**Henry County Soldiers' and**
**Sailors' Memorial Hospital d/b/a**

# Henry County Health Center

**Mt. Pleasant, Iowa**

**Financial Statements**
**June 30, 2012 and 2011**

**Together with Independent Auditor's Report**

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**Henry County Soldiers' and Sailors' Memorial Hospital d/b/a**
## Henry County Health Center

### Officials
### June 30, 2012

| Name | Title | Term Expires |
|---|---|---|
| County Board of Supervisors: | | |
| Kent White | Chairperson | December 2012 |
| Gary See | Vice-Chairperson | December 2012 |
| Mark Lindeen | Member | December 2014 |
| Hospital Board of Trustees: | | |
| Robert Meyer | Chairperson | December 2012 |
| Kent Severson | Vice-Chairperson | December 2016 |
| Jan Towne | Secretary / Treasurer | December 2016 |
| Richard Garrels | Trustee | December 2014 |
| Carmen Heaton | Trustee | December 2014 |
| Megan Wenstrand | Trustee | December 2012 |
| Hospital Officials: | | |
| Robb Gardner | President / Chief Executive Officer | |
| David Muhs | Chief Financial Officer | |
| Jodi Geerts | Chief Nursing Officer | |

## Independent Auditor's Report

To the Board of Trustees
Henry County Soldiers' and Sailors' Memorial Hospital
d/b/a Henry County Health Center
Mt. Pleasant, Iowa:

We have audited the accompanying basic financial statements of Henry County Soldiers' and Sailors' Memorial Hospital d/b/a Henry County Health Center (Health Center) as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of the Health Center'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.

As explained in Note 1, the accompanying financial statements present only the Health Center Fund of Henry County, Iowa, and are not intended to present fairly the financial position of Henry County, Iowa, and changes in financial position and cash flows in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Health Center as of June 30, 2012 and 2011, and the respective change in financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 8, 2012 on our consideration of the Health Center's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements 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 about 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.



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Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The other supplementary statements (Exhibits 1 – 6) are presented for the purposes of additional analysis and are not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates 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 audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the 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 financial statements as a whole.

SEIM JOHNSON, LLP

Omaha, Nebraska,
October 8, 2012.

This discussion and analysis of Henry County Soldiers' and Sailors' Memorial Hospital d/b/a Henry County Health Center (Health Center) financial performance provides an overview of financial activities for the fiscal years ended June 30, 2012 and 2011. This discussion and analysis should be read in conjunction with financial statements, which begin on page 8.

## Financial Highlights

- The Health Center's net assets increased in 2012 by $1,595,034 or 4%. In 2011, net assets increased by $1,256,526 or 4%.

- The Health Center reported an operating income in 2012 of $63,545 compared to an operating income of $28,371 in 2011.

- The Health Center's non-operating revenues decreased by $29,030 in 2012 compared to 2011.

## Using This Annual Report

The Health Center's financial statements consist of three statements—a Balance Sheet; a Statement of Revenues, Expenses, and Changes in Net Assets; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Health Center, including resources held by the Health Center but restricted for specific purposes by contributors, grantors, or enabling legislation.

### The Balance Sheet and Statement of Revenue, Expenses, and Changes in Net Assets

Analysis of the Health Center's finances begins on page 8. The Balance Sheet and the Statement of Revenue, Expenses, and Changes in Net Assets report information about the Health Center's resources and activities in a way that helps answer the question of whether the Health Center, as a whole, is better or worse off as a result of the year's activities. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenue and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Health Center's net assets and changes in them. Over time, increases or decreases in net assets are an indicator of whether its financial health is improving or deteriorating. To access the overall health of the Health Center, non-financial factors, such as changes in the patient base of the Health Center and measures of the quality of service it provides to the community, as well as local economic factors, need to be considered.

### The Statement of Cash Flows

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It shows where cash came from and what the cash was used for. It also provides the change in cash balance during the reporting period.

### Net Assets

The Health Center's net assets are the difference between assets and liabilities reported in the Balance Sheet on page 8. The Health Center's net assets increased this past year by $1,595,034 or 4%, as shown in **Table 1**.

*Table 1: Assets, Liabilities, and Net Assets*

| | 2012 | 2011 | 2010 | Dollar Change | Percent Change |
|---|---|---|---|---|---|
| **Assets:** | | | | | |
| Total current assets | $ 7,766,107 | 7,730,638 | 6,887,879 | 35,469 | 0% |
| Capital assets, net | 18,350,116 | 15,863,173 | 16,109,473 | 2,486,943 | 16% |
| Assets limited as to use | 14,297,695 | 15,654,962 | 14,726,383 | (1,357,267) | -9% |
| Investments | 3,398,589 | 3,139,794 | 2,951,665 | 258,795 | 8% |
| Other non-current assets | 1,523,282 | 1,352,188 | 1,122,095 | 171,094 | 13% |
| Total assets | $ 45,335,789 | 43,740,755 | 41,797,495 | 1,595,034 | 4% |
| **Liabilities:** | | | | | |
| Long-term debt | $ 4,172,071 | 3,960,000 | 4,565,000 | 212,071 | 5% |
| Estimated third-party payor settlements | 1,261,400 | 1,200,000 | 534,071 | 61,400 | 5% |
| Other current and non-current liabilities | 3,527,062 | 3,435,715 | 2,809,910 | 91,347 | 3% |
| Total liabilities | 8,960,533 | 8,595,715 | 7,908,981 | 364,818 | 4% |
| **Net Assets:** | | | | | |
| Net assets | 36,375,256 | 35,145,040 | 33,888,514 | 1,230,216 | 4% |
| Total liabilities and net assets | $ 45,335,789 | 43,740,755 | 41,797,495 | 1,595,034 | 4% |

## Operating Results and Changes in Net Assets

In 2012, the Health Center's net assets increased by $1,595,034 or 4%, as shown in **Table 2**. This increase is made up of several different components.

### *Table 2: Condensed Statements of Revenues, Expenses and Changes in Net Assets*

| | 2012 | 2011 | 2010 | Dollar Change | Percent Change |
|---|---|---|---|---|---|
| **Operating revenue:** | | | | | |
| Net patient service revenue | $ 29,244,952 | 30,708,621 | 27,998,522 | (1,463,669) | -5% |
| Provision for bad debt | (1,128,277) | (1,497,821) | (1,060,972) | 369,544 | -25% |
| Other operating revenue | 2,407,060 | 1,690,124 | 1,726,433 | 716,936 | 42% |
| Total operating revenue | 30,523,735 | 30,900,924 | 28,663,983 | (377,189) | -1% |
| **Operating Expenses:** | | | | | |
| Salaries and employee benefits | 16,536,279 | 16,020,489 | 15,124,744 | 515,790 | 3% |
| Purchased services and other | 11,893,105 | 12,649,401 | 11,398,988 | (756,296) | -6% |
| Depreciation and amortization | 1,838,794 | 1,974,646 | 2,052,311 | (135,852) | -7% |
| Interest | 192,012 | 228,017 | 671,651 | (36,005) | -16% |
| Total operating expenses | 30,460,190 | 30,872,553 | 29,247,694 | (412,363) | -1% |
| **Operating income (loss)** | 63,545 | 28,371 | (583,711) | 35,174 | |
| **Non-Operating Revenue and Expenses** | | | | | |
| Property taxes | 568,586 | 552,692 | 540,000 | 15,894 | 3% |
| Investment income | 475,957 | 612,573 | 823,524 | (136,616) | -22% |
| Other non-operating revenue | 371,005 | 279,313 | 186,232 | 91,692 | 33% |
| Total non-operating revenue, net | 1,415,548 | 1,444,578 | 1,549,756 | (29,030) | -2% |
| **Excess of revenue over expenses** | 1,479,093 | 1,472,949 | 966,045 | 6,144 | 0% |
| **Capital grants and contributions** | -- | -- | 100,000 | -- | 0% |
| **Change in unrealized gains and losses** | (248,877) | (216,423) | (52,074) | (32,454) | 15% |
| Increase in net assets | 1,230,216 | 1,256,526 | 1,013,971 | (26,310) | -2% |
| Net assets – beginning of year | 35,145,040 | 33,888,514 | 32,874,543 | 1,256,526 | 4% |
| Net assets – end of year | $ 36,375,256 | 35,145,040 | 33,888,514 | 1,230,216 | 4% |

## Operating Income

The first component of the overall change in the Health Center's net assets is its operating income —generally, the difference between net patient service revenues and the expenses incurred to perform those services.

The primary components affecting operating income are:

- Medicare/Medicaid Cost Report Settlements and other third party contractual relationships.
- Salary adjustments to stay competitive.
- Employee health insurance.
- Professional/Physician contracts for ancillary departments.

A component of the Health Center's costs is expenses for salaries and benefits. In 2012 salaries and benefit costs totaled $16,536,279. In 2011 salaries and benefit costs totaled $16,020,489.

The Health Center at times provides care for patients who have little or no health insurance or other means of repayment. Because there is no expectation of repayment, charity care is not reported as patient service revenues of the Health Center.

**Non-operating Revenues and Expenses**

Non-operating revenues consist primarily of property taxes levied for the Health Center, interest revenue, and investment earnings. The county tax levy amounted to $568,586 in 2012 and $552,692 in 2011.

## Cash Flows

Changes in cash flows are consistent with changes in operating income and non-operating revenues and expenses, discussed earlier. Cash flows provided by operating activities increase in 2012 due to proceeds from long term debt and sale of investments.

