

Fayette County Memorial Hospital

Financial Report

December 31, 2003



**Auditor of State
Betty Montgomery**

Board of Directors
Fayette County Memorial Hospital

We have reviewed the Independent Auditor's Report of the Fayette County Memorial Hospital, Fayette County, prepared by Plante & Moran, PLLC for the audit period January 1, 2003 through December 31, 2003. 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

June 1, 2004

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Fayette County Memorial Hospital

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Independent Auditor's Report

To the Board of Directors
Fayette County Memorial Hospital

We have audited the accompanying financial statements of Fayette County Memorial Hospital (a component unit of Fayette County, Ohio), as of December 31, 2003 and 2002, for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Fayette County Memorial Hospital at December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, the Hospital adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* as of January 1, 2003.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 20, 2004, on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis is presented for purposes of additional analysis and is not a required part of the financial statements of Fayette County Memorial Hospital. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and, accordingly, do not express an opinion thereon.

Plante & Moran, PLLC

February 20, 2004



A worldwide association of independent accounting firms

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, 2003. Management is responsible for the completeness and fairness of the financial statements and the related footnote disclosures along with the discussion and analysis.

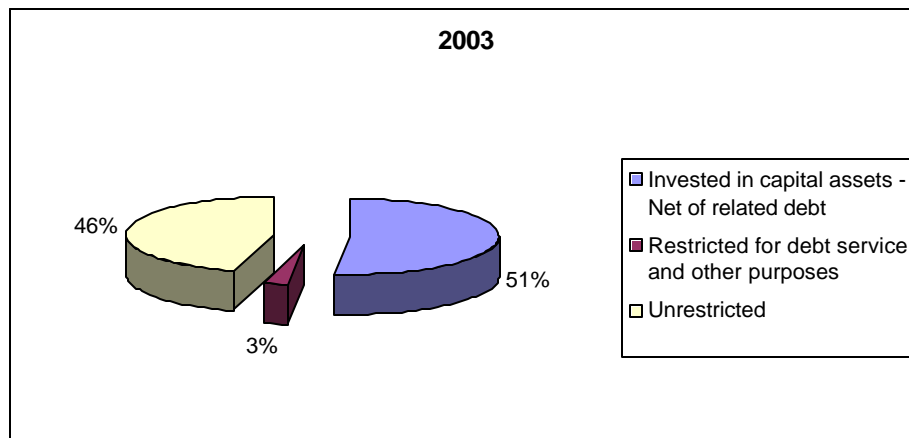
Using this Annual Report

The Hospital's financial statements consist of three statements – Balance Sheet, a Statement of Revenue, Expenses, 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

The Hospital's financial position improved slightly during the year ended December 31, 2003. Capital assets increased \$3.1 million, while long-term debt increased \$3.2 million 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 revenues and other support exceeded expenses, creating an increase in net assets of \$433,971 (compared to a \$1,405,876 increase in the previous year). The increase in net assets resulted from a slight increase in patient revenue due largely to price increases.

The following chart provides a breakdown of net assets by category for the year ended December 31, 2003:



Fayette County Memorial Hospital

Management's Discussion and Analysis (Continued)

The Balance Sheet and the Statement of Revenue, 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 the Statement of Revenue, 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 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 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, 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 (Continued)

Condensed Financial Information

The following is a comparative analysis of the major components of the Balance Sheet of the Hospital as of December 31, 2003:

	Year Ended December 31		Change	
	2003	2002	Amount	Percent
Current assets	\$ 7,154,954	\$ 6,690,928	\$ 464,026	6.9%
Non-current assets	4,436,473	3,996,965	439,508	11.0%
Capital assets	<u>13,020,488</u>	<u>9,899,338</u>	<u>3,121,150</u>	31.5%
Total assets	<u>\$ 24,611,915</u>	<u>\$ 20,587,231</u>	<u>\$ 4,024,684</u>	19.5%
Current liabilities	\$ 3,017,744	\$ 2,693,951	\$ 323,793	12.0%
Long-term debt	<u>3,513,680</u>	<u>246,760</u>	<u>3,266,920</u>	1323.9%
Total liabilities	<u>\$ 6,531,424</u>	<u>\$ 2,940,711</u>	<u>\$ 3,590,713</u>	122.1%
Net assets:				
Invested in capital assets, net of debt	\$ 9,373,728	\$ 9,523,158	\$ (149,430)	-1.6%
Restricted assets	458,515	214,013	244,502	114.2%
Unrestricted	<u>8,248,248</u>	<u>7,909,349</u>	<u>338,899</u>	4.3%
Total net assets	<u>\$ 18,080,491</u>	<u>\$ 17,646,520</u>	<u>\$ 433,971</u>	2.5%

The primary change in the Balance Sheet relates to the construction of the new medical office building. This change is reflected in the significant increases to capital assets (for the cost of the building) and long-term debt (for debt service on the building). Operating results were favorable and contributed to the 2.5% increase in net assets.

