

FAYETTE COUNTY MEMORIAL HOSPITAL

FINANCIAL STATEMENTS

DECEMBER 31, 2008 AND 2007



Mary Taylor, CPA
Auditor of State

Board of Trustees
Fayette County Memorial Hospital
1430 Columbus Ave
Washington Court House, Ohio 43160

We have reviewed the *Report of Independent Auditors* of Fayette County Memorial Hospital, prepared by Blue & Co., LLC, for the audit period January 1, 2008 through December 31, 2008. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

Our review was made in reference to the applicable sections of legislative criteria, as reflected by the Ohio Constitution, and the Revised Code, policies, procedures and guidelines of the Auditor of State, regulations and grant requirements. Fayette County Memorial Hospital is responsible for compliance with these laws and regulations.

Mary Taylor

Mary Taylor, CPA
Auditor of State

September 16, 2009

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FAYETTE COUNTY MEMORIAL HOSPITAL

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Blue & Co., LLC / 8800 Lyra Drive, Suite 450 / Columbus, OH 43240
main 614.885.BLUE (2583) fax 614.885.0580 email blue@blueandco.com

REPORT OF INDEPENDENT AUDITORS

Board of Trustees
FAYETTE COUNTY MEMORIAL HOSPITAL
Washington Court House, Ohio

We have audited the accompanying balance sheets of Fayette County Memorial Hospital (the "Hospital"), a part of the primary government of Fayette County, Ohio as of December 31, 2008 and 2007, and the related statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital'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 audits 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 discussed in Note 1, the financial statements of Fayette County Memorial Hospital are intended to present the financial position and the changes in financial position and cash flows of only that portion of the business-type activities of Fayette County, Ohio that is attributable to the transactions of Fayette County Memorial Hospital. They do not purport to, and do not, present fairly the financial position of Fayette County, Ohio, and the changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fayette County Memorial Hospital at December 31, 2008 and 2007, and the results of its operations, changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods and measurement and presentation of the required supplementary information. However, we did not audit the information and, accordingly, do not express an opinion thereon.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 10, 2009, on our consideration of the Hospital's internal control over financial reporting and on 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, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Blue & Co., LLC

August 10, 2009

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Management's Discussion and Analysis

The discussion and analysis of Fayette County Memorial Hospital's (the Hospital) financial statements provides an overview of the Hospital's financial activities for the years ended December 31, 2008, 2007 and 2006. Management is responsible for the completeness and fairness of the financial statements and the related footnote disclosures along with the discussion and analysis.

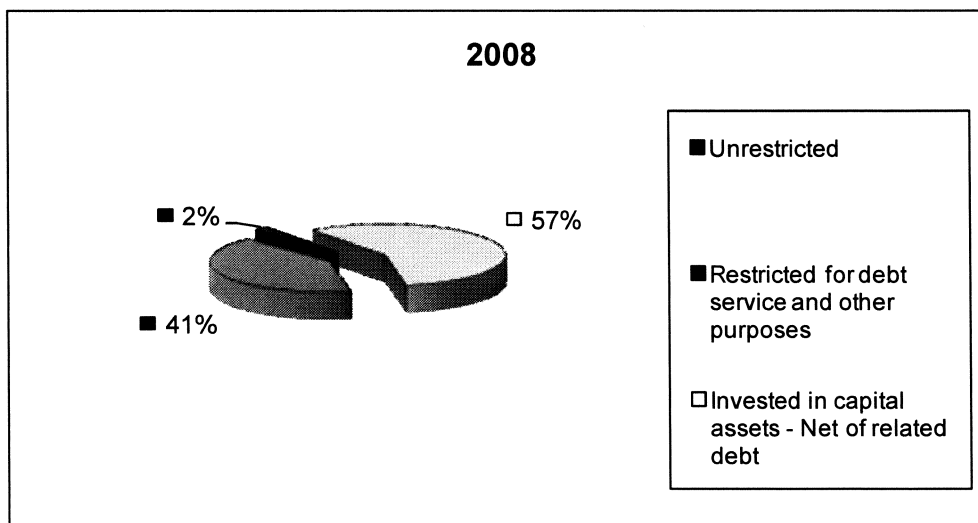
Using this Annual Report

The Hospital's financial statements consist of the three statements – Balance Sheet, a Statement of Operations and Changes in Net Assets, and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Hospital, including resources held by the Hospital but restricted for specific purpose by contributors, grantors, or enabling legislation.

Financial Highlights

Cash and investments decreased approximately \$601,000 while accounts receivables decreased approximately \$1,228,000. In total, the Hospital's expenses exceeded revenues and other support, creating a decrease in net assets of \$1,688,176 (compared to an increase of \$767,912 in the previous year).

The following chart provides a breakdown of net assets by category for the year ended December 31, 2008:



FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

The Balance Sheet and the Statement of Operations and Changes in Net Assets

One of the most important questions asked about the Hospital's finances is, "Is the Hospital as a whole better off or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Operations and Changes in Net Assets report information on the Hospital as a whole and on its activities in a way that helps answer this question. When revenue and other support exceed expenses, the result is an increase in net assets. When the reverse occurs, the result is a decrease in net assets. The relationship between revenue and expenses may be thought of as the Hospital's operating results.

These two statements report the Hospital's net assets and changes in them. You can think of Hospital's net assets – the difference between assets and liabilities – as a way to measure the Hospital's financial health, or financial position. Over time, an increase or decrease in the Hospital's net assets are indicators of whether its financial health is improving or deteriorating. You will need to consider many other non-financial factors, such as the trend in patient days, outpatient visits, conditions of the buildings, and strength of the medical staff, to assess the overall health of the Hospital.

The statements include all assets and liabilities using the accrual basis of accounting. All of the current year's revenue and expenses are taken in to account regardless of when cash is received or paid.

**FAYETTE COUNTY MEMORIAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS
(UNAUDITED)**

Condensed Financial Information

The following is a comparative analysis of the major components of the Balance Sheet of the Hospital as of December 31, 2008, 2007, and 2006.