## Capital Asset and Debt Administration

**Capital Assets**

At the end of 2012, the Health Center had $18,350,116 invested in capital assets, net of accumulated depreciation, as detailed in Note 6 to the financial statements. In 2012, the Health Center purchased new equipment costing $1,940,613 and had Construction in Progress of over $3,600,000. See Note 6 for a discussion of the Health Center's renovation, construction, and expansion project.

**Debt**

At fiscal year-end, the Health Center had $4,172,071 in capital loan notes outstanding. During 2012 the Health Center entered into notes available in multiple advances not to exceed $12,500,000. During 2012, the Health Center also retired $1,250,000 of notes five year early. The amount of debt issued is subject to limitations that apply to the County and its component units as a whole. There have been no changes in the Health Center's debt ratings in the past two years.

**Other Economic Factors**

The 2012 fiscal year provided the Health Center substantial challenges due to federal program reimbursement requirements, pressures from other insurers, and the fluctuation of patient demand.

Inflation continued in 2012 with supply and equipment costs increasing at market rates and the pressure on nursing and other salary costs being driven by the shortage of supply of these health care professionals.

## Contacting Health Center Financial Management

This financial report is designed to provide patients, suppliers, taxpayers, and creditors with a general overview of the Health Center finances. Questions about this report or requests for additional information should be directed to:

Henry County Health Center
Attn: David J. Muhs, CFO
407 South White Street
Mount Pleasant IA 52641
319-385-6716

## Balance Sheets
## June 30, 2012 and 2011

| **ASSETS** | | **2012** | **2011** |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents | $ | 2,341,867 | 2,018,899 |
| Assets limited as to use or restricted | | 753,006 | 646,691 |
| Receivables - | | | |
| Patient, net of allowance for doubtful accounts of $920,000 and $1,100,000 in 2012 and 2011, respectively | | 3,012,538 | 3,392,631 |
| Other receivables | | 124,143 | 143,341 |
| Current portion of notes receivable | | 6,448 | 5,526 |
| Inventories | | 578,178 | 591,262 |
| Prepaid expenses | | 367,203 | 370,641 |
| Succeeding year property tax receivable | | 582,724 | 561,647 |
| Total current assets | | 7,766,107 | 7,730,638 |
| Assets limited as to use or restricted | | 14,297,695 | 15,654,962 |
| Investments | | 3,398,589 | 3,139,794 |
| Capital assets, net | | 18,350,116 | 15,863,173 |
| Other assets | | 1,334,306 | 1,322,348 |
| Deferred financing costs | | 188,976 | 29,840 |
| Total assets | $ | 45,335,789 | 43,740,755 |
| **LIABILITIES AND NET ASSETS** | | | |
| Current liabilities: | | | |
| Current portion of long-term debt | $ | 744,591 | 630,000 |
| Accounts payable - | | | |
| Trade | | 718,623 | 837,008 |
| Construction | | 147,553 | -- |
| Accrued salaries and vacation | | 1,895,987 | 1,767,950 |
| Other accrued expenses | | 182,175 | 269,110 |
| Estimated third-party payor settlements | | 1,261,400 | 1,200,000 |
| Deferred revenue for succeeding year property tax receivable | | 582,724 | 561,647 |
| Total current liabilities | | 5,533,053 | 5,265,715 |
| Long-term liabilities: | | | |
| Long-term debt, net of current portion | | 3,427,480 | 3,330,000 |
| Total liabilities | | 8,960,533 | 8,595,715 |
| Commitments and Contingencies: | | | |
| Net assets: | | | |
| Invested in capital assets, net of related debt | | 14,178,045 | 11,903,173 |
| Restricted - expendable | | 1,500,000 | 500,000 |
| Unrestricted | | 20,697,211 | 22,741,867 |
| Total net assets | | 36,375,256 | 35,145,040 |
| Total liabilities and net assets | $ | 45,335,789 | 43,740,755 |

*See notes to financial statements*

## Statements of Revenue, Expenses and Changes in Net Assets
## For the Years Ended June 30, 2012 and 2011

| | | 2012 | 2011 |
|---|---|---|---|
| OPERATING REVENUE: | | | |
| Net patient service revenue before provision for bad debt | $ | 29,244,952 | 30,708,621 |
| Provision for bad debt | | (1,128,277) | (1,497,821) |
| Net patient service revenue | | 28,116,675 | 29,210,800 |
| Other operating revenue | | 2,407,060 | 1,690,124 |
| Total operating revenue | | 30,523,735 | 30,900,924 |
| OPERATING EXPENSES: | | | |
| Salaries | | 12,564,312 | 12,517,842 |
| Employee benefits | | 3,971,967 | 3,502,647 |
| Professional fees | | 2,357,006 | 2,381,389 |
| Supplies | | 4,932,085 | 5,775,326 |
| Other expenses | | 4,604,014 | 4,492,686 |
| Depreciation and amortization | | 1,838,794 | 1,974,646 |
| Interest | | 192,012 | 228,017 |
| Total operating expenses | | 30,460,190 | 30,872,553 |
| OPERATING INCOME | | 63,545 | 28,371 |
| NONOPERATING REVENUES, NET: | | | |
| County tax revenues | | 568,586 | 552,692 |
| Investment income, net | | 475,957 | 612,573 |
| Noncapital grants and contributions | | 22,498 | 26,293 |
| Gain from equity investments | | 403,028 | 316,600 |
| Gain from disposal of capital assets | | 4,026 | 2,210 |
| Rental activity, net | | (58,547) | (65,790) |
| Nonoperating revenues, net | | 1,415,548 | 1,444,578 |
| EXCESS OF REVENUE OVER EXPENSES | | 1,479,093 | 1,472,949 |
| CHANGE IN UNREALIZED GAINS AND LOSSES ON OTHER THAN TRADING SECURITIES | | (248,877) | (216,423) |
| INCREASE IN NET ASSETS | | 1,230,216 | 1,256,526 |
| NET ASSETS, beginning of year | | 35,145,040 | 33,888,514 |
| NET ASSETS, end of year | $ | 36,375,256 | 35,145,040 |

*See notes to financial statements*

## Statements of Cash Flows
## For the Years Ended June 30, 2012 and 2011

| | | 2012 | 2011 |
|---|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Cash received from patients and third party payors | $ | 28,558,168 | 29,302,709 |
| Cash paid for employee salaries and benefits | | (16,408,242) | (15,723,054) |
| Cash paid to suppliers and contractors | | (11,935,448) | (12,583,408) |
| Other receipts and payments, net | | 2,407,060 | 1,690,124 |
| Net cash provided by operating activities | | 2,621,538 | 2,686,371 |
| CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES: | | | |
| County tax receipts | | 568,586 | 552,692 |
| Noncapital grants and contributions | | 22,498 | 26,293 |
| Net cash provided by noncapital financing activities | | 591,084 | 578,985 |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES: | | | |
| Proceeds from issuance of long term debt | | 2,092,071 | -- |
| Bond issuance costs | | (196,622) | -- |
| Payments on long-term debt | | (1,880,000) | (605,000) |
| Interest payments | | (200,288) | (230,538) |
| Purchase of property and equipment, net | | (4,400,911) | (1,967,647) |
| Net cash used in capital and related financing activities | | (4,585,750) | (2,803,185) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Investment income | | 510,128 | 523,492 |
| Deposits to investments | | (2,001,135) | (1,134,026) |
| Proceeds from sale of investments | | 1,692,088 | 939,724 |
| Deposits to assets limited as to use or restricted | | (6,409,688) | (3,147,157) |
| Proceeds from sale of assets limited as to use or restricted | | 7,445,318 | 2,074,930 |
| Proceeds from equity investments | | 253,693 | 160,802 |
| Proceeds from rental activities, net | | 205,692 | 210,068 |
| Net cash used in investing activities | | 1,696,096 | (372,167) |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | | 322,968 | 90,004 |
| CASH AND CASH EQUIVALENTS - Beginning of year | | 2,018,899 | 1,928,895 |
| CASH AND CASH EQUIVALENTS - End of year | $ | 2,341,867 | 2,018,899 |

*See notes to financial statements*

## Statements of Cash Flows (Continued)
## For the Years Ended June 30, 2012 and 2011

| | | 2012 | 2011 |
|---|---|---|---|
| RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES: | | | |
| Operating income | $ | 63,545 | 28,371 |
| Adjustments to reconcile operating income to net cash provided by operating activities - | | | |
| Depreciation and amortization | | 1,838,794 | 1,974,646 |
| Interest expense included in operating expenses | | 192,012 | 228,017 |
| Forgiveness of notes and physician receivables | | 36,455 | 20,525 |
| (Increase) decrease in current assets - | | | |
| Receivables - | | | |
| Patients | | 380,093 | (574,020) |
| Other | | 19,198 | (70,380) |
| Current portion of notes receivable | | (922) | (3,955) |
| Inventories | | 13,084 | 14,234 |
| Prepaid expenses | | 3,438 | (78,400) |
| Increase (decrease) in current liabilities - | | | |
| Accounts payable - trade | | (118,385) | 145,805 |
| Accrued salaries and vacation | | 128,037 | 297,435 |
| Other accrued expenses | | 4,789 | 38,164 |
| Estimated third-party payor settlements | | 61,400 | 665,929 |
| Net cash provided by operating activities | $ | 2,621,538 | 2,686,371 |

*See notes to financial statements*

## (1) Description of Reporting Entity and Summary of Significant Accounting Policies

The following is a description of the reporting entity and a summary of significant accounting policies of Henry County Soldiers' and Sailors' Memorial Hospital d/b/a Henry County Health Center (Health Center). These policies are in accordance with accounting principles generally accepted in the United States of America. The Health Center is a Critical Access Hospital, operating with 25 acute-care beds and 49 long-term care beds. The Health Center also has related health care ancillary and outpatient services.