Fayette County Memorial Hospital

Management's Discussion and Analysis (Continued)

Operating Results for the Year

	2003	2002	Change	
			Amount	Percent
Operating Revenue				
Net patient service revenue	\$ 26,859,670	\$ 25,777,121	\$ 1,082,549	4.2%
Other	72,908	71,330	1,578	2.2%
Total operating revenue	26,932,578	25,848,451	1,084,127	4.2%
Operating Expenses				
Salaries and wages	9,634,364	9,103,201	531,163	5.8%
Benefits	3,171,652	2,814,104	357,548	12.7%
Physician fees	1,332,142	1,276,958	55,184	4.3%
Other fees	3,085,217	2,257,018	828,199	36.7%
Supplies	3,775,241	3,730,732	44,509	1.2%
Depreciation and amortization	1,236,366	1,150,729	85,637	7.4%
Provision for bad debts	2,340,310	2,453,418	(113,108)	-4.6%
Other expenses	2,262,979	1,945,017	317,962	16.3%
Total operating expenses	26,838,271	24,731,177	2,107,094	8.5%
Operating Income	94,307	1,117,274	(1,022,967)	-91.6%
Non-Operating Gains - Net	339,664	288,602	51,062	17.7%
Increase in Net Assets	433,971	1,405,876	(971,905)	-69.1%
Net Assets - Beginning of year	17,646,520	16,240,644		
Net Assets - End of year	\$ 18,080,491	\$ 17,646,520		

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.

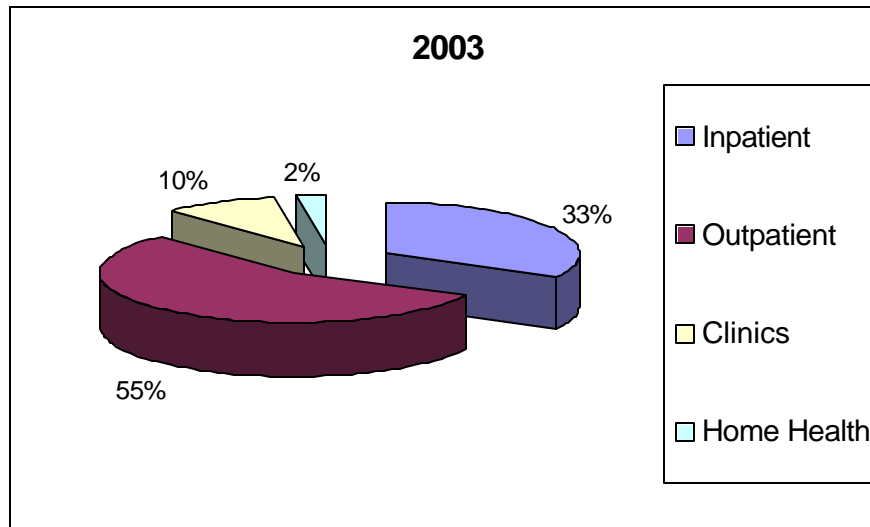
Fayette County Memorial Hospital

Management's Discussion and Analysis (Continued)

Operating Revenues (Continued)

Operating revenue changes were a result of the following factors:

- Net patient service revenue increased 4.2 percent. This was attributable to a 7 percent price increase as well as a small increase in Radiology, Clinic, and Emergency Room volumes. Inpatient admissions remained constant from 2002 to 2003. 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 35.7 to 37.3 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. Charges forgone (written-off) under this program increased by 57 percent in 2003.
- Other operating revenue increased slightly due to an increase in gifts to the Hospital.
- The following is a graphic illustration of operating revenues by source:



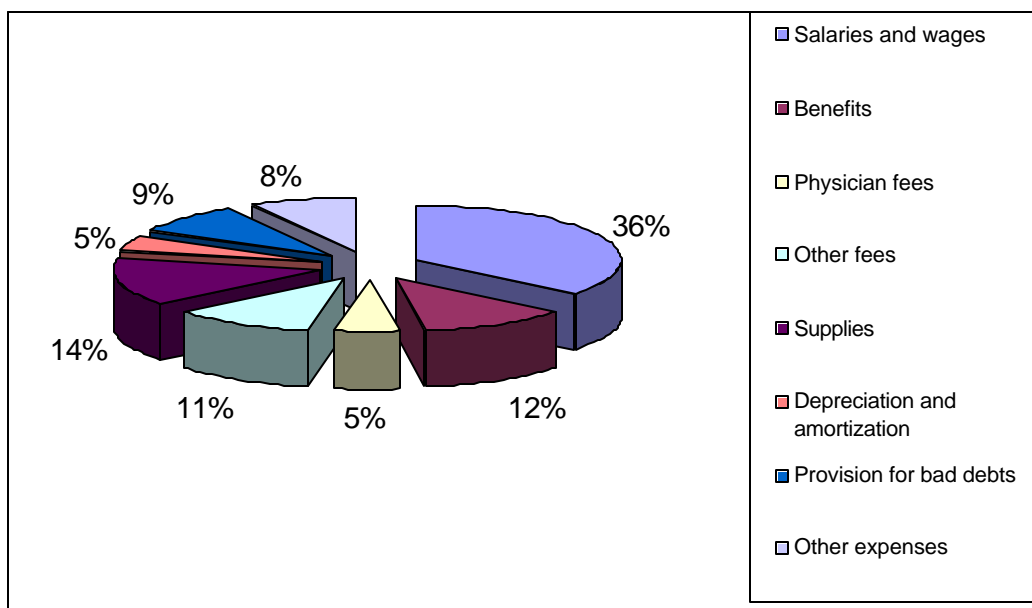
Fayette County Memorial Hospital

Management's Discussion and Analysis (Continued)

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 5.8 percent due to employee raises and a 2.6 percent increase in the number of FTE's.
- Benefit costs increased 12.7 percent due to dramatic increases in health insurance premiums paid by the Hospital for covered employees.
- Other fees increased 36.7 percent due to the need to hire contract nursing staff to cover staffing shortages and the need of a contract for CRNA coverage.
- Bad debt expense decreased 4.6 percent, but is still 5.3 percent of gross revenue.
- The following is a graphic illustration of operating expenses by type:



Non-Operating Gains

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 operation of the medical office building (rents), investment income (including realized and unrealized gains and losses), and grants and contracts that do not require any services to be performed.

There was a slight increase this year in gifts and grants, as well as income from the medical office building.

Fayette County Memorial Hospital

Management's Discussion and Analysis (Continued)

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 needs for external financing

	2003	2002	Increase (Decrease)
Cash provided (used) by:			
Operating and non-operating activities	\$ 844,747	\$ 3,311,694	\$ (2,466,947)
Capital and related financing activities	(1,097,539)	(2,086,883)	989,344
Noncapital and related financing activities	201,671	156,401	45,270
Investing activities	(262,580)	(3,347,309)	3,084,729
Net increase (decrease) in cash	(313,701)	(1,966,097)	1,652,396
Cash - Beginning of the year	2,365,407	4,331,504	(1,966,097)
Cash - End of year	<u>\$ 2,051,706</u>	<u>\$ 2,365,407</u>	<u>\$ (313,701)</u>

The Hospital's liquidity declined slightly during the 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 2003 of \$2.1 million.

Capital purchases increased by \$2.4 million in 2003. However, this increase was offset by the Hospital financing \$3.4 million of the new medical office building, thereby reducing the cash used by capital and related financing activities compared to 2002.

Investing activities declined significantly as cash was used to acquire capital assets versus being reinvested.

Fayette County Memorial Hospital

Management's Discussion and Analysis (Continued)

Capital Asset and Debt Administration

Capital Assets

At December 31, 2003, the Hospital had \$24 million invested in capital assets, net of accumulated depreciation of \$11 million. Depreciation and amortization totaled \$1.2 million for the current year compared to \$1.1 million last year. Details of these assets for the past two years are shown below.

