	522,647	482,135	439,309
163,263	154,698	842,650	725,401
50,282	61,293	88,214	78,490
5,207	3,415	34,724	14,837
36,253	38,669	700,082	553,790
93,849	95,584	470,032	383,260
859,290	718,975	2,673,925	2,175,654
-	-	451,040	432,128
-	-	4,320,358	3,911,891
-	-	911,030	785,084
161,750	150,851	2,486,212	2,047,670
-	-	946,661	696,477
-	-	634,831	548,569
48,690	26,047	406,279	334,858
<u>3,268,116</u>	<u>2,743,095</u>	<u>26,172,650</u>	<u>22,552,505</u>
<u>\$ 6,254,758</u>	<u>\$ 5,291,234</u>	<u>\$ 26,172,650</u>	<u>\$ 22,552,505</u>

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Schedules of Other Operating Revenues
Years Ended June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Other Operating Revenues		
Home health support	\$ 285,006	\$ 308,759
Business health	80,029	77,985
Meals sold	64,292	63,978
Lifeline	49,871	50,405
Specialty clinic	34,930	29,829
Willow Ridge	3,822	3,085
Other	<u>7,285</u>	<u>19,095</u>
Total Other Operating Revenues	<u>\$ 525,235</u>	<u>\$ 553,136</u>

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Schedules of Operating Expenses
Years Ended June 30, 2011 and 2010

	2011	2010
Medical and Surgical		
Salaries and wages	\$ 948,934	\$ 864,303
Supplies and other	114,091	79,655
	<u>1,063,025</u>	<u>943,958</u>
Nursery		
Salaries and wages	39,736	41,985
Supplies and other	6,677	3,744
	<u>46,413</u>	<u>45,729</u>
Long-Term Care		
Salaries and wages	640,805	632,475
Supplies and other	55,820	47,994
	<u>696,625</u>	<u>680,469</u>
Nursing Administration		
Salaries and wages	211,789	210,731
Supplies and other	13,277	9,886
	<u>225,066</u>	<u>220,617</u>
Operating Room		
Salaries and wages	444,519	382,127
Supplies and other	195,060	219,989
	<u>639,579</u>	<u>602,116</u>
Labor and Delivery Room		
Salaries and wages	3,677	6,568
Supplies and other	7,559	9,136
	<u>11,236</u>	<u>15,704</u>
Anesthesiology		
Supplies and other	297,133	264,630
	<u>297,133</u>	<u>264,630</u>
Radiology		
Salaries and wages	349,162	330,226
Supplies and other	450,928	623,369
	<u>800,090</u>	<u>953,595</u>
Laboratory		
Salaries and wages	401,223	331,822
Supplies and other	455,582	464,088
	<u>856,805</u>	<u>795,910</u>
Blood		
Salaries and wages	92	2,450
Supplies and other	41,014	56,735
	<u>41,106</u>	<u>59,185</u>

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Schedules of Operating Expenses
Years Ended June 30, 2011 and 2010

	2011	2010
Respiratory Therapy		
Salaries and wages	\$ 47,408	\$ 43,080
Supplies and other	40,736	37,506
	<u>88,144</u>	<u>80,586</u>
Physical Therapy		
Salaries and wages	249,310	251,887
Supplies and other	33,965	32,155
	<u>283,275</u>	<u>284,042</u>
Occupational Therapy		
Salaries and wages	42,875	46,142
Supplies and other	5,052	1,314
	<u>47,927</u>	<u>47,456</u>
Speech Therapy		
Supplies and other	29,959	12,469
	<u>29,959</u>	<u>12,469</u>
Electrocardiography		
Salaries and wages	85,939	90,286
Supplies and other	83,300	75,867
	<u>169,239</u>	<u>166,153</u>
Medical and Surgical Supplies		
Salaries and wages	16,914	22,721
Supplies and other	256,050	234,544
	<u>272,964</u>	<u>257,265</u>
Pharmacy		
Supplies and other	809,413	715,585
	<u>809,413</u>	<u>715,585</u>
Graettinger Clinic		
Salaries and wages	229,515	217,059
Supplies and other	91,216	96,339
	<u>320,731</u>	<u>313,398</u>
Emmetsburg Clinic		
Salaries and wages	928,150	876,379
Supplies and other	1,665,137	1,544,027
	<u>2,593,287</u>	<u>2,420,406</u>
West Bend Clinic		
Salaries and wages	290,448	273,799
Supplies and other	173,855	185,044
	<u>464,303</u>	<u>458,843</u>