### *A. Reporting Entity*

Generally accepted accounting principles require the financial reporting entity to include (1) the primary government, (2) organizations for which the primary government is financially accountable and (3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading. The Health Center was organized in 1919 under Chapter 347 of the Iowa Code. The Health Center is a municipal corporation governed by a Board of Trustees, which is elected by the public and has the exclusive responsibility and accountability for the decisions it makes. It has the right to sue and to be sued and has the right to buy, sell, lease or mortgage property in its own name. Based upon these criteria, the Health Center is considered a primary government and there are no agencies or entities which should be presented with the Health Center.

### *B. Industry Environment*

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, reimbursements for patient services, and Medicare and Medicaid fraud and abuse. Violations 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 services previously billed.

Management believes that the Health Center is in compliance with applicable government laws and regulations as they apply to the areas of fraud and abuse. While no regulatory inquiries have been made which are expected to have a material effect on the Health Center's financial statements, compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

As a result of recently enacted federal healthcare reform legislation, substantial changes are anticipated in the United States healthcare system. Such legislation includes numerous provisions affecting the delivery of healthcare services, the financing of healthcare costs, reimbursement of healthcare providers and the legal obligations of health insurers, providers and employers. These provisions are currently slated to take effect at specified times over approximately the next decade.

### *C. Basis of Presentation*

The Balance Sheets display the Health Center's assets and liabilities, with the difference reported as net assets. Net assets are reported in the following categories:

Invested in capital assets, net of related debt – This component of net assets 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 - Expendable – This component of net assets results when constraints placed on net asset use are either externally imposed or imposed by law through constitutional provisions or enabling legislation.

Unrestricted net assets – This component of net assets consists 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 resources are available for use, generally it is the Health Center's policy to use restricted resources first.

*D. Measurement Focus and Basis of Accounting*

Measurement focus refers to when revenue 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 accompanying financial statements have been prepared on the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. Revenue is recognized when earned and expenses are recorded when the liability is incurred.

Pursuant to Section 1600 of the Governmental Accounting Standards Board's (GASB) Codification of Governmental Accounting and Financial Reporting Standards, Health Services has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

*E. Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

*F. Cash and Cash Equivalents*

Cash and cash equivalents for purposes of the statements of cash flows include investments in highly liquid debt instruments with original maturities of three months or less, excluding amounts limited as to use by the Board of Trustees and under note agreements.

*G. Patient Receivables, Net*

Net patient receivables are uncollateralized patient and third-party payor obligations. Unpaid patient receivables are not assessed interest.

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

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

*H. Inventories*

Inventories are stated at the lower of cost, determined by the first-in, first-out method, or market.

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

*J. Assets Limited as to Use or Restricted*

Assets limited as to use or restricted include the following:

Board of Trustees - Periodically, the Health Center's Board of Trustees has set aside assets for future capital improvements and debt retirement. The Board retains control over these assets and may, at its discretion, subsequently use them for other purposes.

Hospital Revenue Capital Loan Refunding Note or Hospital Revenue Note Agreements – These funds are reserve funds held as security for the Series 2002, 2011 and 2012 Notes. These funds are used for the payment of principal and interest on the Series 2002, 2011 and 2012 Notes when insufficient funds are available in the sinking fund.

*K. Fair Value of Financial Instruments*

The carrying value of all financial instruments approximates estimated fair value. Cash and cash equivalents, assets limited as to use, accounts receivable, and accounts payable approximate fair value due to the relatively short period of time between their origination and expected realization. Fair values for investments are based on quoted market prices, if available, or estimated using quoted market prices of similar securities. The carrying value of long-term debt approximates fair value since the interest rates closely reflect current market rates.

*L. Investments*

Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in excess of revenue over expenses unless the income is restricted by donor or law. Unrealized gains and losses on investments are excluded from the excess of revenue over expenses unless the investments are trading securities. Periodically the Health Center reviews its investments to determine whether any unrealized losses are other than temporary. During 2012 and 2011, there were no investment declines that were determined to be other than temporary.

The investments in joint ventures and cooperative arrangements with other health care entities are accounted for by the equity method of accounting, under which the net income or loss of the affiliates is recognized as income or expense and distributions are treated as reductions to the investment account. As of June 30, 2012, the Health Center has a 25% interest in Southeastern Renal Dialysis, L.C. and is a member of Health Enterprises.

*M. Capital Assets*

Capital asset acquisitions in excess of $5,000 are capitalized and recorded at cost. Depreciation is provided over the estimated life of each depreciable asset and is computed using the straight-line method.

Useful lives are determined using guidelines from the American Hospital Association Guide for Estimated Useful Lives of Depreciable Hospital Assets. Lives range by capital asset classification as follows:

| | |
|---|---|
| Land improvements | 5 to 30 years |
| Buildings and building improvements | 5 to 40 years |
| Equipment, computers and furniture | 3 to 20 years |

The Health Center's long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the sum of the expected cash flows is less than the carrying amount of the asset, a loss is recognized.

Gifts of long-lived assets such as land, buildings or equipment are reported as unrestricted support and are excluded from the excess of revenue over expenses, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed into service.

*N. Deferred Financing Costs*

Deferred financing costs related to the issuance of the long-term debt are being amortized over the life of the related debt under the effective interest method for the Series 2002 note and the straight line method for the Series 2011 and 2012 notes. Amortization expense of $37,486 and $34,347 for fiscal year 2012 and 2011, respectively, is included in depreciation and amortization in the accompanying statements of revenue, expenses and changes in net assets.

*O. Compensated Absences*

Paid Time Off (PTO) vests bi-weekly and may be carried forward by an employee in an amount not to exceed 576 hours for management and 512 for staff. PTO expense is accrued as an expense and a liability as it is earned. PTO expenditures are recognized to the extent it is paid during the year and the vested amount is recorded as a current liability. Accrued PTO payable at June 30, 2012 and 2011 was $993,487 and $906,086, respectively.

Short-term disability does not vest and, therefore, no liability has been accrued. The payment for short-term disability is based on 70% of the regular earnings of the employee and is available for up to eight weeks.

*P. Self-Insured Employee Health Benefits*

The estimated losses from self-insured claims, including incurred but unreported claims, are accrued as the losses occur.

*Q. Income Taxes*

Under the Code of Iowa, Chapter 347, the Health Center is an instrumentality of the County of Henry, Iowa. As such, the Health Center is exempt from paying income taxes.

*R. Excess of Revenue Over Expenses*

The statements of revenue, expenses and changes in net assets include excess of revenue over expense as a performance indicator. Changes in unrestricted net assets that are excluded from excess of revenue over expenses, consistent with industry practice, include unrealized gains and losses on investments other than trading securities and contributions of long-lived assets (including assets acquired using contributions, which by donor restriction were to be used for the purpose of acquiring such assets).

*S. Net Patient Service Revenue*

The Health Center has agreements with third-party payors that provide for payments to the Health Center at amounts different from its established rates. Payment arrangements include prospectively determined rates, reimbursed costs and discounted charges. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. 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.

*T. Grants and Contributions*

From time to time, the Health Center receives grants and contributions from individuals and private organizations. Revenue 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 restricted for a specific operating purpose are reported as nonoperating revenue. Amounts restricted to capital acquisitions are reported after nonoperating revenue and expenses.

*U. Charity Care*

The Health Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Health Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

The Health Center is dedicated to providing comprehensive healthcare services to all segments of society, including the aged and otherwise economically disadvantages. In addition, the Health Center provides a variety of community health services at or below cost.

*V. County Tax Revenue*

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

*W. Risk Management*

The Health Center 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. Settled claims from these risks have not exceeded commercial insurance coverage for the past three years.

*X. Subsequent Events*

The Health Center considered events occurring through October 8, 2012 for recognition or disclosure in the financial statements as subsequent events. That date is the date the financial statements were available to be issued.

## (2) Cash, Investments and Assets Limited as to Use or Restricted

The Health Center's deposits in banks at June 30, 2012 and 2011 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 Center 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.

The Health Center manages the following risks in accordance with their formal investment policy:

*Credit Risk:* The Health Center has invested in U.S. treasuries, government agencies securities, and corporate bonds. The value of these investments is determined based on market and economic conditions that can and will fluctuate from time to time.

*Interest Rate Risk:* The Health Center has a formal investment policy that limits investment maturities to 397 days or less as a means of managing its exposure to fair value losses arising from changes in interest rates for current operating funds (funds which are reasonably expected to be used for the operation of the hospital within fifteen months). Funds not identified as operating funds may be invested in investments with maturities in excess of 397 days. When investing assets of the Health Center for a period longer than 397 days, the Health Center shall request competitive investment proposals for comparable credit and term investments from a minimum of two investment providers.

The weighted average duration of securities invested in U.S. treasuries, government agencies, corporate bonds, and certificate of deposits was 14 months as of June 30, 2012.

*Custodial credit risk*: Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The Health Center's investment policy requires the fund to be deposited into banking institutions that have the ability to collateralize any deposits made in excess of the Federal Deposit Insurance Corporation's insurance limits.

The Health Center's investments are carried at fair value. All bank deposit accounts are fully insured or collateralized by securities held by the Health Center's agent in the Health Center's name.

