

FAYETTE COUNTY MEMORIAL HOSPITAL

FINANCIAL STATEMENTS

DECEMBER 31, 2009 AND 2008



Mary Taylor, CPA
Auditor of State

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

We have reviewed the *Report of Independent Auditors* of Fayette County Memorial Hospital, prepared by Blue & Co., LLC, for the audit period January 1, 2009 through December 31, 2009. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

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

Mary Taylor

Mary Taylor, CPA
Auditor of State

June 17, 2010

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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 (the "Hospital"), a business-type activity of Fayette County, Ohio, as of December 31, 2009 and 2008, and the related statements of operations and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the 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 the 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 the Hospital at December 31, 2009 and 2008, and the results of its operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 26, 2010, 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 the results of that testing, and not to provide an opinion 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.

The accompanying financial statements have been prepared assuming the Hospital will continue as a going concern. As discussed in Note 16 to the financial statements, the Hospital has experienced recurring losses from operations and was in default on certain covenants of its bond agreements at March 31, 2010. The bank may demand repayment of a substantial portion of the Hospital's long-term debt, though no such demand has been made. The Hospital is currently negotiating with the banks to remedy the violation, but cannot predict what the outcome of the negotiations will be. These conditions raise substantial doubt about the Hospital's ability to continue as a going concern. These financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Management's discussion and analysis on pages i through ix 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.

Blue & Co., LLC

May 26, 2010

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

(UNAUDITED)

Management's Discussion and Analysis

The discussion and analysis of Fayette County Memorial Hospital's (the Hospital) financial statements provides an overview of the Hospital's financial activities for the years ended December 31, 2009 and 2008. Management is responsible for the completeness and fairness of the financial statements and the related footnote disclosures along with the discussion and analysis.

Financial Highlights

Cash, investments, and assets limited as to use increased approximately \$62,000 while accounts receivables decreased approximately \$405,000. In total, the Hospital's expenses exceeded revenues and other support, creating a decrease in net assets of \$1,095,875 (compared to a decrease of \$1,688,176 in the previous year).

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.

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

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

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

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

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

The Statement of Cash Flows

The final required statement is the statement of cash flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. It provides answers to such questions as "Where did cash come from?" "What was cash used for?" and "What was the change in cash balance during the reporting period?"

Condensed Financial Information

The following is a comparative analysis of the major components of the Balance Sheet of the Hospital as of, December 31, 2009 and 2008.

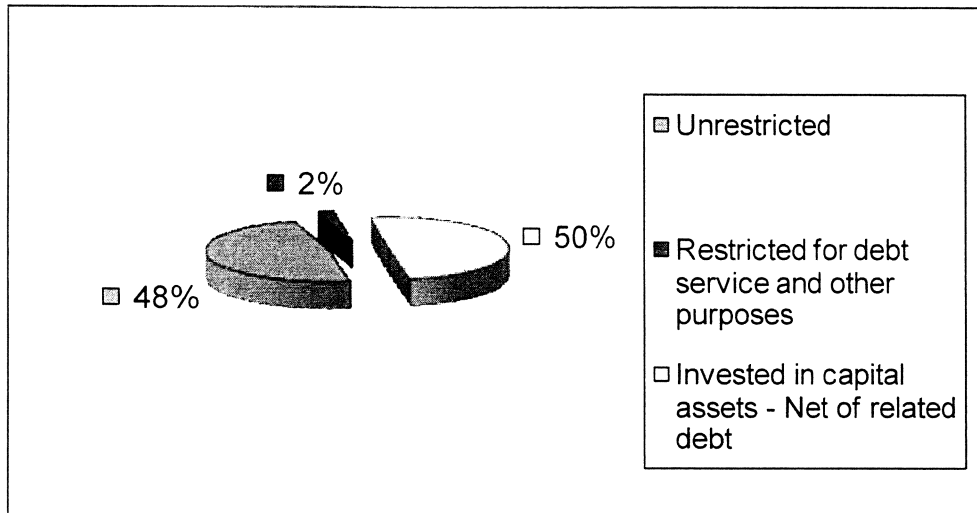
Assets, Liabilities and Net Assets

| | December 31 | | |
|---|----------------------|----------------------|----------------------|
| | 2009 | 2008 | 2007 |
| Current assets | \$ 6,944,822 | \$ 8,160,409 | \$ 9,411,047 |
| Noncurrent assets | 4,815,032 | 4,900,006 | 4,478,659 |
| Capital assets | 11,737,918 | 12,970,371 | 13,448,839 |
| Total assets | \$ 23,497,772 | \$ 26,030,786 | \$ 27,338,545 |
| Current liabilities | \$ 5,013,900 | \$ 6,436,719 | \$ 6,235,658 |
| Long-term liabilities | 4,487,803 | 4,502,123 | 4,322,767 |
| Total liabilities | \$ 9,501,703 | \$ 10,938,842 | \$ 10,558,425 |
| Net assets | | | |
| Invested in capital assets, net of debt | \$ 6,941,379 | \$ 8,647,605 | \$ 8,775,207 |
| Restricted | 301,399 | 269,019 | 219,471 |
| Unrestricted | 6,753,291 | 6,175,320 | 7,785,442 |
| Total net assets | \$ 13,996,069 | \$ 15,091,944 | \$ 16,780,120 |

The primary changes in the assets, liabilities and net assets relates to the decrease in accounts receivable of \$405,052, a decrease in net capital assets of \$1,232,453, a decreased liability for estimated third-party settlements of \$608,970, and decrease in net assets of \$1,095,875.