Assets, Liabilities and Net Assets

	December 31		
	2008	2007	2006
Current assets	\$ 8,160,409	\$ 9,411,047	\$ 8,685,051
Noncurrent assets	4,900,006	4,478,659	3,410,098
Capital assets	12,970,371	13,448,839	12,389,103
Total assets	\$ 26,030,786	\$ 27,338,545	\$ 24,484,252
Current liabilities	\$ 6,436,719	\$ 6,235,658	\$ 4,340,642
Long-term debt	4,502,123	4,322,767	4,131,402
Total liabilities	\$ 10,938,842	\$ 10,558,425	\$ 8,472,044
Net assets			
Invested in capital assets, net of debt	\$ 8,647,605	\$ 8,775,207	\$ 8,033,792
Restricted	269,019	219,471	219,471
Unrestricted	6,175,320	7,785,442	7,758,945
Total net assets	\$ 15,091,944	\$ 16,780,120	\$ 16,012,208

The primary changes in the assets, liabilities and net assets relates to the decrease in accounts receivable of \$1,227,573, a reduction in amounts payable under line of credit of \$750,000, an increased liability for estimated third-party settlements of \$515,450, and a loss from operations of \$1,782,759.

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Operating Results and Changes in Net Assets

	Year Ended		
	2008	2007	2006
Operating revenues			
Net patient service revenues	\$ 31,811,135	\$ 33,178,073	\$ 30,870,961
Other	80,286	65,044	80,717
Total operating revenues	31,891,421	33,243,117	30,951,678
Operating expenses			
Salaries and wages	15,104,441	13,737,028	11,888,791
Benefits	4,976,933	4,321,526	3,943,772
Physicians fees	431,464	1,593,512	1,692,450
Other fees	3,386,611	2,957,425	3,159,801
Supplies	4,909,440	5,137,772	4,721,667
Depreciation and amortization	1,670,424	1,383,908	1,321,517
Other expenses	3,194,867	3,448,542	3,282,698
Total operating expenses	33,674,180	32,579,713	30,010,696
Income (loss) from operations	(1,782,759)	663,404	940,982
Non-operating gains - net	94,583	104,508	69,029
Change in net assets	(1,688,176)	767,912	1,010,011
Net assets - beginning of year	16,780,120	16,012,208	15,002,197
Net assets - end of year	\$ 15,091,944	\$ 16,780,120	\$ 16,012,208

Operating Revenues

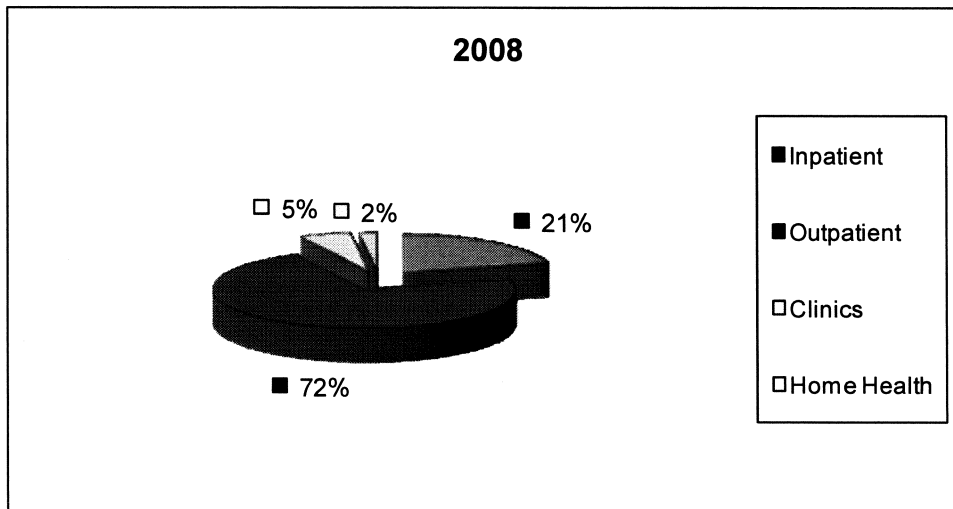
Operating revenues include all transactions that result in the sales and/or receipts from goods and services such as inpatient services, outpatient services, physician's offices, and the cafeteria. In addition, certain federal, state, and private grants are considered operating if they are not for capital purposes and are considered a contract for services.

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Operating revenue changes were a result of the following factors:

- Net patient service revenue decreased 4.1%. Gross patient revenue is reduced by revenue deductions. These deductions are the amounts that are not paid to the Hospital under contractual arrangements primarily with Medicare, Medicaid, UHC, Medical Mutual, and various other commercial payors. These revenue deductions were approximately 54% and 51% of gross revenue in 2008 and 2007, respectively. The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Charity care provided during 2008 amounted to \$1,955,395, a 3% percent decrease from 2007.

The following is a graphic illustration of operating revenues by source:



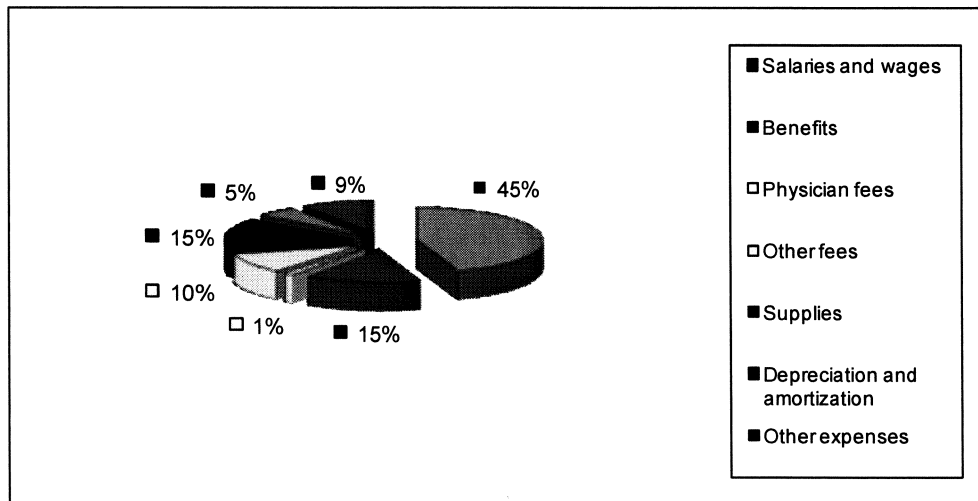
FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Operating Expenses

Operating expenses are all the costs necessary to perform and conduct the services of the Hospital. The operating expense changes were the result of the following factors:

- Salary costs increased 10.0%.
- Benefit costs increased 15.2%.

The following is a graphic illustration of 2008 operating expenses by type:



Non-Operating Gains - net

Non-operating gains and losses are all sources and uses that are primarily non-exchange in nature. They would consist primarily of income from the operations of the medical office building (rents), investment income (including realized and unrealized gains and losses), grants and contracts and interest expense that do not require any services to be performed.

