

**MEMORIAL HOSPITAL OF UNION COUNTY
AND AFFILIATES**

COMBINED FINANCIAL STATEMENTS

DECEMBER 31, 2006 AND 2005



Mary Taylor, CPA

Auditor of State

Board of Trustees
Memorial Hospital of Union County and Affiliates
500 London Avenue
Marysville, Ohio 43040

We have reviewed the *Report of Independent Auditors* of the Memorial Hospital of Union County and Affiliates, Union County, prepared by Blue & Co., LLC, for the audit period January 1, 2006 through December 31, 2006. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

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

Mary Taylor

Mary Taylor, CPA
Auditor of State

May 10, 2007

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**MEMORIAL HOSPITAL OF UNION COUNTY
AND AFFILIATES**

TABLE OF CONTENTS
DECEMBER 31, 2006 AND 2005

	Page
Report of Independent Auditors	1
Required Supplementary Information	
Management's Discussion and Analysis (unaudited).....	i-ix
Combined Financial Statements	
Combined Balance Sheets.....	3
Combined Statements of Revenues, Expenses and Changes in Net Assets.....	5
Combined Statements of Cash Flows.....	6
Notes to Combined Financial Statements.....	8
Additional Information	
Report of Independent Auditors on Other Financial Information.....	29
Combining Balance Sheet	30
Combining Statement of Revenue, Expenses, and Changes in Net Assets.....	32
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.....	33



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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES
Marysville, Ohio

We have audited the accompanying combined balance sheet of Memorial Hospital of Union County and Affiliates (the "Hospital"), as of and for the year ended December 31, 2006 and the related combined statement of revenues, expenses, and changes in net assets and cash flows for the year then ended. These combined financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these combined financial statements based on our audit. The financial statements as of December 31, 2005 were audited by other auditors whose report dated March 17, 2006, expressed an unqualified opinion.

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. 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.

As discussed in Note 1, the financial statements of Memorial Hospital of Union County and Affiliates 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 Union County that is attributable to the transactions of Memorial Hospital of Union County and Affiliates. They do not purport to, and do not, present fairly the financial position of Union County as of December 31, 2006, 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.

Board of Trustees
MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Memorial Hospital of Union County and Affiliates as of December 31, 2006, and the changes in financial position and 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, under separate cover, a report dated April 20, 2007 on our consideration of Memorial Hospital of Union County and Affiliates' 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 of internal control over financial reporting and compliance and the results of that 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 Audit Standards* and should be read in conjunction with this report when considering the results of our audit.

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 of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Blue & Co., LLC

April 25, 2007

Memorial Hospital of Union County and Affiliates

Management's Discussion and Analysis

The management's discussion and analysis of Memorial Hospital of Union County, the Gables at Green Pastures, and Union County Hospital Association (collectively, the "Hospital") provides an overview of the combined financial activities for the year ended December 31, 2006. Management is responsible for the completeness and fairness of the combined financial statements and the related footnote disclosures along with the management's discussion and analysis.

Using This Annual Report

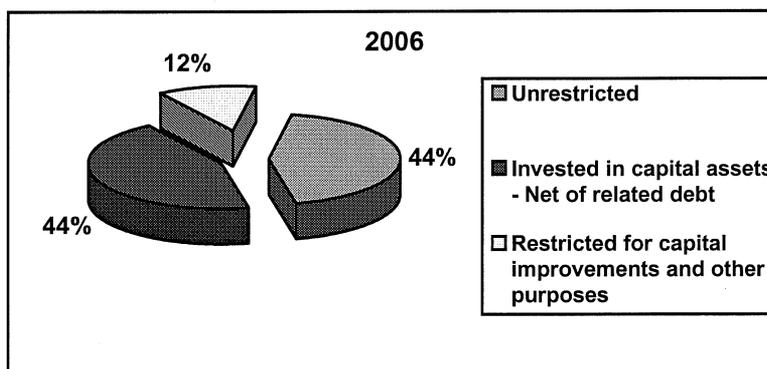
The Hospital's combined financial statements consist of three statements- a balance sheet, a statement of revenues, expenses, and changes in net assets, and a statement of cash flows. The combined financial statements and related notes provide information about activities of the Hospital, including resources held by the Hospital but restricted by specific purpose by contributors, bond indenture, grantors or enabling legislation.

This annual financial report includes the report of independent auditors, this management's discussion and analysis, the financial statements in the above referred format, notes to financial statements, and supplemental information.

Financial Highlights

The combined financial position of the Hospital improved in 2006. In total, the Hospital's net assets increased \$2.6 million in 2006. Operating revenues of \$61.6 million exceeded operating expenses of \$59.7 million, producing income from operations of \$1.9 million. Other income (expenses) improved between years, further boosting the increase in net assets. Cash and cash equivalents, including assets limited as to use, increased by \$3.2 million and capital assets increased by \$2.2 million.

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



Memorial Hospital of Union County and Affiliates

Management's Discussion and Analysis

In the year ended December 31, 2006, total operating revenue exceeded total operating expenses and other expenses, creating an increase in net assets of \$2,615,524 (compared to a \$2,721,571 increase in the previous year).

The Balance Sheet and the Statement of Revenues, Expenses, 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 statement of revenues, expenses, 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 revenues 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 revenues and expenses may be thought of as the Hospital's operating results.

These two statements report the Hospital's net assets and the changes in them. You can think of Hospital's net assets - the difference between assets and liabilities - as one way to measure the Hospital's financial health, or financial position. Over time, increases or decreases in the Hospital's net assets are one indicator 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, state and federal regulatory issues, condition of the buildings, and strength of the medical staff, to fully 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 revenues and expenses are taken into account regardless of when cash is received or paid.

Memorial Hospital of Union County and Affiliates

Management's Discussion and Analysis

The following is a comparative analysis of the major components of the balance sheet of the Hospital as of December 31, 2006:

	Year Ended December 31		Change	
	2006	2005	Amount	Percent
Assets				
Current assets	\$ 22,123,377	\$ 19,557,725	\$ 2,565,652	13.1%
Noncurrent assets	2,333,851	3,591,012	(1,257,161)	-35.0%
Capital assets	<u>35,911,306</u>	<u>33,680,071</u>	<u>2,231,235</u>	6.6%
Total assets	60,368,534	56,828,808	3,539,726	6.2%
Liabilities				
Current liabilities	6,039,906	6,050,029	(10,123)	-0.2%
Long-term liabilities	<u>24,470,955</u>	<u>23,536,630</u>	<u>934,325</u>	4.0%
Total liabilities	<u>30,510,861</u>	<u>29,586,659</u>	<u>924,202</u>	3.1%
Net assets				
Invested in capital assets - net of debt	13,124,409	12,584,337	540,072	4.3%
Restricted	3,648,108	1,914,465	1,733,643	90.6%
Unrestricted	<u>13,085,156</u>	<u>12,743,347</u>	<u>341,809</u>	2.7%
Total net assets	<u>\$ 29,857,673</u>	<u>\$ 27,242,149</u>	<u>\$ 2,615,524</u>	9.6%

Current assets increased 13.1 percent, driven by an increase in cash and patient accounts receivables. Capital assets increased 6.6 percent due to increased capital outlays during the year in support of the Hospital's strategic plan. Non-current assets decreased during the year, primarily due to physician advances. Total liabilities increased 3.1 percent during the year due to the refinancing and retirement of debt. Net assets invested in capital assets, net of related debt, increased 4.3 percent due to capital investment. Unrestricted net assets increased 2.7 percent due to positive operating results and donor contributions.