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

The following chart provides a breakdown of net assets by category for the year ended December 31, 2009:



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

Operating Results and Changes in Net Assets

| | Year Ended | | |
|---------------------------------------|----------------------|----------------------|----------------------|
| | 2009 | 2008 | 2007 |
| Operating revenues | | | |
| Net patient service revenues | \$ 33,717,996 | \$ 31,815,478 | \$ 33,178,637 |
| Other | 124,796 | 80,286 | 65,044 |
| Total operating revenues | 33,842,792 | 31,895,764 | 33,243,681 |
| Operating expenses | | | |
| Salaries and wages | 16,290,561 | 15,104,441 | 13,737,028 |
| Benefits | 4,995,588 | 4,892,292 | 4,279,472 |
| Physicians fees | 738,714 | 431,464 | 1,593,512 |
| Other fees | 3,890,201 | 3,479,025 | 2,984,975 |
| Supplies | 4,421,884 | 4,914,038 | 5,138,336 |
| Depreciation and amortization | 1,756,097 | 1,670,424 | 1,383,908 |
| Other expenses | 3,579,471 | 3,186,839 | 3,463,046 |
| Total operating expenses | 35,672,516 | 33,678,523 | 32,580,277 |
| Income (loss) from operations | (1,829,724) | (1,782,759) | 663,404 |
| Non-operating gains - net | 733,849 | 94,583 | 104,508 |
| Change in net assets | (1,095,875) | (1,688,176) | 767,912 |
| Net assets - beginning of year | 15,091,944 | 16,780,120 | 16,012,208 |
| Net assets - end of year | \$ 13,996,069 | \$ 15,091,944 | \$ 16,780,120 |

Operating Revenues

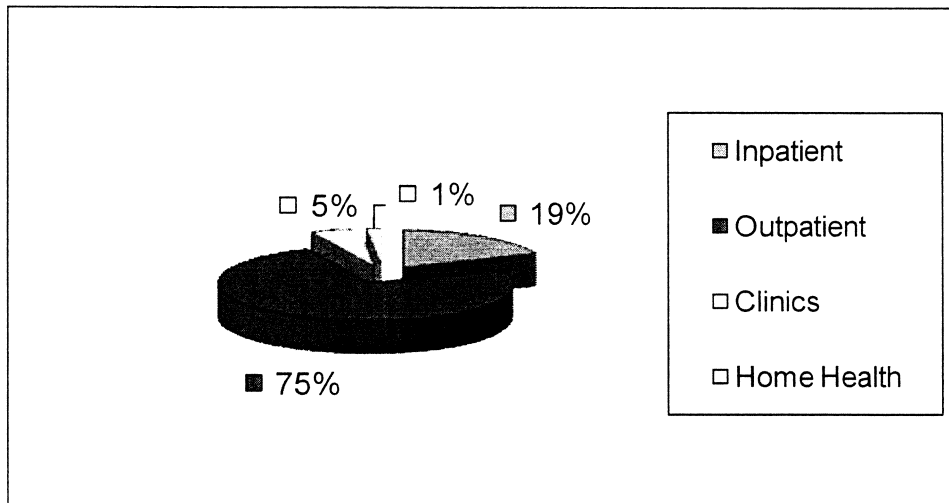
Operating revenues include all transactions that result in the sales and/or receipts from goods and services such as inpatient services, outpatient services, physician's offices, and the cafeteria. In addition, certain federal, state, and private grants are considered operating if they are not for capital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

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

Operating revenue changes were a result of the following factors:

- Net patient service revenue increased 6.0%. 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 56% and 54% of gross revenue in 2009 and 2008, respectively. The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Charity care provided during 2009 amounted to \$2,906,378, a 49% percent increase from 2008.

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



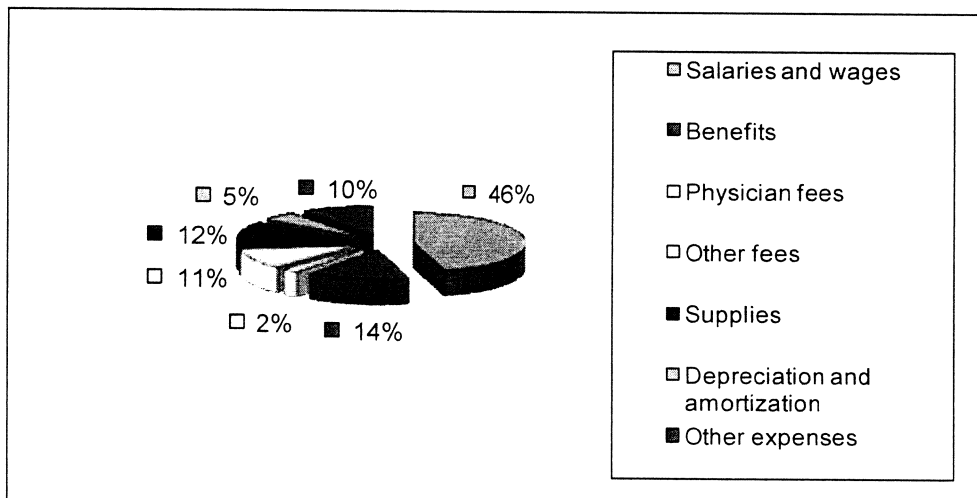
FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Operating Expenses

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

- Salary expenses increased 7.9%.
- Physician fees increased 71.2%.
- Other fees increased 11.8%
- Other expenses increased 12.2%

The following is a graphic illustration of 2009 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. The Hospital receives both capital and operating grants from various sources for specific programs. In 2009, the Hospital received a temporarily restricted contribution of \$598,972 from the Olive M. Blakely trust to be used for indigent care, which was released from restriction during the current year.