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Schedules of Operating Expenses
Years Ended June 30, 2011 and 2010

	2011	2010
Emergency Room		
Salaries and wages	\$ 291,785	\$ 294,252
Supplies and other	674,790	603,949
	<u>966,575</u>	<u>898,201</u>
Specialty Clinic		
Salaries and wages	10,575	11,783
Supplies and other	3,564	6,707
	<u>14,139</u>	<u>18,490</u>
Business Health		
Salaries and wages	91,526	64,558
Supplies and other	24,255	22,573
	<u>115,781</u>	<u>87,131</u>
Ambulance		
Salaries and wages	240,226	211,690
Supplies and other	71,256	60,333
	<u>311,482</u>	<u>272,023</u>
Home Health		
Salaries and wages	468,814	468,463
Supplies and other	139,688	107,978
	<u>608,502</u>	<u>576,441</u>
Hospice		
Salaries and wages	80,601	70,218
Supplies and other	36,023	24,463
	<u>116,624</u>	<u>94,681</u>
Medical Records		
Salaries and wages	222,633	207,750
Supplies and other	42,032	40,358
	<u>264,665</u>	<u>248,108</u>
Dietary		
Salaries and wages	310,229	299,507
Supplies and other	176,080	164,836
	<u>486,309</u>	<u>464,343</u>
Operation of Plant		
Salaries and wages	244,029	255,889
Supplies and other	495,450	494,613
	<u>739,479</u>	<u>750,502</u>

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Schedules of Operating Expenses
Years Ended June 30, 2011 and 2010

	2011	2010
Housekeeping		
Salaries and wages	\$ 202,906	\$ 193,479
Supplies and other	27,701	35,879
	230,607	229,358
Laundry		
Supplies and other	74,386	72,602
Administrative Services		
Salaries and wages	791,113	705,196
Supplies and other	1,681,477	1,657,831
	2,472,590	2,363,027
Diabetic Education		
Salaries and wages	14,772	11,800
Supplies and other	7,736	1,961
	22,508	13,761
Apartments		
Salaries and wages	53,735	52,262
Supplies and other	29,684	42,639
	83,419	94,901
Unassigned Expenses		
Depreciation	1,934,759	1,762,441
Interest and amortization	739,757	728,754
Employee benefits	2,441,901	2,311,688
	5,116,417	4,802,883
Total Operating Expenses	\$ 21,379,803	\$ 20,324,568

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 (Unaudited)
Years Ended June 30, 2011 and 2010

Analysis of Aging

Age of Accounts (Days Since Discharge)	June 30, 2011		June 30, 2010	
	Amount	Percent to Total	Amount	Percent to Total
30 days or less	\$ 2,822,692	66.07%	\$ 2,321,404	62.47%
31 to 60 days	490,590	11.48%	488,812	13.15%
61 to 90 days	204,304	4.78%	259,473	6.98%
91 days and over	754,842	17.67%	646,565	17.40%
	4,272,428	100.00%	3,716,254	100.00%
Less:				
Allowance for doubtful accounts	715,917		599,669	
Allowance for contractual adjustments	1,109,661		940,500	
Net	\$ 2,446,850		\$ 2,176,085	

Analysis of Allowance for Doubtful Accounts Years Ended June 30, 2011 and 2010

	2011	2010
Beginning Balance	\$ 599,669	\$ 660,268
Add:		
Provision for bad debts	713,070	548,685
Recoveries previously written off	468,937	386,304
	1,182,007	934,989
Less:		
Accounts written off	(1,065,759)	(995,588)
Ending balance	\$ 715,917	\$ 599,669

