

Morrow County Hospital and Affiliate

**Financial Report
with Additional Information
December 31, 2007**



Mary Taylor, CPA

Auditor of State

Board of Trustees
Morrow County Hospital and Affiliate
651 West Marion Road
Mt. Gilead, Ohio 43338

We have reviewed the *Independent Auditor's Report* of the Morrow County Hospital and Affiliate, Morrow County, prepared by Plante & Moran, PLLC for the audit period January 1, 2007 through December 31, 2007. 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 Morrow County Hospital and Affiliate is responsible for compliance with these laws and regulations.

Mary Taylor

Mary Taylor, CPA
Auditor of State

May 21, 2008

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Morrow County Hospital and Affiliate

Contents

Report Letter	1
Management's Discussion and Analysis	2-9
Financial Statements	
Balance Sheet	10-11
Statement of Revenues, Expenses, and Changes in Net Assets	12
Statement of Cash Flows	13-14
Notes to Financial Statements	15-29
Additional Information	30
Report Letter	31
Combining Balance Sheet	32-33
Combining Statement of Revenues, Expenses, and Changes in Net Assets	34
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	35-38

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Independent Auditor's Report

To the Board of Trustees
Morrow County Hospital and Affiliate

We have audited the accompanying balance sheet of Morrow County Hospital and Affiliate (the "Hospital"), a component unit of Morrow County, as of December 31, 2007 and 2006 and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Morrow County Hospital and Affiliate at December 31, 2007 and 2006 and the combined results of their operations and 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 supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 31, 2008 on our consideration of Morrow County Hospital and Affiliate's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinions on the effectiveness of 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.

Plante & Moran, PLLC

March 31, 2008

Morrow County Hospital and Affiliate

Management's Discussion and Analysis

Morrow County Hospital, located in Mount Gilead, Ohio, is a county-owned, tax-exempt entity that operates an acute-care hospital facility providing quality inpatient, outpatient, skilled nursing, and home health services to residents of Morrow County and surrounding areas. The reporting entity (the "Hospital") is comprised of Morrow County Hospital and the Morrow County Hospital Foundation, which provides services exclusively for the benefit of Morrow County Hospital. The Hospital is a component unit of the County. Morrow County Hospital is operated under Section 339 of the Ohio Revised Code.

This section of the Hospital's annual financial report presents management's discussion and analysis of the Hospital's financial performance and provides an overall review of the Hospital's financial position and activities as of and for the years ended December 31, 2007, 2006, and 2005. This discussion should be read in conjunction with the accompanying financial statements and notes. The financial statements, notes, and this management's discussion and analysis are the responsibility of the Hospital's management.

Financial and Operating Highlights for 2007

- Net assets increased by \$559,658, a 4 percent increase in net assets as of December 31, 2006.
- The Hospital secured the services of a full time orthopedic surgeon as well as additional physician anesthesia coverage.
- The Hospitalist program was expanded and now includes five physicians.
- The Hospital expanded its radiological services, now offering PET CT, bladderscan ultrasound, and CAD software for chest x-rays.
- Customer and physician satisfaction scores remained extremely positive, and in some areas, rank among the top 10 percent in the nation.

Overview of the Financial Statements

This annual report consists of financial statements prepared in accordance with the provisions of GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. These standards establish comprehensive financial reporting standards for all state and local governments and related entities.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

The balance sheet, statement of revenues, expenses, and changes in net assets, and statement of cash flows provide an indication of the Hospital's financial health. The balance sheet includes the Hospital's assets and liabilities, using the accrual basis of accounting as well as an indication about which assets can be utilized for general purposes and which are restricted for other purposes. The statement of revenues, expenses, and changes in net assets reports the revenues and expenses during the time periods indicated. The statement of cash flows reports the cash provided and used by operating activities, as well as other cash sources, such as investment income, and cash payments for repayment of debt and capital asset acquisitions.

Financial Analysis of the Hospital at December 31, 2007

Total assets decreased by 1.3 percent to \$22.9 million, and total liabilities decreased 8.9 percent to \$8.8 million. The Hospital's total net assets increased from \$13.5 million to \$14.0 million, a 4.1 percent improvement from a year ago as shown in the following table:

	2005	2006	2007	2006 to 2007 Change Amount	Percent
Assets:					
Current assets	\$ 8,334,287	\$ 8,723,221	\$ 8,000,165	\$ (723,056)	(8.3)
Noncurrent assets	3,348,613	3,961,373	4,460,364	498,991	12.6
Capital assets	<u>11,062,017</u>	<u>10,509,736</u>	<u>10,432,063</u>	<u>(77,673)</u>	(0.7)
Total assets	22,744,917	23,194,330	22,892,592	(301,738)	(1.3)
Liabilities:					
Current liabilities	5,820,935	6,003,540	5,753,566	(249,974)	(4.2)
Long-term liabilities	<u>4,377,048</u>	<u>3,690,080</u>	<u>3,078,658</u>	<u>(611,422)</u>	(16.6)
Total liabilities	<u>10,197,983</u>	<u>9,693,620</u>	<u>8,832,224</u>	<u>(861,396)</u>	(8.9)
Net assets:					
Invested in capital assets - Net of debt	6,295,196	6,487,071	7,033,974	546,903	8.4
Unrestricted	<u>6,251,738</u>	<u>7,013,639</u>	<u>7,026,394</u>	<u>12,755</u>	0.2
Total net assets	<u>\$ 12,546,934</u>	<u>\$ 13,500,710</u>	<u>\$ 14,060,368</u>	<u>\$ 559,658</u>	4.1

Current Assets

Total current assets decreased by \$723,056 from the previous year. Cash and cash equivalents decreased \$846,401 due to increased patient accounts receivable. Patient accounts receivable increased \$666,979 due to the extended absence of a hospital biller, problems with the conversion to the new UB-04 billing form, and issues related to the implementation of a new laboratory information system. Short-term investments decreased by \$310,376 due primarily to the transfer of these funds to the funded depreciation fund, which is classified as assets limited as to use.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

Noncurrent Assets

Noncurrent assets, which consist primarily of limited use investments, general long-term investments, and physician advances receivable, increased by \$498,991, or 12.6 percent. Limited use investments increased by \$581,440. The increase was due to the transfer of additional amounts to funded depreciation, a fund used to save for future capital purchases.