Memorial Hospital of Union County and Affiliates

Management's Discussion and Analysis

Operating Results and Changes in the Hospital's Net Assets

	2006	2005	Change	
			Amount	Percent
Operating revenues				
Net patient service revenue	\$60,142,923	\$ 58,674,289	\$ 1,468,634	2.5%
Other operating revenue	1,494,889	1,859,601	(364,712)	-19.6%
Total operating revenues	61,637,812	60,533,890	1,103,922	1.8%
Operating expenses				
Salaries and wages	27,001,228	25,494,013	1,507,215	5.9%
Employee benefits and payroll taxes	8,002,895	7,626,393	376,502	4.9%
Supplies and other	11,409,667	10,801,714	607,953	5.6%
Professional services and consultant fees	1,372,290	1,195,970	176,320	14.7%
Purchased services	7,544,338	7,853,316	(308,978)	-3.9%
Insurance	506,768	576,391	(69,623)	-12.1%
Utilities	1,075,211	1,085,583	(10,372)	-1.0%
Depreciation and amortization	2,833,485	3,113,907	(280,422)	-9.0%
Total operating expenses	59,745,882	57,747,287	1,998,595	3.5%
Operating income	1,891,930	2,786,603	(894,673)	-32.1%
Other income (expense)				
Interest income	576,330	226,078	350,252	154.9%
Noncapital grants and contributions	808,334	543,753	264,581	48.7%
Interest expense	(959,644)	(906,249)	(53,395)	5.9%
Other	298,574	71,386	227,188	318.3%
Total other income (expense)	723,594	(65,032)	788,626	-1212.7%
Increase in net assets	2,615,524	2,721,571	(106,047)	-3.9%
Net assets, beginning of year	27,242,149	24,520,578		
Net assets, end of year	\$29,857,673	\$ 27,242,149		

Memorial Hospital of Union County and Affiliates

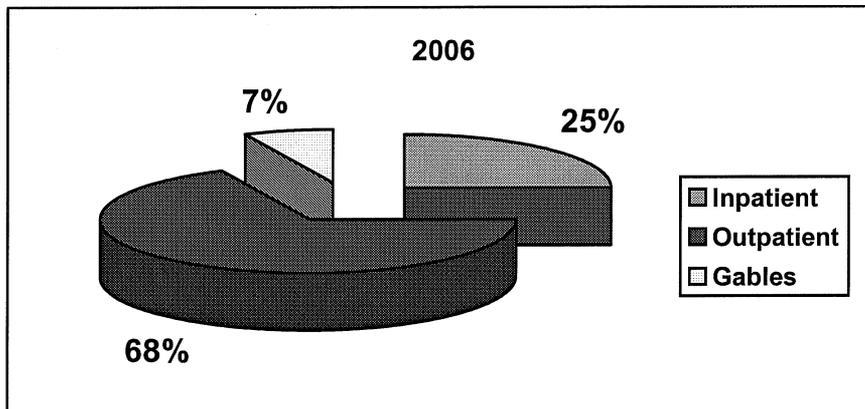
Management's Discussion and Analysis

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 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.

Operating revenue changes were a result of the following factors:

- Net patient service revenue increased 2.5 percent overall. This was attributable to increases in gross inpatient and outpatient services of 7.3 percent reduced by corresponding increases in revenue deductions. These deductions are the amounts that are not paid to the Hospital under contractual arrangements with Medicare, Medicaid, and other payors. These revenue deductions increased from 45 percent to 47 percent as a percentage of gross revenue.
- Other operating revenue decreased 19.6 percent from 2005 due, in general, to a decrease in grant receipts and rental income.
- The following is a graphic illustrations of patient revenues by source:



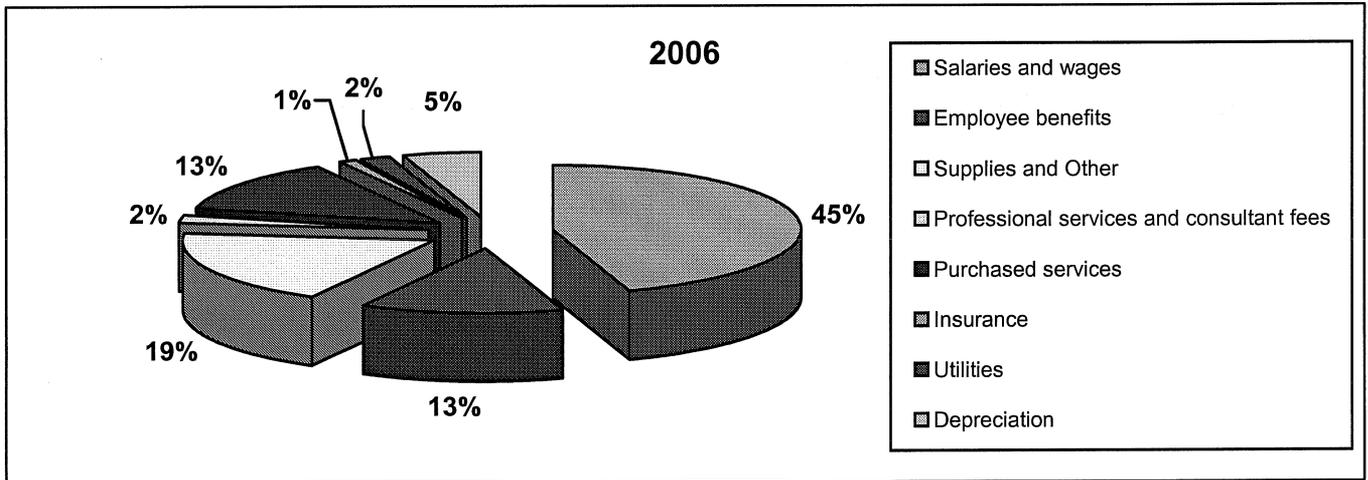
Memorial Hospital of Union County and Affiliates

Management's Discussion and Analysis

Operating Expenses

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

- Salary costs increased 5.9 percent due to pay increases and market adjustments.
- Supplies and other expenses increased 5.6% percent due to the increase in patient service revenues mentioned above and recruitment expenses.
- The following is a graphic illustration of operating expenses by type:



Other Income (Expense)

Other income and expenses are all sources and uses that are primarily non-exchange in nature. They consist primarily of gifts and bequests and investment income.

Significant changes were the result of the following factors:

- Interest income increased \$350,000 due to the increase in cash during the year combined with rising interest rates.
- Unrestricted contributions increased \$212,000.

Memorial Hospital of Union County and Affiliates

Management's Discussion and Analysis

Statement of Cash Flows

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

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

	Year Ended December 31		Increase
	2006	2005	(Decrease)
Cash provided by (used in):			
Operating activities	\$ 5,887,869	\$ 3,954,170	\$ 1,933,699
Capital and related financing activities	(3,583,679)	(1,981,403)	(1,602,276)
Investing activities	874,904	226,078	648,826
Total	3,179,094	2,198,845	980,249
Cash - beginning of year	10,949,385	8,750,540	2,198,845
Cash - end of year	<u>\$ 14,128,479</u>	<u>\$ 10,949,385</u>	<u>\$ 3,179,094</u>

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

Net cash flows provided by operating activities increased over the prior year due mainly to an increase in patient services and the resulting increase in receipts from patients and third-parties.