**FAYETTE COUNTY MEMORIAL HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS
(UNAUDITED)**

Statement of Cash Flows

Another way to assess the financial health of a Hospital is to look at the Statement of Cash Flows. Its primary purpose is to provide relevant information about the cash receipts and cash payments of an entity during a period. The statement of Cash Flows also helps assess:

- An entity's ability to generate future net cash flows
- Its ability to meet its obligations as they come due
- Its need for external financing

	2008	2007	2006
Cash from			
Operating activities	\$ 1,857,876	\$ 1,174,328	\$ 2,029,992
Capital and related financing activities	(2,453,445)	(837,236)	(1,026,472)
Non-capital and related financing activities	248,225	237,949	348,526
Investing activities	(306,332)	(816,276)	(465,027)
Net change in cash and cash equivalents	(653,676)	(241,235)	887,019
Cash - Beginning of year	2,690,346	2,931,581	2,044,562
Cash - End of year	\$ 2,036,670	\$ 2,690,346	\$ 2,931,581

Cash provided by operating activities was \$1,857,876 in 2008 compared to \$1,174,328 in 2007.

Capital purchases were \$1,074,528 in 2008.

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Capital Assets and Debt Administration

Capital Assets

At December 31, 2008, the Hospital had \$28.1 million invested in capital assets, with an accumulated depreciation of \$15.1 million. Depreciation and amortization totaled \$1.5 million for the current year compared to \$1.3 million last year. Details of these assets for the past three years are shown below:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Land	\$ 519,750	\$ 519,750	\$ 519,750
Land improvements	624,690	624,690	624,690
Buildings	15,013,734	15,013,734	14,615,603
Fixed equipment	1,790,393	1,792,376	1,754,516
Major movable equipment	8,733,080	9,232,357	8,845,149
Construction in progress	<u>1,416,782</u>	<u>795,336</u>	<u>42,122</u>
Total	<u>\$ 28,098,429</u>	<u>\$ 27,978,243</u>	<u>\$ 26,401,830</u>

Debt

At year-end, the Hospital had \$4,322,766 in debt outstanding, as compared to \$4,673,632 in 2007. The table below summarizes these amounts by type of debt instrument:

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Notes payable	\$ 3,780,000	\$ 3,945,000	\$ 4,105,000
Lease obligation	<u>542,766</u>	<u>728,632</u>	<u>250,311</u>
Total notes and leases	<u>\$ 4,322,766</u>	<u>\$ 4,673,632</u>	<u>\$ 4,355,311</u>

In addition, the Hospital entered into a line-of-credit agreement in 2007 that expires in December 2009. Borrowings under the line-of-credit were \$750,000 and \$1,500,000 at December 31, 2008 and 2007, respectively.

More detailed information about the Hospital's long-term liabilities is presented in the footnotes to the financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

The Hospital is bound by the terms of the Trust Indenture and Reimbursement Agreement to various operations and financial covenants. These covenants include maintaining a minimum debt service ratio of 1.25 to 1.00, and minimum days cash on hand of 70. The Hospital was not in compliance with certain covenants as of December 31, 2008. The Hospital obtained a waiver from the respective lending institution for the year ended December 31, 2008 and the quarter ended March 31, 2009. The covenants were modified in 2009 to the following:

	<u>Debt Service Coverage Ratio</u>	<u>Days Cash on Hand</u>
Quarter ended June 30, 2009	1.00 to 1.00	40 days
Quarter ended September 30, 2009	1.10 to 1.00	42 days
Quarter ended December 31, 2009	1.15 to 1.00	45 days
Quarter ended March 31, 2010 and thereafter	1.25 to 1.00	50 days

Contacting the Hospital's Management

This financial report is intended to provide the people of Fayette County, the state and federal governments, and our debt holders with a general overview of the Hospital's finances, and to show the Hospital's accountability for the money it receives from the services it provides. If you have questions about this report or need additional information, we welcome you to contact the Chief Financial Officer at 1430 Columbus Avenue, Washington Court House, Ohio 43160.

FAYETTE COUNTY MEMORIAL HOSPITAL

BALANCE SHEETS DECEMBER 31, 2008 AND 2007

ASSETS

	<u>2008</u>	<u>2007</u>
Current assets		
Cash and cash equivalents	\$ 1,708,082	\$ 2,439,598
Patient accounts receivable, net of uncollectible accounts of \$2,028,000 in 2008 and \$2,887,000 in 2007	4,763,626	5,991,199
Current portion of notes receivable	760,311	25,092
Inventories	765,936	768,622
Prepaid expenses and other current assets	162,454	186,536
Total current assets	<u>8,160,409</u>	<u>9,411,047</u>
Other assets		
Notes receivable	1,308,199	925,802
Other assets	188,178	329,311
Investments	3,134,610	3,004,075
Assets limited as to use	269,019	219,471
Capital assets, net	12,970,371	13,448,839
Total other assets	<u>17,870,377</u>	<u>17,927,498</u>
Total assets	<u><u>\$ 26,030,786</u></u>	<u><u>\$ 27,338,545</u></u>

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

BALANCE SHEETS
DECEMBER 31, 2008 AND 2007

LIABILITIES AND NET ASSETS

	<u>2008</u>	<u>2007</u>
Current liabilities		
Current portion of long-term debt	\$ 371,575	\$ 350,865
Payable under line-of-credit	750,000	1,500,000
Accounts payable	1,878,545	1,827,697
Accrued payroll and related benefits	1,699,725	1,550,153
Physician recruitment liability	586,874	372,393
Estimated third-party settlements	1,150,000	634,550
Total current liabilities	<u>6,436,719</u>	<u>6,235,658</u>
Other liabilities	550,932	-
Long-term debt	<u>3,951,191</u>	<u>4,322,767</u>
Total liabilities	<u>10,938,842</u>	<u>10,558,425</u>
Net assets		
Invested in capital assets - net of related debt	8,647,605	8,775,207
Restricted		
Expendable for debt service and other purposes	269,019	219,471
Unrestricted	<u>6,175,320</u>	<u>7,785,442</u>
Total net assets	<u>15,091,944</u>	<u>16,780,120</u>
Total liabilities and net assets	<u>\$ 26,030,786</u>	<u>\$ 27,338,545</u>