Capital Assets

Capital assets decreased by \$77,673 or .7 percent. The decrease was due to depreciation expense of \$1,388,381 offset by additions of \$1,310,618.

Current Liabilities

Current liabilities decreased \$249,974 over the prior year. Accounts payable decreased by \$121,051 due to the timing of payments to vendors. Cost report settlements payable decreased by \$27,373 due to a decrease in the estimated payment rates from Medicare for inpatient and outpatient services. Other accrued liabilities decreased by \$194,176, primarily due to a reduction in estimate for deferred income related to the government's Healthcare Assurance Program (HCAP).

Long-term Liabilities

Long-term liabilities decreased by \$611,422. Long-term debt decreased by \$624,576 from 2006 due to \$760,092 in principal payments, offset by \$135,516 of new capital leases. Additional detail regarding the Hospital's long-term debt can be found in Note 7 of the financial statements.

Net Assets

Total net assets increased by \$559,658, or 4.1 percent, due entirely to excess revenue over expenses.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

Revenue and Expenses

The following table shows the changes in revenues and expenses for 2007 compared to 2006 and 2005:

	2005	2006	2007	Change	
				Amount	Percent
Operating Revenue					
Net patient service revenue	\$ 25,293,111	\$ 26,488,740	\$ 27,019,470	\$ 530,730	2.0%
Other	550,055	713,639	730,468	16,829	2.4%
Total operating revenue	25,843,166	27,202,379	27,749,938	547,559	2.0%
Operating Expenses					
Salaries and benefits	12,329,039	13,236,977	14,253,489	1,016,512	7.7%
Operating supplies and expenses	5,081,308	5,236,485	5,473,785	237,300	4.5%
Purchased services	5,538,478	5,999,809	5,829,136	(170,673)	(2.8%)
Insurance	173,955	155,743	196,180	40,437	26.0%
Utilities	633,800	685,203	626,453	(58,750)	(8.6%)
Rental	509,451	751,459	703,150	(48,309)	(6.4%)
Depreciation and amortization	1,465,771	1,336,451	1,388,381	51,930	3.9%
Total operating expenses	25,731,802	27,402,127	28,470,574	1,068,447	3.9%
Operating Income (Loss)	111,364	(199,748)	(720,636)	(520,888)	260.8%
Nonoperating Gains (Losses)					
Investment income	90,942	198,094	241,853	43,759	22.1%
Property taxes	1,240,000	1,240,176	1,284,130	43,954	3.5%
Interest expense	(350,826)	(284,746)	(245,689)	39,057	(13.7%)
Total nonoperating gains	980,116	1,153,524	1,280,294	126,770	11.0%
Excess of Revenue Over Expenses/ Increase in Net Assets	1,091,480	953,776	559,658	\$ (394,118)	(41.3%)
Net Assets - Beginning of year	11,455,454	12,546,934	13,500,710		
Net Assets - End of year	\$ 12,546,934	\$ 13,500,710	\$ 14,060,368		

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

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, and the cafeteria. In addition, certain federal, state, and private grants are considered operating if they are not utilized for capital purposes and are considered a contract for services. Operating revenue changes were a result of the following factors:

- Net patient service revenue increased \$530,730, or 2.0 percent, from 2006. Gross patient revenue increased by \$1,615,738 or 3.6 percent. The Hospital board of trustees approved a 7 percent rate increase effective January 1, 2007. The positive impact of the rate increase was diluted by decreases in volume for inpatient and outpatient services. Gross patient revenue is reduced by revenue deductions. These deductions are the amounts that are not paid to the Hospital under contractual arrangements with Medicare, Medicaid, and other payors. These revenue deductions increased slightly from 40.7 percent to 41.6 percent as a percentage of gross revenue.

Operating Expenses

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

- Salaries and benefits increased 7.7 percent due to increased costs related to employee health insurance, annual raises, the additional OPERS expense associated with the salary increase, and an increase in the employer contribution rate for OPERS.
- Operating supplies and expenses increased 4.5 percent due to increased physician recruiting increasing these expenses.
- Purchased services decreased 2.8 percent due to the elimination of agency nursing.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

The following is a summary of 2007 operating expenses by type:

Operating Expenses		
Salaries and benefits	50.06%	\$ 14,253,489
Operating supplies and expenses	19.23%	5,473,785
Purchased services	20.47%	5,829,136
Insurance	0.69%	196,180
Utilities	2.20%	626,453
Rental	2.47%	703,150
Depreciation and amortization	4.88%	1,388,381
Total	100.00%	\$ 28,470,574

Nonoperating Gains (Losses)

Nonoperating revenue and expenses are all sources and uses that are primarily nonexchange in nature. At Morrow County Hospital, these consist primarily of property tax levy funds and interest expense.

Significant changes to nonoperating gains (losses) were the result of the following factors:

- Investment income increased by \$43,759 or 22.1 percent, due to the transfer of cash into higher yielding investments.
- Interest expense decreased by \$39,057 or 13.7 percent, due to the payoff of three capital leases during 2007 and the normal paydown of the Hospital's master lease and purchase agreement.