Net cash used by capital and related financing activities increased due to the increased capital acquisitions mentioned previously, combined with refinancing and retirement of debt.

Memorial Hospital of Union County and Affiliates

Management's Discussion and Analysis

Capital Asset and Debt Administration

Capital Assets

At December 31, 2006, the Hospital had \$69.1 million invested in capital assets. Accumulated depreciation totaled \$33.2 million. Net capital assets totaled \$35.9 million. Depreciation and amortization totaled \$2.8 million during the year compared to \$3.1 million in 2005. A summary of these assets is shown below.

	Year Ended December 31 2006	2005	Increase (Decrease)
<u>Capital assets not being depreciated</u>			
Land	\$ 1,947,720	\$ 1,367,780	\$ 579,940
Construction in progress	396,389	241,870	154,519
Subtotal	2,344,109	1,609,650	734,459
<u>Capital assets being depreciated - net of accumulated depreciation</u>			
Land improvements	1,512,507	1,457,314	55,193
Buildings and improvements	26,763,963	24,605,634	2,158,329
Major moveable equipment	4,674,891	5,071,800	(396,909)
Property under capital leases	615,836	935,673	(319,837)
Subtotal	33,567,197	32,070,421	1,496,776
Total	\$ 35,911,306	\$ 33,680,071	\$ 2,231,235

Debt

At year end, the Hospital had \$23.5 million in long-term debt and capital lease obligations outstanding compared to \$21.8 million the previous year. The table below summarizes these amounts by year.

	2006	2005	Increase (Decrease)
Total leases and bonds	\$ 23,454,916	\$ 21,796,792	\$ 1,658,124

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

Memorial Hospital of Union County and Affiliates

Management's Discussion and Analysis

Economic Factors that Will Affect the Future

The economic position of the Hospital is closely tied to that of the local economy in addition to the State's fiscal condition and the healthcare market of the Hospital's service area.

Factors affecting the Hospital during 2007 and future years include the opening of OhioHealth's facility in Dublin, combined with State budget constraints on reimbursements and the ongoing payor shift to the underinsured and uninsured. To offset any potential financial impacts, the Hospital has implemented its strategic plan. The multiyear plan focuses on expanding and retaining our physician base, developing comprehensive service lines in cardiology, oncology, and surgery, increasing the marketability of our facility, and improving our quality and customer service initiatives. Further, in late 2006 and early 2007 the Hospital successfully renegotiated two large managed care contracts.

Contacting the Hospital's Management

This financial report is intended to provide the reader with a general overview of the Hospital's finances. If you have questions about this report or need additional information, we welcome you to contact the chief financial officer.

Jeff Ehlers
Chief Financial Officer

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

COMBINED BALANCE SHEETS DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 10,480,371	\$ 9,034,920
Patient accounts receivable, net of allowances for uncollectible accounts; \$2,643,969 and \$2,166,000 in 2006 and 2005, respectively	7,136,308	7,308,073
Assets limited as to use	3,648,108	1,914,465
Prepaid expenses and other current assets	410,910	465,748
Inventories	347,028	389,407
Other current assets	<u>100,652</u>	<u>445,112</u>
 Total current assets	 22,123,377	 19,557,725
 Capital assets, net	 35,911,306	 33,680,071
 Other assets		
Physician advances receivable	898,068	2,118,273
Investment in joint ventures	368,237	347,448
Bond issue costs	<u>1,067,546</u>	<u>1,125,291</u>
	<u>2,333,851</u>	<u>3,591,012</u>
 Total assets	 <u>\$ 60,368,534</u>	 <u>\$ 56,828,808</u>

See accompanying notes to financial statement.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

COMBINED BALANCE SHEETS
DECEMBER 31, 2006 AND 2005

LIABILITIES AND NET ASSETS

	<u>2006</u>	<u>2005</u>
Current liabilities		
Current portion of long-term debt	\$ 1,185,998	\$ 1,291,882
Accounts payable	2,219,956	2,215,915
Estimated third-party settlements	735,921	669,620
Salaries, wages, and related accruals	<u>1,898,031</u>	<u>1,872,612</u>
Total current liabilities	6,039,906	6,050,029
Long-term debt, net of current portion	22,268,918	20,504,910
Other liabilities		
Accrued compensated absences	2,095,257	1,951,148
Other long-term liabilities	<u>106,780</u>	<u>1,080,572</u>
	<u>2,202,037</u>	<u>3,031,720</u>
Total liabilities	30,510,861	29,586,659
Net assets		
Invested in capital assets - net of related debt	13,124,409	12,584,337
Restricted:		
Nonexpendable permanent endowments	25,000	25,000
Restricted for debt service and capital acquisitions	3,623,108	1,889,465
Unrestricted	<u>13,085,156</u>	<u>12,743,347</u>
Total net assets	<u>29,857,673</u>	<u>27,242,149</u>
Total liabilities and net assets	<u>\$ 60,368,534</u>	<u>\$ 56,828,808</u>

See accompanying notes to financial statements.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

COMBINED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2006 AND 2005

	<u>2006</u>	<u>2005</u>
Operating revenues		
Net patient service revenue	\$ 60,142,923	\$ 58,674,289
Other operating revenue	<u>1,494,889</u>	<u>1,859,601</u>
Total operating revenues	61,637,812	60,533,890
Operating expenses		
Salaries and wages	27,001,228	25,494,013
Employee benefits and payroll taxes	8,002,895	7,626,393
Supplies and other	11,409,667	10,801,714
Professional services and consultant fees	1,372,290	1,195,970
Purchased services	7,544,338	7,853,316
Insurance	506,768	576,391
Utilities	1,075,211	1,085,583
Depreciation and amortization	<u>2,833,485</u>	<u>3,113,907</u>
Total operating expenses	<u>59,745,882</u>	<u>57,747,287</u>
Operating income	1,891,930	2,786,603
Other income (expense)		
Interest income	576,330	226,078
Grants and contributions	808,334	543,753
Interest expense	(959,644)	(906,249)
Other	<u>298,574</u>	<u>71,386</u>
Total other income (expenses)	<u>723,594</u>	<u>(65,032)</u>
Increase in net assets	2,615,524	2,721,571
Net assets - beginning of year	<u>27,242,149</u>	<u>24,520,578</u>
Net assets - end of year	<u><u>\$ 29,857,673</u></u>	<u><u>\$ 27,242,149</u></u>

See accompanying notes to financial statements.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

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

	2006	2005
Operating activities		
Cash received from patients and third-party payors	\$ 60,248,387	\$ 56,995,802
Cash payments to suppliers for services and goods	(21,028,792)	(22,552,223)
Cash payments to employees for services	(34,826,615)	(32,349,010)
Other operating revenue	1,494,889	1,859,601
Net cash from operating activities	5,887,869	3,954,170
Investing activities		
Proceeds from investments	874,904	226,078
Net cash from investing activities	874,904	226,078
Capital and related financing activities		
Acquisition and construction of capital assets	(5,090,493)	(1,143,806)
Grants and contributions	808,334	543,753
Issuance of long-term debt	2,950,000	14,459,770
Interest paid on long-term debt	(959,644)	(872,762)
Principal payments on long-term debt	(1,291,876)	(14,968,358)
Net cash from capital and related financing activities	(3,583,679)	(1,981,403)
Change in cash and cash equivalents	3,179,094	2,198,845
Cash and cash equivalents - beginning of year	10,949,385	8,750,540
Cash and cash equivalents- end of year	\$ 14,128,479	\$ 10,949,385
Balance sheet classification of cash		
Cash and cash equivalents	\$ 10,480,371	\$ 9,034,920
Cash included in assets limited as to use	3,648,108	1,914,465
	\$ 14,128,479	\$ 10,949,385