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

Statement of Cash Flows

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

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

| | 2009 | 2008 | 2007 |
|--|--------------|--------------|--------------|
| Cash from | | | |
| Operating activities | \$ (210,133) | \$ 1,857,876 | \$ 1,174,328 |
| Capital and related financing activities | (910,980) | (2,453,445) | (837,236) |
| Non-capital and related financing activities | 856,509 | 248,225 | 237,949 |
| Investing activities | (165,548) | (306,332) | (816,276) |
| Net change in cash and cash equivalents | (430,152) | (653,676) | (241,235) |
| Cash - Beginning of year | 2,036,670 | 2,690,346 | 2,931,581 |
| Cash - End of year | \$ 1,606,518 | \$ 2,036,670 | \$ 2,690,346 |

Consistent with the current year loss from operations, cash (used)/provided by operating activities was (\$210,133) in 2009 compared to \$1,857,876 in 2008. Capital purchases were \$287,965 in 2009 compared to \$1,074,528 in 2008 contributing to the decrease in cash used by capital and financing related activities.

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

Capital Assets and Debt Administration

Capital Assets

At December 31, 2009, the Hospital had \$27.4 million invested in capital assets, with an accumulated depreciation of \$15.6 million. Depreciation and amortization totaled \$1.6 million for the current year compared to \$1.5 million last year. Details of these gross capital assets for the past three years are shown below:

| | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|--------------------------|----------------------|----------------------|----------------------|
| Land | \$ 519,750 | \$ 519,750 | \$ 519,750 |
| Land improvements | 624,690 | 624,690 | 624,690 |
| Buildings | 15,147,687 | 15,106,324 | 15,013,734 |
| Fixed equipment | 1,790,552 | 1,798,552 | 1,792,376 |
| Major movable equipment | 9,252,961 | 9,994,259 | 9,232,357 |
| Construction in progress | 26,676 | 54,852 | 795,336 |
| | <u>26,676</u> | <u>54,852</u> | <u>795,336</u> |
| Total | <u>\$ 27,362,316</u> | <u>\$ 28,098,427</u> | <u>\$ 27,978,243</u> |

More detailed information about the Hospital's capital assets is presented in the notes to the financial statements.

Debt

At year-end, the Hospital had \$4,796,539 in debt outstanding, as compared to \$4,322,766 in 2008. The table below summarizes these amounts by type of debt instrument:

| | <u>2009</u> | <u>2008</u> | <u>2007</u> |
|-----------------------------|---------------------|---------------------|---------------------|
| Notes payable - 2003 Series | \$ 3,605,000 | \$ 3,780,000 | \$ 3,945,000 |
| Note payable | 735,209 | - | - |
| Lease obligation | 456,333 | 542,766 | 728,632 |
| | <u>456,333</u> | <u>542,766</u> | <u>728,632</u> |
| Total notes and leases | <u>\$ 4,796,542</u> | <u>\$ 4,322,766</u> | <u>\$ 4,673,632</u> |

In addition, the Hospital entered into a line-of-credit agreement in 2007 that was refinanced in December 2009 as a note payable. Borrowings under the note payable and line-of-credit were \$735,206 and \$750,000 at December 31, 2009 and 2008, respectively.

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

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

The Hospital is bound by the terms of the Trust Indenture and Reimbursement Agreement to various operations and financial covenants. For quarter ended December 31, 2009, these covenants include maintaining a minimum debt service ratio of 1.15 to 1.00, and minimum days cash on hand of 45. The Hospital was in compliance with the covenants as of December 31, 2009. For quarter ended March 31, 2010 and thereafter, the covenants include maintaining a minimum debt service ratio of 1.25 to 1.00, and at least 50 days of cash on hand. The Hospital was in violation of its minimum debt service coverage ratio at March 31, 2010 and is currently working with the bank to remedy the violation.

Other Economic Factors

There are many outside factors that may affect the Hospital in 2010 and future years including:

- Healthcare reform signed into law in 2010. All implications for the Hospital are not yet known or understood.
- Federal and state governments are under continued pressure to decrease funding for Medicare and Medicaid.
- Medicare has initiated the Recovery Audit Contractor (RAC) program to identify overpayments. The Hospital is unable to determine if it will be audited and the extent of liability, if any.
- The local and state economies are struggling. This climate may continue to lead to more bad debt expense, charity care, and Medicaid utilization.

Contacting the Hospital's Management

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

FAYETTE COUNTY MEMORIAL HOSPITAL

BALANCE SHEETS
DECEMBER 31, 2009 AND 2008

ASSETS

| | <u>2009</u> | <u>2008</u> |
|---|--------------------------|--------------------------|
| Current assets | | |
| Cash and cash equivalents | \$ 1,031,360 | \$ 1,708,082 |
| Patient accounts receivable, net of uncollectible accounts of \$1,279,000 in 2009 and \$2,028,000 in 2008 | 4,358,574 | 4,763,626 |
| Current portion of notes receivable | 639,022 | 760,311 |
| Inventories | 735,696 | 765,936 |
| Prepaid expenses and other current assets | 180,170 | 162,454 |
| Total current assets | <u>6,944,822</u> | <u>8,160,409</u> |
| Other assets | | |
| Notes receivable | 625,808 | 1,308,199 |
| Other assets | 47,045 | 188,178 |
| Investments | 3,840,780 | 3,134,610 |
| Assets limited as to use | 301,399 | 269,019 |
| Capital assets, net | 11,737,918 | 12,970,371 |
| Total other assets | <u>16,552,950</u> | <u>17,870,377</u> |
| Total assets | <u>\$ 23,497,772</u> | <u>\$ 26,030,786</u> |