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
Operating revenue		
Net patient service revenue	\$ 31,811,135	\$ 33,178,073
Other operating revenue	80,286	65,044
	<u>31,891,421</u>	<u>33,243,117</u>
Operating expenses		
Salaries and wages	15,104,441	13,737,028
Employee benefits	4,976,933	4,321,526
Physician fees	431,464	1,593,512
Other fees	3,386,611	2,957,425
Supplies	4,909,440	5,137,772
Utilities	780,696	747,397
Maintenance and repairs	1,126,536	1,040,200
Leases and rentals	150,473	167,770
Insurance	400,859	383,040
Depreciation and amortization	1,670,424	1,383,908
Other expenses	736,303	1,110,135
Total operating expenses	<u>33,674,180</u>	<u>32,579,713</u>
Income (loss) from operations	(1,782,759)	663,404
Non-operating gains - net	94,583	104,508
Change in net assets	(1,688,176)	767,912
Net assets, beginning of year	<u>16,780,120</u>	<u>16,012,208</u>
Net assets, end of year	<u>\$ 15,091,944</u>	<u>\$ 16,780,120</u>

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2008 AND 2007

	2008	2007
Operating activities		
Cash received from patients and third party payors	\$ 33,554,158	\$ 32,714,174
Cash payments to suppliers for services and goods	(11,844,766)	(14,617,269)
Cash payments to employees for services	(19,931,802)	(16,987,621)
Other operating revenue received	80,286	65,044
Net cash flow from operating activities	1,857,876	1,174,328
Non-capital and related financing activities		
Donations and other	248,225	237,949
Capital and related financing activities		
Acquisition and construction of capital assets	(1,074,528)	(1,732,851)
Loss on disposal of capital assets	23,705	-
Interest expense	(301,756)	(293,456)
Proceeds from line-of-credit, net	(750,000)	1,500,000
Principal payments on long-term debt	(350,866)	(310,929)
Net cash from capital and related financing activities	(2,453,445)	(837,236)
Investing activities		
Other assets	-	(423,400)
Change in advances to physicians	(352,203)	(613,592)
Change in investments, net	(102,243)	48,155
Interest received on investments	148,114	172,561
Net cash from investing activities	(306,332)	(816,276)
Net change in cash and cash equivalents	(653,676)	(241,235)
Cash, beginning of year	2,690,346	2,931,581
Cash, end of year	\$ 2,036,670	\$ 2,690,346
Balance sheet classification of cash		
Current assets	\$ 1,708,082	\$ 2,439,598
Investments	59,569	31,277
Assets limited as to use	269,019	219,471
Total cash	\$ 2,036,670	\$ 2,690,346
A reconciliation of income (loss) from operations to net cash from operating activities		
Income (loss) from operations	\$ (1,782,759)	\$ 663,404
Adjustments to reconcile income (loss) from operations to net cash from operating activities:		
Bad debts	4,510,104	4,640,078
Depreciation and amortization	1,670,424	1,383,908
Changes in assets and liabilities		
Patient accounts receivable	(3,282,531)	(5,074,048)
Inventories	2,686	(442,286)
Prepaid expenses and other assets	24,082	(264,788)
Estimated third-party settlements	515,450	(29,929)
Accounts payable	50,848	(88,419)
Accrued payroll and related benefits	149,572	386,408
Net cash from operating activities	\$ 1,857,876	\$ 1,174,328
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 302,721	\$ 296,295
Capital assets acquired under capital leases	\$ -	\$ 629,250

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

Fayette County Memorial Hospital ("the Hospital") is a general short-term acute care facility, owned by Fayette County, Ohio, and operated by a Board of Trustees. The Hospital's activity is reflected as an enterprise fund in the Fayette County financial statements. In December, 2005, the Hospital obtained Critical Access status. Members of the Board of Trustees are appointed by the County Commissioners, the Probate Court Judge, and the Common Pleas Judge. There is an agreement with Mount Carmel Health System to provide a management team to oversee the operations of the Hospital.

Enterprise Fund Accounting

The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, as amended, the Hospital 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.

Cash and Cash Equivalents

Cash and cash equivalents include cash and investments in highly liquid investments purchased with a maturity of three months or less.

Inventories

Inventories, consisting of medical and office supplies and pharmaceutical products, are stated at cost, as determined by the first-in, first-out method.

Other assets

Other assets relates to the purchase of a physical therapy service in 2007. This asset is being amortized on a straight-line basis over a three year period. Amortization expense was \$141,133 and \$94,089 in 2008 and 2007, respectively.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Investments

The Hospital holds both Level 1 and Level 2 investments. For Level 1 investments, the fair market values are readily determinable using quoted prices in active markets for identical assets as determined by FAS 157: Fair Value Measurements. For Level 2 investments, the fair value is based on prices from broker-dealers who derive fair values for those assets from observable inputs. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in income (loss) from operations.

Assets limited as to use

Assets limited as to use include funds held for debt repayments and assets temporarily restricted by donor.

Capital assets

Capital assets are recorded at cost. Depreciation is computed principally on the straight-line basis over the estimated useful lives of the assets. Equipment under capital leases is amortized on the straight-line method over the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the financial statements. Costs of maintenance and repairs are charged to expense when incurred.

Compensated absences

Paid time off is charged to operations when earned. The earned and unused benefits are recorded as a current liability in the financial statements. Employees accumulate vacation days at varying rates depending on years of service, and may carry over to the next year up to 2 times the number of hours eligible to be earned during the year, or up to 120 hours for part-time employees. Employees also earn sick leave benefits at a Hospital-determined rate for all employees. Employees are not paid for accumulated sick leave if they leave before retirement. However, employees who retire from the Hospital may convert accumulated sick leave to termination payments equal to one-fourth of the accumulated balance calculated at the employee's base pay rate as of the retirement date. There is no limit on the number of sick leave hours that an employee may accumulate; however, employees are only eligible to receive termination payments on one-fourth of the accumulated sick leave balance up to a maximum of 320 hours. Employees accumulate holidays at a Hospital determined rate for all employees.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Restricted Resources

When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

Classification of net assets

Net assets of the Hospital are classified in three components. *Net assets invested in capital assets – net of related debt* consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. *Restricted expendable* net assets are non-capital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital including amounts deposited with trustees as required by revenue note indentures. *Unrestricted* net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Net patient service revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others. Retroactive adjustments to these estimated amounts are recorded in future periods as final settlements are determined.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Final determination of compliance with such laws and regulations is subject to future government review and interpretation. Violations may result in significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Contributions

Contributions of cash and other assets, including unconditional promises to give in the future, are reported as revenue when received and measured at fair value. Contributions with donor imposed time or purpose restrictions are reported as restricted support. All other contributions are reported as unrestricted support.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Income from operations

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as operating revenue and expenses. Peripheral or incidental transactions are reported as non-operating gains and losses.