See accompanying notes to financial statements.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

COMBINED STATEMENTS OF CASH FLOWS (continued)
YEARS ENDED DECEMBER 31, 2006 AND 2005

A reconciliation of operating income to net cash from operating activities follows:

	<u>2006</u>	<u>2005</u>
Operating income	\$ 1,891,930	\$ 2,786,603
Adjustments to reconcile income from operations to net cash from operating activities		
Depreciation and amortization	2,833,485	3,113,907
Provision for bad debt	4,679,295	4,263,583
Loss on disposal of capital assets	25,773	93,451
Changes in assets and liabilities		
Patient accounts receivable	(4,507,530)	(5,942,070)
Other assets	1,698,838	(492,041)
Accounts payable	4,041	(218,711)
Other accrued expenses	<u>(737,963)</u>	<u>349,448</u>
Net cash from operating activities	<u>\$ 5,887,869</u>	<u>\$ 3,954,170</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for interest	\$ 959,644	\$ 872,762

See accompanying notes to financial statements.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

1. NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Principles of Combination

Memorial Hospital of Union County ("Memorial") is an acute care hospital owned by Union County, Ohio and operated by a board of trustees (the "Trustees"). Members of the board of trustees are appointed by the county commissioners and county judges. Memorial is considered a political subdivision of state and is therefore exempt from federal income taxes under Section 115 of the Internal Revenue Code. The Hospital is reported as an enterprise fund of Union County.

In 1994, the board of trustees formed Union County Health System (UCHS) in order to provide a corporate structure under which the Hospital can enter into joint ventures with other institutions and health care providers to provide an integrated delivery system.

In 2006, UCHS merged with the Union County Hospital Association (UCHA). UCHS assumed the name of UCHA. The prior operations of UCHA were dissolved and the remaining assets were transferred to Memorial Hospital of Union County.

In 1994, the Board of County Commissioners of Union County (the "Board") passed a resolution to transfer the management and operations of Union Manor (a nursing home) to the Trustees on January 1, 1995. Pursuant to this resolution, the Trustees accepted control over the assets of Union Manor. Under the terms of the transfer, the Board indicated their support of the Trustees in Union Manor's future efforts to secure financing for renovation and expansion. In 2003, the construction of a new facility was completed. Subsequently, the name was changed to the Gables at Green Pastures (the Gables).

The combined financial statements for the years ended December 31, 2006 and 2005 included herein consists of the financial positions, results of operations, changes in net assets, and cash flows of Memorial Hospital of Union County, UCHS, and The Gables (collectively, the "Hospital"). All intercompany accounts and transactions between all entities have been eliminated.

Basis of Presentation

The Financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by Governmental Accounting Standards Board (GASB) in Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis- for State and Local Governments*, issued in June 1999. The Hospital follows the "business-type" activities reporting requirements of GASB Statement No. 34 that provide a comprehensive look at the Hospital's financial activities. The financial statements include UCHA and The Gables as blended component units in the Hospital's financial statements.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

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

Patient Accounts Receivable

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

Inventories

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

Debt Issuance Costs

Costs incurred in obtaining long-term debt financing are being amortized over the term of the obligations. Amortization expense totaled \$57,745 and \$51,267 in 2006 and 2005 respectively.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

Assets Limited as to Use

Assets whose use is limited consist of invested funds designated by the Trustees for the replacement, improvement, expansion of the Hospital's facilities, self-insured health insurance, and worker's compensation plans and the Hospital's Section 125 Plan and invested funds held by a trustee in connection with the Hospital's bonds. Assets limited as to use also include funds whose use is specified by the donor, as well as permanently restricted endowments, the earnings of which can be used for certain purposes as specified by the donor.

Capital Assets

Capital assets are recorded at cost or, if donated, at fair value at the date of receipt. Depreciation is computed principally on the straight-line basis over the estimated useful lives of the assets. Equipment under capital lease 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.

Physician Advances Receivable

The Hospital advances monies to physicians under various cash flow support and loan arrangements. 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.

Compensated Absences

Paid time off is charged to operations when earned. The unused and earned benefits are recorded as a liability in the financial statements. Employees accumulate vacation days at varying rates depending on years of service, and may carry over accumulated hours to the next year, subject to a maximum of three years' accrual. Employees also earn sick leave benefits at a Hospital-determined rate, which are capped at various levels. 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 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 accumulated sick leave balance up to maximum of 240 hours. Employees accumulate holidays at a Hospital-determined rate for all employees.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

Restricted Resources

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

Classification of Net Assets

Net assets of the Hospital are classified in four components. (1) Net assets invested in capital assets- net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balance of any outstanding borrowings used to finance the purchase or construction of those assets. (2) Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees as required by revenue note indentures. (3) Restricted nonexpendable net assets equal the principal portion of permanent endowments. (4) Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Use of Estimates

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

Operating Revenue and Expenses

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

Reclassifications

Certain 2005 accounts have been reclassified to conform to the 2006 presentation.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for service rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

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

Contributions

Contributions of cash and other assets, including unconditional promises to give in the future, are reported as revenue when received, 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.

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Pension Plans

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

Federal Income Tax

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

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

Risk Management

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

2. CASH AND CASH EQUIVALENTS

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

The Hospital has designated four banks for the deposit of its funds. An investment policy has not been filed with the Auditor of State on behalf of the Hospital. Investment of interim funds is limited to bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality, no-load money market mutual funds, and the Ohio subdivision's fund (STAR Ohio).

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

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

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

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

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

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

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

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

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

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

Custodial Credit Risk of Bank Deposits- Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. At year end, the Hospital had \$14,768,163 of bank deposits (certificates of deposits, checking and savings accounts) that were uninsured but are collateralized with securities held by the pledging financial institution. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance it is impractical to insure all deposits. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used.

The Hospital had the following investments and maturities:

	Carrying Amount	Maturities	
December 31, 2006:		< than 1 year	1 - 5 years
Certificates of deposit	\$ 6,405,629	\$ 6,405,629	\$ -

3. PATIENT ACCOUNTS RECEIVABLE

The details of patient accounts receivable are set forth below:

	2006	2005
Patient accounts receivable	\$ 15,540,742	\$ 14,451,073
Allowance for uncollectible accounts	(2,643,969)	(2,166,000)
Allowance for contractual adjustments	(5,760,465)	(4,977,000)
Patient accounts receivable, net	\$ 7,136,308	\$ 7,308,073

The Hospital provides services without collateral to patients, most of who are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors follows:

	2006	2005
Medicare	19%	20%
Medicaid	6%	9%
Commerical insurance and other	50%	46%
Self-pay	25%	25%
Total	100%	100%

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

4. PATIENT SERVICE REVENUE

Approximately 38 percent of the Hospital's net patient service revenue is received from the Medicare and Medicaid programs. The Hospital has agreements with 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 service and amounts reimbursed by third-party payors. The basis of reimbursements 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. Certain outpatient services, including ambulatory surgery, radiology, and laboratory services are reimbursed on an established fee-for-service methodology. Beginning August 1, 2000, reimbursement for most outpatient services is based on the prospectively determined ambulatory payment classification system.
- **Medicaid-** Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost reimbursement method. Outpatient and physician services are reimbursed 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 changes 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. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying combined financial statements.