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

BALANCE SHEETS
DECEMBER 31, 2009 AND 2008

LIABILITIES AND NET ASSETS

| | <u>2009</u> | <u>2008</u> |
|--|----------------------|----------------------|
| Current liabilities | | |
| Current portion of long-term debt | \$ 433,502 | \$ 371,575 |
| Payable under line-of-credit | - | 750,000 |
| Accounts payable | 403,945 | 496,049 |
| Accrued payroll and related benefits | 1,866,624 | 1,699,725 |
| Other accrued expenses | 1,362,589 | 1,382,496 |
| Current portion of physician recruitment liability | 406,210 | 586,874 |
| Estimated third-party settlements | 541,030 | 1,150,000 |
| Total current liabilities | <u>5,013,900</u> | <u>6,436,719</u> |
| Physician recruitment liability | 124,766 | 550,932 |
| Long-term debt | 4,363,037 | 3,951,191 |
| Total liabilities | <u>9,501,703</u> | <u>10,938,842</u> |
| Net assets | | |
| Invested in capital assets - net of related debt | 6,941,379 | 8,647,605 |
| Restricted | | |
| Expendable for debt service and other purposes | 301,399 | 269,019 |
| Unrestricted | 6,753,291 | 6,175,320 |
| Total net assets | <u>13,996,069</u> | <u>15,091,944</u> |
| Total liabilities and net assets | <u>\$ 23,497,772</u> | <u>\$ 26,030,786</u> |

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2009 AND 2008

| | 2009 | 2008 |
|--------------------------------------|---------------|---------------|
| Operating revenue | | |
| Net patient service revenue | \$ 33,717,996 | \$ 31,815,478 |
| Other operating revenue | 124,796 | 80,286 |
| | 33,842,792 | 31,895,764 |
| Operating expenses | | |
| Salaries and wages | 16,290,561 | 15,104,441 |
| Employee benefits | 4,995,588 | 4,892,292 |
| Physician fees | 738,714 | 431,464 |
| Other fees | 3,890,201 | 3,479,025 |
| Supplies | 4,421,884 | 4,914,038 |
| Utilities | 764,264 | 780,696 |
| Maintenance and repairs | 1,213,237 | 1,126,536 |
| Leases and rentals | 196,921 | 150,473 |
| Insurance | 488,059 | 485,500 |
| Depreciation and amortization | 1,756,097 | 1,670,424 |
| Other expenses | 916,990 | 643,634 |
| Total operating expenses | 35,672,516 | 33,678,523 |
| Income (loss) from operations | (1,829,724) | (1,782,759) |
| Non-operating gains - net | 733,849 | 94,583 |
| Change in net assets | (1,095,875) | (1,688,176) |
| Net assets, beginning of year | 15,091,944 | 16,780,120 |
| Net assets, end of year | \$ 13,996,069 | \$ 15,091,944 |

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2009 AND 2008

| | 2009 | 2008 |
|--|---------------|---------------|
| Operating activities | | |
| Cash received from patients and third party payors | \$ 33,514,078 | \$ 33,554,158 |
| Cash payments to suppliers for services and goods | (12,729,757) | (11,844,766) |
| Cash payments to employees for services | (21,119,250) | (19,931,802) |
| Other operating revenue received | 124,796 | 80,286 |
| Net cash flow from operating activities | (210,133) | 1,857,876 |
| Non-capital and related financing activities | | |
| Donations and other | 856,509 | 248,225 |
| Capital and related financing activities | | |
| Acquisition and construction of capital assets | (287,965) | (1,074,528) |
| Loss on disposal of capital assets | 32,312 | 23,705 |
| Interest paid | (252,242) | (301,756) |
| Payments on line-of-credit | (750,000) | (750,000) |
| Borrowings on long-term debt | 735,206 | - |
| Principal payments on long-term debt | (388,291) | (350,866) |
| Net cash flow from capital and related financing activities | (910,980) | (2,453,445) |
| Investing activities | | |
| Change in advances to physicians | 196,850 | (352,203) |
| Change in investments, net | (491,980) | (102,243) |
| Interest received on investments | 129,582 | 148,114 |
| Net cash flow from investing activities | (165,548) | (306,332) |
| Net change in cash and cash equivalents | (430,152) | (653,676) |
| Cash and cash equivalents, beginning of year | 2,036,670 | 2,690,346 |
| Cash, cash and cash equivalents, end of year | \$ 1,606,518 | \$ 2,036,670 |
| Balance sheet classification of cash and cash equivalents | | |
| Current assets | \$ 1,031,360 | \$ 1,708,082 |
| Investments | 273,759 | 59,569 |
| Assets limited as to use | 301,399 | 269,019 |
| Total cash and cash equivalents | \$ 1,606,518 | \$ 2,036,670 |

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

STATEMENTS OF CASH FLOWS (continued) YEARS ENDED DECEMBER 31, 2009 AND 2008

A reconciliation of loss from operations to net cash flows from operating activities follows:

| | <u>2009</u> | <u>2008</u> |
|---|---------------------|---------------------|
| Cash flows from operating activities | | |
| Loss from operations | \$ (1,829,724) | \$ (1,782,759) |
| Adjustments to reconcile loss from operations to net cash from operating activities: | | |
| Bad debts | 3,976,549 | 4,510,104 |
| Depreciation and amortization | 1,756,097 | 1,670,424 |
| Changes in assets and liabilities | | |
| Patient accounts receivable | (3,571,497) | (3,282,531) |
| Inventories | 30,240 | 2,686 |
| Prepaid expenses and other assets | (17,716) | 24,082 |
| Estimated third-party settlements | (608,970) | 515,450 |
| Accounts payable | (92,104) | 50,848 |
| Other accrued expenses | 146,992 | 149,572 |
| | <u>\$ (210,133)</u> | <u>\$ 1,857,876</u> |
| Supplemental disclosure of cash flow information: | | |
| Capital assets acquired under capital leases | \$ 126,858 | \$ - |

See accompanying notes to financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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

The financial statements of the 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 the County that is attributable to the transactions of the Hospital. They do not purport to, and do not, present fairly the financial position of the County, and the changes in the County's financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America

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 the Financial Accounting Standards Board (FASB) Accounting Standards Codification 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 lower of market or cost, as determined by the first-in, first-out method.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

Investments

The Hospital has investments in U.S. government and agency obligations, which are stated at fair value on the accompanying balance sheet. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in non-operating gains (losses).