The composition of investments and assets limited as to use or restricted as of June 30, 2012 and 2011 is as follows:

| | | 2012 | 2011 |
|---|---|---|---|
| Investments: | | | |
| Operating reserves: | | | |
| Money market funds | $ | 39,330 | 30,889 |
| U.S. treasury and government agency securities | | 2,609,943 | 2,465,270 |
| Corporate bonds | | 738,880 | 622,805 |
| Accrued interest | | 10,436 | 20,830 |
| Total Investments | $ | 3,398,589 | 3,139,794 |
| Assets Limited as to Use or Restricted: | | | |
| By the Board of Trustees for: | | | |
| Capital improvements: | | | |
| Money market funds | $ | 214,733 | 68,782 |
| U.S. treasury and government agency securities | | 10,607,758 | 10,357,474 |
| Corporate bonds | | 2,497,571 | 2,376,668 |
| Accrued interest | | 78,493 | 102,270 |
| | | 13,398,555 | 12,905,194 |
| Bond retirement and sinking fund accounts: | | | |
| Money market funds | | 105,711 | 96,459 |
| Certificates of deposit | | -- | 2,800,000 |
| | | 105,711 | 2,896,459 |
| By bond agreements: | | | |
| Debt service fund accounts: | | | |
| Money market funds | | 46,435 | -- |
| Reserve account: | | | |
| U.S. treasury securities | | 500,000 | -- |
| Certificates of deposit | | 1,000,000 | 500,000 |
| | | 1,500,000 | 500,000 |
| Total assets limited as to use or restricted | | 15,050,701 | 16,301,653 |
| Less amounts required to meet current obligations | | 841,364 | 646,691 |
| Long-term portion | $ | 14,209,337 | 15,654,962 |

Investment return, including return on assets limited as to use or restricted, for the years ended June 30, 2012 and 2011 is summarized as follows:

| | | 2012 | 2011 |
|---|---|---|---|
| Interest and dividends | $ | 447,342 | 540,345 |
| Realized gains (losses), net | | (1,385) | 72,228 |
| | | 445,957 | 612,573 |
| Change in unrealized loss, net | | (248,877) | (216,423) |
| Total investment return | $ | 227,080 | 396,150 |

## (3) Net Patient Service Revenue

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

***Medicare.*** Inpatient acute care services rendered to Medicare program beneficiaries in a Critical Access Hospital are paid based on Medicare defined costs of providing the services. Outpatient services related to Medicare beneficiaries are also paid based on a cost reimbursement methodology. The Health Center is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Health Center and audit thereof by the Medicare Administrative Contractor. The Health Center's Medicare cost reports have been audited by the Medicare Administrative Contractor through June 30, 2010.

***Medicaid***. Inpatient acute services and outpatient services rendered to Medicaid program beneficiaries in a Critical Access Hospital are paid based on Medicaid defined costs of providing the services. The Health Center is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the Health Center.

The Health Center has also entered into payment agreements with certain commercial insurance carriers. This basis for payment to the Health Center under these agreements includes discounts from established charges and prospectively determined rates.

The following illustrates the Health Center's patient service revenue at its established rates and revenue deductions by major third-party payors:

| | 2012 | 2011 |
|---|---|---|
| Gross patient service revenue: | | |
| Inpatient services and swing bed | $ 7,194,505 | 7,065,874 |
| Outpatient | 38,745,943 | 39,798,026 |
| Long-term care | 2,298,573 | 2,319,980 |
| Clinic | 421,966 | 431,344 |
| Total gross patient service revenue | 48,661,017 | 49,615,224 |
| Deductions from patient service revenue: | | |
| Medicare | 10,636,756 | 10,383,229 |
| Medicaid | 2,284,571 | 2,380,057 |
| Other payors | 6,330,460 | 5,960,286 |
| Charity care | 164,278 | 183,031 |
| Total deductions from patient service revenue | 19,416,065 | 18,906,603 |
| Net patient service revenue before provision for bad debt | $ 29,244,952 | 30,708,621 |

The Health Center reports net patient service revenue at estimated net realizable amounts from patients, third-party payors, and others for services rendered and includes estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations.

Revenue from the Medicare and Medicaid programs accounts for approximately 39% and 10%, respectively, of the Health Center's net patient revenue for the year ended June 30, 2012 compared to 37% for Medicare and 11% for Medicaid in 2011. The Health Center grants credit without collateral to their patients, most of who are local residents and are insured under third-party payor agreements. Laws and regulations governing the Medicare and Medicaid 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 2012 and 2011 net patient service revenue increased approximately $840,000 and $545,000, respectively, due to removal of allowances previously estimated that are no longer necessary as a result of final settlements and years no longer subject to audits, review, and investigations.

## (4) Other Revenue

Other revenue for the years ended June 30, 2012 and 2011 consisted of the following:

| | 2012 | 2011 |
|---|---|---|
| Electronic health record incentive payments | $ 844,702 | -- |
| Public health grants | 451,171 | 593,730 |
| Miscellaneous | 336,281 | 253,212 |
| Dietary | 192,371 | 182,983 |
| Ideal protein | 179,908 | 281,235 |
| Professional services to others | 177,603 | 168,834 |
| Management services, physician billings | 163,307 | 135,386 |
| Rental income | 60,967 | 60,967 |
| Reference lab | 750 | 13,777 |
| | $ 2,407,060 | 1,690,124 |

The Health Information Technology for Economic and Clinical Health Act contains specific financial incentives designed to accelerate the adoption of electronic health record (EHR) systems among health care providers. During 2011, Health Services qualified for the financial incentives payments by attesting it met specific criteria set by the Centers for Medicare and Medicaid Services (CMS). Management's attestation is subject to audit by the federal government or its designee. The EHR incentive payment will be earned and received through various payments through 2015. The incentive amount is computed using several elements, one of which includes using the value of un-depreciated assets required to implement the EHR system. The Hospital has elected to record $844,702 of the incentive payment as other operating revenue in the period earned, and defer approximately $352,000 related to future Medicare reimbursement. In addition, the Iowa Department of Health and Human Services (DHHS) provides EHR incentive payments that will be earned and received through various payments through 2014. The amounts recognized are based on management's best estimates and are subject to change, which would be recognized in the period in which the change occurs.

## (5) Composition of Patient Receivables

Patient receivables as of June 30, 2012 and 2011 consist of the following:

| | 2012 | 2011 |
|---|---|---|
| Patient receivables | $ 5,572,615 | 5,937,631 |
| Less estimated third-party contractual adjustments | (1,640,077) | (1,445,000) |
| Less allowance for doubtful accounts | (920,000) | (1,100,000) |
| | $ 3,012,538 | 3,392,631 |

The Health Center is located in Mt. Pleasant, Iowa. The Health Center grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors was as follows:

| | 2012 | 2011 |
|---|---|---|
| Medicare | 26% | 23% |
| Medicaid | 6 | 6 |
| Blue Cross | 20 | 18 |
| Other third-party payors | 15 | 15 |
| Private pay | 33 | 38 |
| | 100% | 100% |

## (6) Capital Assets

Capital assets activity for the years ended June 30, 2012 and 2011 were as follows:

| | June 30, 2011 | Additions | Transfers and Disposals | June 30, 2012 |
|---|---|---|---|---|
| Capital assets, not being depreciated: | | | | |
| Land | $ 911,061 | -- | -- | 911,061 |
| Construction in progress | 407,702 | 3,625,596 | (1,091,908) | 2,941,390 |
| Total capital assets, not being depreciated | 1,318,763 | 3,625,596 | (1,091,908) | 3,852,451 |
| Capital assets, being depreciated: | | | | |
| Land improvements | 1,582,824 | -- | (13,438) | 1,569,386 |
| Buildings | 25,304,139 | 168,338 | (251,919) | 25,220,558 |
| Fixed equipment | 7,252,196 | 88,030 | (497,450) | 6,842,776 |
| Major moveable equipment | 10,551,296 | 1,684,245 | (435,510) | 11,800,031 |
| Total capital assets, being depreciated | 44,690,455 | 1,940,613 | (1,198,317) | 45,432,751 |
| Less accumulated depreciation: | | | | |
| Land improvements | (1,378,861) | (28,676) | 13,438 | (1,394,099) |
| Buildings | (15,271,276) | (911,577) | 355,947 | (15,826,906) |
| Fixed equipment | (6,257,204) | (208,365) | 497,450 | (5,968,119) |
| Major moveable equipment | (7,238,704) | (916,929) | 409,671 | (7,745,962) |
| Total accumulated depreciation | (30,146,045) | (2,065,547) | 1,276,506 | (30,935,086) |
| Total capital assets, being depreciated, net | 14,544,410 | (124,934) | 78,189 | 14,497,665 |
| Total capital assets, net | $ 15,863,173 | 3,500,662 | (1,013,719) | 18,350,116 |

| | June 30, 2010 | Additions | Transfers and Disposals | June 30, 2011 |
|---|---|---|---|---|
| Capital assets, not being depreciated: | | | | |
| Land | $ 911,061 | -- | -- | 911,061 |
| Construction in progress | 107,807 | 506,581 | (206,686) | 407,702 |
| Total capital assets, not being depreciated | 1,018,868 | 506,581 | (206,686) | 1,318,763 |
| Capital assets, being depreciated: | | | | |
| Land improvements | 1,590,990 | -- | (8,166) | 1,582,824 |
| Buildings | 25,220,529 | 290,779 | (207,169) | 25,304,139 |
| Fixed equipment | 7,415,599 | -- | (163,403) | 7,252,196 |
| Major moveable equipment | 10,311,461 | 1,170,287 | (930,452) | 10,551,296 |
| Total capital assets, being depreciated | 44,538,579 | 1,461,066 | (1,309,190) | 44,690,455 |
| Less accumulated depreciation: | | | | |
| Land improvements | (1,358,560) | (29,816) | 9,515 | (1,378,861) |
| Buildings | (14,581,367) | (939,185) | 249,276 | (15,271,276) |
| Fixed equipment | (6,206,773) | (213,834) | 163,403 | (6,257,204) |
| Major moveable equipment | (7,301,274) | (1,033,322) | 1,095,892 | (7,238,704) |
| Total accumulated depreciation | (29,447,974) | (2,216,157) | 1,518,086 | (30,146,045) |
| Total capital assets, being depreciated, net | 15,090,605 | (755,091) | 208,896 | 14,544,410 |
| Total capital assets, net | $ 16,109,473 | (248,510) | 2,210 | 15,863,173 |

The Henry County Health Center intends to construct approximately 54,000 square feet and renovate 22,000 square feet for the Health Center facilities. The project will consist of multiple phases and cover multiple years. Fiscal year 2012 phases included creating a central plant for cooling towers, high-efficiency modular boilers, and gas-fired water heaters. Funding for the estimated $15.6 million renovation, construction, and expansion project will be provided through the Series 2011 and 2012 notes as seen in Note 8 with the remainder to be provided by operations.