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

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

5. CAPITAL ASSETS

Capital assets for the years ended December 31, 2006 and 2005 were as follows:

	2005	Reclassifica- tions	Additions	Disposals and Adjustments	2006
Capital Assets not being depreciated:					
Land and land improvements	\$ 1,367,780	\$ -	\$ 579,940	\$ -	\$ 1,947,720
Construction in progress	241,870	(253,080)	429,990	(22,391)	396,389
Subtotal	<u>1,609,650</u>	<u>(253,080)</u>	<u>1,009,930</u>	<u>(22,391)</u>	<u>2,344,109</u>
Capital assets being depreciated:					
Land improvements	2,098,377	-	117,358	(1,550)	2,214,185
Building	37,838,293	192,588	3,202,728	(143,531)	41,090,078
Major movable equipment	18,285,425	60,492	760,477	(170,902)	18,935,492
Property under capital leases	4,524,091	-	-	-	4,524,091
Subtotal	<u>62,746,186</u>	<u>253,080</u>	<u>4,080,563</u>	<u>(315,983)</u>	<u>66,763,846</u>
Accumulated Depreciation					
Land improvements	641,063	-	62,165	(1,550)	701,678
Building	13,232,659	-	1,247,836	(154,380)	14,326,115
Major moveable equipment	13,213,625	-	1,203,647	(156,671)	14,260,601
Property under capital leases	3,588,418	-	319,837	-	3,908,255
Subtotal	<u>30,675,765</u>	<u>-</u>	<u>2,833,485</u>	<u>(312,601)</u>	<u>33,196,649</u>
Capital assets, net	<u>\$ 33,680,071</u>	<u>\$ -</u>	<u>\$ 2,257,008</u>	<u>\$ (25,773)</u>	<u>\$ 35,911,306</u>

	2004	Reclassifica- tions	Additions	Disposals and Adjustments	2005
Capital Assets not being depreciated:					
Land and land improvements	\$ 1,394,280	\$ -	\$ -	\$ (26,500)	\$ 1,367,780
Construction in progress	5,830,399	(5,797,382)	208,853	-	241,870
Subtotal	<u>7,224,679</u>	<u>(5,797,382)</u>	<u>208,853</u>	<u>(26,500)</u>	<u>1,609,650</u>
Capital assets being depreciated:					
Land improvements	2,090,900	-	7,477	-	2,098,377
Building	32,751,048	4,933,614	218,395	(64,764)	37,838,293
Major movable equipment	16,820,670	863,768	709,081	(108,094)	18,285,425
Property under capital leases	4,524,091	-	-	-	4,524,091
Subtotal	<u>56,186,709</u>	<u>5,797,382</u>	<u>934,953</u>	<u>(172,858)</u>	<u>62,746,186</u>
Accumulated Depreciation					
Land improvements	580,612	-	60,451	-	641,063
Building	11,958,278	-	1,274,381	-	13,232,659
Major moveable equipment	11,939,784	-	1,379,748	(105,907)	13,213,625
Property under capital leases	3,189,091	-	399,327	-	3,588,418
Subtotal	<u>27,667,765</u>	<u>-</u>	<u>3,113,907</u>	<u>(105,907)</u>	<u>30,675,765</u>
Capital assets, net	<u>\$ 35,743,623</u>	<u>\$ -</u>	<u>\$ (1,970,101)</u>	<u>\$ (93,451)</u>	<u>\$ 33,680,071</u>

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

Depreciation expense totaled \$2,833,485 and \$3,113,907 in 2006 and 2005, respectively.

6. ASSETS LIMITED AS TO USE

Assets limited as to use that are required for obligations classified as current liabilities are reported as current assets. The composition of assets limited as to use at December 31, 2006 and 2005 consists of the following:

	<u>2006</u>	<u>2005</u>
By board of trustees for capital improvements- cash	\$ 1,030,616	\$ 783,743
By board of trustees retirement of indebtedness- cash	16,082	347,864
By board of trustees and self-insurance- cash	1,060,635	182,951
Held by trustee under bond indenture agreement- cash	<u>1,515,775</u>	<u>574,907</u>
Total board-designated and trustee held	3,623,108	1,889,465
Principal for permanent endowments	<u>25,000</u>	<u>25,000</u>
Total board-designated and trustee held	<u><u>\$ 3,648,108</u></u>	<u><u>\$ 1,914,465</u></u>

7. SALARIES, WAGES AND RELATED ACCRUALS

The details of accrued liabilities at December 31, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Payroll and related items	\$ 1,302,871	\$ 1,208,173
Self-insured benefits	<u>595,160</u>	<u>664,439</u>
Total salaries, wages and related accruals	<u><u>\$ 1,898,031</u></u>	<u><u>\$ 1,872,612</u></u>

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

8. LONG-TERM DEBT

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

	2005	Additions	Reductions	2006	Amounts Due Within One Year
Union County General Obligation Bonds, dated July 1, 2005:					
Serial bonds, 3.5% to 5.00% payable through 2016, in annual installments ranging from \$75,000 to \$680,000	\$ 5,035,000	\$ -	\$ (80,000)	\$ 4,955,000	\$ 200,000
Term bonds, 4.10% due December 1, 2018, mandatory annual sinking fund redemption beginning December 1, 2017, ranging from \$515,000 to \$530,000	1,045,000	-	-	1,045,000	-
Serial bonds, 4.00% to 4.125% payable through 2024, in annual installments ranging from \$555,000 to \$675,000	3,695,000	-	-	3,695,000	-
Union County General Obligation Bonds, dated April 1, 2003					
Serial bonds, 1.50% to 5.00% payable through 2033, in annual installements ranging from \$25,000 to \$635,000	5,240,000	-	(25,000)	5,215,000	25,000
Union County General Obligation Bonds, dated July 15, 1999					
Serial bonds, 3.5% to 5.10% payable through 2011, in annual installments ranging from \$55,000 to \$355,000	1,545,000	-	(360,000)	1,185,000	375,000

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

	2005	Additions	Reductions	2006	Amounts Due Within One Year
Union County General Obligation Bonds, Series 1996:					
Series bonds, 3.75% to 5.15% payable through 2009, in annual installments ranging from \$80,000 to \$140,000	120,000	-	(120,000)	-	-
Union County General Obligation Notes, dated April 11, 2006					
Limited tax general obligation notes, 3.82%, refinanced April, 2007	4,075,000	-	(440,000)	3,635,000	460,000
Note payable, bearing interest at 6.63%, due in monthly installments of \$20,362 through January 1, 2012	-	2,950,000	-	2,950,000	38,947
Note payable, bearing interest at 5.3%, due in monthly installments of \$6,242 through July 10, 2020	701,058	-	(33,039)	668,019	34,833
Installment obligations	340,734	-	(233,837)	106,897	52,218
Total long-term debt	<u>\$ 21,796,792</u>	<u>\$ 2,950,000</u>	<u>\$ (1,291,876)</u>	<u>\$ 23,454,916</u>	<u>\$ 1,185,998</u>

Long-term debt activity for the year ended December 31, 2005 follows:

	2004	Additions	Reductions	2005	Amounts Due Within One Year
Union County General Obligation Bonds, dated July 1, 2005					
Serial bonds, 3.50% to 5.00% payable through 2016, in annual installments ranging from \$75,000 to \$680,000	\$ -	\$ 5,110,000	\$ (75,000)	\$ 5,035,000	\$ 80,000
Term bonds, 4.10% due December 1, 2018, mandatory annual sinking fund redemption beginning December 1, 2017, ranging from \$515,000 to \$530,000	-	1,045,000	-	1,045,000	-
Serial bonds, 4.00% to 4.125% payable through 2024, in annual installments ranging from \$555,000 to \$675,000	-	3,695,000	-	3,695,000	-

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

	2004	Additions	Reductions	2005	Amounts Due Within One Year
Union County General Obligation Bonds, dated April 1, 2003					
Serial bonds, 1.50% to 5.00% payable through 2033, in annual installements ranging from \$25,000 to \$635,000	5,265,000	-	(25,000)	5,240,000	25,000
Union County General Obligation Bonds, dated July 15, 1999					
Serial bonds, 3.5% to 5.10% payable through 2011, in annual installments ranging from \$55,000 to \$355,000	2,680,000	-	(1,135,000)	1,545,000	360,000
Term bonds, 5.00% due December 1, 2014, mandatory annual sinking fund redemption beginning December 1, 2012, ranging from \$375,000 to \$415,000	1,185,000	-	(1,185,000)	-	-
Term bonds, 5.30% due December 1, 2019 mandatory annual sinking fund redemption beginning December 1, 2015, ranging from \$435,000 to \$535,000	2,420,000	-	(2,420,000)	-	-
Term bonds 5.25% due December 1, 2024, mandatory annual sinking fund redemption beginning December 1, 2020, ranging from \$565,000 to \$690,000	3,135,000	-	(3,135,000)	-	-
Union County General Obligation Bonds, Series 1996:					
Series bonds, 3.75% to 5.15% payable through 2009, in annual installments ranging from \$80,000 to \$140,000	630,000	-	(510,000)	120,000	120,000

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

	2004	Additions	Reductions	2005	Amounts Due Within One Year
Term bonds, 5.50% due December 1, 2016, mandatory annual sinking fund redemption beginning December 1, 2010 ranging from \$145,000 to \$200,000	1,200,000	-	(1,200,000)	-	-
Union County General Obligation Notes, dated April 12, 2005					
Limited tax general obligation notes, 3.75% payable April 11, 2006	-	4,505,000	(430,000)	4,075,000	440,000
Union County General Obligation Notes, dated April 1, 2004					
Limited tax general obligation notes, 1.75% payable April 15, 2005	4,505,000	-	(4,505,000)	-	-
Note payable, bearing interest at 5.3%, due in monthly installments of \$6,242 through July 10, 2020	732,395	-	(31,337)	701,058	33,039
Installment obligations	552,985	104,770	(317,021)	340,734	233,843
Total long-term debt	\$ 22,305,380	\$ 14,459,770	\$ (14,968,358)	\$ 21,796,792	\$ 1,291,882

The bonds and notes payable are summarized as follows:

The 2006 Union County General Obligation Notes - dated April 11, 2006, were issued in the amount of \$3,635,000 to refinance the 2005 Notes in anticipation of the issuance of bonds for capital improvements to the Hospital's facilities.

The 2005 Union County General Obligation Bonds - dated July 1, 2005, were issued in the amount of \$9,850,000 to refund a callable portion of the 1996 General Obligation Bonds and the 1999 Improvement Bonds. There were \$5,110,000 of 3.5 percent to 5.0 percent Serial Bonds, \$1,045,000 of 4.1 percent Term Bonds, and \$3,695,000 of 4.0 percent to 4.125 percent Serial bonds included in this issue. A total of \$1,655,000 and \$8,195,000 was refunded for the 1996 and 1999 bonds, respectively. The average interest rate on the 2005 issue was 4.03 percent, replacing an average interest rate of the refunded bonds of 5.25 percent. The refunding reduced the total debt service payments over the next 20 years by approximately \$515,000, which represents an economic gain of approximately \$362,000.

The 2005 Union County General Obligation Notes - dated April 12, 2005, were issued in the amount of \$4,505,000 to refinance the 2004 notes.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

The 2004 Union County General Obligation Notes - dated April 1, 2004, were issued in the amount of \$5,255,000 to refinance the 2003 notes and refund the 1993 bonds.

The 2003 Union County General Obligation Bonds and Notes - dated April 1, 2003, were issued in the amount of \$8,740,000 to finance the acquisition and construction of capital improvements to the Hospital's facilities, including redesigning of the obstetrics unit and various other projects.

The 1999 Union County Improvement Bonds - dated July 15, 1999, were issued in the amount of \$11,000,000. Proceeds of the 1999 issue were divided 67 percent to the Gables and 33 percent to Memorial. The Gables' portion was utilized to finance the construction of the new nursing home facility. The Hospital's portion was utilized to complete the emergency room, HVAC, and information technology projects. In 2005, \$8,195,000 was refunded by the 2005 bonds.

The 1996 Union County General Obligation Bonds - Series 1996, were issued in the amount of \$2,590,000 to finance the acquisition and construction of capital improvements to the Hospital's facilities, including the emergency room, to purchase land for the new Gables site, and to repay the bond anticipation notes, which matured in 1995. In 2005, \$1,655,000 was refunded by the 2005 bonds.

The 1993 Union County Improvements Bonds - dated May 15, 1993, were issued in the amount of \$5,170,000. Proceeds of the 1993 issue were deposited into an escrow account with a trustee to advance refund the 1987 general obligation bonds and to provide the Hospital additional funds for improvements of approximately \$2,000,000. In 2004, the 1993 bonds were refunded by the 2004 notes.

The Hospital leases medical and office equipment, furniture and fixtures used in its operations under capital leases which generally require the Hospital to pay insurance and maintenance costs. These capital leases are due in monthly installments including interest at rates ranging from 2.96 percent to 3.51 percent annually. These leases expire at various dates through 2007, and are collateralized by the equipment leased.

The Hospital has a \$1,000,000 revolving line of credit, the borrowings of which are collateralized by certain Hospital assets. The line bears interest at 65 percent of the bank's prime commercial rate and expires in April 2007. There was no balance outstanding as of December 31, 2006 or 2005.

The Hospital has a \$2,950,000 commercial installment note, proceeds from which were used to purchase medical buildings in December 2006. The loan bears interest at 6.63% with monthly payments of \$20,362. The balance on the loan is \$2,950,000 at December 31, 2006, as payments are not scheduled to begin until January 2007.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

The following is a schedule by years of debt principal and interest payments and capital lease principal and interest payments::

Years Ending December 31	Long-term Debt		Capital Lease Obligation	
	Principal	Interest	Principal	Interest
2007	\$ 1,133,780	\$ 829,855	\$ 52,218	\$ 2,793
2008	1,182,475	832,938	21,298	1,579
2009	829,068	825,119	22,058	819
2010	843,977	807,949	11,323	116
2011	784,465	798,054	-	-
2012-2016	6,727,937	2,697,948	-	-
2017-2021	3,797,712	1,981,439	-	-
2022-2026	3,770,797	1,657,577	-	-
2027-2031	3,037,808	935,916	-	-
2032-2033	1,240,000	124,210	-	-
Total	<u>\$ 23,348,019</u>	<u>\$ 11,491,005</u>	<u>\$ 106,897</u>	<u>\$ 5,307</u>

The Hospital has various operating lease agreements for equipment. Rent expense for all operating leases approximated \$1,342,000 in 2006 and \$1,348,000 in 2005.

