

FAYETTE COUNTY MEMORIAL HOSPITAL

FINANCIAL STATEMENTS

DECEMBER 31, 2006 AND 2005



Mary Taylor, CPA
Auditor of State

Board of Governors
Fayette County Memorial Hospital
1430 Columbus Avenue
Washington Court House, Ohio 43160

We have reviewed the *Report of Independent Auditors* of the Fayette County Memorial Hospital, Fayette County, prepared by Blue & Co., LLC, for the audit period January 1, 2006 through December 31, 2006. 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. The Fayette County Memorial Hospital is responsible for compliance with these laws and regulations.

Mary Taylor

Mary Taylor, CPA
Auditor of State

May 14, 2007

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FAYETTE COUNTY MEMORIAL HOSPITAL

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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 as of December 31, 2006 and 2005, 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 audit.

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, 2006 and 2005, and the results of its operations 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 April 23, 2007, 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 audit.

Blue & Co., LLC

April 23, 2007

Fayette County Memorial Hospital MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2006 and 2005. Management is responsible for the completeness and fairness of the financial statements and the related footnote disclosures along with the discussion and analysis.

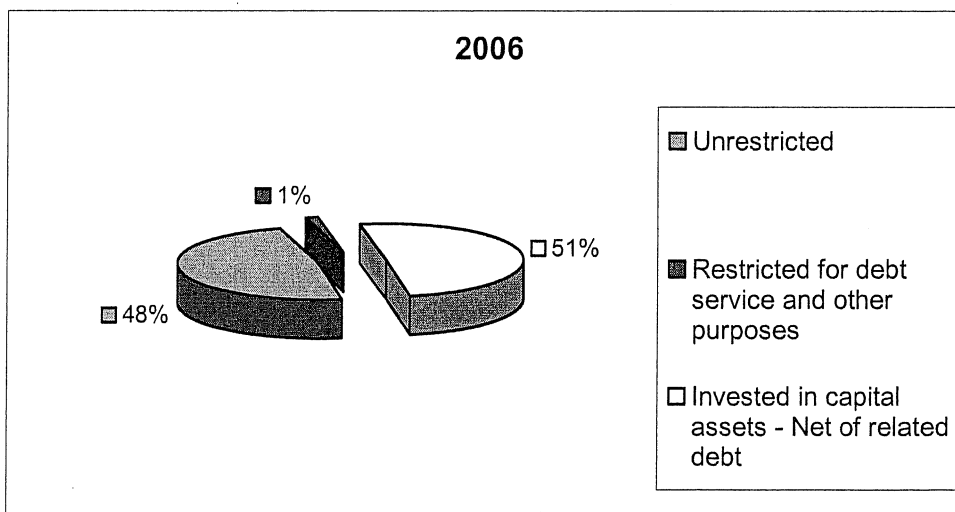
Using this Annual Report

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 increased approximately \$1,809,000 while accounts payable and other accruals increased approximately \$680,000. In total, the Hospital's revenues and other support exceeded revenues and other support, creating a increase in net assets of \$1,010,011 (compared to a deficit of \$1,292,087 in the previous year).

The following chart provides a breakdown of net assets by category for the year ended December 31, 2006:



FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

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

Condensed Financial Information

The following is a comparative analysis of the major components of the Balance Sheet of the Hospital as of December 31, 2006 and 2005:

Assets, Liabilities and Net Assets

	December 31		Change	
	2006	2005	Amount	Percent
Current assets	\$ 8,685,051	\$ 7,253,528	\$ 1,431,523	19.7%
Noncurrent assets	3,410,098	2,573,510	836,588	32.5%
Capital assets	12,389,103	13,190,123	(801,020)	-6.1%
Total assets	\$ 24,484,252	\$ 23,017,161	\$ 1,467,091	6.4%
Current liabilities	\$ 4,340,642	\$ 3,659,653	\$ 680,989	18.6%
Long-term debt	4,131,402	4,355,311	(223,909)	-5.1%
Total liabilities	\$ 8,472,044	\$ 8,014,964	\$ 457,080	5.7%
Net assets				
Invested in capital assets, net of debt	\$ 8,033,792	\$ 8,608,334	\$ (574,542)	-6.7%
Restricted	219,471	214,012	5,459	2.6%
Unrestricted	7,758,945	6,179,851	1,579,094	25.6%
Total net assets	\$ 16,012,208	\$ 15,002,197	\$ 1,010,011	6.7%

The primary changes in the assets, liabilities and net assets relates to the increase in cash and investments of \$1,809,00 and a gain from operations of \$940,982 during 2006.

