

FAYETTE COUNTY MEMORIAL HOSPITAL

FINANCIAL STATEMENTS

DECEMBER 31, 2004 AND 2003



**Auditor of State
Betty Montgomery**

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

We have reviewed the *Report of Independent Auditors* of the Fayette County Memorial Hospital, prepared by Blue & Co., LLC, for the audit period January 1, 2004 through December 31, 2004. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

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

A handwritten signature in cursive script that reads "Betty Montgomery".

BETTY MONTGOMERY
Auditor of State

July 6, 2005

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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 sheet of Fayette County Memorial Hospital (a component unit of Fayette County, Ohio), as of December 31, 2004, and the related statement of operations and changes in net assets and cash flows for the year ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements as of December 31, 2003 were audited by other auditors whose report dated February 20, 2004, expressed an unqualified opinion on those statements.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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 Fayette County Memorial Hospital at December 31, 2004, and the results of its operations and its cash flows for the year 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 March 24, 2005, on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis are not a required part of the basic financial statements but are 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

March 24, 2005

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis

The discussion and analysis of Fayette County Memorial Hospital's (the Hospital) financial statements provides an overview of the Hospital's financial activities for the year ended December 31, 2004. Management is responsible for the completeness and fairness of the financial statements and the related footnote disclosures along with the discussion and analysis.

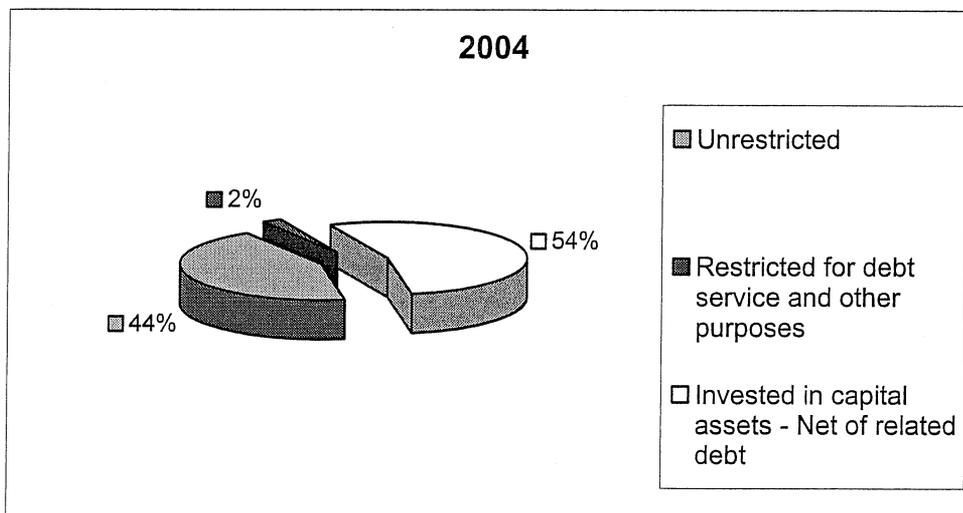
Using this Annual Report

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

Financial Highlights

Capital assets increased \$256,570, while long-term debt increased \$866,921 from the prior year. These increases were due to the construction of a second medical office building, along with the issuance of revenue notes to fund the construction. In total, the Hospital's expenses exceeded revenues and other support, creating a decrease in net assets of \$1,786,207 (compared to a \$433,971 increase in the previous year).

The following chart provides a breakdown of net assets by category for the year ended December 31, 2004:



FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

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

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

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

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

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Condensed Financial Information

The following is a comparative analysis of the major components of the Balance Sheet of the Hospital as of December 31, 2004:

Assets, Liabilities and Net Assets

	December 31		Change	
	2004	2003	Amount	Percent
Current assets	\$ 6,508,651	\$ 7,154,954	\$ (646,303)	-9.0%
Noncurrent assets	3,156,607	4,436,473	(1,279,866)	-28.8%
Capital assets	<u>13,277,058</u>	<u>13,020,488</u>	<u>256,570</u>	2.0%
Total assets	<u>\$ 22,942,316</u>	<u>\$ 24,611,915</u>	<u>\$ (1,669,599)</u>	-6.8%
Current liabilities	\$ 2,376,313	\$ 3,017,744	\$ (641,431)	-21.3%
Long-term debt	<u>4,271,719</u>	<u>3,513,680</u>	<u>758,039</u>	21.6%
Total liabilities	<u>\$ 6,648,032</u>	<u>\$ 6,531,424</u>	<u>\$ 116,608</u>	1.8%
Net assets				
Invested in capital assets, net of debt	\$ 8,763,377	\$ 9,373,728	\$ (610,351)	-6.5%
Restricted	405,601	458,515	(52,914)	-11.5%
Unrestricted	<u>7,125,306</u>	<u>8,248,248</u>	<u>(1,122,942)</u>	-13.6%
Total net assets	<u>\$ 16,294,284</u>	<u>\$ 18,080,491</u>	<u>\$ (1,786,207)</u>	-9.9%

The primary change in the liabilities and net assets relates to the decrease in accounts payable, borrowings of \$1,000,000 in debt and the loss from operations of \$1,977,333 during 2004.