9. NET PATIENT SERVICE REVENUE

Net patient service revenue consists of the following:

	2006	2005
Patient Revenue		
Inpatient services:		
Routine services	\$ 9,789,323	\$ 9,951,486
Ancillary services	18,868,686	17,128,347
Outpatient services	77,749,127	71,971,516
Net resident revenue	<u>7,901,443</u>	<u>7,437,554</u>
Total patient revenue	114,308,579	106,488,903
Revenue deductions		
Provision for contractual allowances	49,020,505	43,519,962
Provision for bad debt allowances	4,679,295	4,263,583
Charity care, net of Hospital Care Assurance	<u>465,856</u>	<u>31,069</u>
Total revenue deductions	<u>54,165,656</u>	<u>47,814,614</u>
Total net patient service revenue	<u>\$ 60,142,923</u>	<u>\$ 58,674,289</u>

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

10. 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 provides retirement and disability benefits, annual cost-of-living adjustments, healthcare benefits and death benefits to plan members and beneficiaries. Members of the MD plan do not qualify for ancillary benefits, including post-employment health care coverage. OPERS issues a publicly available comprehensive annual financial report, which includes financial statements and required supplementary information for OPERS. That report may be obtained by writing to Public Employees Retirement System of Ohio, 277 East Town Street, Columbus, Ohio, 43215-4642 or by calling (614) 222-5601 or (800) 222-PERS (7377).

Funding Policy

The required, actuarially-determined contribution rates for the Hospital and for employees are 13.7% and 9.0%, respectively. The Hospital's contributions, representing 100% of employer contributions, for the last three years follows:

<u>Year</u>	<u>Contribution</u>
2006	\$ 3,651,000
2005	\$ 3,479,000
2004	\$ 3,376,000

OPERS also provides post-retirement health care coverage to age and service retirees with 10 or more years of qualifying Ohio service credit. Healthcare coverage for disability recipients and primary survivor recipients is available. The healthcare coverage provided by the retirement system is considered an Other Post-employment Benefit (OPEB). A portion of each employer's contribution to OPERS is set aside for the funding of post-retirement healthcare. The Ohio Revised Code provides statutory authority for employer contributions. The portion of the 2006 and 2005 employer contribution rates of 13.7% used to fund healthcare was 4.5%. The Ohio Revised Code provides the statutory authority requiring public employers to fund post-retirement healthcare through their contributions to OPERS.

The assumptions and calculations below are based on OPERS' latest actuarial review performed as of December 31, 2005. An entry-age normal actuarial cost method of valuation is used in determining the present value of OPEB. The difference between assumed and actual experience (actuarial gains and losses) becomes part of the

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

unfunded actuarial accrued liability. All investments are carried at market value. For actuarial purposes, a smoothed market approach is used. Under this approach, assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually, not to exceed a 12% corridor. The investment return assumption rate for 2005 was 6.5%. An annual increase of 4% compounded annually is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally, annual pay increases, over and above the 4% base increase, were assumed to range from .5% to 6.3%. Health care costs were assumed to increase at the projected wage inflation rate plus an additional factor ranging from .5% to 6% for the next 9 years. In subsequent years (10 and beyond), healthcare costs were assumed to increase at 4% (the projected wage inflation rate).

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

Hospital contributions made to fund post-employment benefits approximated \$1,199,000, \$1,027,000 and \$997,000 for 2006, 2005 and 2004, respectively.

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

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

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

11. MEDICAL MALPRACTICE CLAIMS

Based on the nature of its operations, the Hospital is at times subject to pending or threatened legal actions, which arise in the normal course of its activities. The Hospital is insured against medical malpractice claims under a claims-based policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claims exceeding

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

\$1,000,000, or aggregate claims \$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. Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on the occurrences during the claims-made term, but reported subsequently, will be uninsured.

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

12. DEFERRED COMPENSATION

Any employee of the Hospital may participate in a deferred compensation plan created by the State of Ohio under the provisions of Internal Revenue Code (IRC) Section 457, *Deferred Compensation Plan with Respect to Service for State and Local Governments*. Under the plan, employees may elect to defer a portion of their salaries and avoid paying taxes on the deferred portion until the withdrawal date. The deferred compensation amount is not available for withdrawal by employees until termination, retirement, death or unforeseeable emergency.

13. SELF-INSURED BENEFITS

The Hospital is partially self-insured under a plan covering substantially all employees for health benefits. The plan is covered by a stop-loss policy that covers claims over \$90,000 per employee or total claims in excess of \$3,094,000. Claims in excess of employee premiums are charged to operations. Claims were approximately \$3,409,000 and \$3,861,000 for the years ended December 31, 2006 and 2005, respectively. In addition, the Hospital self-insures for worker's compensation. The Hospital has a \$500,000 per claim stop-loss policy with a private insurance carrier for worker's compensation.

14. RELATED PARTY AND AFFILIATION

During 1995, Memorial Physicians, Inc (MPI) was formed, in which UCHA had a 100 percent ownership interest. In 2000, UCHA transferred 50 percent of the ownership interest to a group of physicians. This entity is a professional for-profit corporation organized to bring primary care and other specialty physicians together from multiple sites. UCHA guaranteed 50 percent of a \$262,500 note between MPI and a local financial institution. The remaining balance on the note is approximately \$36,000 at December 31, 2006, which was paid in full in March, 2007 upon the sale of certain MPI assets.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

NOTES TO COMBINED FINANCIAL STATEMENTS DECEMBER 31, 2006 AND 2005

15. INVESTMENT IN JOINT VENTURES

During 1996, the Hospital and two other area health care entities formed Health Partners, Ltd. (Health Partners), of which the Hospital has a 33 1/3 percent ownership interest. This corporation was formed to provide management services to the clinic of a major area corporation. In 1996, the Hospital contributed \$100,000 to Health Partners through UCHA. During 2006 and 2005, the Hospital received distributions from Health Partners totaling \$125,531 and \$100,678, respectively, through UCHA.

During 1997, the Hospital entered into a partnership with Quantum Health and area physicians to build a local health care network. The purpose of the network was to allow physicians and the Hospital to keep and retain Union County patients within the community and not see them access services in a different setting. The Hospital has a 25 percent ownership interest and received distributions of \$2,185 and \$4,809 during 2006 and 2005 respectively through UCHA. This partnership was dissolved in March 2006.

During 2002, the Hospital and other area health entities formed MPI Real Estate, LLC, of which the Hospital has a 20 percent ownership interest. The organization was formed to promote health care and physician services and to own, lease, operate, and provide health care facilities for the promotion of health in the area serviced. During 2002, the Hospital contributed \$50,000 through UCHA. During 2006 and 2005, the Hospital received distributions from MPI Real Estate, LLC of \$2,500 and \$7,500 respectively, through UCHA. This partnership was dissolved in March, 2007.

During 2003, the Hospital and other area health providers formed Marysville Ohio Surgery Center, LLC, of which the hospital has a 22.47 percent ownership interest. The organization was formed to promote health care and to provide outpatient surgical service in the area serviced. During 2003, the Hospital contributed \$159,000 through UCHA. During 2006 and 2005, the Hospital received distributions of \$110,353 and \$0, respectively.