Assets Limited as to Use

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

Capital Assets

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

Compensated Absences

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

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, 2009 AND 2008

Classification of Net Assets

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

Net Patient Service Revenue and Accounts Receivable

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 and accounts receivable are 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.

The Hospital estimates an allowance for doubtful accounts based on an evaluation of historical losses, current economic conditions, and other factors unique to the Hospital.

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.

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.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

Income Taxes

The Hospital, as a political subdivision, is exempt from federal income taxes under Section 115 of the Internal Revenue 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 \$2,906,378 and \$1,955,395 for 2009 and 2008, 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.

Physician Recruitment Agreements and Physician Advances Receivable

Consistent with the Hospital's policy on physician relocations and recruitment, the Hospital provides income guarantees to certain physicians who agree to relocate to the community to fill a need in the Hospital's service area and commit to remain in practice for a specified term. Under such agreements, the Hospital is required to make payments to the physicians in excess of amounts earned in their respective practices up to the amount of the income guarantee. Income guarantee periods are generally two years. Such payments are recoverable from the physician in the event that their commitment period is not met, which is typically three years. The Hospital also advances monies to physicians under various loan agreements. These loans are unsecured and are forgiven systematically in accordance with the loan agreements. Should the arrangement between the Hospital and the physician be terminated prior to the end date agreed upon by both parties, the Hospital will pursue collection of any outstanding advances.

The Hospital recorded a liability of \$530,976 and \$1,137,806 at December 31, 2009 and 2008, respectively, for the estimated obligation to the Hospital under these agreements with an offsetting asset recorded within the accompanying balance sheet.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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 certain reported amounts and disclosures in the financial statements. Actual results could differ from those estimates.

Reclassifications

Certain amounts in the 2008 financial statements have been reclassified to conform to current year presentation. There was no change in previously reported net assets as a result of these reclassifications.

Subsequent Events

The Hospital has evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying financial statements through the date the financial statements are issued, which is May 26, 2010.

2. FAIR VALUE OF FINANCIAL INSTRUMENTS

Major classes of assets and liabilities that are measured at fair value are categorized according to a fair value hierarchy that prioritizes the inputs to value techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3).

Level 1 inputs are readily determinable using unadjusted quoted prices for identical assets or liabilities in active markets. Level 2 inputs are derived from quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets (other than those included in Level 1) which are observable for the asset or liability, either directly or indirectly. Level 3 inputs are derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable. If the inputs used fall within different levels of the hierarchy, the categorization is based upon the lowest level input that is significant to the fair value measurement.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

Assets measured at fair value based on Level 2 inputs consisted of investments in United States government and agency obligations of \$3,567,021 and \$3,075,041 as of December 31, 2009 and 2008, respectively.

3. DEPOSITS AND INVESTMENTS

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

| <u>2009</u> | <u>Cash and Cash Equivalents</u> | <u>Investments</u> | <u>Assets Limited as to Use</u> |
|--|--------------------------------------|---------------------|-------------------------------------|
| Deposits | \$ 1,031,360 | \$ 273,759 | \$ 301,399 |
| United States government and agency obligations | - | 3,567,021 | - |
| Total | <u>\$ 1,031,360</u> | <u>\$ 3,840,780</u> | <u>\$ 301,399</u> |
| | | | |
| <u>2008</u> | <u>Cash and Cash Equivalents</u> | <u>Investments</u> | <u>Assets Limited as to Use</u> |
| Deposits | \$ 1,708,082 | \$ 59,569 | \$ 269,019 |
| United States government and agency obligations | - | 3,075,041 | - |
| Total | <u>\$ 1,708,082</u> | <u>\$ 3,134,610</u> | <u>\$ 269,019</u> |

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

| <u>Deposits</u> | <u>2009</u> | <u>2008</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) | \$ 1,597,900 | \$ 2,253,718 |
| Amount of deposits covered by federal depository insurance | 845,521 | 440,978 |
| Amounts of deposits uninsured | <u>\$ 752,379</u> | <u>\$ 1,812,740</u> |

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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. 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:

| | Carrying | <u>Maturities</u> | |
|--------------------------|--------------|-------------------------|------------------|
| December 31, 2009 | amount | <u>< than 1 year</u> | <u>1-5 years</u> |
| Certificates of deposit | \$ 201,974 | \$ 96,812 | \$ 105,162 |
| Government obligations | \$ 3,567,021 | \$ 308,999 | \$ 3,258,022 |

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

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

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

4. PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable at December 31, 2009 and 2008 is as follows:

| | <u>2009</u> | <u>2008</u> |
|-----------------------------------|---------------------|---------------------|
| Total patient accounts receivable | \$ 9,304,217 | \$ 10,525,716 |
| Less allowance for: | | |
| Uncollectible accounts | (1,279,018) | (2,028,179) |
| Contractual adjustments | (3,666,625) | (3,733,911) |
| Net patient accounts receivable | <u>\$ 4,358,574</u> | <u>\$ 4,763,626</u> |

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

The Hospital provides services without collateral to its patients, most of whom are insured under third-party payor agreements. The mix of receivables and revenue from patients and third-party payors follows:

| | 2009 | | 2008 | |
|-------------------|------|---------|------|---------|
| | AR | Revenue | AR | Revenue |
| Medicare | 18% | 39% | 13% | 38% |
| Medicaid | 3% | 22% | 5% | 19% |
| Private insurance | 48% | 30% | 52% | 35% |
| Self pay | 31% | 9% | 30% | 8% |
| | 100% | 100% | 100% | 100% |

5. NOTES RECEIVABLE

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

6. RESTRICTED FUNDS

Restricted funds are available for the following purposes:

| | 2009 | 2008 |
|---------------------------|------------|------------|
| Community health services | \$ 236,971 | \$ 204,595 |
| Capital expenditures | 64,428 | 64,424 |
| | \$ 301,399 | \$ 269,019 |

7. ESTIMATED THIRD PARTY SETTLEMENTS

Approximately 61 percent and 57 percent of the Hospital's revenues from patient services were received from the Medicare and Medicaid programs for 2009 and 2008, respectively. The Hospital has agreements with these payors that provide for reimbursement to the Hospital at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospital's established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with these third-party payors follows.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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. Medicare cost reports are final settled through 2007.