Income taxes

The Hospital, as a political subdivision, is exempt from federal income taxes under Section 115 of the Internal Revenue Code.

Accounting for Uncertainty in Income taxes

The Financial Accounting Standards Board ("FASB") has issued Interpretation No. 48 ("FIN 48"), which clarifies generally acceptable accounting principles for recognition, measurement, presentation and disclosure relating to uncertain tax positions. FIN 48 applies to business enterprises, not-for-profit entities, and pass-through entities, such as S corporations and limited liability companies. As permitted by FIN 48 (as amended), the Hospital has elected to defer the application of FIN 48 until issuance of its December 31, 2009 financial statements. For financial statements covering periods prior to calendar 2009, the Hospital evaluates uncertain tax positions in accordance with existing generally accepted accounting principles and makes such accruals and disclosures as might be required thereunder.

Charity care

The Hospital 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 Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. Charges foregone for charity care totaled \$1,955,395 and \$2,021,155 for 2008 and 2007, respectively.

Pension plan

Substantially all of the Hospital's employees are eligible to participate in a defined benefit pension plan sponsored by the Ohio Public Employees Retirement System (OPERS). The Hospital funds pension costs, based on contribution rates determined by OPERS.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Use of estimates

The preparation of financial statements in conformity with accounting principals generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures in the financial statements. Actual results could differ from those estimates.

2. FAIR VALUE OF FINANCIAL INSTRUMENTS

Statement on Financial Accounting Standards No. 157, Fair Value Measurements (as amended), requires certain disclosures regarding the fair value of financial instruments. Financial instruments held by the Hospital impacted by this pronouncement include the Hospital's investments which are measured using quoted prices in active markets.

The Hospital partially adopted the provisions of FAS 157 for fiscal year 2008, but will delay adoption of non-financial assets and non-financial liabilities covered by FASB Staff Position No. FAS 157-2. This Staff Position permits companies to partially defer the effective date of FAS 157 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, until fiscal year 2009.

When fully adopted, the Hospital will apply the provisions of FAS 157-2 to certain non-financial assets and liabilities and is currently evaluating the impact of the full adoption of this statement on the consolidated results of operations and consolidated financial position.

Fair values of financial instruments at December 31, 2008 follow:

Description:	12/31/2008	Fair Value Measurements at Reporting Date Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments	\$ 3,403,629	\$ 328,588	\$ 3,075,041	\$ -

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

3. DEPOSITS AND INVESTMENTS

The Hospital's deposits and investments are composed of the following:

2008	Cash and Cash Equivalents	Investments	Assets Limited as to Use
Deposits	\$ 1,708,082	\$ 59,569	\$ 269,019
Federal Bonds	-	3,075,041	-
Total	<u>\$ 1,708,082</u>	<u>\$ 3,134,610</u>	<u>\$ 269,019</u>

2007	Cash and Cash Equivalents	Investments	Assets Limited as to Use
Deposits	\$ 2,439,598	\$ 31,277	\$ 219,471
Federal Bonds	-	2,972,798	-
Total	<u>\$ 2,439,598</u>	<u>\$ 3,004,075</u>	<u>\$ 219,471</u>

Deposits	2008	2007
Amount of deposits reflected on the accounts of the bank (without recognition of checks written but not yet cleared, or of deposits in transit)	\$ 2,253,718	\$ 3,249,499
Amount of deposits covered by federal depository insurance	440,978	269,965
Amounts of deposits uninsured	<u>\$ 1,812,740</u>	<u>\$ 2,979,534</u>

Amounts uninsured are collateralized with securities held by the financial institution or by its trust department or agent but not in the Hospital's name.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

The Hospital had the following investments and maturities, all of which are held in the Hospital's name by custodial banks that are agents of the Hospital:

December 31, 2008	Carrying amount	Maturities	
		< than 1 year	1-5 years
Certificates of deposit	\$ 269,019	\$ 54,801	\$ 214,218
Government obligations	\$ 3,075,041	\$ 864,205	\$ 2,210,836

December 31, 2007	Carrying amount	Maturities	
		< than 1 year	1-5 years
Certificates of deposit	\$ 219,471	\$ 158,575	\$ 60,896
Government obligations	\$ 2,972,798	\$ 575,744	\$ 2,397,054

Interest rate risk – The Hospital has a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

Credit risk – The Hospital may invest in United States obligations or any other obligation guaranteed by the United States; bonds, notes or any other obligations or securities issued by any federal government or instrumentality; time certificate of deposit or savings or deposit accounts, including passbook accounts, in any eligible institution mentioned in Section 135.32; bonds and other obligations of the State of Ohio or the political subdivisions of the state provided that such political subdivisions are located wholly or partly within the same county; and certain no load money market mutual funds; certain commercial paper; and certain repurchase agreements.

Concentration of credit risk – The Hospital has a policy whereby deposits and investments are diversified between several issuers. The Hospital maintains its cash and investments, which at times may exceed federally insured limits. The Hospital has not experienced any losses in such accounts. The Hospital believes that it is not exposed to any significant credit risk on investments.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

4. PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable at December 31, 2008 and 2007 is as follows:

	<u>2008</u>	<u>2007</u>
Total patient accounts receivable	\$ 10,525,716	\$ 13,541,407
Less allowance for:		
Uncollectible accounts	(2,028,179)	(2,887,560)
Contractual adjustments	<u>(3,733,911)</u>	<u>(4,662,648)</u>
Net patient accounts receivable	<u>\$ 4,763,626</u>	<u>\$ 5,991,199</u>

5. NOTES RECEIVABLE

Notes receivable represent loans and minimum guarantee obligations to physicians under various cash flow support and loan arrangements. These loans are to be repaid in varying monthly installments including interest at rates ranging from 0 percent to 6.5 percent, and are unsecured. A portion of the physicians notes receivable are forgiven over time under the terms of the physician loan agreement.