Collection Statistics

	2011	2010
Net Accounts Receivable - Patients and Residents	\$ 2,446,850	\$ 2,176,085
Number of Days Charges Outstanding (1)	41	39
Uncollectible Accounts (2)	\$ 995,734	\$ 721,229
Percentage of Uncollectible Accounts to Total Charges	3.1%	2.6%

(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, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Supplies		
Pharmacy	\$ 125,237	\$ 103,435
Central supply	43,223	44,893
Dietary	12,110	11,441
Other	<u>121,841</u>	<u>124,790</u>
 Total supplies	 <u>\$ 302,411</u>	 <u>\$ 284,559</u>
 Prepaid Expense		
Dues and other	<u>\$ 117,394</u>	<u>\$ 80,100</u>

Palo Alto County Hospital
d/b/a Palo Alto County Health System
Schedules of Comparative Statistics (Unaudited)
June 30, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Patient Days		
Acute	1,499	1,277
Swing-bed	820	876
Long-term care	7,728	7,927
Nursery	246	241
Totals	<u>10,293</u>	<u>10,321</u>
Admissions		
Acute	468	437
Swing-bed	102	111
Long-term care	13	3
Totals	<u>583</u>	<u>551</u>
Discharges		
Acute	468	435
Swing-bed	102	112
Long-term care	13	3
Totals	<u>583</u>	<u>550</u>
Acute Average Length of Stay	<u>3.2</u>	<u>2.9</u>
Swing-Bed Average Length of Stay	<u>8.0</u>	<u>7.8</u>
Acute Beds	<u>25</u>	<u>25</u>
Long-Term Care Beds	<u>22</u>	<u>22</u>
Percentage of Occupancy		
Acute and swing-bed (based on 25 beds)	25.4%	23.6%
Long-term care (based on 22 beds)	<u>96.2%</u>	<u>98.7%</u>
Outpatient Visits	<u>22,771</u>	<u>21,986</u>
Clinic Visits		
Graettinger	<u>2,898</u>	<u>2,926</u>
Emmetsburg	<u>23,678</u>	<u>22,733</u>
West Bend	<u>4,586</u>	<u>4,140</u>



**Report on Internal Control over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

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

We have audited the accompanying balance sheet of Palo Alto County Hospital, d/b/a Palo Alto County Health System (Health System), as of June 30, 2011, and its discretely presented component unit, Palo Alto County Health Care Foundation, as of December 31, 2010, 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 6, 2011. 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 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 a 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 noncompliance or other matters that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance or other matters that are described in Part II of the accompanying Schedule of Finding and Responses.

Comments involving statutory and other legal matters about the Health System's operations for the year ended June 30, 2011, are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Health System. 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.



Dubuque, Iowa
September 6, 2011

Part I: Findings Related to the Financial Statements:

Significant Deficiencies:

I-A-11 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 Hospital d/b/a 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.

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

I-B-11 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 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 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

Part II: Other Findings Related to Required Statutory Reporting:

- II-A-11** **Certified Budget:** Disbursements during the year ended June 30, 2011, did not exceed the amount budgeted.
- II-B-11** **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-11** **Travel Expense:** No expenditures of Health System money for travel expenses of spouses of Health System officials and/or employees were noted.
- II-D-11** **Business Transactions:** We noted no material business transactions between the Health System and Health System officials and/or employees.
- II-E-11** **Board Minutes:** No transactions were found that we believe should have been approved in the Board minutes but were not.
- II-F-11** **Deposits and Investments:** The Health System exceeded limits within its depository resolution at certain times during the year ended June 30, 2011.
- Recommendation:** It is recommended that the Health System increase its depository resolution limits to not exceed allowable amounts in the future.
- Response:** Subsequent to year end, the Health System transferred funds from the bank in order to comply with their depository resolution.
- Conclusion:** Response accepted.
- II-G-11** **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.