During 2003, the Hospital and other area health providers formed Marysville Ohio Medical Properties, LLC, of which the Hospital has a 25 percent ownership interest. The organization was formed as the property owner for the Marysville Ohio Surgery Center facility. During 2003, the Hospital contributed \$130,000 through UCHA. During 2006 and 2005, the Hospital received \$36,395 and \$40,698 respectively, through UCHA.

16. SUBSEQUENT EVENT

In April, 2007, the Hospital advance refunded the 2003 bonds, refinanced \$3,175,000 of the 2006 General Obligation notes and obtained new debt of approximately \$1,825,000. The subsequent financing totaled approximately \$9,750,000.

ADDITIONAL FINANCIAL INFORMATION



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Report of Independent Auditors on Other Financial Information

To the Board of Trustees
Memorial Hospital of Union County and Affiliates

We have audited the combined financial statements of Memorial Hospital of Union County and Affiliates as of December 31, 2006. Our audit was made for the purpose of forming an opinion on the combined financial statements taken as a whole. The combining information in the accompanying schedules on pages 30-32 is presented for the purposed of additional analysis of the combined financial statements rather than to present the financial position, results of operations, and cash flows of the individual entities and is not a required part of the basic combined financial statements. The combining information has been subjected to the procedures applied in the audit of the combined financial statements and, in our opinion, is fairly stated in all material aspects in relations to the combined financial statements taken as a whole.

Blue & Co., LLC

April 25, 2007

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

COMBINING BALANCE SHEET
DECEMBER 31, 2006

ASSETS

	Memorial Hospital of Union County	The Gables	Union County Hospital Association	Eliminating Entries	Total
Current assets					
Cash and cash equivalents	\$ 9,890,920	\$ 325,852	\$ 263,599	\$ -	\$ 10,480,371
Patient accounts receivable	6,164,690	971,618	-	-	7,136,308
Assets limited as to use	3,134,580	513,528	-	-	3,648,108
Prepaid expenses	396,962	13,948	-	-	410,910
Inventories	347,028	-	-	-	347,028
Other current assets	100,652	-	-	-	100,652
Total current assets	20,034,832	1,824,946	263,599	-	22,123,377
Capital assets - net					
	28,573,234	7,220,689	117,383	-	35,911,306
Other assets					
Notes and advances to affiliates	3,303,759	-	668,019	(3,971,778)	-
Physician advances receivable	898,068	-	-	-	898,068
Investment in joint ventures	-	-	368,237	-	368,237
Bond issue costs	483,171	584,375	-	-	1,067,546
Total assets	\$ 53,293,064	\$ 9,630,010	\$ 1,417,238	\$ (3,971,778)	\$ 60,368,534

See report of independent auditors on other financial information on page 29.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

COMBINING BALANCE SHEET
DECEMBER 31, 2006

LIABILITIES AND NET ASSETS

	Memorial Hospital of Union County	The Gables	Union County Hospital Association	Eliminating Entries	Total
Current liabilities					
Current portion of long-term debt	\$ 861,165	\$ 290,000	\$ 34,833	\$ -	\$ 1,185,998
Accounts payable	1,955,781	264,175	-	-	2,219,956
Estimated third-party settlements	400,000	335,921	-	-	735,921
Salaries, wages and related accruals	1,641,724	256,307	-	-	1,898,031
Total current liabilities	<u>4,858,670</u>	<u>1,146,403</u>	<u>34,833</u>	<u>-</u>	<u>6,039,906</u>
Long-term debt - net of current portion	15,721,532	5,914,200	633,186	-	22,268,918
Other Liabilities					
Notes and advances to affiliates	668,019	3,179,783	123,976	(3,971,778)	-
Accrued compensated absences	1,912,053	183,204	-	-	2,095,257
Other long-term liabilities	106,780	-	-	-	106,780
Total liabilities	<u>23,267,054</u>	<u>10,423,590</u>	<u>791,995</u>	<u>(3,971,778)</u>	<u>30,510,861</u>
Net assets					
Invested in capital assets - net of related debt	11,990,537	1,016,489	117,383	-	13,124,409
Nonexpandable permanent endowments	25,000	-	-	-	25,000
Restricted for debt service and capital acquisitions	3,109,580	513,528	-	-	3,623,108
Unrestricted	14,900,893	(2,323,597)	507,860	-	13,085,156
Total liabilities and net assets	<u>\$ 53,293,064</u>	<u>\$ 9,630,010</u>	<u>\$ 1,417,238</u>	<u>\$ (3,971,778)</u>	<u>\$ 60,368,534</u>

See report of independent auditors on other financial information on page 29.

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS YEAR ENDED DECEMBER 31, 2006

	Memorial Hospital of Union County	The Gables	Union County Hospital Association	Eliminating Entries	Total
Operating revenues					
Net patient service revenue	\$ 52,402,685	\$ 7,740,238	\$ -	\$ -	\$ 60,142,923
Other operating revenue	1,614,889	-	-	(120,000)	1,494,889
Total operating revenue	<u>54,017,574</u>	<u>7,740,238</u>	<u>-</u>	<u>(120,000)</u>	<u>61,637,812</u>
Operating expenses					
Salaries and wages	23,327,698	3,673,530	-	-	27,001,228
Employee benefits and payroll taxes	6,713,024	1,289,871	-	-	8,002,895
Supplies and other	10,503,954	857,814	47,899	-	11,409,667
Professional services and consultant fees	1,340,184	152,106	-	(120,000)	1,372,290
Purchased services	6,663,909	880,429	-	-	7,544,338
Insurance	438,462	68,306	-	-	506,768
Utilities	888,570	185,148	1,493	-	1,075,211
Depreciation and amortization	2,536,709	294,340	2,436	-	2,833,485
Total operating expenses	<u>52,412,510</u>	<u>7,401,544</u>	<u>51,828</u>	<u>(120,000)</u>	<u>59,745,882</u>
Operating income (loss)	1,605,064	338,694	(51,828)	-	1,891,930
Other income (expenses)					
Interest income	531,810	43,269	1,251	-	576,330
Grants and contributions	804,418	3,916	-	-	808,334
Interest expense	(663,698)	(295,946)	-	-	(959,644)
Other	-	-	298,574	-	298,574
Total other income (expense)	<u>672,530</u>	<u>(248,761)</u>	<u>299,825</u>	<u>-</u>	<u>723,594</u>
Change in net assets	<u>\$ 2,277,594</u>	<u>\$ 89,933</u>	<u>\$ 247,997</u>	<u>\$ -</u>	<u>\$ 2,615,524</u>

See report of independent auditors on other financial information on page 29.



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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 Trustees
Memorial Hospital of Union County and Affiliates

We have audited the financial statements of Memorial Hospital of Union County and Affiliates as of and for the year ended December 31, 2006, and have issued our report thereon dated April 25, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United State 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 Memorial Hospital of Union County and Affiliates' 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 Memorial Hospital of Union County and Affiliates' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Memorial Hospital of Union County and Affiliates' internal control over financial reporting.

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

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the combined financial statements of Memorial Hospital of Union County and Affiliates 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 that are required to be reported under *Government Auditing Standards*.

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

Blue & Co., LLC

April 25, 2007



Mary Taylor, CPA
Auditor of State

MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

UNION COUNTY

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
MAY 22, 2007**