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Operating Results and Changes in Net Assets

	Year Ended		Change	
	2006	2005	Amount	Percent
Operating revenues				
Net patient service revenues	\$ 30,870,961	\$ 26,102,069	\$ 4,768,892	18.3%
Other	80,717	(13,546)	94,263	-695.9%
Total operating revenues	30,951,678	26,088,523	4,863,155	18.6%
Operating expenses				
Salaries and wages	11,888,791	10,711,215	1,177,576	11.0%
Benefits	3,943,772	3,740,984	202,788	5.4%
Physicians fees	1,692,450	1,646,839	45,611	2.8%
Other fees	3,159,801	2,847,100	312,701	11.0%
Supplies	4,721,667	4,188,548	533,119	12.7%
Depreciation and amortization	1,321,517	1,394,882	(73,365)	-5.3%
Other expenses	3,282,698	2,941,264	341,434	11.6%
Total operating expenses	30,010,696	27,470,832	2,539,864	9.2%
Income (loss) from operations	940,982	(1,382,309)	2,323,291	-168.1%
Non-operating gains - net	69,029	90,222	(21,193)	-23.5%
Change in net assets	1,010,011	(1,292,087)	2,302,098	-178.2%
Net assets - beginning of year	15,002,197	16,294,284		
Net assets - end of year	\$ 16,012,208	\$ 15,002,197		

Operating Revenues

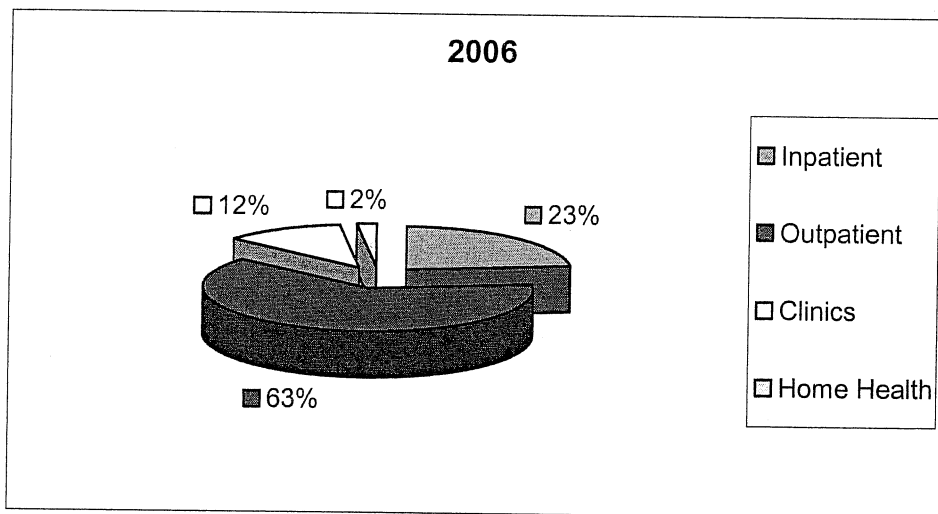
Operating revenues include all transactions that result in the sales and/or receipts from goods and services such as inpatient services, outpatient services, physician's offices, and the cafeteria. In addition, certain federal, state, and private grants are considered operating if they are not for capital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

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Operating revenue changes were a result of the following factors:

- Net patient service revenue increased 18.3%. Gross inpatient revenue declined 8.7% in 2006 while gross outpatient revenue increased 20% in 2006. 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 43% of gross revenue in 2006 and 2005. 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 2006 amounted to \$1,851,552, a 71% percent increase from 2005.

