

FAYETTE COUNTY MEMORIAL HOSPITAL

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2011 AND 2010



Dave Yost • Auditor of State

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

We have reviewed the *Report of Independent Auditors* of the Fayette County Memorial Hospital, prepared by Blue & Co., LLC, for the audit period January 1, 2011 through December 31, 2011. 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 black ink that reads "Dave Yost".

Dave Yost
Auditor of State

July 2, 2012

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FAYETTE COUNTY MEMORIAL HOSPITAL

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REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying consolidated balance sheets of Fayette County Memorial Hospital (the "Hospital"), a business-type activity of Fayette County, Ohio, as of December 31, 2011 and 2010, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

As discussed in Note 1, the consolidated financial statements of the Hospital are intended to present the financial position and the changes in financial position and cash flows of only that portion of the business-type activities of Fayette County, Ohio that is attributable to the transactions of the Hospital. They do not purport to, and do not, present fairly the financial position of Fayette County, Ohio, and the changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Hospital at December 31, 2011 and 2010, and its consolidated results of operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 27, 2012, on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing, and the results of that testing, and not to provide an opinion on the effectiveness of internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages i through ix be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audit of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



April 27, 2012

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

Management's Discussion and Analysis

The discussion and analysis of Fayette County Memorial Hospital's (the Hospital) financial statements provides an overview of the Hospital's financial activities for the years ended December 31, 2011 and 2010. Management is responsible for the completeness and fairness of the financial statements and the related footnote disclosures along with the discussion and analysis.

Financial Highlights

Cash, investments, and assets limited as to use increased approximately \$1,200,000 while accounts receivable increased approximately \$530,000. In total, the Hospital's revenues and other support exceeded expenses, creating an increase in net assets of \$748,338 (compared to a decrease of \$624,244 in the previous year).

In 2010, the Hospital formed Fayette County Memorial Hospital Foundation (the Foundation), a 501(c)(3) nonprofit corporation. The Foundation is governed by a 15 member board of directors. The Foundation's purpose is to raise funds, create awareness and support the Hospital's mission.

Also in 2010, the Hospital closed the obstetrics department and sold the Hospital's home health. Proceeds from the sale of home health are included in non-operating gains for 2010.

Using this Annual Report

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

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

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

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

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

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

The Statement of Cash Flows

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

Condensed Financial Information

The following is a comparative analysis of the major components of the balance sheets of the Hospital as of December 31, 2011 and 2010.

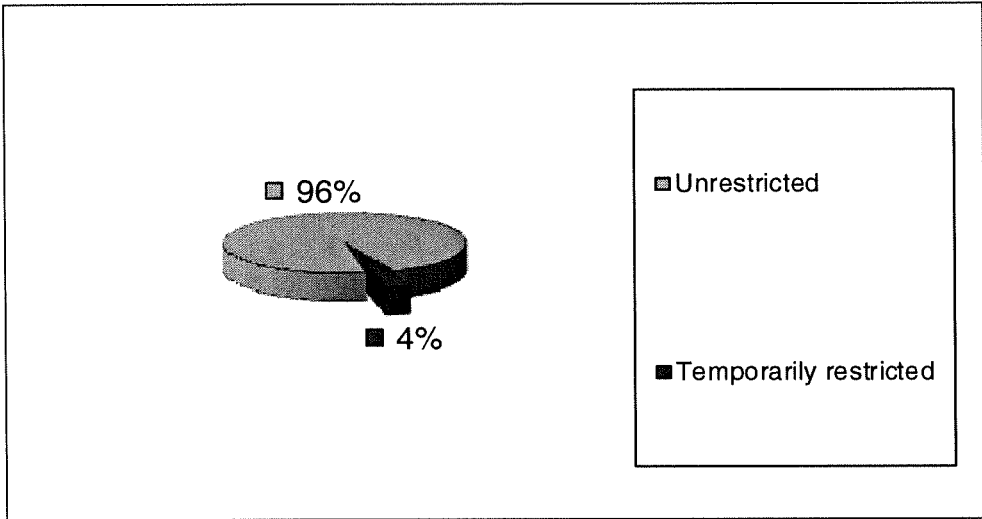
Assets, Liabilities and Net Assets

	December 31		
	2011	2010	2009
Current assets	\$ 8,321,093	\$ 7,048,013	\$ 6,944,822
Noncurrent assets	5,759,796	4,998,321	4,815,032
Capital assets	9,757,567	10,262,555	11,737,918
Total assets	\$ 23,838,456	\$ 22,308,889	\$ 23,497,772
Current liabilities	\$ 5,961,962	\$ 4,962,276	\$ 5,013,900
Long-term liabilities	4,435,878	4,154,335	4,667,350
Total liabilities	\$ 10,397,840	\$ 9,116,611	\$ 9,681,250
Net assets			
Unrestricted	13,447,701	12,669,216	13,515,123
Restricted	492,915	523,062	301,399
Total net assets	\$ 13,940,616	\$ 13,192,278	\$ 13,816,522