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Operating Results and Changes in Net Assets

	Year Ended		Change	
	2004	2003	Amount	Percent
Operating revenues				
Net patient service revenues	\$ 25,146,962	\$ 24,519,360	\$ 627,602	2.6%
Other	68,588	72,908	(4,320)	-5.9%
Total operating revenues	25,215,550	24,592,268	623,282	2.5%
Operating expenses				
Salaries and wages	10,578,232	9,634,364	943,868	9.8%
Benefits	3,803,657	3,171,652	632,005	19.9%
Physicians fees	1,666,191	1,332,142	334,049	25.1%
Other fees	3,096,998	3,085,217	11,781	0.4%
Supplies	4,122,035	3,775,241	346,794	9.2%
Depreciation and amortization	1,391,852	1,236,366	155,486	12.6%
Other expenses	2,533,918	2,244,543	289,375	12.9%
Total operating expenses	27,192,883	24,479,525	2,713,358	11.1%
Operating (loss) income	(1,977,333)	112,743	(2,090,076)	-1853.8%
Non-operating gains - net	191,126	321,228	(130,102)	-40.5%
Change in net assets	(1,786,207)	433,971	(2,220,178)	-511.6%
Net assets - beginning of year	18,080,491	17,646,520		
Net assets - end of year	\$ 16,294,284	\$ 18,080,491		

Operating Revenues

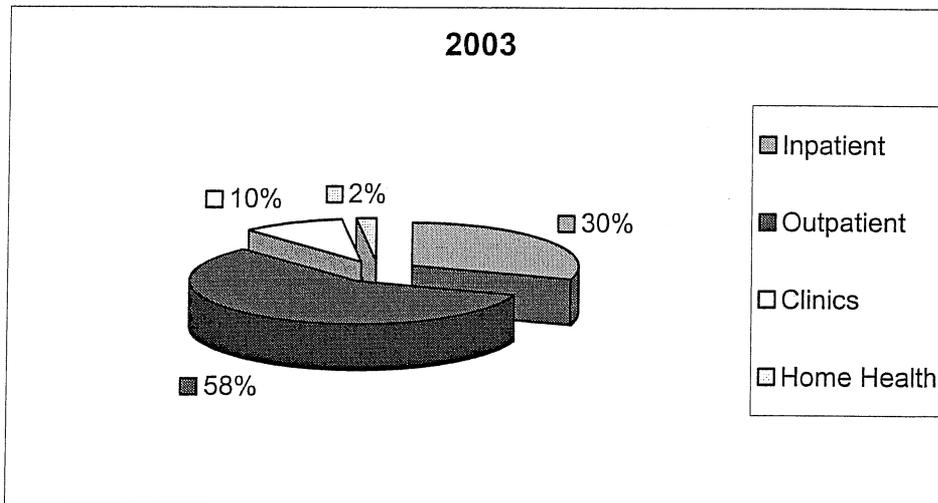
Operating revenues include all transactions that result in the sales and/or receipts from goods and services such as inpatient services, outpatient services, physician's offices, and the cafeteria. In addition, certain federal, state, and private grants are considered operating if they are not for capital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

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Operating revenue changes were a result of the following factors:

- Net patient service revenue increased 2.6 percent. Inpatient admissions showed a decline in 2004 of 6.7%, representing a 2.3 percent decrease in gross inpatient revenue. Gross outpatient revenue increased approximately \$2,600,000 or 8.7 percent in 2004. 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 increased from 37.3 to 38.5 percent as a percentage of gross revenue. In addition, 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 2004 amounted to \$765,353 or a 1.5 percent increase from 2003.

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



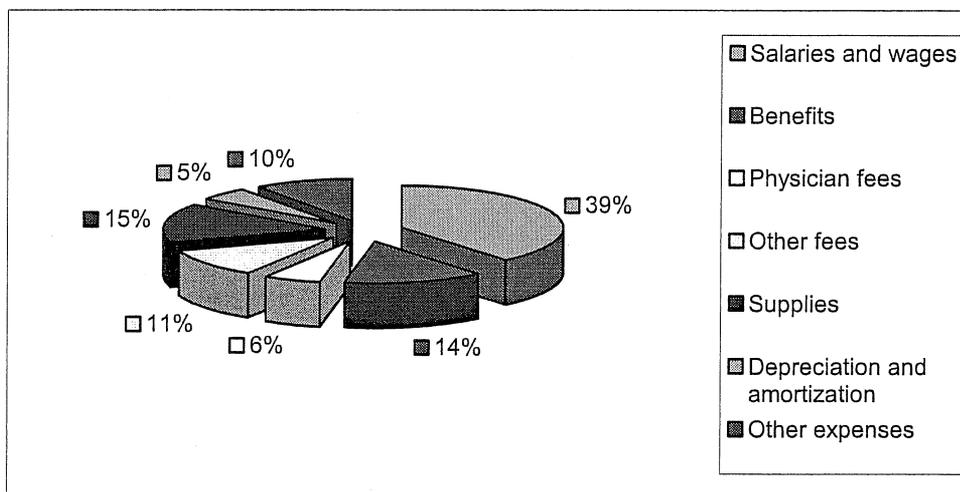
FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Operating Expenses