	2003	2002	Increase (Decrease)
Land	\$ 519,750	\$ 519,750	\$ -
Land improvements	184,292	238,703	(54,411)
Buildings	5,037,908	5,192,681	(154,773)
Fixed equipment	711,444	717,151	(5,707)
Major movable equipment	2,596,121	2,857,108	(260,987)
Construction in progress	3,970,973	373,945	3,597,028
Total	<u>\$ 13,020,488</u>	<u>\$ 9,899,338</u>	<u>\$ 3,121,150</u>

Debt

At year-end, the Hospital had \$3,646,760 in debt outstanding, as compared to \$376,180 in the previous year. The table below summarizes these amounts by type of debt instrument:

	2003	2002	Increase (Decrease)
Notes payable	\$ 3,400,000	\$ -	3,400,000
Lease obligations	246,760	376,180	(129,420)
Total notes and leases	<u>\$ 3,646,760</u>	<u>\$ 376,180</u>	<u>\$ 3,270,580</u>

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 (Continued)

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 that has exceeded its growth in revenue. The upward pressure on wages is expected to continue in 2004. In an effort to grow the revenue base, the Hospital is incurring significant expenses in an effort to recruit new physicians to the community. While much of the recruitment expense will occur in 2004, the Hospital will not realize all of the benefits until future years. As a result, it is anticipated that 2004 will be a year of sacrifice as the Hospital will expend resources now in return for the expected benefits to both the Hospital and the community in the future. Reimbursement for existing patients is limited by federal and state mandate as well as contracts with third-party insurance companies. The board of trustees approved a 5% increase on charges for 2004 in an effort to maximize reimbursement under our current managed care contracts. Additionally in 2004, the Hospital will explore the benefits and drawbacks of converting to a Critical Access Hospital. This status provides for cost-based reimbursement for Medicare services. If the Hospital elects Critical Access Status, it would not be effective before 2005.

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 debtholders with a general overview of the Hospital's finances, and to show the Hospital's accountability for the money it receives from the services it provides. If you have questions about this report or need additional information, we welcome you to contact the Chief Financial Officer.

Michael I. Gonsalves,
Chief Financial Officer

Fayette County Memorial Hospital

Balance Sheet

	December 31	
	2003	2002
Assets		
Current Assets		
Cash and cash equivalents (Note 2)	\$ 1,593,191	\$ 2,151,394
Patient accounts receivable (Note 3)	4,756,336	4,015,672
Current portion of notes receivable (Note 4)	280,520	74,953
Inventories	285,374	264,010
Prepaid expenses and other current assets	234,351	174,361
Third-party settlements (Note 5)	<u>5,182</u>	<u>10,538</u>
Total current assets	7,154,954	6,690,928
Notes Receivable (Note 4)	782,068	679,496
Investments (Note 2)	3,195,890	3,103,456
Assets Limited as to Use (Note 2)	458,515	214,013
Capital Assets (Note 6)	13,020,488	9,899,338
Total assets	<u>\$ 24,611,915</u>	<u>\$ 20,587,231</u>
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 8)	\$ 133,080	\$ 129,420
Accounts payable	1,800,774	1,397,085
Accrued payroll and related benefits (Note 7)	<u>1,083,890</u>	<u>1,167,446</u>
Total current liabilities	3,017,744	2,693,951
Long-Term Debt (Note 8)	3,513,680	246,760
Net Assets		
Invested in capital assets - net of related debt	9,373,728	9,523,158
Restricted (Note 2):		
Expendable for debt service and other purposes	458,515	214,013
Unrestricted	<u>8,248,248</u>	<u>7,909,349</u>
Total net assets	<u>18,080,491</u>	<u>17,646,520</u>
Total liabilities and net assets	<u>\$ 24,611,915</u>	<u>\$ 20,587,231</u>

Fayette County Memorial Hospital

Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended December 31	
	2003	2002
Operating Revenue		
Net patient service revenue (Note 9)	\$ 26,859,670	\$ 25,777,121
Other operating revenue	<u>72,908</u>	<u>71,330</u>
Total revenue	26,932,578	25,848,451
Operating Expenses		
Salaries and wages	9,634,364	9,103,201
Benefits	3,171,652	2,814,104
Physician fees	1,332,142	1,276,958
Other fees	3,085,217	2,257,018
Supplies	3,775,241	3,730,732
Utilities	499,257	509,164
Maintenance and repairs	697,008	692,066
Leases and rentals	120,945	137,527
Insurance	265,640	177,034
Interest expense	18,436	25,381
Depreciation and amortization (Note 6)	1,236,366	1,150,729
Provision for bad debts	2,340,310	2,453,418
Other expenses	<u>661,693</u>	<u>403,845</u>
Total operating expenses	<u>26,838,271</u>	<u>24,731,177</u>
Income from Operations	94,307	1,117,274
Non-Operating Gains - Net (Note 10)	<u>339,664</u>	<u>288,602</u>
Increase in Net Assets	433,971	1,405,876
Net Assets - Beginning of year	<u>17,646,520</u>	<u>16,240,644</u>
Net Assets - End of year	<u>\$ 18,080,491</u>	<u>\$ 17,646,520</u>