## (7) Other Assets

Other assets held by the Health Center as of June 30, 2012 and 2011 are as follows:

| | 2012 | 2011 |
|---|---|---|
| Investments in joint ventures and cooperative arrangements with other health care entities | $ 1,221,806 | 1,072,472 |
| Notes receivable | -- | 30,928 |
| Physician receivables | 118,948 | 224,474 |
| | 1,340,754 | 1,327,874 |
| Less current portion of notes receivable | 6,448 | 5,526 |
| | $ 1,334,306 | 1,322,348 |

Physician receivables are related to physician income guarantee agreements and sign-on bonuses to recruit physicians to the community of Mount Pleasant, Iowa. An offsetting physician income guarantee liability of $112,500 and $212,500 representing the maximum potential payments under the agreements are included in other accrued expenses for 2012 and 2011, respectively. All monies advanced under these agreements will be forgiven up to a five year period in which the physicians practice in the community. Advances must be repaid with interest if the physician fails to fulfill their contract responsibilities.

## (8) Long-Term Debt

Long-term debt activity of the Health Center as of June 30, 2012 and 2011 consisted of the following:

| | | June 30, 2011 | Borrowings | Payments | June 30, 2012 | Due Within One Year |
|---|---|---|---|---|---|---|
| Series 2002 (A) | $ | 3,960,000 | -- | (1,880,000) | 2,080,000 | 660,000 |
| Series 2011 (B) | | -- | 50,001 | -- | 50,001 | 50,001 |
| Series 2012 (B) | | -- | 2,042,070 | -- | 2,042,070 | 34,590 |
| | $ | 3,960,000 | 2,092,071 | (1,880,000) | 4,172,071 | 744,591 |

| | | June 30, 2010 | Borrowings | Payments | June 30, 2011 | Due Within One Year |
|---|---|---|---|---|---|---|
| Series 2002 (A) | $ | 4,565,000 | -- | (605,000) | 3,960,000 | 630,000 |

(A) The Health Center issued $6,055,000 of Hospital Revenue Capital Loan Refunding Notes, Series 2002. The proceeds of these bonds were used to achieve a current refunding of its Hospital Revenue Notes, Series 1993 and for paying bond issuance costs incurred. The Series 2002 notes bear interest at rates ranging from 5.00% to 5.25%. Annual principal payments are due in amounts ranging from $500,000 to $730,000 through June 2015. During 2012 the Health Center paid the 2016 and 2017 principal amounts totaling $1,250,000.

The Series 2002 notes grant a security interest in all revenue either accrued or received in connection with operations of the Health Center. The terms of the trust indenture require the Health Center to comply with certain covenants. The covenants provide for restrictions as to financial reporting, restrictions on the sale of the health care facilities and require the Health Center to maintain a sinking fund account and to maintain a specified debt service coverage ratio.

(B) The Health Center entered into Hospital Revenue Notes, Series 2011, for multiple advances not to exceed $10,000,000 and Hospital Revenue Notes, Series 2012 for multiple advances not to exceed $2,500,000. The proceeds of these bonds will be used to pay the cost to construct the multiple phases Health Center project as noted in Note 6. The Series 2011 and 2012 notes bear interest at a rate of 2.875%. Annual principal payments vary depending on the total amount advanced. Anticipated annual payments range from $172,000 to $1,310,000 commencing January 2013 and through November 2026. During 2012 the Health Center was advanced a total of $2,092,071.

The Series 2011 and 2012 bonds grant a security interest in all revenue either accrued or received in connection with operations of the Health Center. The terms of the trust indenture require the Health Center to comply with certain covenants. The covenants provide for restrictions as to financial reporting, restrictions on the sale of the health care facilities and require the Health Center to maintain various reserve accounts.

A summary of the Health Center's future principal and interest payments as of June 30, 2012 is as follows:

| Year | Principal | Interest | Total |
|---|---|---|---|
| 2013 | $ 744,591 | 71,720 | 816,311 |
| 2014 | 734,448 | 104,800 | 839,248 |
| 2015 | 774,629 | 105,520 | 880,149 |
| 2016 | 49,087 | 67,682 | 116,769 |
| 2017 | 108,775 | 65,486 | 174,261 |
| 2018 - 2022 | 1,135,252 | 210,860 | 1,346,112 |
| 2023 - 2026 | 625,289 | 40,353 | 665,642 |
| | $ 4,172,071 | 666,421 | 4,838,492 |

The Health Center's policy is to capitalize interest cost on the construction in progress. For the year ended June 30, 2012, the Health Center capitalized $13,655 of interest cost associated with the Series 2011 and 2012 notes.

**(9) Professional Liability Insurance**

The Health Center carries a professional liability policy (including malpractice) providing coverage of $1,000,000 for injuries per occurrence and $3,000,000 aggregate coverage. In addition, the Health Center carries an umbrella policy which also provides $9,000,000 per occurrence and aggregate coverage. These policies provide coverage on a claims-made basis covering only those claims which have occurred and are reported to the insurance company while the coverage is in force. In the event the Health Center should elect not to purchase insurance from the present carrier or the carrier should elect not to renew the policy, any unreported claims which occurred during the policy year may not be recoverable from the carrier.

Accounting principles generally accepted in the United States of America require a healthcare provider to accrue the expense of its share of malpractice claim costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Hospital's claims experience, no such accrual has been made.

**(10) Pension Plan**

The Health Center 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, PO Box 9117, Des Moines, Iowa 50306-9117.

Plan members are required to contribute 5.38% of their annual salary and the Health Center is required to contribute 8.07% of annual covered payroll. Contribution requirements are established by State statute. The Health Center's contribution to IPERS for the years ended June 30, 2012, 2011, and 2010 were $991,390, $845,259, and $779,405, respectively, equal to the required contributions for each year.

**(11) Contingencies**

The Health Center is involved in litigation arising in the normal course of business. These claims are covered under policies of their previous insurance carrier. After consultation with legal counsel, management estimates these matters will be resolved without material adverse affect on the Health Center's future financial position or results from operations.

## (12) Self-Funded Health Insurance

The Health Center has established a self-funded employee health insurance fund. All employees' payroll withholdings for health insurance and the Health Center's contributions are deposited into a separate benefit trust account. Under the self-insured plan, the Health Center pays claims from this fund, up to certain limits, and carries stop loss insurance for claims in excess of the limits. Stop-loss coverage is provided through a commercial insurance company. The Health Center incurred health insurance expenses of $1,442,396 and $1,172,610 as of June 30, 2012 and 2011, respectively.

## (13) Commitments and Contingencies

*Operating Leases*

The Health Center leases certain equipment under an operating lease expiring in January 2013. Total rental expense in 2012 and 2011 for this equipment was $195,302. The Health Center has future minimum lease payments under operating leases as of June 30, 2012 that require $113,926 in lease payments during the fiscal year ending June 30, 2013.

## (14) Deferred Compensation Plan

The Health Center offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan is available to all Health Center employees and permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

The plan complies with IRC Section 457(g), which requires the plan to hold its assets in trust. Under these requirements, the Health Center does not own the amounts deferred by employees and, therefore, the liability and corresponding investment is not reflected in the financial statements. The plan assets totaled $2,318,821 and $2,719,796 as of June 30, 2012 and 2011, respectively.

## (15) Management Services

The Health Center has various contractual agreements with Great Rivers Health Systems, Inc. (GRHS) under which GRHS provides management consultation, therapy, emergency, and other services to the Health Center. The arrangement does not alter the authority or responsibility of the Board of Trustees of the Health Center. The amount paid to GRHS for the years ended June 30, 2012 and 2011 are as follows:

| | 2012 | 2011 |
|---|---|---|
| Emergency room contract services | $ 1,294,785 | 735,413 |
| Physical and speech therapy contract services | 568,745 | 505,940 |
| Administration | 264,489 | 243,150 |
| Laundry | 70,567 | 51,961 |
| Critical access hospital | 20,000 | 20,000 |
| Telephone | 2,395 | 7,462 |
| | $ 2,220,981 | 1,563,929 |

## (16) Risks and Uncertainties

Investment securities, in general, are exposed to various risks, such as interest rate risk, credit risk and overall market volatility. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such change could materially affect the amounts reported in the financial statements.