Statement of Cash Flows

The statement of cash flows provides relevant information about the entity's cash receipts and cash payments. 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 needs for external financing

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

The following table shows condensed cash flow information for the years 2007, 2006, and 2005:

	2005	2006	2007	Increase (Decrease)
Cash provided (used) by:				
Operating activities	\$ 1,652,919	\$ 1,615,875	\$ 46,248	\$ (1,569,627)
Capital and related financing activities	(634,307)	(575,457)	(899,558)	(324,101)
Investing activities	(440,277)	130,559	706,744	576,185
Net Increase (Decrease) in Cash	578,335	1,170,977	(146,566)	(1,317,543)
Cash - Beginning of year	988,325	1,566,660	2,737,637	1,170,977
Cash - End of year	<u>\$ 1,566,660</u>	<u>\$ 2,737,637</u>	<u>\$ 2,591,071</u>	<u>\$ (146,566)</u>

The following discussion amplifies the overview of cash flows presented above:

- Net cash provided by operating activities decreased \$1,569,627 over the prior year due to a decrease of \$796,562 in payments received from our patients and third-party payors and an additional \$1,065,995 paid to employees for wages and benefits, offset by a decrease of \$276,101 in payments to suppliers for goods and services.
- Net cash used in capital and related financing activities increased slightly from 2006 due to the paydown of capital leases and long-term debt, offset by a \$391,021 increase in the acquisition and construction of capital assets.
- Investing activities provided \$576,185 more cash in 2007 than in 2006. This was due primarily to a \$460,730 increase in the net sale/purchase of investments compared to 2006 and \$43,759 in additional investment income.

Economic Factors and Next Year's Budget

The board of trustees and the Morrow County Commissioners approved the 2008 operating budget in October 2007. The budget calls for gross revenue of \$50 million, total operating expenses of \$32.3 million, and excess revenue over expense of \$1.2 million. The board of trustees approved an average increase of 6 percent in the patient charge structure for the upcoming fiscal year.

There are several factors and uncertainties that may affect the Hospital during 2008 and future years including:

- There are pressures at both the federal and state levels to decrease funding for the Medicare and Medicaid programs. This could negatively affect the Hospital's reimbursement for its acute-care and skilled-nursing facilities.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

- The federal government's upper payment limit program, which provides additional reimbursement to public hospitals for Medicaid inpatients, and the Hospital Care Assurance Program, which provides funding for indigent patients, face uncertain futures. The Hospital's reimbursement from both programs was reduced in 2007.
- The economic position of the Hospital is influenced by the local economy. Compared to other Ohio counties, Morrow County has higher than average unemployment and below average per capita income.
- The success of the Hospital is closely tied to that of its medical staff. The Hospital occasionally faces pressures on its relationship with its physicians due to external factors such as changes in reimbursement, the implementation of new technologies, and the utilization and referral patterns of the physicians.
- Due to its rural location, the Hospital must occasionally address physician shortages including family practitioners and specialists.
- The Hospital's strategic plan calls for the expansion and renovation of its facility. The timing and financial impact of this project is uncertain as of the report date.

Contacting the Hospital's Management

This financial report is intended to provide the people of Morrow County, state and federal governments, and our debt holders with a general overview of the Hospital's finances. In addition, this report discloses the uses of the money received from services provided and county property taxes. If you have questions about this report or need additional information, please contact me.

Joseph Schueler
Chief Financial Officer

Morrow County Hospital and Affiliate

Balance Sheet

	December 31, 2007	December 31, 2006
Assets		
Current Assets		
Cash and cash equivalents (Note 4)	\$ 547,730	\$ 1,394,131
Short-term investments (Note 4)	300,000	610,376
Accounts receivable (Note 3)	4,954,795	4,287,816
Levied taxes receivable	1,250,000	1,250,000
Prepaid expenses and other	481,303	661,981
Inventory	400,748	397,981
Other current assets - Physician advances	65,589	120,936
Total current assets	8,000,165	8,723,221
Assets Limited as to Use (Note 4)	4,083,890	3,502,450
General Long-term Investments (Note 4)	315,723	351,843
Capital Assets (Note 5)	10,432,063	10,509,736
Other Assets - Physician advances	60,751	107,080
Total assets	\$ 22,892,592	\$ 23,194,330

Morrow County Hospital and Affiliate

Balance Sheet (Continued)

	December 31, 2007	December 31, 2006
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 7)	\$ 781,704	\$ 746,733
Accounts payable	1,620,759	1,741,810
Third-party settlements payable (Note 6)	316,777	344,150
Accrued liabilities and other:		
Accrued compensation	1,457,815	1,397,445
Accrued interest	15,305	18,020
Deferred revenue for levied taxes	1,250,000	1,250,000
Other accrued liabilities	311,206	505,382
Total current liabilities	5,753,566	6,003,540
Long-term Debt - Net of current portion (Note 7)	2,616,385	3,275,932
Other Liabilities - Compensated absences (Note 7)	462,273	414,148
Total liabilities	8,832,224	9,693,620
Net Assets		
Invested in capital assets - Net of related debt	7,033,974	6,487,071
Unrestricted	7,026,394	7,013,639
Total net assets	14,060,368	13,500,710
Total liabilities and net assets	\$ 22,892,592	\$ 23,194,330

Morrow County Hospital and Affiliate

Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended	
	December 31, 2007	December 31, 2006
Operating Revenues		
Net patient service revenue	\$ 27,019,470	\$ 26,488,740
Other	730,468	713,639
Total operating revenues	27,749,938	27,202,379
Operating Expenses		
Salaries and wages	10,003,019	9,474,973
Employee benefits and payroll taxes	4,250,470	3,762,004
Operating supplies and expenses	5,473,785	5,236,485
Purchased services	5,829,136	5,999,809
Insurance	196,180	155,743
Utilities	626,453	685,203
Rental	703,150	751,459
Depreciation and amortization	1,388,381	1,336,451
Total operating expenses	28,470,574	27,402,127
Operating Loss	(720,636)	(199,748)
Nonoperating Income (Expense)		
Investment income	241,853	198,094
Property taxes	1,284,130	1,240,176
Interest expense	(245,689)	(284,746)
Total nonoperating income	1,280,294	1,153,524
Increase in Net Assets	559,658	953,776
Net Assets - Beginning of year	13,500,710	12,546,934
Net Assets - End of year	\$ 14,060,368	\$ 13,500,710