Fayette County Memorial Hospital

Statement of Cash Flows

	Year Ended December 31	
	2003	2002
Cash Flows from Operating and Non-Operating Activities		
Cash received from patients and third-party payors	\$ 23,784,052	\$ 23,342,362
Cash payments to suppliers for services and goods	(10,114,808)	(8,192,420)
Cash payments to employees for services	(12,889,572)	(11,917,406)
Other operating revenue received	83,511	104,539
Interest paid	(18,436)	(25,381)
Net cash provided by operating and non-operating activities	844,747	3,311,694
Cash Flows from Non-Capital and Related Financing Activities		
Donations and other	201,671	156,401
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(4,368,119)	(1,964,592)
Proceeds from issuance of long-term debt	3,400,000	-
Principal payments on long-term debt	(129,420)	(122,291)
Net cash used in capital and related financing activities	(1,097,539)	(2,086,883)
Cash Flows from Investing Activities		
Proceeds from physician loan repayments	21,395	18,298
Proceeds from sale of investments	1,233,916	714,140
Interest received on investments	137,993	132,201
Purchases of investments	(1,326,350)	(3,806,902)
Advances to physicians	(329,534)	(405,046)
Net cash used in investing activities	(262,580)	(3,347,309)
Net Decrease in Cash and Cash Equivalents	(313,701)	(1,966,097)
Cash and Cash Equivalents - Beginning of year	2,365,407	4,331,504
Cash and Cash Equivalents - End of year	\$ 2,051,706	\$ 2,365,407
Balance Sheet Classification of Cash and Cash Equivalents		
Current assets	\$ 1,593,191	\$ 2,151,394
Assets limited as to use	458,515	214,013
Total cash and cash equivalents	\$ 2,051,706	\$ 2,365,407

Fayette County Memorial Hospital

Statement of Cash Flows (Cont.)

A reconciliation of income from operations to net cash from operating and non-operating activities is as follows:

	Year Ended December 31	
	2003	2002
Income from operations	\$ 94,307	\$ 1,117,274
Adjustments to reconcile income from operations to net cash provided by operating and non-operating activities:		
Bad debt expense	2,340,310	2,453,418
Depreciation and amortization	1,236,366	1,150,729
Loss of disposal of equipment	10,603	33,209
(Increase) decrease in assets:		
Patient accounts receivable	(3,080,974)	(2,462,677)
Inventories	(21,364)	(15,810)
Prepaid expenses and other current assets	(59,990)	417,348
Third-party settlements	5,356	27,918
Increase (decrease) in liabilities:		
Accounts payable	403,689	590,386
Accrued payroll and related benefits	(83,556)	(101)
Net cash provided by operating and non-operating activities	<u>\$ 844,747</u>	<u>\$ 3,311,694</u>

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 1 - Nature of Business and Significant Accounting Policies

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.

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 June 1999. The Hospital now follows the "business-type" activities reporting requirements of GASB Statement No. 34 that provides a comprehensive one-line look at the Hospital's financial activities. There was no impact to the net assets of the Hospital in adopting GASB No. 34. No component units are required to be reported in the Hospital's financial statements. The Hospital also applies the Financial Accounting Standard Board Statements and Interpretations to the extent that they do not conflict with or contradict GASB pronouncements.

Accrual Basis - The financial statements have been prepared on the accrual basis of accounting, whereby revenue is recognized when earned and expenditures are recognized when the related liabilities are incurred and certain measurement and matching criteria are met.

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, determined by the first-in, first-out method.

Investments - Investments are carried at amortized cost.

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

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

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

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

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

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.

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

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

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, measured at fair value. Contributions with donor imposed time or purpose restrictions are reported as restricted support. All other contributions are reported as unrestricted support.

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

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.

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

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

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

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles 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.

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

Note 2 - Deposits and Investments

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

2003	Cash and Cash Equivalents	Investments	Assets Limited as to 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>

2002	Cash and Cash Equivalents	Investments	Assets Limited as to Use
Deposits	\$ 2,151,394	\$ -	\$ 214,013
Federal bonds	-	3,103,456	-
Total	<u>\$ 2,151,394</u>	<u>\$ 3,103,456</u>	<u>\$ 214,013</u>

Deposits	2003	2002
Amount of deposits reflected on the accounts of the bank (without recognition of checks written but not yet cleared, or of deposits in transit)	\$ 2,358,662	\$ 2,599,748
Amount of deposits covered by federal depository insurance	<u>375,131</u>	<u>314,013</u>
Amount of deposits uninsured	<u>\$ 1,983,531</u>	<u>\$ 2,285,735</u>

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 2 - Deposits and Investments (Cont.)