6. RESTRICTED FUNDS

Restricted funds are available for the following purposes:

	<u>2008</u>	<u>2007</u>
Community health services	\$ 204,595	\$ 219,471
Capital expenditures	64,424	-

7. ESTIMATED THIRD PARTY SETTLEMENTS

Approximately 57 percent and 55 percent of the Hospital's revenues from patient services were received from the Medicare and Medicaid programs for 2008 and 2007, respectively. The Hospital has agreements with these payors that provide for reimbursement to the Hospital at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospital's established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with these third-party payors follows.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

Medicare

Effective December, 2005, the Hospital was designated as a Critical Access Hospital. As a result, Medicare inpatient and outpatient services are reimbursed at the approximate cost plus 1% of providing those services. Previously, inpatient, acute-care services rendered to Medicare program beneficiaries were paid at prospectively determined rates per discharge. These rates varied according to a patient classification system based on clinical, diagnostic, and other factors. Medicare cost reports are final settled through December 2006.

Medicaid

Inpatient, acute-care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Capital costs relating to Medicaid inpatients are paid on a cost-reimbursement method. The Hospital is reimbursed for outpatient services on an established fee-for-service methodology.

The Medicaid payment system in Ohio is prospective, whereby rates for the following state fiscal year beginning July 1 are based upon filed cost reports for the preceding calendar year. The continuity of this system is subject to the uncertainty of the fiscal health of the State of Ohio, which can directly impact future rates and the methodology currently in place. Any significant change in rates, or the payment system itself, could have a material impact on the future Medicaid funding to providers.

Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts they are not expected to have a material effect on the accompanying financial statements. Medicaid cost reports have been final settled through 2002.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

8. CAPITAL ASSETS

Capital assets activity for the year ended December 31, 2008 and 2007 follows:

	2007	Additions	Retirements	2008	Depreciable Life - Years
Land	\$ 519,750	\$ -	\$ -	\$ 519,750	
Land improvements	624,690	-	-	624,690	10-20
Buildings	15,013,734	-	-	15,013,734	15-50
Fixed equipment	1,792,376	-	(1,983)	1,790,393	5-20
Major movable equipment	9,232,357	453,082	(952,359)	8,733,080	5-25
Construction in progress	795,336	621,446	-	1,416,782	
Total	27,978,243	1,074,528	(954,342)	28,098,429	
Less accumulated depreciation					
Land improvements	506,054	14,342	-	520,396	
Buildings	6,163,117	470,651	-	6,633,768	
Fixed equipment	1,193,446	72,748	(1,982)	1,264,212	
Major movable equipment	6,666,787	971,550	(928,655)	6,709,682	
Total	14,529,404	1,529,291	(930,637)	15,128,058	
Net carrying amount	<u>\$ 13,448,839</u>			<u>\$ 12,970,371</u>	

	2006	Additions	Retirements	2007	Depreciable Life - Years
Land	\$ 519,750	\$ -	\$ -	\$ 519,750	
Land improvements	624,690	-	-	624,690	10-20
Buildings	14,615,603	398,131	-	15,013,734	15-50
Fixed equipment	1,754,516	37,860	-	1,792,376	5-20
Major movable equipment	8,845,149	1,172,898	(785,690)	9,232,357	5-25
Construction in progress	42,122	753,214	-	795,336	
Total	26,401,830	2,362,103	(785,690)	27,978,243	
Less accumulated depreciation					
Land improvements	491,712	14,342	-	506,054	
Buildings	5,680,768	482,349	-	6,163,117	
Fixed equipment	1,119,626	73,820	-	1,193,446	
Major movable equipment	6,720,621	719,308	(773,142)	6,666,787	
Total	14,012,727	1,289,819	(773,142)	14,529,404	
Net carrying amount	<u>\$ 12,389,103</u>			<u>\$ 13,448,839</u>	

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

9. LONG-TERM DEBT

Long-term debt activity for the years ended December 31, 2008 and 2007 follows:

2008	Beginning Balance	Current Year Additions	Current Year Reductions	Ending Balance	Current Portion
Leases and notes payable:					
Lease obligation	\$ 728,632	\$ -	\$ (185,866)	\$ 542,766	\$ 196,575
Note payable - 2003 series	3,945,000	-	(165,000)	3,780,000	175,000
Total leases and notes payable	<u>\$ 4,673,632</u>	<u>\$ -</u>	<u>\$ (350,866)</u>	<u>\$ 4,322,766</u>	<u>\$ 371,575</u>
2007	Beginning Balance	Current Year Additions	Current Year Reductions	Ending Balance	Current Portion
Leases and notes payable:					
Lease obligations	\$ 250,311	\$ 629,250	\$ (150,929)	\$ 728,632	\$ 185,865
Note payable - 2003 series	4,105,000	-	(160,000)	3,945,000	165,000
Total leases and notes payable	<u>\$ 4,355,311</u>	<u>\$ 629,250</u>	<u>\$ (310,929)</u>	<u>\$ 4,673,632</u>	<u>\$ 350,865</u>

The County of Fayette, Ohio, acting by and through the Fayette County Memorial Hospital Board of Directors, issued Variable Rate Taxable Demand Revenue Notes, Series 2003 (the notes) to finance the acquisition and construction of a medical office building, along with the financing costs associated therewith and with related transactions (the project).

The Hospital is bound by the terms of the Trust Indenture and Reimbursement Agreement to various operations and financial covenants. These covenants include maintaining a minimum debt service ratio of 1.25 to 1.00, and minimum days cash on hand of 70. The Hospital was not in compliance with certain covenants as of December 31, 2008. The Hospital obtained a waiver from the respective lending institution for the year ended December 31, 2008 and the quarter ended March 31, 2009. The covenants were modified in 2009 to the following: for the quarter ended June 30, 2009, a debt service coverage ratio of 1.00 to 1.00 and days cash on hand of 40 days; for the quarter ended September 30, 2009, a debt service coverage ratio of 1.10 to 1.00 and days cash on hand of 42 days; for the quarter ended December 31, 2009, a debt service coverage ratio of 1.15 to 1.00 and days cash on hand of 45 days; and the for the quarter ended March 31, 2010 and thereafter, a debt service coverage ratio of 1.25 to 1.00 and days cash on hand of 50 days.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

The notes shall be issued in an amount not to exceed \$4,400,000, and shall be available to the Hospital to be drawn upon as principal as needed. The notes will be sold in series as funds are needed for the project. The initial series was issued and drawn in July 2003, in the amount of \$2,400,000. The second series was issued and drawn in October 2003, in the amount of \$1,000,000. The Hospital drew an additional \$1,000,000 in 2004.