Morrow County Hospital and Affiliate

Statement of Cash Flows

	Year Ended	
	December 31, 2007	December 31, 2006
Cash Flows from Operating Activities		
Cash received from patients and third-party payors	\$ 26,325,118	\$ 27,121,680
Cash payments to suppliers for services and goods	(12,816,219)	(13,092,320)
Cash payments to employees for services	(14,193,119)	(13,127,124)
Other receipts from operations	730,468	713,639
Net cash provided by operating activities	46,248	1,615,875
Cash Flows from Investing Activities		
Proceeds from sale of investments	2,206,888	784,212
Investment income	241,853	198,094
Decrease in assets limited as to use	8,378	11,832
Purchase of investments	(1,750,375)	(788,429)
Advances to physicians	-	(75,150)
Net cash provided by investing activities	706,744	130,559
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(1,175,192)	(784,171)
Property tax levy	1,284,130	1,240,176
Interest paid on long-term debt	(248,404)	(287,306)
Principal payments on long-term debt	(760,092)	(744,156)
Net cash used in capital and related financing activities	(899,558)	(575,457)
Net (Decrease) Increase in Cash and Cash Equivalents	(146,566)	1,170,977
Cash and Cash Equivalents - Beginning of year	2,737,637	1,566,660
Cash and Cash Equivalents - End of year	\$ 2,591,071	\$ 2,737,637
Supplemental Cash Flow Information		
Included in current assets	\$ 547,730	\$ 1,394,131
Included in assets limited as to use	1,878,067	1,288,249
Included in general long-term investments	165,274	55,257
Cash and Cash Equivalents - End of year	\$ 2,591,071	\$ 2,737,637

Morrow County Hospital and Affiliate

Statement of Cash Flows (Continued)

A reconciliation of operating loss to net cash from operating activities is as follows:

	Year Ended	
	December 31, 2007	December 31, 2006
Cash Flows from Operating Activities		
Operating loss	\$ (720,636)	\$ (199,748)
Adjustments to reconcile operating loss to net cash from operating activities:		
Depreciation and amortization	1,388,381	1,336,451
Provision for bad debts	2,839,002	2,364,511
Forgiveness of physician advances	101,676	69,937
(Increase) decrease in assets:		
Patient accounts receivable	(3,505,981)	(2,184,571)
Third-party settlement receivables	-	108,850
Inventories	(2,767)	(116,641)
Other current assets	180,678	(105,267)
Increase (decrease) in liabilities:		
Accounts payable	(121,051)	(211,384)
Accrued expenses	(85,681)	209,587
Third-party settlement payables	(27,373)	344,150
Net cash provided by operating activities	<u>\$ 46,248</u>	<u>\$ 1,615,875</u>

Equipment obtained via capital lease during 2007 amounted to \$135,516.

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note I - Nature of Business and Significant Accounting Policies

Organization - The accompanying financial statements include the accounts of Morrow County Hospital and Morrow County Hospital Foundation (collectively, the "Hospital"). All significant intercompany transactions and balances have been eliminated.

Morrow County Hospital is an acute and extended-care facility owned by, and is a component unit of, Morrow County, Ohio and operated by a board of trustees. Members of the board of trustees are appointed by the County Commissioners. The Hospital is a political subdivision of the State of Ohio and is therefore exempt from federal income taxes under Section 115 of the Internal Revenue Code. The Hospital was formed under the provisions of the Ohio Revised Code.

During 1997, the Hospital formed Morrow County Hospital Foundation (the "Foundation"). The purpose of the Foundation is to support the Hospital and community programs to improve the health and well-being of the people served by the Hospital. The Foundation is exempt under Section 501(a) as an organization described in Section 501(c)(3) of the Internal Revenue Code.

Basis of Presentation - The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued in June 1999. The Hospital follows the "business-type" activities reporting requirements of GASB Statement No. 34, which provide a comprehensive look at the Hospital's financial activities. The Foundation is required to be reported in the Hospital's financial statements.

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 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 an original maturity of three months or less. Cash and cash equivalents included in assets limited as to use and general long-term investments are considered cash and cash equivalents for the purpose of the statement of cash flows.

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Investments - Investments include certificates of deposit and government securities and are recorded at fair value in the balance sheet. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in nonoperating revenue when earned.

Patient Accounts Receivable - Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges. An allowance for uncollectible accounts is established on an aggregate basis by using historical write-off rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the Hospital's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for doubtful accounts in the period they are determined to be uncollectible. An allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

Inventories - Inventories, which consist of medical and office supplies and pharmaceutical products, are stated at cost, determined on a first-in, first-out basis or market, whichever is lower.

Assets Limited as to Use - Assets limited as to use consist of invested funds designated by the Hospital's board of trustees for operations.

Capital Assets - Property and equipment amounts are recorded at cost, or if donated, at fair value at the date of receipt. Depreciation is computed principally on the straight-line basis over the estimated useful lives of the assets. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or 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. Unused and earned benefits are recorded as a liability in the financial statements. Employees accumulate vacation days and sick leave benefits at varying rates depending on years of service. 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, up to a maximum of 240 hours, calculated at the employee's base pay rate as of the retirement date.

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note I - Nature of Business and Significant Accounting Policies (Continued)

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 noncapital 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 debt service arrangements. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

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

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 for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted 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 exclusions from the Medicare and Medicaid programs.

Contributions - The Hospital reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Hospital reports the expiration of donor restrictions when the assets are placed in service.

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Income from Operations - The Hospital's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing healthcare services - the Hospital's principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide healthcare services, other than financing costs.

Property Taxes - The Hospital received approximately 4.5 percent in 2007 and 2006 of its financial support from property taxes. These funds were used as follows:

	<u>2007</u>	<u>2006</u>
Used to support operations	\$ 1,284,130	\$ 1,240,176
Levied for debt service	-	-

Property taxes are levied by the County on the Hospital's behalf on January 1 and are intended to finance the Hospital's activities of the same calendar year. Amounts levied are based on assessed property values as of the preceding July 1. The property tax calendar includes these dates:

Levy date	January 1
Lien date	January 1
Tax bill mailed	January 21
First installment payment due	February 16
Second installment payment due	July 13

Property taxes are considered delinquent on the day following each payment due date.