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	
<u>2003</u>				
Federal bonds	<u>\$ -</u>	<u>\$3,178,694</u>	<u>\$ -</u>	<u>\$3,178,694</u>
<u>2002</u>				
Federal bonds	<u>\$ -</u>	<u>\$3,103,456</u>	<u>\$ -</u>	<u>\$3,103,456</u>

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

	<u>2003</u>	<u>2002</u>
By Board for bond repayments	\$ 244,502	\$ -
By donor - for specific purposes	<u>214,013</u>	<u>214,013</u>
Total assets limited as to use	<u>\$ 458,515</u>	<u>\$ 214,013</u>

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	<u>2003</u>	<u>2002</u>
Total patient accounts receivable	\$ 8,361,336	\$ 7,658,672
Less allowance for:		
Uncollectible accounts	(1,150,000)	(1,218,000)
Contractual adjustments	<u>(2,455,000)</u>	<u>(2,425,000)</u>
Net patient accounts receivable	<u>\$ 4,756,336</u>	<u>\$ 4,015,672</u>

Note 4 - Notes Receivable

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

	<u>2003</u>	<u>2002</u>
Net notes receivable	\$ 1,062,588	\$ 754,449
Less: Current portion	<u>280,520</u>	<u>74,953</u>
Long term portion	<u>\$ 782,068</u>	<u>\$ 679,496</u>

Note 5 - Cost Report 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.

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 5 - Cost Report Settlements (Cont.)

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. Some outpatient services and defined capital costs related to Medicare beneficiaries are paid based upon a cost reimbursement method. Other outpatient services, including ambulatory surgery, radiology, and laboratory services, are reimbursed on an established fee-for-service methodology. Beginning August 1, 2000, 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.

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

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 6 - Property and Equipment

Capital asset activity for the year ended December 31, 2003 was as follows:

	2002	Additions	Retirements	2003	Depreciable Life - Years
Land	\$ 519,750	\$ -	\$ -	\$ 519,750	
Land improvements	618,690	-	-	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	19,719,431	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	\$ 9,899,338			\$ 13,020,488	

Depreciation expense aggregated \$1,236,366 and \$1,150,729 for the years ended December 31, 2003 and 2002, respectively.

Construction in progress at December 31, 2003, consists of a new medical office building and miscellaneous hospital renovations.

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 7 - Accrued Liabilities

The details of accrued liabilities are as follows:

	2003	2002
Payroll and related amounts	\$ 304,343	\$ 522,834
Compensated absences	580,351	554,612
Other	199,196	90,000
Total accrued liabilities	<u><u>\$ 1,083,890</u></u>	<u><u>\$ 1,167,446</u></u>

Compensated absences represent the estimated liability to be paid to employees under the Hospital's vacation and holiday policies. Under the Hospital's policies, employees earn vacation time based on length of service to the hospital and holiday time at an equal rate for all employees.

Note 8 - Long-Term Debt

Long-term debt activity for the year ended December 31, 2003 was as follows:

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

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 8 - Long-Term Debt (Cont.)

The Hospital is bound by the terms of the Trust Indenture and Reimbursement Agreement to various operational 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 expects to request one additional series of notes during the next fiscal year. The series of notes are payable semi-annually with principal payments ranging from \$110,000 to \$270,000, in aggregate, maturing on August 1, 2023. The interest rate on the variable rate notes was 1.18 percent at December 31, 2003. The notes are secured by an irrevocable letter-of-credit with the Trustee bank.

The notes are remarketed on a weekly basis. Should the remarketing agent be unable to remarket the notes based on its best efforts, these notes would be "put" back to the Trustee, who would draw down on the letter-of-credit to pay down the notes. However, Hospital management has assessed any unsuccessful remarketing of the notes to be unlikely. Under the Reimbursement Agreement between the Trustee and the Hospital, the Hospital is obliged to reimburse the Trustee for any draws made on the letter-of-credit. Interest is applied to letter-of-credit draws at a variable rate based on the current market interest rates. 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 in July 2003, the hospital entered into an interest 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 5.24 percent on \$2.4 million of the proceeds.

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 8 - Long-Term Debt (Cont.)