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

- Salary costs increased 9.8 percent due to employee raises and an increase in full-time equivalents of 12 during 2004.
- Benefit costs increased 19.9 percent due to dramatic increases in health insurance premiums paid by the Hospital for covered employees, workers compensation rate increases and an increase in employees during 2004.
- Physician fees increased 25.1 percent due to a shift of a physician from part-time to full-time in 2004 and an increase in emergency room fees.
- Supplies increased 9.2 percent due to a significant increase in pharmacy costs and inflationary increases on medical supplies.

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



Non-Operating Gains - net

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

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Statement of Cash Flows

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

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

	2004	2003	Increase (Decrease)
Cash from			
Operating activities	(1,269,334)	863,183	(2,132,517)
Capital and related financing activities	(963,277)	(1,115,975)	152,698
Noncapital and related financing activities	271,602	201,671	69,931
Investing activities	1,170,116	(262,580)	1,432,696
Net change in cash	(790,893)	(313,701)	(477,192)
Cash - Beginning of year	2,051,706	2,365,407	
Cash - End of year	\$ 1,260,813	\$ 2,051,706	

The Hospital's liquidity declined slightly during this year. The following discussion amplifies the overview of cash flows presented above.

Cash provided by operating activities decreased largely due to the increase in operating expenses in 2004 of \$2.7 million.

Capital purchases increased by \$1.7 million in 2004. However, this increase was offset by the Hospital financing \$1.0 million of the new medical office building.

Investing activities generated cash of \$1.2 million due to the utilization of investments for cash flow.

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Capital Assets and Debt Administration

Capital Assets

At December 31, 2004, the Hospital had \$25.6 million invested in capital assets, with an accumulated depreciation of \$12.3 million. Depreciation and amortization totaled \$1.7 million for the current year compared to \$1.4 million last year. Details of these assets for the past two years are shown below:

	2004	2003	Increase (Decrease)
Land	\$ 519,750	\$ 519,750	\$ -
Land improvements	618,690	618,690	-
Buildings	14,022,678	9,282,995	4,739,683
Fixed equipment	1,628,557	1,618,812	9,745
Major movable equipment	8,686,800	7,977,491	709,309
Construction in progress	122,046	3,970,973	(3,848,927)
Total	\$ 25,598,521	\$ 23,988,711	\$ 1,609,810

Debt

At year-end, the Hospital had \$4,513,681 in debt outstanding, as compared to \$3,646,760 in 2003. The table below summarizes these amounts by type of debt instrument:

	2004	2003	Increase (Decrease)
Notes payable	\$ 4,400,000	\$ 3,400,000	\$ 1,000,000
Lease obligations	113,681	246,760	(133,079)
Total notes and leases	\$ 4,513,681	\$ 3,646,760	\$ 866,921

As part of its effort to recruit new physicians to serve the people of Fayette County, the Hospital began constructing a new medical office building. The financing of this project required the issuance of new debt in 2003. More detailed information about the Hospital's long-term liabilities is presented in the footnotes to the financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS

Economic Factors That Will Affect the Future

As a small rural hospital, the economic position of Fayette County Memorial Hospital is closely tied to its ability to grow revenue while attempting to hold down costs. In order to recruit and retain key patient care personnel, the Hospital has provided an increase in wages exceeding its growth in revenue. The upward pressure on wages is expected to continue in 2005. In an effort to grow the revenue base, the Hospital is incurring significant expenses in an effort to recruit new physicians to the community. Reimbursement for existing patients is limited by federal and state mandate as well as contracts with third-party insurance companies. The board of trustees approved a 10% increase on charges for 2005 in an effort to maximize reimbursement under our current managed care contracts. Additionally in 2005, the Hospital is expected to complete its conversion to a Critical Access Hospital. This status provides for cost-based reimbursement for Medicare services.

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

Contacting the Hospital's Management

This financial report is intended to provide the people of Fayette County, the state and federal governments, and our debt holders with a general overview of the Hospital's finances, and to show the Hospital's accountability for the money it receives from the services it provides. If you have questions about this report or need additional information, we welcome you to contact us.