Risk Management - The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. During 2007 and 2006, the Hospital provided charity care of approximately \$577,000 and \$340,000, respectively.

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

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 accrued, based on contribution rates determined by OPERS.

Note 2 - Deposits and Investments

Chapter 135 of the Ohio Uniform Depository Act authorizes local and governmental units to make deposits in any national bank located in the state subject to inspection by the superintendent of financial institutions. Section 135.14 of the Ohio Revised Code allows the local governmental to invest in United States Treasury bills, notes, bonds, or any other obligation or security issued by the United States Treasury or any other obligation guaranteed as to principal and interest by the United States of America and bonds and other obligations of the State of Ohio. Investments in no-load money market mutual funds, repurchase agreements, commercial paper, and bankers' acceptances are permitted subject to certain limitations that include completion of additional training, approved by the auditor of state, by the treasurer or governing board investing in these instruments.

The Hospital has designated three banks for the deposit of its funds. Investment of interim funds is limited to bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality, no-load money market mutual funds, and the Ohio subdivision's fund (STAR Ohio).

Statutes require the classification of funds held by the Hospital into three categories:

Active Funds - Active funds are those funds required to be kept in a "cash" or "near cash" status for immediate use by the Hospital. Such funds must be maintained either in depository accounts or withdrawable on demand, including negotiable order of withdrawal (NOW) accounts.

Inactive Funds - Inactive funds are those funds not required for use within the current five-year period of designated depositories. Ohio law permits inactive monies to be deposited or invested as certificates of deposit, maturing not later than the end of the current period of designated depositories or as savings or deposit accounts, including, but not limited to passbook accounts.

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 2 - Deposits and Investments (Continued)

Interim Funds - Interim funds are those funds which are not needed for immediate use but will be needed before the end of the current period of designation of deposit. Ohio law permits interim funds to be invested or deposited in the following securities:

1. Bonds, notes, or other obligations guaranteed by the United States, or those for which the faith of the United States is pledged for the payment of principal and interest
2. Bonds, notes debentures, or other obligations or securities issued by any federal governmental agency
3. No-load money market mutual funds consisting exclusively of obligations described in (1) or (2) above and repurchase agreements secured by such obligations, provided that investments in securities described in this division are made only through eligible institutions
4. Interim deposits in the eligible institutions applying for interim funds to be evidenced by time certificates of deposit maturing not more than one year from date of deposit, or by savings or deposit accounts, including but not limited to, passbook accounts
5. Bonds and other obligations of the State of Ohio
6. The Ohio State Treasurer's investment pool (STAR Ohio)
7. Commercial paper and bankers' acceptances which meet the requirements established by Ohio Revised Code, SEC 135.142
8. Under limited circumstances, corporate debt interest in either of the two highest rating classifications by at least two nationally recognized rating agencies

Protection of the Hospital's deposits is provided by the Federal Deposit Insurance Corporation, by eligible securities pledged by the financial institution as security for repayment, by surety company bonds deposited with the treasurer by the financial institution, or by single collateral pool established by the financial institution to secure the repayment of all public funds deposited with the institution.

Investments in stripped principal or interest obligations, reverse repurchase agreements, and derivatives are prohibited. The issuance of taxable notes for the purpose of arbitrage, the use of leverage, and short selling is also prohibited. An investment must mature within five years from the date of purchase unless matched to a specific obligation or debt of the Hospital, and must be purchased with the expectation that it will be held to maturity.

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 2 - Deposits and Investments (Continued)

The Hospital's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories. At year end, all Hospital bank deposits (certificates of deposit, checking, and savings accounts) were fully collateralized.

Custodial Credit Risk of Investments

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Hospital does not have a policy for custodial credit risk. At year end, the following investment securities were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the Hospital's name:

Type of Investment	Carrying Value	How Held
2007 U.S. government bonds	\$ 2,356,272	Counterparty
2006 U.S. government bonds	2,510,787	Counterparty

Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Hospital does not have an investment policy that addresses interest rate risk. At year end, the average maturities of investments are as follows:

Investment	Fair Value	Weighted Average Maturity
2006 U.S. government bonds	\$ 2,356,272	2.78 years
2005 U.S. government bonds	2,510,787	2.25 years

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	<u>2007</u>	<u>2006</u>
Patient accounts receivable	\$ 9,344,795	\$ 7,791,816
Less:		
Allowance for uncollectible accounts	(1,980,000)	(1,537,000)
Allowance for contractual adjustments	<u>(2,410,000)</u>	<u>(1,967,000)</u>
Net accounts receivable	<u>\$ 4,954,795</u>	<u>\$ 4,287,816</u>

The Hospital grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	<u>Percent</u>	
	<u>2007</u>	<u>2006</u>
Medicare	31	30
Medicaid	11	7
Commercial insurance and HMOs	35	38
Self-pay	<u>23</u>	<u>25</u>
Total	<u>100</u>	<u>100</u>

Note 4 - Assets Limited as to Use and Investments

Cash deposits, assets whose use is limited, and investments of the Hospital are composed of the following:

	<u>Fair Value</u>	
	<u>2007</u>	<u>2006</u>
Demand deposits and money market accounts	\$ 2,591,071	\$ 2,737,637
Certificates of deposit	300,000	610,376
U.S. government obligations	<u>2,356,272</u>	<u>2,510,787</u>
Total	<u>\$ 5,247,343</u>	<u>\$ 5,858,800</u>

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 4 - Assets Limited as to Use and Investments (Continued)

	Fair Value	
	2007	2006
Amounts summarized by fund type -		
General funds:		
Cash and cash equivalents	\$ 547,730	\$ 1,394,131
Short-term investments	300,000	610,376
Board designated	4,083,890	3,502,450
General long-term investments	315,723	351,843
Total	<u>\$ 5,247,343</u>	<u>\$ 5,858,800</u>

Note 5 - Capital Assets

Cost of capital assets and related depreciable lives for December 31, 2007 are summarized below:

	2006	Additions	Transfers	Retirements	2007	Depreciable Life - Years
Land and land improvements	\$ 546,059	\$ -	\$ -	\$ -	\$ 546,059	5-25
Building	5,049,889	15,735	-	-	5,065,624	10-40
Equipment	14,419,521	573,930	518,502	-	15,511,953	5-20
Construction in progress	133,838	721,043	(518,502)	-	336,379	-
Total	20,149,307	1,310,708	-	-	21,460,015	
Less accumulated depreciation:						
Land and land improvements	326,976	27,088	-	-	354,064	
Building	2,390,880	223,702	-	-	2,614,582	
Equipment	6,921,715	1,137,591	-	-	8,059,306	
Total	9,639,571	1,388,381	-	-	11,027,952	
Net carrying amount	<u>\$10,509,736</u>	<u>\$ (77,673)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$10,432,063</u>	

Cost of capital assets and related depreciable lives for December 31, 2006 are summarized below:

	2005	Additions	Transfers	Retirements	2006	Depreciable Life - Years
Land and land improvements	\$ 536,904	\$ 46,507	\$ -	\$ (37,352)	\$ 546,059	5-25
Building	5,372,006	101,880	33,927	(457,924)	5,049,889	10-40
Equipment	14,993,987	502,512	246,014	(1,322,992)	14,419,521	5-20
Construction in progress	280,507	133,272	(279,941)	-	133,838	-
Total	21,183,404	784,171	-	(1,818,268)	20,149,307	
Less accumulated depreciation:						
Land and land improvements	335,114	29,214	-	(37,352)	326,976	
Building	2,622,758	226,046	-	(457,924)	2,390,880	
Equipment	7,163,515	1,081,192	-	(1,322,992)	6,921,715	
Total	10,121,387	1,336,452	-	(1,818,268)	9,639,571	
Net carrying amount	<u>\$11,062,017</u>	<u>\$ (552,281)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$10,509,736</u>	

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 6 - Cost Report Settlements

Approximately 60 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 these 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 October 1, 2002, the Hospital received full accreditation from the Center for Medicare and Medicaid Services for the critical access hospital designation. As a critical access hospital, the Hospital receives cost-based reimbursement for both inpatient and outpatient services provided to Medicare beneficiaries.

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 a fee-for-service methodology.

The Medicaid payment system in Ohio is a prospective one, 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 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.

The Hospital also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Hospital under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 7 - Long-term Debt and Other Noncurrent Liabilities

Long-term liability activity for the year ended December 31, 2007 was as follows:

	2006	Current Year Additions	Current Year Reductions	2007	Amounts Due Within One Year
Master lease and purchase agreement	\$ 3,383,872	\$ -	\$ (509,738)	\$ 2,874,134	\$ 539,981
Capital lease obligations	638,793	135,516	(250,354)	523,955	241,723
Total long-term debt	4,022,665	135,516	(760,092)	3,398,089	781,704
Compensated absences	414,148	888,059	(839,934)	462,273	462,273
Total noncurrent liabilities	<u>\$ 4,436,813</u>	<u>\$ 1,023,575</u>	<u>\$ (1,600,026)</u>	<u>\$ 3,860,362</u>	<u>\$ 1,243,977</u>

Long-term liability activity for the year ended December 31, 2006 was as follows:

	2005	Current Year Additions	Current Year Reductions	2006	Amounts Due Within One Year
Master lease and purchase agreement	\$ 3,864,655	\$ -	\$ (480,783)	\$ 3,383,872	\$ 509,738
Capital lease obligations	902,166	-	(263,373)	638,793	236,995
Total long-term debt	4,766,821	-	(744,156)	4,022,665	746,733
Compensated absences	354,385	849,319	(789,556)	414,148	414,148
Total noncurrent liabilities	<u>\$ 5,121,206</u>	<u>\$ 849,319</u>	<u>\$ (1,533,712)</u>	<u>\$ 4,436,813</u>	<u>\$ 1,160,881</u>

The bonds payable are summarized as follows:

- Under a master lease and purchase agreement, the Hospital borrowed \$4,950,000 under an arrangement with a finance company to finance the construction of facilities improvements. The financing was provided by the issuance of a 10-year note maturing August 2012, with interest at 5.89 percent. The debt is collateralized by capital assets purchased with the proceeds. The lease and purchase agreement provides, among other things, for certain covenants and payoff options which allow for early retirement of the debt by the Hospital.

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 7 - Long-term Debt and Other Noncurrent Liabilities (Continued)

- The Hospital leases medical and office equipment and furniture and fixtures used in its operations under capital leases which generally require the Hospital to pay insurance and maintenance costs. These capital leases are due in monthly installments including interest at rates ranging from 1.34 percent to 11.52 percent annually. These leases expire at various dates through 2012 and are collateralized by the leased equipment. Capitalized costs at December 31, 2007 and 2006 were approximately \$1,591,000 and \$1,605,000 less accumulated depreciation of \$1,071,000 and \$966,000, respectively.

The following is a schedule by years of principal and interest as of December 31, 2007:

Years Ending December 31	Long-term Debt		Capital Lease Obligation	
	Principal	Interest	Principal	Interest
2008	\$ 539,981	\$ 157,939	\$ 241,724	\$ 41,400
2009	572,958	124,962	212,530	18,559
2010	607,464	90,456	24,118	5,078
2011	644,049	53,871	26,283	2,912
2012	509,682	15,120	19,300	669
Total payments	<u>\$ 2,874,134</u>	<u>\$ 442,348</u>	<u>\$ 523,955</u>	<u>\$ 68,618</u>

Note 8 - Medical Malpractice Claims

Based on the nature of its operations, the Hospital is at times subject to pending or threatened legal actions, which arise in the normal course of its activities.

The Hospital is insured against medical malpractice claims under a claims-based policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claims 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 \$4,000,000 of coverage.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on the occurrences during the claims-made term, but reported subsequently, will be uninsured.