## Budgetary Comparison Schedule of Revenue, Expenses and Changes in Net Assets – Budget and Actual (Accrual Basis) June 30, 2012

This budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary prospective differences.

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 accrual 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.

For the year ended June 30, 2012, the Health Center's expenditures did not exceed the amounts budgeted.

| | Actual Accrual Basis | Budgeted Accrual Amounts | Variance Favorable (Unfavorable) |
|---|---|---|---|
| Amount raised by taxation | $ 568,586 | 561,647 | 6,939 |
| Estimated other revenues / receipts | 31,121,820 | 38,180,060 | (7,058,240) |
| Expenses / Disbursements | 30,460,190 | 37,409,244 | 6,949,054 |
| Net | 1,230,216 | 1,332,463 | (102,247) |
| Balance beginning of year | 35,145,040 | 18,783,517 | |
| Balance end of year | $ 36,375,256 | 20,115,980 | |

*See accompanying independent auditor's report*

## Patient Service Revenue
## For the Years Ended June 30, 2012 and 2011

| | 2012 | | | | | 2011 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Inpatient and Swing Bed | Outpatient | Clinic | Long-Term Care | Total | Inpatient and Swing Bed | Outpatient | Clinic | Long-Term Care | Total |
| **DAILY PATIENT SERVICES:** | | | | | | | | | | |
| Long term care | $ -- | -- | -- | 2,298,573 | 2,298,573 | -- | -- | -- | 2,319,980 | 2,319,980 |
| Medical and surgical | 1,189,034 | -- | -- | -- | 1,189,034 | 1,238,984 | -- | -- | -- | 1,238,984 |
| Swing bed | 376,068 | -- | -- | -- | 376,068 | 352,800 | -- | -- | -- | 352,800 |
| Observation | 339,939 | -- | -- | -- | 339,939 | 290,550 | -- | -- | -- | 290,550 |
| Nursery | 182,005 | -- | -- | -- | 182,005 | 174,385 | -- | -- | -- | 174,385 |
| Dialysis | 74,301 | -- | -- | -- | 74,301 | 82,213 | -- | -- | -- | 82,213 |
| | 2,161,347 | -- | -- | 2,298,573 | 4,459,920 | 2,138,932 | -- | -- | 2,319,980 | 4,458,912 |
| **OTHER NURSING SERVICES:** | | | | | | | | | | |
| Operating and recovery room | 1,128,629 | 7,869,392 | -- | -- | 8,998,021 | 897,926 | 7,979,517 | -- | -- | 8,877,443 |
| Emergency services | 89,122 | 4,329,168 | -- | -- | 4,418,290 | 61,957 | 4,049,353 | -- | -- | 4,111,310 |
| Delivery and labor room | 322,118 | 158,336 | -- | -- | 480,454 | 291,102 | 114,811 | -- | -- | 405,913 |
| Aide | -- | 32,236 | -- | -- | 32,236 | -- | 34,807 | -- | -- | 34,807 |
| | 1,539,869 | 12,389,132 | -- | -- | 13,929,001 | 1,250,985 | 12,178,488 | -- | -- | 13,429,473 |
| **OTHER PROFESSIONAL SERVICES:** | | | | | | | | | | |
| Pharmacy | 1,387,843 | 6,621,164 | -- | -- | 8,009,007 | 1,238,108 | 7,378,665 | -- | -- | 8,616,773 |
| Laboratory | 469,987 | 4,017,423 | -- | -- | 4,487,410 | 498,929 | 4,017,037 | -- | -- | 4,515,966 |
| CT scans | 162,013 | 2,976,816 | -- | -- | 3,138,829 | 153,549 | 3,275,963 | -- | -- | 3,429,512 |
| Physical, occupational and respiratory therapy | 912,213 | 1,935,417 | -- | -- | 2,847,630 | 1,023,409 | 1,863,511 | -- | -- | 2,886,920 |
| Anesthesiology | 294,976 | 2,345,783 | -- | -- | 2,640,759 | 255,415 | 2,268,471 | -- | -- | 2,523,886 |
| Radiology | 37,226 | 1,682,604 | -- | -- | 1,719,830 | 43,800 | 1,743,212 | -- | -- | 1,787,012 |
| MRI | 16,183 | 1,295,800 | -- | -- | 1,311,983 | 41,779 | 1,123,919 | -- | -- | 1,165,698 |
| Ambulance | 33,775 | 1,519,345 | -- | -- | 1,553,120 | 30,821 | 1,566,172 | -- | -- | 1,596,993 |
| EKG | 13,484 | 1,097,604 | -- | -- | 1,111,088 | 18,031 | 1,096,438 | -- | -- | 1,114,469 |
| Chemotherapy | 99,154 | 1,448,848 | -- | -- | 1,548,002 | 83,430 | 1,536,868 | -- | -- | 1,620,298 |
| Nuclear medicine | 28,237 | 590,334 | -- | -- | 618,571 | 56,794 | 598,590 | -- | -- | 655,384 |
| Ultrasound | 28,536 | 825,193 | -- | -- | 853,729 | 50,322 | 823,534 | -- | -- | 873,856 |
| Central supply | 9,662 | 480 | -- | -- | 10,142 | 181,570 | 327,158 | -- | -- | 508,728 |
| Clinic | -- | -- | 421,996 | -- | 421,996 | -- | -- | 431,344 | -- | 431,344 |
| | 3,493,289 | 26,356,811 | 421,996 | -- | 30,272,096 | 3,675,957 | 27,619,538 | 431,344 | -- | 31,726,839 |
| Gross patient service revenue | $ 7,194,505 | 38,745,943 | 421,996 | 2,298,573 | 48,661,017 | 7,065,874 | 39,798,026 | 431,344 | 2,319,980 | 49,615,224 |
| **LESS: DEDUCTIONS FROM PATIENT SERVICE REVENUE** | | | | | | | | | | |
| Contractual allowances and other deductions, primarily Medicare and Medicaid | | | | | (19,251,787) | | | | | (18,723,572) |
| Charity care services | | | | | (164,278) | | | | | (183,031) |
| **NET PATIENT SERVICE REVENUE BEFORE PROVISION FOR BAD DEBT** | | | | | 29,244,952 | | | | | 30,708,621 |
| Provision for bad debt | | | | | (1,128,277) | | | | | (1,497,821) |
| **NET PATIENT SERVICE REVENUE** | | | | | $ 28,116,675 | | | | | $ 29,210,800 |

*See accompanying independent auditor’s report*

 

## Other Operating Revenue
## For the Years Ended June 30, 2012 and 2011

| | 2012 | 2011 |
|---|---|---|
| Electronic health record incentive payments | $ 844,702 | - |
| Public health grants | 451,171 | 593,730 |
| Miscellaneous | 336,281 | 253,212 |
| Dietary | 192,371 | 182,983 |
| Ideal protein | 179,908 | 281,235 |
| Professional services to others | 177,603 | 168,834 |
| Management services, physician billings | 163,307 | 135,386 |
| Rental income | 60,967 | 60,967 |
| Reference lab | 750 | 13,777 |
| | $ 2,407,060 | 1,690,124 |