The series of notes are payable semi-annually with principal payments ranging from \$150,000 to \$270,000, in aggregate, maturing on August 1, 2023. The interest rate on the variable rate notes was 2.73 percent at December 31, 2008. The notes are secured by an irrevocable letter-of-credit with the Trustee bank.

The notes are remarketed on a weekly basis. Should the remarketing agent be unable to remarket the notes based on its best efforts, these notes would be "put" back to the Trustee, who would draw down on the letter-of-credit to pay down the notes. Under the Reimbursement Agreement between the Trustee and the Hospital, the Hospital is obliged to reimburse the Trustee for any draws made on the letter-of credit. A draw due to default would result in payment due on demand, while a draw on the letter due to a failed remarketing would be due at the expiration of the letter of credit. Interest is applied to letter-of-credit draws at a variable rate based on the current market interest rates.

The letter-of-credit expires upon the earliest of August 16, 2012, unless extended, or receipt by the Trustee of payment in full of principal and interest on the notes. In the event of the expiration of the letter-of-credit, all outstanding notes would be subject to mandatory purchase by the Hospital. Additionally, there is a commitment fee with respect to the issuance and maintenance of the letter-of-credit. The Hospital's obligation to the Trustee for draws on the letter-of-credit is secured by a pledge of its gross receipts pursuant to an Assignment and Security Agreement, and a lien on any leases pursuant to an Assignment of Rents and Leases.

The Hospital also entered into an interest rate swap agreement with a financial institution to reduce the impact of changes in interest rates on the Variable Rate Taxable Demand Revenue Notes, Series 2003. The total notational amount of the interest rate swap agreement is \$1,900,000 and matures August 1, 2013. The Hospital is required to make additional monthly interest payments to the financial institution if the fixed rate outlined below exceeds the variable rate, or receives a rebate on the interest paid if the fixed rate falls below the rate. The fixed rate on the interest rate swap agreement is 5.24%. The fair value of this interest rate swap at December 31, 2008 was a liability of \$253,535. The Hospital has designated the interest rate swap agreement as a cash flow hedge instrument.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

As of December 31, 2008, debt service requirements of the variable-rate debt and capital lease obligations for their term were as follows:

Year Ending December 31	Capital Lease Obligations	Principal Payments on Long-Term Debt	Interest Payments on Long-Term Debt	Interest Rate Swap, Net	Total Payments
2009	\$ 220,580	\$ 175,000	\$ 49,788	\$ 100,543	\$ 545,911
2010	187,742	185,000	47,195	95,958	515,895
2011	141,766	195,000	44,636	91,045	472,447
2012	36,580	200,000	42,008	85,871	364,459
2013	-	210,000	59,992	40,872	310,864
2014-2018	-	1,235,000	311,630	-	1,546,630
2019-2023	-	1,580,000	123,123	-	1,703,123
Total Payments	<u>\$ 586,668</u>	<u>\$ 3,780,000</u>	<u>\$ 678,372</u>	<u>\$ 414,289</u>	<u>\$ 5,459,329</u>
Less amount representing interest	<u>43,902</u>				
Net present value	<u>\$ 542,766</u>				

Capital leases have imputed interest rates of 4.48 percent to 5.13 percent. They expire at various times through 2012 and are collateralized by the equipment leased.

	2008	2007
Cost of equipment under capital lease	\$ 964,958	\$ 964,958
Less accumulated amortization	<u>433,369</u>	<u>237,113</u>
Net carrying amount	<u>\$ 531,589</u>	<u>\$ 727,845</u>

10. LINE OF CREDIT AGREEMENT

The Hospital has a line of credit agreement with a bank to provide availability of cash borrowings up to \$1,500,000. The agreement expires December 18, 2009. The agreement is secured by all equipment and inventory. Under the terms of the agreement, cash borrowings bear interest at 5%. Outstanding borrowings under the line of credit at December 31, 2008 and 2007 were \$750,000 and \$1,500,000, respectively.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

11. NET PATIENT SERVICE REVENUE

Net patient service revenue consists of the following:

	<u>2008</u>	<u>2007</u>
Revenue		
Inpatient service		
Routine service	\$ 4,702,233	\$ 4,675,345
Ancillary services	9,761,083	9,859,157
Outpatient ancillary services	<u>55,281,874</u>	<u>53,365,751</u>
 Total patient revenue	 69,745,190	 67,900,253
Revenue deductions		
Provision for contractual allowances	31,018,058	27,887,717
Provision for charity care	1,955,395	2,021,155
Bad debts	4,510,104	4,640,078
Other allowances	<u>450,498</u>	<u>173,230</u>
 Total revenue deductions	 <u>37,934,055</u>	 <u>34,722,180</u>
 Total net patient service revenue	 <u>\$ 31,811,135</u>	 <u>\$ 33,178,073</u>

12. NON-OPERATING GAINS

Non-operating gains consist of the following:

	<u>2008</u>	<u>2007</u>
Donations, gifts and grants	\$ 146,142	\$ 46,203
Investment income	148,114	172,561
Interest expense	(301,756)	(293,456)
Other gains	<u>102,083</u>	<u>179,200</u>
 Non-operating gains - net	 <u>\$ 94,583</u>	 <u>\$ 104,508</u>

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

13. DEFINED BENEFIT PENSION PLAN

The Hospital contributed to the Ohio Public Employees Retirement System of Ohio, (OPERS). OPERS administers three separate pension plans: The Traditional Pension Plan – a cost sharing multiple-employer defined benefit pension plan; the Member-Directed Plan (MD) – a defined contribution plan; and the Combined Plan (CO) – a cost sharing multiple-employer defined benefit pension plan that has elements of both a defined benefit and defined contribution plan. OPERS provides retirement, disability, and survivor benefits as well as postretirement health care coverage to qualifying members of both the Traditional Plan and the Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits, including post-employment health care coverage.

OPERS issues a publicly available comprehensive annual financial report, which includes financial statements and required supplementary information for PERS. That report may be obtained by writing to Public Employees Retirement System of Ohio, 277 East Town Street, Columbus, Ohio, 43215-4642 or by calling (614) 222-5601 or (800) 222-PERS (7377).

Funding Policy

The required, actuarially-determined contribution rates for the Hospital and for employee are 14% and 10%, respectively. The Hospital's contributions, representing 100% of employer contributions, for the last three years follows:

<u>Year</u>	<u>Contribution</u>
2008	\$ 2,020,633
2007	\$ 1,845,664
2006	\$ 1,567,909

PERS also provides post-retirement healthcare coverage to age and service retirees with 10 or more years of qualifying Ohio service credit. Healthcare coverage for disability recipients and primary survivor recipients is available. The healthcare coverage provided by the retirement system is considered an Other Post-employment Benefit (OPEB). A portion of each employer's contribution to PERS is set aside for the funding of post-retirement healthcare. The Ohio Revised Code provides statutory authority for employer contributions. The portion of the 2008 employer contribution rates of 14% used to fund healthcare was 7.0%.