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 8 - Medical Malpractice Claims (Continued)

The Hospital is not aware of any medical malpractice claims, either asserted or unasserted, that would exceed the policy limits. No claims have been settled during the past three years that have exceeded policy coverage limits. The cost of this insurance policy represents the Hospital's cost for such claims for the past three years, and it has been charged to operations as a current expense.

Note 9 - Defined Benefit Pension Plan

Plan Description - The Hospital contributes to the Ohio Public Employees' Retirement System of Ohio (OPERS). OPERS administers three separate pension plans: the Traditional Pension Plan (TP) - 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 post-employment healthcare coverage to qualifying members of both the TP and CO plans. Members of the MD do not qualify for ancillary benefits, including postemployment healthcare coverage.

The Ohio Revised Code permits, but does not mandate, OPERS to provide OPEB benefits to its eligible members and beneficiaries. Authority to establish and amend benefits is provided in Chapter 145 of the Ohio Revised Code.

OPERS issues a stand-alone financial report. Interested parties may obtain a copy by making a written request to Ohio Public Employees' Retirement System, 277 East Town Street, Columbus, Ohio 43215-4642 or by calling 614-222-5601 or 1-800-222-PERS (7377).

Funding Policy - The Ohio Revised Code provides statutory authority requiring public employers to fund retirement and postretirement benefits through their contributions to OPERS for member and employer contributions. A portion of each employer's contribution to OPERS is set aside for the funding of postretirement benefits.

For 2007, member and employer contribution rates were consistent across all three plans (TP, MD, and CO), and are actuarially determined. The 2007 member contribution rate for members of local government units was 9.50 percent of their annual covered salary. The 2007, 2006, and 2005 employer contribution rate for local government units was 13.85 percent, 13.70 percent, and 13.55 percent, respectively, of covered payroll. The Hospital's contributions to OPERS for the years ended December 31, 2007, 2006, and 2005 were approximately \$1,409,000, \$1,326,000, and \$1,248,000, respectively. Required employer contributions for all plans are equal to 100 percent of employer charges and must be extracted from the employer's records.

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 9 - Defined Benefit Pension Plan (Continued)

Postretirement Benefits - In order to qualify for postretirement healthcare coverage under the TP and CO plans, age and service retirees must have 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 postemployment benefit (OPEB), as described in GASB Statement No. 12. A portion of each employer's contribution to OPERS is set aside for the funding of postretirement health care. The Ohio Revised Code provides statutory authority for employer contributions. The 2007 and 2006 employer contribution rates for local government employer units was 13.85 percent and 13.70 percent of covered payroll, respectively. Of these amounts, 5 percent and 6 percent were used for January 1 through June 30, 2007 and July 1 through December 31, 2007, respectively, and 4.50 percent was used to fund health care during 2006. The portion of the employer's contribution used to fund postemployment benefits for 2007 and 2006 was \$560,000 and \$436,000, respectively.

The Ohio Revised Code provides the statutory authority requiring public employers to fund postretirement health care through their contributions to OPERS.

An entry-age normal actuarial cost method of valuation is used in determining the present value of OPEB. Actuarial valuation includes a number of assumptions. The investment return assumption rate for 2006 was 6.50 percent. An annual increase of 4.00 percent 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 4.00 percent base increase, were assumed to range from 0.50 percent to 6.30 percent. Healthcare costs were assumed to increase at the projected wage inflation rate plus an additional factor ranging from 0.50 percent to 5.00 percent for the next eight years. In subsequent years (nine and beyond), healthcare costs were assumed to increase at 4.00 percent (the projected wage inflation rate) annually. These assumptions and calculations are based on the System's latest actuarial review performed as of December 31, 2006.

The number of active contributing participants in the TP and CO plans at December 31, 2007 was 374,979. The number of active contributing participants for both plans used in the December 31, 2006 actuarial valuation was 362,130. As of December 31, 2006, the actuarial value of the retirement system's net assets available for OPEB was \$12.0 billion. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$30.7 billion and \$18.7 billion, respectively.

Morrow County Hospital and Affiliate

Notes to Financial Statements December 31, 2007 and 2006

Note 9 - Defined Benefit Pension Plan (Continued)

Healthcare Plan - On September 9, 2004, the OPERS retirement board adopted a healthcare preservation plan (HCPP) with an effective date of January 1, 2007. Member and employer contribution rates increased as of January 1, 2006, 2007, and 2008, which will allow additional funds to be allocated to the healthcare plan.

Note 10 - Affiliation

The Hospital contracts with OhioHealth for management, information technology, and other support services. OhioHealth employs the Hospital's chief executive and chief financial officers and also appoints one nonvoting representative to the Hospital's board of trustees. Fees for services amounted to approximately \$487,000 and \$557,000 for the years ended December 31, 2007 and 2006, respectively. Amounts due to OhioHealth for services amounted to approximately \$44,000 and \$43,000 at December 31, 2007 and 2006, respectively, and have been included in accounts payable on the balance sheet.

Additional Information



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To the Board of Trustees
Morrow County Hospital and Affiliate

We have audited the financial statements of Morrow County Hospital and Affiliate as of December 31, 2007 and 2006. Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying combining balance sheet and statement of operations information is presented for the purpose of additional analysis of the basic financial statements rather than to present the financial position and results of operations of the individual entities and is not a required part of the basic financial statements. The combining information has been subjected to the procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Plante & Moran, PLLC

March 31, 2008

Morrow County Hospital and Affiliate

Combining Balance Sheet December 31, 2007

	Morrow County Hospital	Morrow County Hospital Foundation	Eliminating Entries	Total
Assets				
Current Assets				
Cash and cash equivalents	\$ 368,046	\$ 179,684	\$ -	\$ 547,730
Short-term investments	300,000	-	-	300,000
Accounts receivable	4,942,189	12,606	-	4,954,795
Levied taxes receivable	1,250,000	-	-	1,250,000
Prepaid expenses and other	436,720	44,583	-	481,303
Inventory	400,748	-	-	400,748
Other current assets - Physician advances	65,589	-	-	65,589
	<hr/>	<hr/>	<hr/>	<hr/>
Total current assets	7,763,292	236,873	-	8,000,165
Assets Limited as to Use	4,083,890	-	-	4,083,890
General Long-term Investments	-	315,723	-	315,723
Capital Assets	10,432,063	-	-	10,432,063
Other Assets - Physician advances	60,751	-	-	60,751
	<hr/>	<hr/>	<hr/>	<hr/>
Total assets	<u>\$ 22,339,996</u>	<u>\$ 552,596</u>	<u>\$ -</u>	<u>\$ 22,892,592</u>