FAYETTE COUNTY MEMORIAL HOSPITAL

BALANCE SHEETS
DECEMBER 31, 2004 AND 2003

ASSETS

	<u>2004</u>	<u>2003</u>
Current assets		
Cash and cash equivalents	\$ 855,212	\$ 1,593,191
Patient accounts receivable, net of uncollectible accounts of \$1,172,000 in 2004 and \$1,150,000 in 2003	4,781,003	4,756,336
Current portion of notes receivable	440,656	280,520
Inventories	300,437	285,374
Prepaid expenses and other current assets	131,343	234,351
Estimated third-party settlements	-	5,182
Total current assets	<u>6,508,651</u>	<u>7,154,954</u>
Other assets		
Notes receivable	710,256	782,068
Investments	2,040,750	3,195,890
Assets limited as to use	405,601	458,515
Capital assets	13,277,058	13,020,488
Total other assets	<u>16,433,665</u>	<u>17,456,961</u>
Total assets	<u>\$ 22,942,316</u>	<u>\$ 24,611,915</u>

See accompanying notes to combined financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

BALANCE SHEETS
DECEMBER 31, 2004 AND 2003

LIABILITIES AND NET ASSETS

	<u>2004</u>	<u>2003</u>
Current liabilities		
Current portion of long-term debt	\$ 241,962	\$ 133,080
Accounts payable	900,735	1,800,774
Accrued payroll and related benefits	1,233,616	1,083,890
Total current liabilities	<u>2,376,313</u>	<u>3,017,744</u>
Long-term debt	4,271,719	3,513,680
Total liabilities	<u>6,648,032</u>	<u>6,531,424</u>
Net assets		
Invested in capital assets - net of related debt	8,763,377	9,373,728
Restricted		
Expendable for debt service and other purposes	405,601	458,515
Unrestricted	7,125,306	8,248,248
Total net assets	<u>16,294,284</u>	<u>18,080,491</u>
Total liabilities and net assets	<u>\$ 22,942,316</u>	<u>\$ 24,611,915</u>

See accompanying notes to combined financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2004 AND 2003

	2004	2003
Operating revenue		
Net patient service revenue	\$ 25,146,962	\$ 24,519,360
Other operating revenue	68,588	72,908
Total revenues	25,215,550	24,592,268
Operating expenses		
Salaries and wages	10,578,232	9,634,364
Employee benefits	3,803,657	3,171,652
Physician fees	1,666,191	1,332,142
Other fees	3,096,998	3,085,217
Supplies	4,122,035	3,775,241
Utilities	547,654	499,257
Maintenance and repairs	800,379	697,008
Leases and rentals	113,782	120,945
Insurance	358,366	265,640
Depreciation and amortization	1,391,852	1,236,366
Other expenses	713,737	661,693
Total operating expenses	27,192,883	24,479,525
Income (loss) from operations	(1,977,333)	112,743
Non-operating gains - net	191,126	321,228
Change in net assets	(1,786,207)	433,971
Net assets, beginning of year	18,080,491	17,646,520
Net assets, end of year	\$ 16,294,284	\$ 18,080,491

See accompanying notes to combined financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2004 AND 2003

	2004	2003
Operating activities		
Cash received for patients and third party payors	\$ 25,127,146	\$ 23,784,052
Cash payments to suppliers for services and goods	(12,231,236)	(10,114,808)
Cash payments to employees for services	(14,233,832)	(12,889,572)
Other operating revenue received	68,588	83,511
Net cash flow from operating activities	(1,269,334)	863,183
Non-capital and related financing activities		
Donations and other	271,602	201,671
Capital and related financing activities		
Acquisition and construction of capital assets	(1,652,995)	(4,368,119)
Interest expense	(177,203)	(18,436)
Proceeds from issuance of long-term debt	1,000,000	3,400,000
Principal payments on long-term debt	(133,079)	(129,420)
Net cash from capital and related financing activities	(963,277)	(1,115,975)
Investing activities		
Change in advances to physicians	(88,324)	(308,139)
Change in investments, net	1,155,140	(92,434)
Interest received on investments	103,300	137,993
Net cash from investing activities	1,170,116	(262,580)
Net change in cash and cash equivalents	(790,893)	(313,701)
Cash, beginning of year	2,051,706	2,365,407
Cash, end of year	\$ 1,260,813	\$ 2,051,706
Balance sheet classification of cash		
Current assets	\$ 855,212	\$ 1,593,191
Assets limited as to use	405,601	458,515
Total cash	\$ 1,260,813	\$ 2,051,706
A reconciliation of income from operations to net cash from operating activities		
Income (loss) from operations	\$ (1,977,333)	\$ 112,743
Adjustments to reconcile income (loss) from operations to net cash from operating activities:		
Bad debt expense	2,510,788	2,340,310
Depreciations and amortization	1,391,852	1,236,366
Loss of disposal of equipment	-	10,603
Changes in assets and liabilities		
Patient accounts receivable	(2,535,455)	(3,080,974)
Inventories	(15,063)	(21,364)
Prepaid expenses and other current assets	103,008	(59,990)
Estimated third party settlements	5,182	5,356
Accounts payable	(900,039)	403,689
Accrued payroll and related benefits	147,726	(83,556)
Net cash from operating activities	\$ (1,269,334)	\$ 863,183

See accompanying notes to combined financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

Fayette County Memorial Hospital ("the Hospital") is a 70-bed, general short-term acute care facility, owned by Fayette County, Ohio, and operated by a Board of Directors. The Hospital is a component unit of Fayette County. Members of the Board of Directors are appointed by the County Commissioners, the Probate Court Judge, and the Common Pleas Judge. Mount Carmel Health System, under a contract expiring in July 2005, manages the Hospital. The agreement provides that Mount Carmel Health System will provide a management team to oversee the operations of the Hospital.