*See accompanying independent auditor's report*

Henry County Soldiers' and Sailors' Memorial Hospital d/b/a

**Exhibit 3**

## Henry County Health Center

### Departmental Expenses
### For the Years Ended June 30, 2012 and 2011

| | 2012 | | | | 2011 | | | |
|---|---|---|---|---|---|---|---|---|
| | Salaries and Wages | Professional Fees | Supplies and Other | TOTAL | Salaries and Wages | Professional Fees | Supplies and Other | TOTAL |
| **NURSING SERVICES:** | | | | | | | | |
| Operating and recovery room | $ 1,886,025 | 568 | 1,599,472 | 3,486,065 | 1,772,893 | 180 | 1,601,932 | 3,375,005 |
| Medical and surgical | 1,478,285 | 86,311 | 653,657 | 2,218,253 | 1,581,972 | 60,490 | 624,677 | 2,267,139 |
| Long-term care | 1,164,471 | 1,441 | 573,373 | 1,739,285 | 1,168,295 | 27,815 | 562,256 | 1,758,366 |
| Emergency room | 585,592 | 1,297,565 | 242,660 | 2,125,817 | 561,568 | 1,377,023 | 263,415 | 2,202,006 |
| Nursing administration | 123,122 | 100 | 72,012 | 195,234 | 311,384 | -- | 96,763 | 408,147 |
| | 5,237,495 | 1,385,985 | 3,141,174 | 9,764,654 | 5,396,112 | 1,465,508 | 3,149,043 | 10,010,663 |
| **OTHER PROFESSIONAL SERVICES:** | | | | | | | | |
| Pharmacy | 360,431 | -- | 2,130,330 | 2,490,761 | 303,687 | -- | 2,434,294 | 2,737,981 |
| Physical, occupational and speech therapy | 214,004 | 568,745 | 132,021 | 914,770 | 239,728 | 505,940 | 138,894 | 884,562 |
| Laboratory | 419,916 | 163,696 | 680,484 | 1,264,096 | 417,610 | 147,651 | 692,833 | 1,258,094 |
| Ambulance | 580,580 | -- | 376,431 | 957,011 | 609,860 | 1,710 | 368,060 | 979,630 |
| Anesthesiology | 689,142 | -- | 182,196 | 871,338 | 683,408 | -- | 171,348 | 854,756 |
| Community health | 406,927 | 731 | 232,692 | 640,350 | 402,958 | 13,676 | 229,591 | 646,225 |
| Radiology | 294,009 | -- | 828,169 | 1,122,178 | 300,837 | -- | 757,399 | 1,058,236 |
| Respiratory therapy | 244,392 | 7,873 | 129,807 | 382,072 | 267,358 | 7,660 | 150,062 | 425,080 |
| EKG | 194,271 | 3,633 | 69,239 | 267,143 | 191,342 | 2,270 | 54,239 | 247,851 |
| Medical and surgical supplies | 116,924 | -- | 110,998 | 227,922 | 117,244 | 120 | 200,951 | 318,315 |
| CT scans | 40,312 | -- | 318,277 | 358,589 | 40,389 | -- | 323,083 | 363,472 |
| Physician offices | 125,750 | -- | 39,889 | 165,639 | 109,163 | -- | 31,047 | 140,210 |
| Chemotherapy | 181,967 | 181,684 | 88,324 | 451,975 | 176,125 | 217,033 | 80,766 | 473,924 |
| Nuclear medicine | 17,703 | -- | 110,468 | 128,171 | 17,116 | -- | 104,130 | 121,246 |
| Ultrasound | 72,775 | -- | 34,075 | 106,850 | 75,109 | -- | 31,779 | 106,888 |
| Clinic | 143,312 | 39,298 | 101,161 | 283,771 | 156,871 | 14,321 | 130,643 | 301,835 |
| | 4,102,415 | 965,660 | 5,564,561 | 10,632,636 | 4,108,805 | 910,381 | 5,899,119 | 10,918,305 |
| **GENERAL SERVICES:** | | | | | | | | |
| Plant | 352,573 | -- | 1,130,156 | 1,482,729 | 361,125 | -- | 1,310,878 | 1,672,003 |
| Dietary | 379,430 | -- | 517,018 | 896,448 | 377,367 | -- | 518,181 | 895,548 |
| Housekeeping | 362,291 | -- | 278,765 | 641,056 | 338,923 | -- | 263,783 | 602,706 |
| Laundrty and linen | 14,332 | -- | 104,818 | 119,150 | 18,175 | -- | 83,781 | 101,956 |
| | 1,108,626 | -- | 2,030,757 | 3,139,383 | 1,095,590 | -- | 2,176,623 | 3,272,213 |
| **ADMINISTRATIVE SERVICES:** | | | | | | | | |
| Finance | 233,735 | -- | 172,598 | 406,333 | 228,448 | -- | 152,482 | 380,930 |
| Patient accounts | 237,309 | -- | 224,530 | 461,839 | 230,786 | -- | 225,162 | 455,948 |
| Regisration | 282,273 | -- | 117,526 | 399,799 | 273,199 | -- | 101,556 | 374,755 |
| Information technology | 237,167 | -- | 762,208 | 999,375 | 245,237 | -- | 701,001 | 946,238 |
| Administration | 304,380 | -- | 788,887 | 1,093,267 | 331,566 | -- | 815,456 | 1,147,022 |
| Human resources | 163,978 | -- | 117,191 | 281,169 | 163,825 | -- | 140,029 | 303,854 |
| Medical records | 272,668 | -- | 103,359 | 376,027 | 274,748 | -- | 113,865 | 388,613 |
| Other adminisrative services | 384,266 | 5,361 | 485,275 | 874,902 | 169,526 | 5,500 | 296,323 | 471,349 |
| | 2,115,776 | 5,361 | 2,771,574 | 4,892,711 | 1,917,335 | 5,500 | 2,545,874 | 4,468,709 |
| **NONDEPARTMENTAL:** | | | | | | | | |
| Depreciation and amortization | -- | -- | 1,838,794 | 1,838,794 | -- | -- | 1,974,646 | 1,974,646 |
| Interest | -- | -- | 192,012 | 192,012 | -- | -- | 228,017 | 228,017 |
| | -- | -- | 2,030,806 | 2,030,806 | -- | -- | 2,202,663 | 2,202,663 |
| **TOTAL EXPENSES** | $ 12,564,312 | 2,357,006 | 15,538,872 | 30,460,190 | 12,517,842 | 2,381,389 | 15,973,322 | 30,872,553 |

*See accompanying independent auditor's report*

## Patient Receivables and Allowance for Doubtful Accounts
## For the Years Ended June 30, 2012 and 2011

ANALYSIS OF AGING:

| | | 2012 | | 2011 | |
|---|---|---|---|---|---|
| Days Since Discharge | | Amount | Percent of Total | Amount | Percent of Total |
| 0-30 | $ | 3,729,186 | 66.92 % | 3,992,834 | 67.25 % |
| 31-60 | | 610,174 | 10.95 | 644,850 | 10.86 |
| 61-90 | | 271,072 | 4.86 | 320,751 | 5.40 |
| 91-120 | | 233,598 | 4.19 | 244,514 | 4.12 |
| 121 and over | | 728,585 | 13.08 | 734,682 | 12.37 |
| | | 5,572,615 | 100.00 % | 5,937,631 | 100.00 % |
| Less: | | | | | |
| Allowance for doubtful accounts | | (920,000) | | (1,100,000) | |
| Allowance for contractual adjustments | | (1,640,077) | | (1,445,000) | |
| | $ | 3,012,538 | | 3,392,631 | |

| | | 2012 | 2011 |
|---|---|---|---|
| ALLOWANCE FOR DOUBTFUL ACCOUNTS: | | | |
| Balance, beginning of year | $ | (1,100,000) | (1,030,000) |
| Provision of uncollectible accounts | | 1,128,277 | 1,497,821 |
| Recoveries of accounts previously written off | | 422,883 | 420,521 |
| Accounts written off | | (1,371,160) | (1,988,342) |
| Balance, end of year | $ | (920,000) | (1,100,000) |

*See accompanying independent auditor's report*

## Inventory/Prepaid Expenses
## For the Years Ended June 30, 2012 and 2011

| | 2012 | 2011 |
|---|---|---|
| INVENTORY: | | |
| Pharmacy | $ 301,973 | 303,953 |
| Central service | 82,214 | 66,438 |
| Surgery | 186,925 | 209,092 |
| Other | 7,066 | 11,779 |
| | $ 578,178 | 591,262 |
| PREPAID EXPENSES: | | |
| Deposits | $ 103,138 | 101,096 |
| Service contracts | 88,986 | 80,860 |
| Insurance | 75,504 | 137,623 |
| Other | 99,575 | 51,062 |
| | $ 367,203 | 370,641 |

*See accompanying independent auditor's report*

## Financial and Statistical Highlights
## For the Years Ended June 30, 2012 and 2011

| | 2012 | 2011 |
|---|---|---|
| Patient days: | | |
| Adult and pediatric - | | |
| Medicare | 780 | 792 |
| All other | 663 | 789 |
| Swing-bed - | | |
| Skilled | 766 | 841 |
| Intermediate | 48 | 1 |
| Newborn | 296 | 280 |
| Long-term care | 15,121 | 16,100 |
| Total | 17,674 | 18,803 |
| Patient discharges: | | |
| Hospital adult and pediatric - | | |
| Medicare | 241 | 255 |
| All other | 262 | 291 |
| Total | 503 | 546 |
| Average length of stay (based on discharge days): | | |
| Hospital adult and pediatric - | | |
| Medicare | 3.24 days | 3.10 days |
| All other | 2.53 days | 2.71 days |
| Surgical procedures | 2,137 | 2,370 |
| Emergency room visits | 8,450 | 8,777 |
| Number of employees - full-time equivalents | 264.20 | 262.58 |

*See accompanying independent auditor's report*

SEIM JOHNSON

# Independent Auditor's 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

To the Board of Trustees
Henry County Soldiers' and Sailors' Memorial Hospital
d/b/a Henry County Health Center
Mt. Pleasant, Iowa:

We have audited the financial statements of Henry County Soldiers' and Sailors' Memorial Hospital d/b/a Henry County Health Center (Health Center) as of and for the years ended June 30, 2012 and 2011, and have issued our report thereon, dated October 8, 2012. 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*

Management of the Health Center is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Health Center'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 Center's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Health Center'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 entity'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 a certain deficiency in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs as item II-A-12, that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or 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 Health Center's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.



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Comments involving statutory and other legal matters about the Health Center's operations for the year ended June 30, 2012 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Health Center. 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.

We noted certain matters that we reported to management of the Hospital in a separate letter dated October 8, 2012.

The Health Center's responses to findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the Health Center'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, customers and taxpayers of the Health Center and other parties to whom the Health Center may report, including federal awarding agencies and pass-through entities. 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 the personnel of the Health Center 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.

SEIM JOHNSON, LLP

Omaha, Nebraska,
October 8, 2012.

## Schedule of Findings and Questioned Costs
## For the Year Ended June 30, 2012

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

(a) An unqualified opinion was issued on the financial statements.

(b) A significant deficiency in internal control over financial reporting was disclosed by the audit of the financial statements.

(c) The audit did not disclose any non-compliance which is material to the financial statements.

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

**II-A-12**

***Instances of Non-Compliance:***

No matters were reported.

***Significant Deficiencies:***

Segregation of Duties: One important aspect of internal controls is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. The limited number of office personnel prevents a proper segregation of accounting functions necessary to assure optimal internal control. Due to a limited number of administrative personnel, a lack of segregation of duties exists.

Recommendation: Proper segregation of duties ensures an adequate internal control structure and, without this segregation, a greater risk of fraud and defalcation may exist. We recommend the Health Center continue to monitor and improve its segregation of duties.

Response: Management is aware of this deficiency in internal control and believes it is economically not feasible for the Health Center to employ additional personnel for the purpose of greater segregation of duties. The Health Center will continue to maintain and improve its segregation of duties.