Morrow County Hospital and Affiliate

Combining Balance Sheet (Continued) December 31, 2007

	Morrow County Hospital	Morrow County Hospital Foundation	Eliminating Entries	Total
Liabilities and Net Assets				
Current Liabilities				
Current portion of long-term debt	\$ 781,704	\$ -	\$ -	\$ 781,704
Accounts payable	1,620,759	-	-	1,620,759
Third-party settlements payable	316,777	-	-	316,777
Accrued liabilities and other:				
Accrued compensation	1,457,815	-	-	1,457,815
Accrued interest	15,305	-	-	15,305
Deferred revenue for levied taxes	1,250,000	-	-	1,250,000
Other accrued liabilities	311,206	-	-	311,206
	<u>5,753,566</u>	<u>-</u>	<u>-</u>	<u>5,753,566</u>
Total current liabilities				
	5,753,566	-	-	5,753,566
Long-term Debt - Net of current portion	2,616,385	-	-	2,616,385
Other Liabilities - Compensated absences	462,273	-	-	462,273
	<u>8,832,224</u>	<u>-</u>	<u>-</u>	<u>8,832,224</u>
Total liabilities				
	8,832,224	-	-	8,832,224
Net Assets				
Invested in capital assets - Net of related debt	7,033,974	-	-	7,033,974
Unrestricted	6,473,798	552,596	-	7,026,394
	<u>6,473,798</u>	<u>552,596</u>	<u>-</u>	<u>7,026,394</u>
Total liabilities and net assets	<u>\$ 22,339,996</u>	<u>\$ 552,596</u>	<u>\$ -</u>	<u>\$ 22,892,592</u>

Morrow County Hospital and Affiliate

Combining Statement of Revenues, Expenses, and Changes in Net Assets Year Ended December 31, 2007

	Morrow County Hospital	Morrow County Hospital Foundation	Eliminating Entries	Total
Operating Revenues				
Total patient service revenue	\$ 46,273,425	\$ -	\$ -	\$ 46,273,425
Revenue deductions	(19,253,955)	-	-	(19,253,955)
Net patient service revenue	27,019,470	-	-	27,019,470
Other	621,041	109,427	-	730,468
Total operating revenues	27,640,511	109,427	-	27,749,938
Operating Expenses				
Salaries and wages	10,003,019	-	-	10,003,019
Employee benefits and payroll taxes	4,250,470	-	-	4,250,470
Operating supplies and expenses	5,471,854	1,931	-	5,473,785
Purchased services	5,829,136	-	-	5,829,136
Insurance	196,180	-	-	196,180
Utilities	626,453	-	-	626,453
Rental	703,150	-	-	703,150
Depreciation and amortization	1,388,381	-	-	1,388,381
Total operating expenses	28,468,643	1,931	-	28,470,574
Operating (Loss) Income	(828,132)	107,496	-	(720,636)
Nonoperating Income (Expense)				
Investment income	241,853	-	-	241,853
Property taxes	1,284,130	-	-	1,284,130
Interest expense	(245,689)	-	-	(245,689)
Total nonoperating income	1,280,294	-	-	1,280,294
Excess of Revenue Over Expenses	452,162	107,496	-	559,658
Transfer from (to) Affiliate	7,763	(7,763)	-	-
Increase in Net Assets	\$ 459,925	\$ 99,733	\$ -	\$ 559,658

**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***

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

To the Board of Trustees
Morrow County Hospital and Affiliate

We have audited the financial statements of Morrow County Hospital and Affiliate as of and for the year ended December 31, 2007 and have issued our report thereon dated March 31, 2008. 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 Morrow County Hospital and Affiliate'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 internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Morrow County Hospital and Affiliate's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control 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 following to be significant deficiencies in internal control over financial reporting.

To the Board of Trustees
Morrow County Hospital and Affiliate

Significant Deficiencies

While performing procedures of the information technology general controls in place at the Hospital that could have a direct impact on the financial statement accumulation and/or internal control processes, we noted instances which we believe require attention as they relate to certain controls around password policies and procedures. Specifically, password complexity is not enforced, passwords have no minimum age, are not remembered, and there is no account lockout period defined after a certain number of unsuccessful attempts to log into an account. These weaknesses alone represent a high risk deficiency, but when combined with the risk associated with nonexpiring noncomplex passwords in PeopleSoft, the risk has the potential to be significant.

While performing our interim procedures, we noted one instance where proper board approval was not obtained when entering into a new capital lease. A chemical analyzer was purchased that was not included in the approved budget and specific board approval was not obtained.

During our year-end balance procedures for accounts payable, it was discovered that a third party accessed the Hospital's accounts payable system and made adjustments to that system. The Hospital was not aware of these adjustments and the Hospital's internal controls did not catch the error that was created by these adjustments.

During our year-end balance procedures for contractual allowance, we noted that no allowance was computed on Medicaid managed care accounts receivable, resulting in required allowances to be underallowed for. Finance personnel were not aware that the required allowance on these receivables was not made.

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.

Our consideration of 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, 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 Morrow County Hospital and Affiliate'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*.

To the Board of Trustees
Morrow County Hospital and Affiliate

We noted certain matters that we reported to management of Morrow County Hospital and Affiliate in a separate letter dated March 31, 2008.

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

Plante & Moran, PLLC

March 31, 2008



Mary Taylor, CPA
Auditor of State

MORROW COUNTY HOSPITAL AND AFFILIATE

MORROW 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
JUNE 3, 2008**