Enterprise Fund Accounting

The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents

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

Inventories

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

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

Investments

Investments are carried at fair value.

Assets limited as to use

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

Capital assets

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

Compensated absences

Paid time off is charged to operations when earned. The unused and earned benefits are recorded as a current liability in the financial statements. Employees accumulate vacations days at varying rates depending on years of service, and may carry over to the next year up to 2 times the number of hours eligible to be earned during the year, or up to 120 hours for part-time employees. Employees also earn sick leave benefits at a Hospital-determined rate for all employees. Employees are not paid for accumulated sick leave if they leave before retirement. However, employees who retire from the Hospital may convert accumulated sick leave to termination payments equal to one-third of the accumulated balance calculated at the employee's base pay rates as of the retirement date. There is no limit on the number of sick leave hours that an employee may accumulate; however, employees are only eligible to receive termination payments on one-third of the accumulated sick leave balance up to a maximum of 400 hours. Employees accumulate holidays at a Hospital determined rate for all employees. Employees may carry over a maximum of five holidays to the next year.

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, 2004 AND 2003

Classification of net assets

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

Net patient service revenue

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

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

Contributions

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

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

Income from operations

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

Income taxes

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

Charity care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue. Charges foregone for charity care totaled \$765,353 and \$755,093 for 2004 and 2003, respectively.

Pension plan

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

Use of estimates

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

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

Reclassification

Certain prior period balances were reclassified for consistency with the current year presentation.

2. DEPOSITS AND INVESTMENTS

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

2004	Cash and Cash Equivalents	Investments	Assets Limited to as Use
Deposits	\$ 855,212	\$ 65,539	\$ 405,601
Federal Bonds	-	1,975,211	-
Total	<u>\$ 855,212</u>	<u>\$ 2,040,750</u>	<u>\$ 405,601</u>

2003	Cash and Cash Equivalents	Investments	Assets Limited to as Use
Deposits	\$ 1,593,191	\$ 17,196	\$ 458,515
Federal Bonds	-	3,178,694	-
Total	<u>\$ 1,593,191</u>	<u>\$ 3,195,890</u>	<u>\$ 458,515</u>

<u>Deposits</u>	<u>2004</u>	<u>2003</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)	\$ 2,112,439	\$ 2,358,531
Amount of deposits covered by federal depository insurance	<u>450,053</u>	<u>375,131</u>
Amounts of deposits uninsured	<u>\$ 1,662,386</u>	<u>\$ 1,983,400</u>

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

The Hospital's investments are categorized below to give an indication of the level of risk assumed by the entity. Risk Category 1 includes those investments that meet any one of the following criteria:

- a. Insured
- b. Registered
- c. Held by the Hospital or its agent

Risk Categories 2 and 3 include investments that are neither insured nor registered. Category 2 includes investments that are held by the counterparty's trust department (or agent) in the Hospital's name. Category 3 includes investments held by:

- a. The counter-party
- b. The counter-party's trust department (or agent) but not in the Hospital's name.

	Category			Carrying Amount
	1	2	3	
2004				
Federal bonds	\$ -	\$ 1,975,211	\$ -	\$ 1,975,211
2003				
Federal bonds	\$ -	\$ 3,178,694	\$ -	\$ 3,178,694

Assets limited as to use are designated or restricted as follows:

	2004	2003
By Board for bond repayments	\$ 191,588	\$ 244,502
By donor - for specific purposes	214,013	214,013
Total assets limited as to use	\$ 405,601	\$ 458,515

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

3. PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable at December 31, 2004 and 2003 is as follows:

	<u>2004</u>	<u>2003</u>
Total patient accounts receivable	\$ 8,281,040	\$ 8,361,451
Less allowance for:		
Uncollectible accounts	(1,172,321)	(1,150,428)
Contractual adjustments	<u>(2,327,716)</u>	<u>(2,454,687)</u>
Net patient accounts receivable	<u>\$ 4,781,003</u>	<u>\$ 4,756,336</u>

4. NOTES RECEIVABLE

Notes receivable represent loans to physicians under various cash flow support and loan arrangements. These loans are to be repaid in varying monthly installments including interests 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. A summary of these amounts outstanding is as follows:

	<u>2004</u>	<u>2003</u>
Net notes receivable	\$ 1,150,912	\$ 1,062,588
Less: Current portion	<u>440,656</u>	<u>280,520</u>
Long term portion	<u>\$ 710,256</u>	<u>\$ 782,068</u>

5. RESTRICTED FUNDS

Restricted funds are available for the following purposes:

	<u>2004</u>	<u>2003</u>
Community health services	\$ 214,012	\$ 214,012
Debt service	<u>191,589</u>	<u>244,503</u>
	<u>\$ 405,601</u>	<u>\$ 458,515</u>

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

6. ESTIMATED THIRD PARTY SETTLEMENTS

Approximately 56 percent of the Hospital's revenues from patient services are received from the Medicare and Medicaid programs. The Hospital has agreements with these payors that provide for reimbursement to the Hospital at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospital's established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with these third-party payors follows.

Medicare

Inpatient, acute-care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Reimbursement for all outpatient services are based on the prospectively determined ambulatory payment classification system. However, the Hospital is held harmless until July 31, 2003, under this new outpatient payment system, should it result in less reimbursement than the payment system in place before August 1, 2000. The Medicare Modernization Act of 2003 extended these provisions until January 1, 2006. Certain other outpatient services are reimbursed on an established fee-for-service methodology. Medicare cost reports are final settled through 2003.

Medicaid

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

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

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts they are not expected to have a material effect on the accompanying financial statements. Medicaid cost reports have been final settled through 1999.

7. CAPITAL ASSETS

Capital assets activity for the year ended December 31, 2004 and 2003 follows:

	2003	Additions	Retirements	2004	Depreciable Life - Years
Land	\$ 519,750	\$ -	\$ -	\$ 519,750	
Land improvements	618,690	-	-	618,690	10-20
Buildings	9,282,995	4,739,683	-	14,022,678	15-50
Fixed equipment	1,618,812	9,745	-	1,628,557	5-20
Major movable equipment	7,977,491	752,494	(43,185)	8,686,800	5-25
Construction in progress	3,970,973	(3,848,927)	-	122,046	
Total	23,988,711	1,652,995	(43,185)	25,598,521	
Less accumulated depreciation					
Land improvements	434,398	24,007	-	458,405	
Buildings	4,245,087	470,423	-	4,715,510	
Fixed equipment	907,368	70,934	-	978,302	
Major movable equipment	5,381,370	826,488	(38,612)	6,169,246	
Total	10,968,223	1,391,852	(38,612)	12,321,463	
Net carrying amount	<u>\$ 13,020,488</u>			<u>\$ 13,277,058</u>	

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

	2002	Additions	Retirements	2003	Depreciable Life - Years
Land	\$ 519,750	\$ -	\$ -	\$ 519,750	
Land improvements	618,691	-	-	618,690	10-20
Buildings	9,092,824	190,171	-	9,282,995	15-50
Fixed equipment	1,549,506	69,306	-	1,618,812	5-20
Major movable equipment	7,564,716	505,707	(92,932)	7,977,491	5-25
Construction in progress	373,945	3,602,935	(5,907)	3,970,973	
Total	19,719,432	4,368,119	(98,839)	23,988,711	
Less accumulated depreciation					
Land improvements	379,987	54,411	-	434,398	
Buildings	3,900,143	344,944	-	4,245,087	
Fixed equipment	832,355	75,013	-	907,368	
Major movable equipment	4,707,608	761,998	(88,236)	5,381,370	
Total	9,820,093	1,236,366	(88,236)	10,968,223	
Net carrying amount	\$ 9,899,339			\$ 13,020,488	

8. LONG-TERM DEBT

Long-term debt activity for the years ended December 31, 2004 and 2003 follows:

	Beginning Balance	Current Year Additions	Current Year Reductions	Ending Balance	Current Portion
2004					
Leases and notes payable:					
Lease obligations	\$ 246,760	\$ -	\$ (133,079)	\$ 113,681	\$ 96,962
Notes payable - 2003 series	3,400,000	1,000,000	-	4,400,000	145,000
Total leases and notes payable	\$ 3,646,760	\$ 1,000,000	\$ (133,079)	\$ 4,513,681	\$ 241,962

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

2003	<u>Beginning Balance</u>	<u>Current Year Additions</u>	<u>Current Year Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>
Leases and notes payable:					
Lease obligations	\$ 376,180	\$ -	\$ (129,420)	\$ 246,760	\$133,080
Notes payable - 2003 series	<u>-</u>	<u>3,400,000</u>	<u>-</u>	<u>3,400,000</u>	<u>-</u>
Total leases and notes payable	<u>\$ 376,180</u>	<u>\$ 3,400,000</u>	<u>\$ (129,420)</u>	<u>\$ 3,646,760</u>	<u>\$ 133,080</u>

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

The Hospital is bound by the terms of the Trust Indenture and Reimbursement Agreement to various operations and financial covenants. These covenants include maintaining a minimum debt service ratio of 1.25 to 1.00, and minimum days cash on hand of 70.