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. Medicaid cost reports have been final settled through 2004.

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

Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. During the years ended December 31, 2009 and 2008, the Hospital recognized a change in estimate of approximately \$519,000 and \$235,000, respectively, due to the difference between original estimates and subsequent revisions due to final settlements and changes in allowance methodology.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

8. CAPITAL ASSETS

Capital assets activity for the years ended December 31, 2009 and 2008 follows:

| | 2008 | Additions | Retirements | 2009 | Depreciable Life - Years |
|-------------------------------|---------------|-----------|-------------|---------------|-----------------------------|
| Land | \$ 519,750 | \$ - | \$ - | \$ 519,750 | |
| Land improvements | 624,690 | - | - | 624,690 | 10-20 |
| Buildings | 15,106,324 | 50,644 | (9,281) | 15,147,687 | 15-50 |
| Fixed equipment | 1,798,552 | 8,040 | (16,040) | 1,790,552 | 5-20 |
| Major movable equipment | 9,994,259 | 376,815 | (1,118,113) | 9,252,961 | 5-25 |
| Construction in progress | 54,852 | (20,676) | (7,500) | 26,676 | |
| Total | 28,098,427 | 414,823 | (1,150,934) | 27,362,316 | |
| Less accumulated depreciation | | | | | |
| Land improvements | 520,396 | 14,265 | - | 534,661 | |
| Buildings | 6,633,766 | 450,477 | (9,282) | 7,074,961 | |
| Fixed equipment | 1,264,212 | 68,899 | (15,786) | 1,317,325 | |
| Major movable equipment | 6,709,682 | 1,081,323 | (1,093,554) | 6,697,451 | |
| Total | 15,128,056 | 1,614,964 | (1,118,622) | 15,624,398 | |
| Net carrying amount | \$ 12,970,371 | | | \$ 11,737,918 | |
| | | | | | |
| | 2007 | Additions | Retirements | 2008 | Depreciable Life - Years |
| Land | \$ 519,750 | \$ - | \$ - | \$ 519,750 | |
| Land improvements | 624,690 | - | - | 624,690 | 10-20 |
| Buildings | 15,013,734 | 92,590 | - | 15,106,324 | 15-50 |
| Fixed equipment | 1,792,376 | 8,159 | (1,983) | 1,798,552 | 5-20 |
| Major movable equipment | 9,232,357 | 1,714,261 | (952,359) | 9,994,259 | 5-25 |
| Construction in progress | 795,336 | (740,484) | - | 54,852 | |
| Total | 27,978,243 | 1,074,526 | (954,342) | 28,098,427 | |
| Less accumulated depreciation | | | | | |
| Land improvements | 506,054 | 14,342 | - | 520,396 | |
| Buildings | 6,163,115 | 470,651 | - | 6,633,766 | |
| Fixed equipment | 1,193,446 | 72,748 | (1,982) | 1,264,212 | |
| Major movable equipment | 6,666,787 | 971,550 | (928,655) | 6,709,682 | |
| Total | 14,529,402 | 1,529,291 | (930,637) | 15,128,056 | |
| Net carrying amount | \$ 13,448,841 | | | \$ 12,970,371 | |

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

9. LONG-TERM DEBT

Long-term debt activity for the years ended December 31, 2009 and 2008 follows:

| 2009 | Beginning Balance | Current Year Additions | Current Year Reductions | Ending Balance | Current Portion |
|---|----------------------------|---------------------------|----------------------------|----------------------------|--------------------------|
| Leases and notes payable: | | | | | |
| Lease obligation | \$ 542,766 | \$ 126,858 | \$ (213,291) | \$ 456,333 | \$ 190,571 |
| Notes payable - 2003 series | 3,780,000 | - | (175,000) | 3,605,000 | 185,000 |
| Note payable | - | 735,209 | - | 735,209 | 57,931 |
| Total leases and notes payable | <u>\$ 4,322,766</u> | <u>\$ 862,067</u> | <u>\$ (388,291)</u> | <u>\$ 4,796,542</u> | <u>\$ 433,502</u> |
| | | | | | |
| 2008 | Beginning Balance | Current Year Additions | Current Year Reductions | Ending Balance | Current Portion |
| Leases and notes payable: | | | | | |
| Lease obligations | \$ 728,632 | \$ - | \$ (185,866) | \$ 542,766 | \$ 196,575 |
| Notes payable - 2003 series | 3,945,000 | - | (165,000) | 3,780,000 | 175,000 |
| Total leases and notes payable | <u>\$ 4,673,632</u> | <u>\$ -</u> | <u>\$ (350,866)</u> | <u>\$ 4,322,766</u> | <u>\$ 371,575</u> |

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 1.15 to 1.00, and minimum days cash on hand of 45 for the quarter ended December 31, 2009. The Hospital was in compliance with these covenants as of December 31, 2009.

Notes were issued in an amount not to exceed \$4,400,000, and were available to the Hospital to be drawn upon as principal as needed. The Notes were sold in series as funds were 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.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

The 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 0.29 percent at December 31, 2009. The Notes are secured by an irrevocable letter-of-credit with the Trustee bank.