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

**III-A-12**

Official Depositories: A resolution naming official depositories has been adopted by the Board. The maximum deposit amounts stated in the resolution were not exceeded during the year ended June 30, 2012.

**III-B-12**

Certified Budget: Health Center disbursements during the year ended June 30, 2012 did not exceed amounts budgeted.

**III-C-12**

Questionable Expenditure: We noted no expenditures that may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979.

**III-D-12**

Travel Expense: No expenditures of Health Center money for travel expenses of spouses of Health Center officials and/or employees were noted.

**Schedule of Findings and Questioned Costs**
**For the Year Ended June 30, 2012**

**III-E-12**

Business Transactions: No business transactions between the Health Center and Health Center officials and/or employees were noted to violate Chapter 347.9A(2)(a) of the Code of Iowa which limits a trustee's pecuniary interest in the purchase or sale of any commodities or supplies procured for or disposed of by said Health Center to $1,500 without publicly invited and opened written competitive bids.

**III-F-12**

Board Minutes: No transactions were found that we believe should have been approved in the Board minutes but were not.

**III-G-12**

Deposits and Investments: We noted no instances of noncompliance with the deposit and investment provisions of Chapter 12B and Chapter 12C of the Code of Iowa and the Health Center's investment policy.

**III-H-12**

Publication of Bills Allowed and Salaries: Chapter 347.13(11) of the Code of Iowa states in part, "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 newspaper the schedule of salaries paid by job classification and category…" We noted no instances of noncompliance with the publication of bills allowed and salaries. The Health Center publishes a list of expenditures quarterly which are summarized by major classification and vendor. They also publish a schedule of salaries annually by category.

## Summary Schedule of Prior Year Audit Findings
## For the Year Ended June 30, 2012

| Finding | Finding title | Status | If not corrected, corrective action plan or other explanation |
|---|---|---|---|
| II-A-11 | Segregation of duties in the accounting and data processing areas. | Not corrected. | Management is aware of this deficiency in internal control and believes it is economically not feasible for the Health Center to employ additional personnel for the purpose of greater segregation of duties. The Health Center will continue to maintain and improve its segregation of duties. Similar finding reported at II-A-12. |

## Audit Staff
## For the Year Ended June 30, 2012

**This audit was performed by:**

Brian D. Green, FHFMA, CPA, Partner

Jeremy J. Behrens, CHFP, CPA, Senior Manager

Marcus P. Goldenstein, In-Charge

SEIM JOHNSON

October 8, 2012

To the Board of Trustees
Henry County Soldiers' and Sailors' Memorial Hospital
d/b/a Henry County Health Center
Mt. Pleasant, Iowa:

In planning and performing our audit of the financial statements of Henry County Soldiers' and Sailors' Memorial Hospital d/b/a Henry County Health Center (Health Center) as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the Health Center's internal control over financial reporting (internal control) 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 Health Center's internal control. Accordingly, we do not express an opinion on the effectiveness of Health Center's internal control.

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 entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weakness, as defined above. However, we identified a certain deficiency in internal control that we consider to be significant deficiency. 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.

**Segregation of Duties over Financial Reporting**

One important aspect of internal control over financial reporting is segregation of duties among employees to prevent an individual employee the ability to circumvent the system of internal control. In reviewing the process and controls of the Health Center, due to a limited number of administrative personnel, a lack of segregation of duties exists. Proper segregation of duties ensures an adequate internal control structure and, without this segregation, a greater risk of fraud and defalcation may exist. We recommend the Health Center continue to monitor and improve its segregation of duties.

Management is aware of this deficiency in internal control and believes it is economically not feasible for the Health Center to employ additional personnel for the purpose of greater segregation of duties. The Health Center will continue to maintain and improve its segregation of duties.

---

Following are descriptions of other identified control deficiencies that we determined did not constitute significant deficiencies or material weaknesses:

**Estimation Process and Accrued Vacation**

During the audit we recommended audit journal entries related to the incurred but not reported health care claims accrual and to the accrual for paid time off. The entry to the incurred but not reported health care claims was a result of unusually high claims paid in July 2012 related to the fiscal year 2012. We recommend that management review its process for estimating incurred but not report health care claims at year end. The entry to the accrual for paid time off was a result of certain employees being inadvertently removed for the accrual as a result of changes in their employment contracts. We recommend that management review all new employment contracts as well as amendments to existing contracts to ensure that accrued paid time off is properly recorded.

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The following are offered as constructive suggestions to be considered part of the ongoing process of modifying and improving the Health Center's policies and procedures:

**Healthcare Reform**

On March 23, 2011, President Obama signed into law the Patient Protection and Affordable Care Act, and on March 30, 2011 he signed the Healthcare and Education Reconciliation Act of 2011. Many are suggesting this legislative change is the greatest to impact healthcare in our country since the enactment of Medicare. Key legislative provisions include the following:

- Insurance coverage provided to uninsured or underinsured 32 million Americans by 2019.

  Medicare cost cutting provisions by reducing market basket update adjustments and Medicare and Medicaid DSH payments.
- Delivery system reforms including implementation of value-based purchasing, reduced payments for high volumes of hospital acquired conditions and readmissions, and pilot programs to test bundled payments and medical homes concepts.
- Expansion of Medicaid.
- New criteria for not-for-profit providers to retain tax-exempt status:
  - Conduct community needs assessment every two years and execute against it.
  - Develop, implement and communicate charity care policy.
  - Limit charges for emergency or other medically necessary care provided to individuals eligible for charity care to the lowest amounts charged to individuals with insurance.
  - Use aggressive collection efforts only after attempts to determine eligibility for charity care have been exhausted.
- Mandates will be given to individuals that will require or penalize those without insurance.
- Mandates will be given to businesses to provide health insurance coverage or be penalized.

Implementation of these reform packages will occur over the next decade. We encourage management and the Board of Trustees to continue to gather more information about the reform legislation and prepare analysis regarding payment changes to best plan for the future needs of your community.

**Accounting for Leases**

The International Accounting Standards Board (IASB), the body responsible for setting International Financial Reporting Standards (IFRS), and the Financial Accounting Standards Board (FASB), the body responsible for setting accounting principles generally accepted in the United States of America, issued a Proposed Accounting Standards Update on August 17, 2010 to Topic 840, *Leases* in response to concerns raised by users of financial statements regarding the treatment of leases. Existing lease accounting treatment has been criticized for its complexity on the basis that it has proved difficult to define the dividing line between capital and operating leases, as the current standards require the application of subjective judgments.

This proposal would apply a right-of-use model in accounting for all leases with a few exceptions. For leases within the scope of the standard, the following guidance would apply to lessees:

- A lessee would recognize an asset representing its right to use the leased asset for the lease term and a liability to make lease payments
- A lessor would recognize an asset representing its right to receive lease payments and, depending on its exposure to risks and benefits, would either:
  - Recognize a liability while continuing to recognize the underlying asset; or
  - Derecognize the asset and continue to recognize a residual asset representing rights to the asset at the end of the lease term

The lease term would be determined assuming the longest possible lease term that is more likely than not to occur. The measurement basis would use an expected outcome technique to reflect lease payments, including contingent rentals and expected payments under term option penalties and residual value guarantees. Those measurement bases would be updated when changes in facts or circumstances indicate that there would be a significant change in those assets or liabilities since the previous reporting period. Leases with terms of 12 months or less would be subject to simplified requirements.

In July 2011, IASB and FASB announced their intention to re-expose their revised proposals for a common leasing standard in order to allow interested parties an opportunity to comment on the revisions the boards have undertaken since publication of the initial exposure draft. In June 2012, the IASB and FASB voted on the lessee accounting approach that would be included in the next exposure draft, in which they agreed on a dual expense-recognition approach. Some assets would be treated as the purchase of a right-of-use asset in which a nonfinancial asset would be measured at cost, less accumulated amortization. The amortization charge on the asset and the interest expense on the liability would be the total lease expense for the period. Other contracts would be considered as payment for access to and use of the asset over time. The total lease payments would be allocated over the term of the lease and equal amounts would be expensed in each period. Equipment leases would be presumed to be accounted for on the right-of-use approach while real estate leases would be accounted for using the straight-line presentation unless the term or payments account for a substantially all of the life or value of the asset.

There currently is no indication of a proposed effective date. Although these provisions will most likely not be adopted in the near future, it would be prudent for businesses to plan ahead on the basis that the current accounting rules are expected to change, especially when they are negotiating long-term leases or loan facilities with financial covenants that could be impacted by these changes.

**Revenue Cycle Disclosures**

On October 6, 2011, the Financial Accounting Standards Board issued a Proposed Accounting Standards Update to Topic 954, *Health Care Entities*. The proposed update, *Disclosure about Net Revenue and Allowance for Doubtful Accounts*, would increase required disclosures. Enhanced disclosures would be disaggregated by major payor sources and would include the policies assessing collectability in the timing and amounts of recognition for bad debt expense and a tabular reconciliation of the activity in the allowance for doubtful accounts for the period. Additionally, the major payor sources of net revenue by major payor type will need to be disclosed. Although the proposal did not state a proposed effective date, we recommend management evaluate their ability to track the required information for each payor class.

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This communication is intended solely for the information and use of the Board of Trustees and management within the organization and is not intended to be and should not be used by anyone other than these specified parties. We would be pleased to answer any questions you may have regarding the comments and suggestions contained in the preceding paragraphs.

We would like to thank you and your staff for all the cooperation extended to us during the audit.

SEIM JOHNSON, LLP

Omaha, Nebraska,
October 8, 2012.