Under the swap, the hospital pays the counterparty a fixed payment of 5.24 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 is 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. As of December 31, 2003 rates were as follows:

Interest rate swap:		
Fixed payment to counterparty	Fixed	5.24%
Less variable payment from counterparty	100% of LIBOR	<u>1.18%</u>
Net interest rate swap payments		4.06%
Variable-rate note payments	Counterparty published rate	<u>1.18%</u>
Synthetic interest rate on notes		<u>5.24%</u>

As of December 31, 2003, the swap had a negative fair value of \$147,590. 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, 2003, 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 that results in the rates' moving to convergence, the expected cost savings may not be realized.

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 8 - Long-Term Debt (Cont.)

The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Hospital or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. If the swap is terminated, the variable-rate notes would no longer carry a synthetic interest rate. Also, if at the time of termination the swap has a negative fair value, the Hospital, would be liable to the counterparty for a payment equal to the swap's fair value.

As of December 31, 2003, 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. As rates vary, variable rate note interest payments and net swap payments will vary.

Year Ending December 31	Principal	Interest - Unswapped	Interest - Swapped	Interest Rate Swaps, Net	Leases Payable
2004	\$ -	\$ 11,800	\$ 28,320	\$ 97,440 *	\$ 143,786
2005	110,000	11,594	27,769	94,192	101,047
2006	115,000	11,240	26,776	90,741	16,841
2007	125,000	10,836	25,842	87,290	-
2008	130,000	10,374	24,751	83,636	-
2009-2013	745,000	44,417	106,200	356,265	-
2014-2018	955,000	29,461	70,830	232,232	-
2019-2023	<u>1,220,000</u>	<u>10,767</u>	<u>25,528</u>	<u>73,283</u>	-
Total payments	<u>\$3,400,000</u>	<u>\$ 140,489</u>	<u>\$ 336,016</u>	<u>\$1,115,079</u>	261,674
Less amount representing interest					14,914
Net present value					<u>\$246,760</u>

*Computed: (5.24% - 1.18%) x \$2,400,000

Note: The Swap is only on \$2,400,000 of the total proceeds of the notes, therefore, the \$2,400,000 is reduce annually for principal payments on this portion of the notes for purposes of the computation.

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 8 - Long-Term Debt (Cont.)

Capital leases are due in monthly installments totaling approximately \$12,306 at December 31, 2003, 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.

	2003	2002
Cost of equipment under capital lease	\$ 641,328	\$ 641,328
Less accumulated amortization	<u>366,913</u>	<u>238,647</u>
Net carrying amount	<u>\$ 274,415</u>	<u>\$ 402,681</u>

Note 9 - Net Patient Service Revenue

Net patient service revenue consists of the following:

	<u>2003</u>	<u>2002</u>
Revenue:		
Inpatient services:		
Routine services	\$ 5,536,429	\$ 5,049,572
Ancillary services	8,950,705	8,724,595
Outpatient ancillary services	<u>29,780,270</u>	<u>27,257,669</u>
Total patient revenue	44,267,404	41,031,836
Revenue deductions:		
Provision for contractual allowances	16,517,744	14,657,588
Provision for charity care	755,093	481,774
Other allowances	<u>134,897</u>	<u>115,353</u>
Total revenue deductions	<u>17,407,734</u>	<u>15,254,715</u>
Total net patient service revenue	<u>\$ 26,859,670</u>	<u>\$ 25,777,121</u>

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 10 - Non-Operating Gains

Non-operating gains consist of the following:

	2003	2002
Donations, gifts and grants	\$ 58,523	\$ 40,162
Investment income	137,993	132,201
Other gains	143,148	116,239
Non-operating gains - net	<u>\$ 339,664</u>	<u>\$ 288,602</u>

Note 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 Pension Plan (TP) – a cost-sharing multiple-employer defined benefit pension plan; the Member-Directed Plan (MD) – a defined contribution plan; and the Combined Plan (CO) – a cost-sharing multiple-employer defined benefit pension plan that has elements of both a defined benefit and defined contribution plan. OPERS provides retirement, disability, 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-employment 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 Employees Retirement System, 277 East Town Street, Columbus, Ohio 43215-4642 or by calling 614-222-6705 or 1-800-222-PERS (7377).

Funding Policy – The Ohio Revised Code provides statutory authority for member and employer contributions. For 2003, member and employer contribution rates were consistent across all three plans (TP, MD, and CO), and are actuarially determined. The 2003 member contribution rate for members of local government units was 8.50 percent of their annual covered salary. The 2003 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, 2003, 2002, and 2001, were \$1,283,472, \$1,192,732, and \$1,101,383, respectively. Required employer contributions for all plans are equal to 100% of employer charges and must be extracted from the employer's records.