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



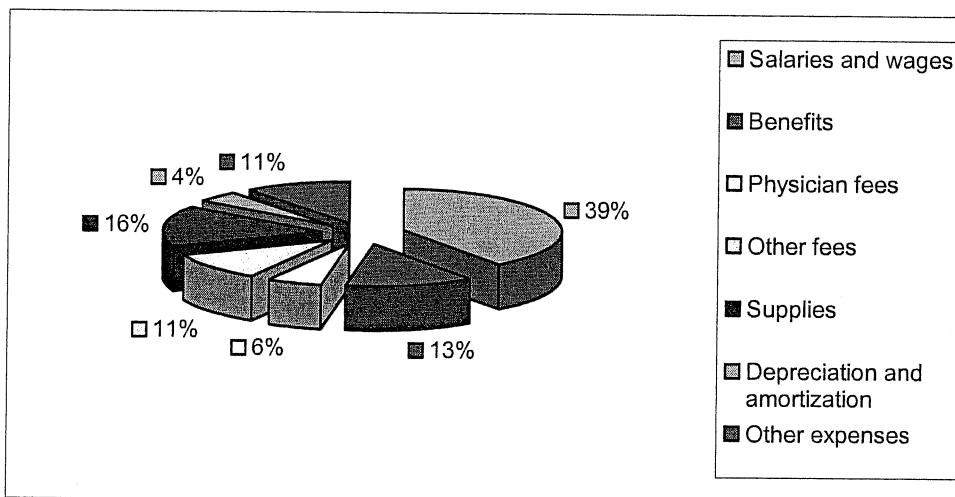
FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

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 11.0%.
- Benefit costs increased 5.4%.
- Other expenses increased 11.6%.

The following is a graphic illustration of 2006 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

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

	2006	2005	Increase (Decrease)
Cash from			
Operating activities	\$ 2,029,992	\$ 1,634,932	\$ 395,060
Capital and related financing activities	(1,026,472)	(1,502,223)	475,751
Noncapital and related financing activities	348,526	234,833	113,693
Investing activities	(631,507)	416,207	(1,047,714)
Net change in cash	720,539	783,749	(63,210)
Cash - Beginning of year	2,044,562	1,260,813	
Cash - End of year	\$ 2,765,101	\$ 2,044,562	

Cash provided by operating activities increased due to increased profitability in 2006.

Capital purchases decreased \$476,000 in 2006.

Investing activities utilized cash of \$632,000.

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Capital Assets and Debt Administration

Capital Assets

At December 31, 2006, the Hospital had \$26.4 million invested in capital assets, with an accumulated depreciation of \$12.3 million. Depreciation and amortization totaled \$1.4 million for the current year compared to \$1.33 million last year. Details of these assets for the past two years are shown below:

	<u>2006</u>	<u>2005</u>	<u>Increase (Decrease)</u>
Land	\$ 519,750	\$ 519,750	\$ -
Land improvements	624,690	624,690	-
Buildings	14,615,603	14,600,667	14,936
Fixed equipment	1,754,516	1,744,575	9,941
Major movable equipment	8,845,149	9,393,189	(548,040)
Construction in progress	<u>42,122</u>	<u>-</u>	<u>42,122</u>
Total	<u>\$ 26,401,830</u>	<u>\$ 26,882,871</u>	<u>\$ (481,041)</u>

Debt

At year-end, the Hospital had \$4,355,311 in debt outstanding, as compared to \$4,581,789 in 2005. The table below summarizes these amounts by type of debt instrument:

	<u>2006</u>	<u>2005</u>	<u>Increase (Decrease)</u>
Notes payable	\$ 4,105,000	\$ 4,255,000	\$ (150,000)
Lease obligation	<u>250,311</u>	<u>326,789</u>	<u>(76,478)</u>
Total notes and leases	<u>\$ 4,355,311</u>	<u>\$ 4,581,789</u>	<u>\$ (226,478)</u>

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

Economic Factors That Will Affect the Future

As a small rural hospital, the economic position of Fayette County Memorial Hospital is closely tied to its ability to grow revenue while attempting to hold down costs. The upward pressure on wages is expected to continue in 2007. In an effort to grow the revenue base, the Hospital is incurring significant expenses in an effort to recruit new physicians to the community. Reimbursement for existing patients is limited by federal and state mandate as well as contracts with third-party insurance companies. The board of trustees approved a 5% increase on charges for 2007 in an effort to maximize reimbursement under our current managed care contracts. Additionally in December 2005, the Hospital received approval as a Critical Access Hospital. This status provides for cost-based reimbursement for Medicare services.