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

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

The Hospital also entered into an interest rate swap agreement with a financial institution to reduce the impact of changes in interest rates on the Notes. The total notational amount of the interest rate swap agreement is \$2,200,000 and matures August 1, 2013. The Hospital is required to make additional monthly interest payments to the financial institution if the fixed rate outlined below exceeds the variable rate, or receives a rebate on the interest paid if the fixed rate falls below the rate. The fixed rate on the interest rate swap agreement is 5.24%. The fair value of the interest rate swap was estimated using a method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curves. The fair value of this interest rate swap at December 31, 2009 was a liability of \$179,547 and has not been recorded in the accompanying financial statements.

The Hospital is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreements. However, the Hospital does not anticipate nonperformance by the counterparties. The Hospital is exposed to interest rate risk on its receive-fixed, pay-variable interest rate swap. As the London Interbank Offered Rate (LIBOR) increases, the Hospital's net payment on the swap increases.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

The variable-rate debt hedged by the Hospital's derivative instrument is the Notes. The Hospital is exposed to basis risk on its pay-fixed interest rate swap and rate cap derivative instrument that is hedging the Notes, because the variable-rate payments received by the Hospital on the derivative instrument is based on a rate or index other than the interest rates the Hospital pays on the Notes. At December 31, 2009, the weighted-average interest rate on the Hospital's variable-rate hedged debt is 2.78 percent, while LIBOR is 0.23 percent.

During 2009, the Hospital refinanced its line of credit to a note payable to a bank. The note is unsecured and requires monthly payments of \$7,824 including interest at 5% through maturity at December 21, 2012.

As of December 31, 2009, debt service requirements of the variable-rate debt and note payable for their term were as follows:

| Year Ending December 31 | Principal Payments on Note Payable | Interest Payments on Note Payable | Principal Payments on 2003 Notes Payable | Interest Payments on 2003 Notes Payable | Interest Rate Swap, Net | Total Payments |
|----------------------------|--|---|---|--|----------------------------|---------------------|
| 2010 | \$ 57,931 | \$ 35,956 | \$ 185,000 | \$ 5,122 | \$ 93,993 | \$ 378,002 |
| 2011 | 61,445 | 32,442 | 195,000 | 4,843 | 89,211 | 382,941 |
| 2012 | 615,833 | 26,981 | 200,000 | 4,557 | 84,168 | 931,538 |
| 2013 | - | - | 210,000 | 4,274 | 78,797 | 293,070 |
| 2014 | - | - | 225,000 | 7,997 | - | 232,997 |
| 2015-2019 | - | - | 1,295,000 | 29,493 | - | 1,324,493 |
| 2020-2024 | - | - | 1,295,000 | 8,693 | - | 1,303,693 |
| Total Payments | <u>\$ 735,209</u> | <u>\$ 95,379</u> | <u>\$ 3,605,000</u> | <u>\$ 64,978</u> | <u>\$ 346,168</u> | <u>\$ 4,846,734</u> |

The Hospital has entered into operating lease agreements for equipment, which expire at various times through 2014. Operating lease expense totaled \$196,921 and \$150,473 in 2009 and 2008, respectively.

The Hospital has entered into various non-cancelable capital lease agreements for equipment. Capital leases have imputed interest rates of 4.48 percent to 8.52 percent. They expire at various times through 2014 and are collateralized by the equipment leased.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

Minimum payments on these obligations to maturity as of December 31, 2009 are as follows:

| | Capital Leases | Operating Leases | Total |
|-----------------------------------|-------------------|---------------------|--------------|
| 2010 | \$ 213,057 | \$ 210,786 | \$ 423,843 |
| 2011 | 173,013 | 190,462 | 363,475 |
| 2012 | 66,870 | 155,439 | 222,309 |
| 2013 | 31,247 | 120,676 | 151,923 |
| 2014 | 15,623 | 59,066 | 74,689 |
| Total minimum payments | \$ 499,810 | \$ 736,429 | \$ 1,236,239 |
| Less amount representing interest | 43,477 | | |
| Total | \$ 456,333 | | |

| | 2009 | 2008 |
|---------------------------------------|--------------|------------|
| Cost of equipment under capital lease | \$ 1,091,816 | \$ 964,958 |
| Less accumulated amortization | 647,608 | 433,369 |
| Net carrying amount | \$ 444,208 | \$ 531,589 |

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

11. NET PATIENT SERVICE REVENUE

Net patient service revenue consists of the following:

| | <u>2009</u> | <u>2008</u> |
|---------------------------------------|--------------------------|--------------------------|
| Revenue | | |
| Inpatient service | | |
| Routine service | \$ 4,833,705 | \$ 4,702,233 |
| Ancillary services | 9,584,919 | 9,761,083 |
| Outpatient ancillary services | <u>62,284,381</u> | <u>55,286,217</u> |
| Total patient revenue | 76,703,005 | 69,749,533 |
| Revenue deductions | | |
| Provision for contractual allowances | 35,511,991 | 31,018,058 |
| Provision for charity care | 2,906,378 | 1,955,395 |
| Bad debts | 3,976,549 | 4,510,104 |
| Other allowances | <u>590,091</u> | <u>450,498</u> |
| Total revenue deductions | <u>42,985,009</u> | <u>37,934,055</u> |
| Total net patient service revenue | <u>\$ 33,717,996</u> | <u>\$ 31,815,478</u> |

12. NON-OPERATING GAINS

Non-operating gains consist of the following:

| | <u>2009</u> | <u>2008</u> |
|-------------------------------|-----------------------|----------------------|
| Donations, gifts and grants | \$ 674,009 | \$ 146,142 |
| Investment income | 129,582 | 148,114 |
| Interest expense | (252,242) | (301,756) |
| Other gains | <u>182,500</u> | <u>102,083</u> |
| Non-operating gains - net | <u>\$ 733,849</u> | <u>\$ 94,583</u> |

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

13. DEFINED BENEFIT PENSION PLAN

The Hospital contributed to the Ohio Public Employees Retirement System (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 maintains a cost-sharing multiple employer defined benefit post-employment healthcare plan, which includes a medical plan, prescription drug program and Medicare Part B premium reimbursement, to qualifying members of both the Traditional Pension and the Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits, including post-employment health care coverage.