The notes shall be issued in an amount not to exceed \$4,400,000, and shall be available to the Hospital to be drawn upon as principal as needed. The notes will be sold in series as funds are needed for the project. The initial series was issued and drawn in July 2003, in the amount of \$2,400,000. The second series was issued and drawn in October 2003, in the amount of \$1,000,000. The Hospital drew an additional \$1,000,000 in 2004. The Hospital expects to request an additional series of notes during the next fiscal year. The series of notes are payable semi-annually with principal payments ranging from \$145,000 to \$270,000, in aggregate, maturing on August 1, 2023. The interest rate on the variable rate notes was 2.5 percent at December 31, 2004. The notes are secured by an irrevocable letter-of-credit with the Trustee bank.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

The notes are remarketed on a weekly basis. Should the remarketing agent be unable to remarket the notes based on its best efforts, these notes would be "put" back to the Trustee, who would draw down on the letter-of-credit to pay down the notes. However, Hospital management has assessed any unsuccessful remarketing of the notes to be unlikely. Under the Reimbursement Agreement between the Trustee and the Hospital, the Hospital is obliged to reimburse the Trustee for any draws made on the Letter-of credit. Interest is applied to letter-of-credit draws at a variable rate based on the current market interest rates. The letter-of-credit expires upon the earliest of June 16, 2008, unless extended, or receipt by the Trustee of payment in full of principal and interest on the notes. In the event of the expiration of the letter-of-credit, all outstanding notes would be subject to mandatory purchase by the Hospital. Additionally, there is a commitment fee with respect to the issuance and maintenance of the letter-of-credit. The Hospital's obligation to the Trustee for draws on the letter-of-credit is secured by a pledge of its gross receipts pursuant to an Assignment and Security Agreement, and a lien on any leases pursuant to an Assignment of Rents and Leases.

As a means to lower its borrowing costs, when compared against fixed-rate notes at the time of issuance, the Hospital entered into a rate swap in connection with its notes. The intention of the swap was to effectively change the hospital's variable interest rate on the notes to a synthetic fixed rate of 5.25 percent on \$2.4 million of the proceeds.

Under the swap, the hospital pays the counterparty a fixed payment of 5.25 percent and receives a variable payment computed at 100 percent of the London Interbank Offered Rate (LIBOR). The swap has a notational amount of \$2.4 million and the associated variable-rate notes that were swapped have a \$2.4 million principal amount. The swap was entered into at the same time the notes were issued (July 2003). Starting in fiscal year 2005, the notational value of the swap and the principal amount of the associated debt decline by a set maturity schedule. The notes' variable rate is based on the counterparty's published variable rate. The swap agreement is in place for five years and then renewable upon determination of the Hospital's creditworthiness. If at any time the Hospital elects to withdraw from the swap agreement they would pay the notes at the variable rate until their maturity on August 1, 2023.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

As of December 31, 2004 and 2003, the swap had a negative fair value of \$131,402 and \$147,590, respectively. The negative fair value of the swap may be countered by reductions in total interest payments required under the variable-rate notes, creating lower than synthetic rates. Because the coupons on the government's variable-rate notes adjust to changing interest rates, the notes do not have a corresponding fair value increase.

As of December 31, 2004, the Hospital was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the Hospital would be exposed to credit risk in the amount of the derivative's fair value.

As noted above, the swap exposes the Hospital to basis risk should the relationship between LIBOR and the counterparty's published rate converge, changing the synthetic rate on the notes. If a change occurs the results in the rates' moving to convergence, the expected cost savings may not be realized.

As of December 31, 2004, debt service requirements of the variable-rate debt and net swap payments for their term, *assuming interest rates remain the same*, and payments on capital lease obligations for their term were as follows:

Year Ending December 31	Principal	Interest - Unswapped	Interest Swapped	Interest Rate Swaps, Net	Leases Payable
2005	\$ 145,000	\$ 48,373	\$ 58,072	\$ 66,640	\$ 101,047
2006	150,000	46,848	56,059	64,330	16,841
2007	160,000	45,201	54,046	62,020	-
2008	165,000	43,432	51,911	59,750	-
2009	175,000	41,602	49,715	57,050	-
2010 - 2014	1,015,000	175,741	210,877	241,990	-
2015 - 2019	1,295,000	112,850	235,298	155,260	-
2020 - 2023	1,295,000	33,248	39,711	45,570	-
Total Payments	<u>\$ 4,400,000</u>	<u>\$ 547,295</u>	<u>\$ 755,689</u>	<u>\$ 752,610</u>	\$ 117,888
Less amount representing interest					<u>4,207</u>
Net present value					<u>\$ 113,681</u>

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

Capital leases are due in monthly installments totaling approximately \$12,306 at December 31, 2004, including imputed interest at rates ranging from 5.32 percent to 5.86 percent. They expire at various times through 2006, and are collateralized by the equipment leased.