The Hospital's current financial and capital plans indicate that the expenditures for the second medical office building and on-going physician recruitment will result in the infusion of additional financial resources that will enable it to maintain its present level of service to the community.

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 us.

FAYETTE COUNTY MEMORIAL HOSPITAL

BALANCE SHEETS DECEMBER 31, 2006 AND 2005

ASSETS

	<u>2006</u>	<u>2005</u>
Current assets		
Cash and cash equivalents	\$ 2,545,630	\$ 1,830,550
Patient accounts receivable, net of uncollectible accounts of \$1,916,000 in 2006 and \$1,255,000 in 2005	5,250,935	4,419,440
Current portion of notes receivable	334,108	533,730
Inventories	326,336	307,311
Prepaid expenses and other current assets	228,042	162,497
Total current assets	<u>8,685,051</u>	<u>7,253,528</u>
Other assets		
Notes receivable	3,194	260,745
Investments	3,187,433	2,098,753
Assets limited as to use	219,471	214,012
Capital assets	12,389,103	13,190,123
Total other assets	<u>15,799,201</u>	<u>15,763,633</u>
 Total assets	 <u><u>\$ 24,484,252</u></u>	 <u><u>\$ 23,017,161</u></u>

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

BALANCE SHEETS
DECEMBER 31, 2006 AND 2005

LIABILITIES AND NET ASSETS

	<u>2006</u>	<u>2005</u>
Current liabilities		
Current portion of long-term debt	\$ 223,909	\$ 226,478
Accounts payable	1,916,116	1,774,138
Accrued payroll and related benefits	1,536,138	1,378,998
Estimated third-party settlements	664,479	280,039
Total current liabilities	<u>4,340,642</u>	<u>3,659,653</u>
Long-term debt	<u>4,131,402</u>	<u>4,355,311</u>
Total liabilities	8,472,044	8,014,964
Net assets		
Invested in capital assets - net of related debt	8,033,792	8,608,334
Restricted		
Expendable for debt service and other purposes	219,471	214,012
Unrestricted	7,758,945	6,179,851
Total net assets	<u>16,012,208</u>	<u>15,002,197</u>
Total liabilities and net assets	<u>\$ 24,484,252</u>	<u>\$ 23,017,161</u>

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Operating revenue		
Net patient service revenue	\$ 30,870,961	\$ 26,102,069
Other operating revenue	80,717	(13,546)
Total operating revenues	30,951,678	26,088,523
Operating expenses		
Salaries and wages	11,888,791	10,711,215
Employee benefits	3,943,772	3,740,984
Physician fees	1,692,450	1,646,839
Other fees	3,159,801	2,847,100
Supplies	4,721,667	4,188,548
Utilities	698,680	597,950
Maintenance and repairs	965,688	783,322
Leases and rentals	125,051	120,810
Insurance	380,630	265,826
Depreciation and amortization	1,321,517	1,394,882
Other expenses	1,112,649	1,173,356
Total operating expenses	30,010,696	27,470,832
Income (loss) from operations	940,982	(1,382,309)
Non-operating gains - net	69,029	90,222
Change in net assets	1,010,011	(1,292,087)
Net assets, beginning of year	15,002,197	16,294,284
Net assets, end of year	\$ 16,012,208	\$ 15,002,197