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 11 - Defined Benefit Pension Plan (Cont.)

Post-Retirement Benefits – In order to qualify for post-retirement health care coverage, age and service retirees must have ten or more years of qualifying Ohio service credit. Health care coverage for disability recipients and primary survivor recipients is available. The health care coverage provided by the Retirement System is considered an Other Post-Employment Benefit (OPEB), as described in GASB Statement No. 12. A portion of each employer's contribution to OPERS is set aside for the funding of post-retirement health care. The Ohio Revised Code provides statutory authority for employer contributions. The 2003 and 2002 employer contribution rate for local government employer units was 13.55 percent of covered payroll. Of this amount, 5.0 percent was the portion that was used to fund health care during 2003 and 2002, respectively. The portion of the employer's contribution used to fund post-employment benefits for 2003 and 2002 was \$473,601 and \$440,818, respectively.

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

Post-Retirement Benefits (Cont.)

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 2002 was 8.00%. An annual increase of 4.00 compounded annually, is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally, annual pay increases, over and above the 4.00% base increase, were assumed to range from 0.50% to 6.30%. Health care costs were assumed to increase 4.00% annually. These assumptions and calculations are based on the System's latest Actuarial Review performed as of December 31, 2002.

The number of active contributing participants in the Traditional and Combined Plans during 2003 was 364,881. As of December 31, 2002, the actuarial value of the Retirement System's net assets available for OPEB was \$10.0 billion. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$18.7 billion and \$8.7 billion, respectively.

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 11 - Defined Benefit Pension Plan (Cont.)

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.

In response to the adverse investment returns experienced by OPERS from 2000 through 2002 and the continued staggering rate of health care inflation, the OPERS Board, during 2003, considered extending “Choices” type cost cutting measures to all active members and benefit recipients. As of December 31, 2003, the Board has not determined the exact changes that will be made to the health care plan. However, changes to the plan are expected to be approved by the summer of 2004.

Note 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 claims are reported to the insurance carrier. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claim exceeding \$1,000,000 or aggregate claims exceeding \$3,000,000 for claims asserted in the policy year. In addition, the Hospital has an umbrella policy with an additional \$5,000,000 of coverage.

Fayette County Memorial Hospital

Notes to Financial Statements December 31, 2003 and 2002

Note 12 - Risk Management (Cont.)

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.

Note 13 - Commitment and Subsequent Event

The Hospital has entered into contracts for construction of its medical office building. The third and final series of Variable Rate Taxable Demand Revenue Notes, which are described in detail in Note 8 herein, was issued and drawn in January 2004 in the amount of \$1,000,000. The proceeds from this issuance are to be used to fund the remaining commitment for construction of the medical office building.

Report Letter on Compliance with Laws and Regulations and Internal
Control – Basic Financial Statements

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

We have audited the financial statements of Fayette County Memorial Hospital (a component of Fayette County, Ohio) as of and for the year ended December 31, 2003, and have issued our report thereon dated February 20, 2004. 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.

Compliance

As part of obtaining reasonable assurance about whether Fayette County Memorial Hospital financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 two instances of noncompliance that are required to be reported under *Government Auditing Standards*. These two instances of noncompliance were also reported to management in a report under separate cover dated February 20, 2004.

Condition – We were unable to obtain evidence that the Hospital has a written policy in regards to the availability of records open to public inspection, costs of copies and times when records are available for inspection. Further, the Hospital is required to publish notice in local newspapers that informs the public the financial information (at year-end) is available for inspection. Finally, the Hospital should inform the general public, through reasonable means, of when and where board meetings are to be held.

Criteria – During our testing of Ohio Compliance Supplement, Chapter 7, Part 2, Section A: General, (7-5, 7-8, 7-9 compliance requirements) we noted the above conditions. These compliance sections relate to Ohio Revised Code sections 117.38, 121.22, and 149.43.

Recommendation – We recommend the Hospital develop and maintain a written policy in relation to documents which are open for public inspection, costs of copies and times when records may be reviewed. Further, we recommend the hospital post notice in local newspapers that inform the public of the availability of the year-end financial statements and how they may obtain them and when and where board meetings are to be held.

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

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 assurance 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 over financial reporting 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 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, a report was issued to management under separate cover regarding internal control issues and other operational efficiencies which we did not consider to be material weaknesses.

This report is intended solely for the information and use of the Auditor of the State of Ohio, the Board of Directors, 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.

Plante & Moran, PLLC

February 20, 2004





**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
JUNE 15, 2004**