The Ohio Revised Code provides the statutory authority requiring public employers to fund post-retirement healthcare through their contributions to PERS.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

The assumptions and calculations below are based upon PERS' latest actuarial review performed as of December 31, 2007. An entry-age normal actuarial cost method of valuation is used in determining the present value of OPEB. The difference between assumed and actual experience (actuarial gains and losses) becomes part of the unfunded actuarial accrued liability. All investments are carried at market value. For actuarial purposes, a smoothed market approach is used. Under this approach, assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually, not to exceed a 12% corridor. The investment return assumption rate for 2007 was 6.5%. An annual increase of 4% compounded annually is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally, annual pay increases, over and above the 4% base increase, were assumed to range from .5% to 6.3%.

Healthcare costs were assumed to increase at the projected wage inflation rate plus an additional factor ranging from .5% to 4% for the next 7 years. In subsequent years (8 and beyond), healthcare costs were assumed to increase at 4% (the projected wage inflation rate).

The Traditional Pension and Combined Plans had 363,503 active contributing participants as of December 31, 2008. The number of active contributing participants for both plans used in the December 31, 2007 actuarial valuation was 364,076.

The actuarial value of OPERS net assets at December 31, 2007 were \$12.8 billion. The actuarially accrued liability and the unfunded actuarial accrued liability for OPEB, based on the actuarial cost method was \$29.8 billion and \$17.0 billion, respectively.

OPEB are financed through employer contributions and investment earnings there on. The contributions allocated to retiree healthcare, along with investment income on allocated assets and periodic adjustments in healthcare provisions are expected to be sufficient to sustain the program indefinitely.

The Health Care Preservation Plan (HCPP) adopted by the PERS Retirement Board on September 9, 2004 is effective on January 1, 2007. PERS took additional actions to improve the solvency of the Health Care Fund in 2005 by creating a separate investment pool for health care assets. Member and employer contribution rates increased as of January 1, 2006, January 1, 2007, and January 1, 2008, which will allow additional funds to be allocated to the health care plan.

14. RISK MANAGEMENT

The Hospital is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries (workers' compensation). The Hospital has purchased commercial insurance for malpractice, general liability, employee medical stop-loss and workers' compensation claims.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2008 AND 2007

The Hospital is insured against medical malpractice claims under an occurrence-based policy. The policy covers claims resulting from incidents that occurred during the policy terms, regardless of when the claim is reported to the insurance carrier. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claim exceeding \$1,000,000 or aggregate claims exceeding \$3,000,000 for claims asserted in the policy year. In addition, the Hospital has an umbrella policy with an additional \$5,000,000 of coverage.

While there is pending litigation against the Hospital, management is not aware of any such medical malpractice claims, either asserted or unasserted, that would exceed the policy limits. The cost of this insurance policy represents the Hospital's cost for such claims for the year, and it has been charged to operations as a current expense. There have been no claims settled in the last five years that have exceeded insured limits.

15. MANAGEMENT'S PLANS

The Hospital did not meet certain covenants related to the bonds outstanding at December 31, 2008 (footnote 9). As defined in footnote 9, these covenants have been modified and management believes with the modification that the Hospital will be in compliance with the quarterly calculations in 2009. Should the Hospital fail one of these revised covenants the bank has the right to call the loan. The Hospital's net assets decreased approximately \$1,688,000 in 2008. Further, while the Hospital's operating revenues decreased to approximately \$31,800,000, expenses increased to \$33,674,000. The result is a loss from operations of approximately \$1,783,000 in 2008. These factors could be indicative of the entity's inability to continue as a going concern.

Management of the Hospital plans to return the Hospital to profitability through evaluation of contribution margins of certain lines of business, eliminating certain positions, a salary freeze, termination of certain contracts, flexing staff levels consistent with inpatient census needs in addition to other cost containment initiatives developed by the strategic planning team.

It is not possible at this time to predict the success of the Hospital's future plans, and there is no assurance that these plans will be realized. The Hospital's continued existence is dependent on its ability to achieve profitable operations and positive cash flows, and to maintain adequate financing and meet the required debt covenants.



Blue & Co., LLC / 8800 Lyra Drive, Suite 450 / Columbus, OH 43240

main 614.885.BLUE (2583) fax 614.885.0580 email blue@blueandco.com

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 Directors
Fayette County Memorial Hospital
Washington Court House, Ohio

We have audited the financial statements of Fayette County Memorial Hospital (the Hospital), a part of the primary government of Fayette County, Ohio, as of and for the year ended December 31, 2008, and have issued our report thereon dated August 10, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hospital'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 Hospital's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control over financial reporting.

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying schedule of findings and responses to be a significant deficiency in internal control over financial reporting (2008-1).

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

**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**

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital'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*.

We noted certain matters that we reported to management of the Hospital in a separate letter dated August 10, 2009.

The Hospital's response to the findings identified in our audit are described in the accompanying schedule of findings and responses. We did not audit the Hospital's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the auditor of the State of Ohio, the Board of Directors, and management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Blue & Co., LLC

August 10, 2009

**Fayette County Memorial Hospital
Schedule of Audit Findings and Responses
December 31, 2008**

2008-1: Physician Recruitment Asset and Liability

In accordance with FASB Staff Position FIN 45-3, "Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business Or Its Owners," the Hospital recorded a liability of \$1,137,806 at December 31, 2008 for the fair value of a new guarantee entered into during 2008 with an offsetting asset recorded in other assets within the balance sheet. We recommend that management analyze new physician agreements with income guarantees for possible accounting of future commitments.

We recommend that management analyze new physician agreements with income guarantees for possible accounting of future commitments. We are pleased to be available to answer questions and provide technical accounting guidance with respect to these agreements.

Management's Response:

As the Hospital enters into these agreements we will evaluate and account for related obligations in accordance with the guidance provided above.



Mary Taylor, CPA
Auditor of State

FAYETTE COUNTY MEMORIAL HOSPITAL

FAYETTE COUNTY

CLERK'S CERTIFICATION

This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
SEPTEMBER 29, 2009**