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2006 AND 2005

	2006	2005
Operating activities		
Cash received from patients and third party payors	\$ 30,423,906	\$ 26,743,671
Cash payments to suppliers for services and goods	(15,676,168)	(14,306,817)
Cash payments to employees for services	(12,798,463)	(10,788,376)
Other operating revenue received	80,717	(13,546)
Net cash flow from operating activities	2,029,992	1,634,932
Non-capital and related financing activities		
Donations and other	348,526	234,833
Capital and related financing activities		
Acquisition and construction of capital assets	(520,497)	(974,163)
Interest expense	(279,497)	(260,460)
Principal payments on long-term debt	(226,478)	(267,600)
Net cash from capital and related financing activities	(1,026,472)	(1,502,223)
Investing activities		
Change in advances to physicians	457,173	356,437
Change in investments, net	(1,227,696)	(41,986)
Interest received on investments	139,016	101,756
Net cash from investing activities	(631,507)	416,207
Net change in cash and cash equivalents	720,539	783,749
Cash, beginning of year	2,044,562	1,260,813
Cash, end of year	\$ 2,765,101	\$ 2,044,562
Balance sheet classification of cash		
Current assets	\$ 2,545,630	\$ 1,830,550
Assets limited as to use	219,471	214,012
Total cash	\$ 2,765,101	\$ 2,044,562
A reconciliation of income from operations to net cash from operating activities		
Income (loss) from operations	\$ 940,982	\$ (1,382,309)
Adjustments to reconcile income (loss) from operations to net cash from operating activities:		
Bad debt expense	3,392,136	3,410,448
Depreciation and amortization	1,321,517	1,394,882
Changes in assets and liabilities		
Patient accounts receivable	(4,223,631)	(3,048,885)
Inventories	(19,025)	(6,874)
Prepaid expenses and other current assets	(65,545)	(31,154)
Estimated third party settlements	384,440	280,039
Accounts payable	141,978	873,403
Accrued payroll and related benefits	157,140	145,382
Net cash from operating activities	\$ 2,029,992	\$ 1,634,932
Supplemental disclosure of cash flow information:		
Capital assets acquired under capital leases	\$ -	\$ 335,708

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

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 Directors. 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 Directors 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.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

Investments

Investments are carried at fair value.

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 unused and earned 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-third 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-third of the accumulated sick leave balance up to a maximum of 400 hours. Employees accumulate holidays at a Hospital determined rate for all employees.

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.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

Classification of net assets

Net assets of the Hospital are classified in four 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. *Restricted nonexpendable* net assets equal the principal portion of permanent endowments. *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, 2006 AND 2005

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 is a not-for-profit corporation as described in Section 501 (c) (3) of the Internal Revenue Code and is exempt from federal income taxes on related income pursuant to Section 501 (a) of the Code.

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 \$1,851,552 and \$1,083,659 for 2006 and 2005, 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.

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.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

2. DEPOSITS AND INVESTMENTS

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

<u>2006</u>	<u>Cash and Cash Equivalents</u>	<u>Investments</u>	<u>Assets Limited as to Use</u>
Deposits	\$ 2,545,630	\$ 166,480	\$ 219,471
Federal Bonds	-	3,020,953	-
Total	<u>\$ 2,545,630</u>	<u>\$ 3,187,433</u>	<u>\$ 219,471</u>
<u>2005</u>	<u>Cash and Cash Equivalents</u>	<u>Investments</u>	<u>Assets Limited as to Use</u>
Deposits	\$ 1,830,550	\$ 79,813	\$ 214,012
Federal Bonds	-	2,018,940	-
Total	<u>\$ 1,830,550</u>	<u>\$ 2,098,753</u>	<u>\$ 214,012</u>

<u>Deposits</u>	<u>2006</u>	<u>2005</u>
Amount of deposits reflected on the accounts of the bank (without recognition of checks written but not yet cleared, or of deposits in transit)	\$ 3,200,413	\$ 2,180,444
Amount of deposits covered by federal depository insurance	400,000	355,165
Amounts of deposits uninsured	<u>\$ 2,800,413</u>	<u>\$ 1,825,279</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, 2006 AND 2005

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, 2006	Carrying	Maturities	
	amount	< than 1 year	1-5 years
Certificates of deposit	\$ 219,471	\$ 114,309	\$ 105,162
Government obligations	\$ 3,020,953	\$ 448,875	\$ 2,572,078

Interest rate risk – The Hospital does not have 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 places no limit on the amount it may invest in any one issuer. 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, 2006 AND 2005

3. PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable at December 31, 2006 and 2005 is as follows:

	<u>2006</u>	<u>2005</u>
Total patient accounts receivable	\$ 10,675,853	\$ 9,179,836
Less allowance for:		
Uncollectible accounts	(1,916,477)	(1,255,352)
Contractual adjustments	<u>(3,508,441)</u>	<u>(3,505,044)</u>
Net patient accounts receivable	<u>\$ 5,250,935</u>	<u>\$ 4,419,440</u>

4. NOTES RECEIVABLE

Notes receivable represent loans 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

5. RESTRICTED FUNDS

Restricted funds are available for the following purposes:

	<u>2006</u>	<u>2005</u>
Community health services	\$ 219,471	\$ 214,012

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

6. ESTIMATED THIRD PARTY SETTLEMENTS

Approximately 57 percent of the Hospital's revenues from patient services are received from the Medicare and Medicaid programs. 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.

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 2004.

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.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

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 2000.

7. CAPITAL ASSETS

Capital assets activity for the year ended December 31, 2006 and 2005 follows:

	2005	Additions	Retirements	2006	Depreciable Life - Years
Land	\$ 519,750	\$ -	\$ -	\$ 519,750	
Land improvements	624,690	-	-	624,690	10-20
Buildings	14,600,667	20,847	(5,911)	14,615,603	15-50
Fixed equipment	1,744,575	9,941	-	1,754,516	5-20
Major movable equipment	9,393,189	447,587	(995,627)	8,845,149	5-25
Construction in progress	-	42,122	-	42,122	
Total	26,882,871	520,497	(1,001,538)	26,401,830	
Less accumulated depreciation					
Land improvements	475,759	15,953	-	491,712	
Buildings	5,204,661	479,382	(3,275)	5,680,768	
Fixed equipment	1,046,863	72,763	-	1,119,626	
Major movable equipment	6,965,465	753,419	(998,263)	6,720,621	
Total	13,692,748	1,321,517	(1,001,538)	14,012,727	
Net carrying amount	\$ 13,190,123			\$ 12,389,103	

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

	2004	Additions	Retirements	2005	Depreciable Life - Years
Land	\$ 519,750	\$ -	\$ -	\$ 519,750	
Land improvements	618,690	6,000	-	624,690	10-20
Buildings	14,022,678	577,989	-	14,600,667	15-50
Fixed equipment	1,628,557	116,018	-	1,744,575	5-20
Major movable equipment	8,686,800	731,910	(25,521)	9,393,189	5-25
Construction in progress	122,046	(122,046)	-	-	
	25,598,521	1,309,871	(25,521)	26,882,871	
Less accumulated depreciation					
Land improvements	458,405	17,354	-	475,759	
Buildings	4,715,510	489,151	-	5,204,661	
Fixed equipment	978,302	68,561	-	1,046,863	
Major movable equipment	6,169,246	819,816	(23,597)	6,965,465	
	12,321,463	1,394,882	(23,597)	13,692,748	
Net carrying amount	\$ 13,277,058			\$ 13,190,123	

8. LONG-TERM DEBT

Long-term debt activity for the years ended December 31, 2006 and 2005 follows:

	Beginning Balance	Current Year Additions	Current Year Reductions	Ending Balance	Current Portion
2006					
Leases and notes payable:					
Lease obligation	\$ 326,789	\$ -	\$ (76,478)	\$ 250,311	\$ 63,909
Note payable - 2003 series	4,255,000	-	(150,000)	4,105,000	160,000
	\$ 4,581,789	\$ -	\$ (226,478)	\$ 4,355,311	\$ 223,909
Total leases and notes payable	\$ 4,581,789	\$ -	\$ (226,478)	\$ 4,355,311	\$ 223,909

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

2005	<u>Beginning Balance</u>	<u>Current Year Additions</u>	<u>Current Year Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Leases and notes payable:					
Lease obligations	\$ 113,681	\$ 335,708	\$ (122,600)	\$ 326,789	\$ 76,478
Note payable - 2003 series	<u>4,400,000</u>	<u>-</u>	<u>(145,000)</u>	<u>4,255,000</u>	<u>150,000</u>
Total leases and notes payable	<u>\$ 4,513,681</u>	<u>\$ 335,708</u>	<u>\$ (267,600)</u>	<u>\$ 4,581,789</u>	<u>\$ 226,478</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 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 5.5 percent at December 31, 2006. 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. However, Hospital management has assessed any unsuccessful remarketing of the notes to be unlikely. 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. Interest is applied to letter-of-credit draws at a variable rate based on the current market interest rates.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

The letter-of-credit expires upon the earliest of June 16, 2008, 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.