	2004	2003
Cost of equipment under capital lease	\$ 641,328	\$ 641,328
Less accumulated amortization	495,179	366,913
Net carrying amount	\$ 146,149	\$ 274,415

9. NET PATIENT SERVICE REVENUE

Net patient service revenue consists of the following:

	2004	2003
Revenue		
Inpatient service		
Routine service	\$ 5,141,913	\$ 5,536,429
Ancillary services	9,004,896	8,950,705
Outpatient ancillary services	32,370,995	29,780,270
Total patient revenue	46,517,804	44,267,404
Revenue deductions		
Provision for contractual allowances	17,950,597	16,517,744
Provision for charity care	765,353	755,093
Bad debts	2,510,788	2,340,310
Other allowances	144,104	134,897
Total revenue deductions	21,370,842	19,748,044
Total net patient service revenue	\$ 25,146,962	\$ 24,519,360

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

10. NON-OPERATING GAINS

Non-operating gains consist of the following:

	2004	2003
Donations, gifts and grants	\$ 104,534	\$ 58,523
Investment income	103,698	137,993
Interest expense	(177,203)	(18,436)
Other gains	160,097	143,148
Non-operating gains - net	\$ 191,126	\$ 321,228

11. 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 Pens 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, survivor and death benefits, annual cost of living adjustments, and post-retirement healthcare benefits to qualifying members of both the Traditional and the Combined Plans; however, healthcare benefits are not statutorily guaranteed. Members of the Member-Directed Plan do not qualify for ancillary benefits, including post-employments health care coverage. Chapter 145 of the Ohio Revised Code assigns authority to establish and amend benefit provisions to the OPERS Board of Trustees. OPERS issues a stand-alone financial report. Interested parties may obtain a copy by making a written request to Ohio Public Employee Retirement System, 277 East Town Street, Columbus, Ohio 43215-4642 or by calling 614-222-6705 or 1-800-222-PERS (7377).

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

Funding Policy

The Ohio Revised Code provides statutory authority for member and employer contributions. For 2004, member and employer contribution rates were consistent across all three plans (TP, MD and CO), and are actuarially determined. The 2004 Member contribution rate for members of local government units was 13.55% percent of their annual covered salary. The 2004 employer contribution rate for local government units was 13.55% percent of covered payroll. The Hospital's contributions to OPERS for the years ended December 31, 2004, 2003, and 2002, were \$1,394,504, \$1,283,472, and \$1,192,732, respectively. Required employer contributions for all plans are equal to 100% of employer charges and must be extracted from the employer's records.

Post-Retirement Benefits

An entry-age normal actuarial cost method of valuation is used in determining the present value of OPEB. The difference between assumed and actual experience (actuarial gains and losses) becomes part of the unfunded actuarial accrued liability. All investments are carried at market value. For actuarial valuation purposes, a smoothed market approach is used. Under this approach assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually. The investment return assumption rate for 2003 was 8.00%. An annual increase of 4% compounded annually, is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally annual pay increases, over and above the 4% base increase, were assumed to range from 0.50% to 6.30%. Health care costs were assumed to increase 4% annually. These assumptions and calculations are based on the System's latest Actuarial Review performed as of December 31, 2003.

The number of active contributing participants in the Traditional and Combined Plans during 2004 was 369,885. As of December 31, 2003, the actuarial value of the Retirement System's net assets available for OPEB was \$10.5 billion. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$26.9 billion and \$16.4 billion, respectively.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003

Health Care Plan

In December 2002, the Board adopted the Health Care "Choices" Plan in its continuing effort to respond to the rise in the cost of health care. The Choice Plan will be offered to all persons newly hired in an OPERS covered position after January 1, 2003, with no prior service credit accumulated toward health care coverage. Choices, as the name suggests, will incorporate a cafeteria approach, offering a broader range of health care options. The plan uses a graded scale from ten to thirty years to calculate a monthly health care benefit. This is in contrast to the ten-year "cliff eligibility" standard for the present plan.

The benefit recipient will be free to select the option that best meets their needs. Recipients will fund health care costs in excess of their monthly health care benefit. The plan will also offer a spending account feature, enabling the benefit recipient to apply his or her allowance toward specific medical expenses, much like a Medical Spending Account.

12. RISK MANAGEMENT

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

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

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



**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Directors
Fayette County Memorial Hospital
Washington Court House, Ohio

We have audited the financial statements of Fayette County Memorial Hospital, as of and for the year ended December 31, 2004, and have issued our report thereon dated March 24, 2005. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Fayette County Memorial Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud, in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of Fayette County Memorial Hospital in a separate letter dated March 24, 2005.

Compliance and Other Matters

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

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

Blue & Co., LLC

March 24, 2005



**Auditor of State
Betty Montgomery**

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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
AUGUST 4, 2005**