In order to qualify for post-employment health care coverage, age-and-service retirees under the Traditional Pension and Combined Plans must have 10 or more years of qualifying Ohio service credit. Health care coverage for disability benefit recipients and qualified survivor benefit recipients is available. The health care coverage provided by OPERS meets the definition of an Other Post Employment Benefit (OPEB) as described in GASB Statement 45.

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 writing OPERS, 277 East Town Street, Columbus OH 43215-4642, or by calling 614-222-5601 or 800-222-7377.

Funding Policy

The Ohio Revised Code provides the statutory authority requiring public employers to fund post retirement health care through their contributions to OPERS. A portion of each employer's contribution to OPERS is set aside for the funding of post retirement health care benefits.

Employer contribution rates are expressed as a percentage of the covered payroll of active members. In 2009, state and local employers contributed at a rate of 14.0% of covered payroll. The Ohio Revised Code currently limits the employer contribution to a rate not to exceed 14.0% of covered payroll for state and local employer units. Active members do not make contributions to the OPEB Plan.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

OPERS' Post Employment Health Care plan was established under, and is administrated in accordance with, Internal Revenue Code 401(h). Each year, the OPERS Retirement Board determines the portion of the employer contribution rate that will be set aside for funding of post employment health care benefits. The portion of employer contributions allocated to health care was 7% from January 1 through March 31, 2009 and 5.5% from April 1 through December 31, 2009. The OPERS Retirement Board is also authorized to establish rules for the payment of a portion of the health care coverage by the retiree or their surviving beneficiaries. Payment amounts vary depending on the number of covered dependents and the coverage selected.

The Hospital's contributions, representing 100% of employer contributions, for the last three years follow:

| <u>Year</u> | <u>Contribution</u> |
|-------------|---------------------|
| 2009 | \$ 2,197,826 |
| 2008 | \$ 2,020,633 |
| 2007 | \$ 1,845,669 |

The portion of the Hospital's contribution in the above table was made to fund post-employment health care benefits approximated \$922,000, \$1,010,000 and \$923,000 for 2009, 2008, and 2007, respectively.

The Health Care Preservation Plan (HCPP) adopted by the OPERS Retirement Board on September 9, 2004, was effective January 1, 2007. Member and employer contribution rates for state and local employers increased on January 1 of each year from 2006 to 2008. Rates for law and public safety employers increased over a six year period beginning on January 1, 2006, with a final rate increase on January 1, 2011. These rate increases allowed additional funds to be allocated to the health care plan.

14. RISK MANAGEMENT

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

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.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2009 AND 2008

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

15. SELF-INSURANCE

The Hospital provides health insurance to participating employees under a plan that is partially self-insured. The plan is covered by a stop-loss policy that covers claims over \$60,000 per employee per annum to an aggregate amount of \$1,000,000. Expenses charged to operations, including an estimate of incurred but unreported claims totaled \$2,139,930 and \$2,215,968 in 2009 and 2008, respectively.

16. SUBSEQUENT EVENT AND MANAGEMENT PLANS

As discussed in Note 9 to the financial statements, the Hospital is required to achieve certain minimum financial ratios related to days cash on hand and debt service coverage. For the quarter ended March 31, 2010 and thereafter, a minimum ratio of 50 days cash on hand and a minimum debt service coverage ratio of 1.25 to 1.00 is required to be in compliance with bond documents. The Hospital did not meet the required minimum debt service coverage ratio at March 31, 2010. While no such demand has been made, the violation permits the bank to demand repayment on a substantial portion of the Hospital's long-term debt. These factors when combined with the recurring losses from operations could be indicative of the Hospital's inability to continue as a going concern.

Management plans to return the Hospital to profitability through the elimination of certain non-profitable service offerings and positions, termination of certain contracts, flexing staff levels consistent with inpatient census needs in addition to other cost containment initiatives developed by the strategic planning team. On April 7, 2010, the Hospital decided to discontinue its operations related to its obstetrics department effective June 1, 2010. The financial effects of which have not yet been determined.

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



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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 (the "Hospital") as of and for the year ended December 31, 2009, and have issued our report thereon dated May 26, 2010.

Our report included additional language stating that the accompanying financial statements of the Hospital are intended to present the financial position and the changes in financial position and, where applicable, cash flows of only that portion of the business-type activities of Fayette County, Ohio ("the County") that is attributable to the transactions of the Hospital. Those financial statements do not purport to, and do not, present fairly the financial position of the County as of December 31, 2009, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our report also included additional language stating that the accompanying financial statements have been prepared assuming the Hospital will continue as a going concern. As discussed in Note 16 to the financial statements, the Hospital has experienced recurring losses from operations and was in default on certain covenants of its bond agreements at March 31, 2010. The bank may demand repayment of a substantial portion of the Hospital's long-term debt, though no such demand has been made. The Hospital is currently negotiating with the banks to remedy the violation, but cannot predict what the outcome of the negotiations will be. These conditions raise substantial doubt about the Hospital's ability to continue as a going concern. These financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hospital's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Hospital's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency or combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Blue & Co., LLC

May 26, 2010

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

2008-1: Physician Recruitment Asset and Liability

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

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

Management's Response:

Management analyzes physician agreements for proper accounting treatment. Corrective action was taken.



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
JUNE 29, 2010