As of December 31, 2006, debt service requirements of the variable-rate debt and capital lease obligations for their term were as follows:

Year Ending December 31	Principal	Lease Payable
2007	\$ 160,000	\$ 78,815
2008	165,000	78,815
2009	175,000	78,815
2010	185,000	45,975
2011	195,000	-
2012-2016	1,115,000	-
2017-2021	1,430,000	-
2022-2023	680,000	-
Total Payments	\$ 4,105,000	\$ 282,420
Less amount representing interest		32,109
Net present value		\$ 250,311

Capital leases have imputed interest rates of 4.48 percent to 5.86 percent. They expire at various times through 2010 and are collateralized by the equipment leased.

	2006	2005
Cost of equipment under capital lease	\$ 335,708	\$ 977,036
Less accumulated amortization	100,712	617,779
Net carrying amount	\$ 234,996	\$ 359,257

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

9. NET PATIENT SERVICE REVENUE

Net patient service revenue consists of the following:

	2006	2005
Revenue		
Inpatient service		
Routine service	\$ 4,914,388	\$ 5,446,481
Ancillary services	8,870,803	9,909,045
Outpatient ancillary services	45,923,737	38,181,349
Total patient revenue	59,708,928	53,536,875
Revenue deductions		
Provision for contractual allowances	23,417,238	22,760,257
Provision for charity care	1,851,552	1,083,659
Bad debts	3,392,136	3,410,448
Other allowances	177,041	180,442
Total revenue deductions	28,837,967	27,434,806
Total net patient service revenue	\$ 30,870,961	\$ 26,102,069

10. NON-OPERATING GAINS

Non-operating gains consist of the following:

	2006	2005
Donations, gifts and grants	\$ 66,114	\$ 6,060
Investment income	139,016	101,756
Interest expense	(279,497)	(260,460)
Other gains	143,396	242,866
Non-operating gains - net	\$ 69,029	\$ 90,222

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

11. 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 13.7% and 9.0%, respectively. The Hospital's contributions, representing 100% of employer contributions, for the last three years follows:

<u>Year</u>	<u>Contribution</u>
2006	\$ 1,567,909
2005	\$ 1,386,436
2004	\$ 1,394,504

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 2006 and 2005 employer contribution rates of 13.7% used to fund healthcare was 4.5%.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

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

The assumptions and calculations below are based upon PERS' latest actuarial review performed as of December 31, 2005. 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. The investment return assumption rate for 2005 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 6% for the next 9 years. In subsequent years (10 and beyond), healthcare costs were assumed to increase at 4% (the projected wage inflation rate).

The Traditional Pension and Combined Plans had 369,214 active contributing participants as of December 31, 2006. The number of active contributing participants for both plans used in the December 31, 2005 actuarial valuation was 358,804.

Hospital contributions made to fund post-employment benefits approximated \$515,000 and \$409,000 for 2006 and 2005, respectively.

The actuarial value of OPERS net assets at December 31, 2005 were \$11.1 billion. The actuarially accrued liability and the unfunded actuarial accrued liability for OPEB, based on the actuarial cost method was \$31.3 billion and \$20.2 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.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

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, and January 1, 2007, which will allow additional funds to be allocated to the health care plan.

12. 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 and workers' compensation claims.

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.

13. SUBSEQUENT EVENT

The Hospital entered into a lease agreement in 2007 for a 16 slice CT scanner. The lease agreement is valued at approximately \$1,200,000 and is to be paid over the next five years.



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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, as of and for the year ended December 31, 2006, and have issued our report thereon dated April 23, 2007. 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 Fayette County Memorial 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.

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 material misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Hospital'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 Hospital's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

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 Hospital's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be 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.

**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**

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Fayette County Memorial 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 April 23, 2007.

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

Blue & Co., LLC

April 23, 2007



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
MAY 29, 2007