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

The primary changes in the assets, liabilities and net assets relates to the increase in cash and cash equivalents of \$567,155, an increase in accounts receivable of \$530,020, an increase in assets limited as to use and investments of \$671,820, an increase in notes receivable of \$872,574, a decrease in net capital assets of \$504,988, an increased liability for accounts payable of \$605,954, and an increase in net assets of \$748,338.

The following chart provides a breakdown of net assets by category for the year ended December 31, 2011:



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

Operating Results and Changes in Net Assets

	Year Ended		
	2011	2010	2009
Operating revenues			
Net patient service revenues	\$ 37,009,529	\$ 33,611,880	\$ 33,717,996
Other	109,787	175,731	124,796
Total operating revenues	37,119,316	33,787,611	33,842,792
Operating expenses			
Salaries and wages	17,870,686	16,074,819	16,290,561
Benefits	5,039,642	4,920,045	4,995,588
Physicians fees	775,557	1,517,091	742,254
Other fees	4,303,306	3,469,973	3,890,201
Supplies	4,169,134	4,154,332	4,421,884
Depreciation and amortization	1,193,170	1,589,465	1,756,097
Other expenses	3,400,680	3,902,573	3,575,931
Total operating expenses	36,752,175	35,628,298	35,672,516
Operating gain (loss)	367,141	(1,840,687)	(1,829,724)
Non-operating gains - net	381,197	1,216,443	807,838
Change in net assets	748,338	(624,244)	(1,021,886)
Net assets - beginning of year	13,192,278	13,816,522	14,838,408
Net assets - end of year	\$ 13,940,616	\$ 13,192,278	\$ 13,816,522

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

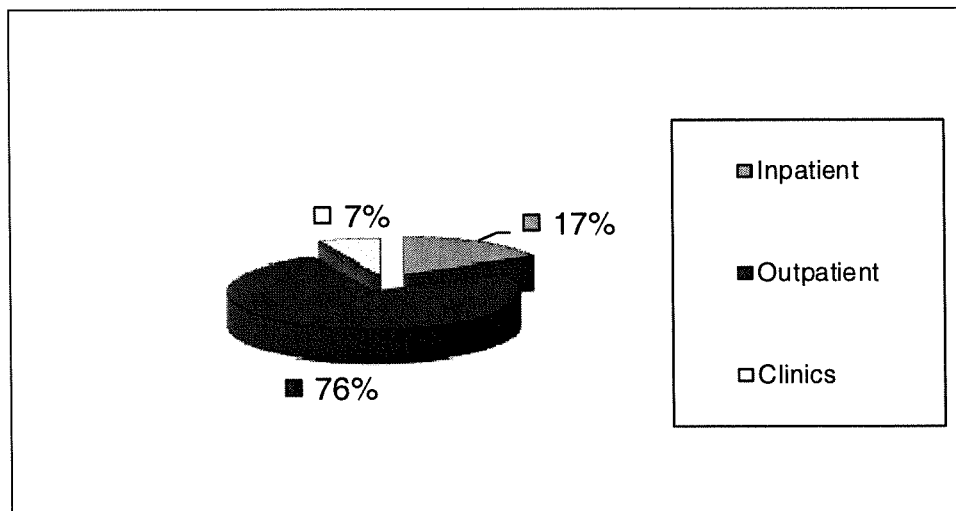
Operating Revenues

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

Operating revenue changes were a result of the following factors:

- Net patient service revenue increased approximately \$3,400,000. 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, United Health Care, Medical Mutual, and various other commercial payors. These revenue deductions were approximately 58% and 57% of gross revenue in 2011 and 2010, respectively. The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The revenue deduction for charity care provided during 2011 amounted to \$3,593,561, an 8% percent increase from 2010.

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



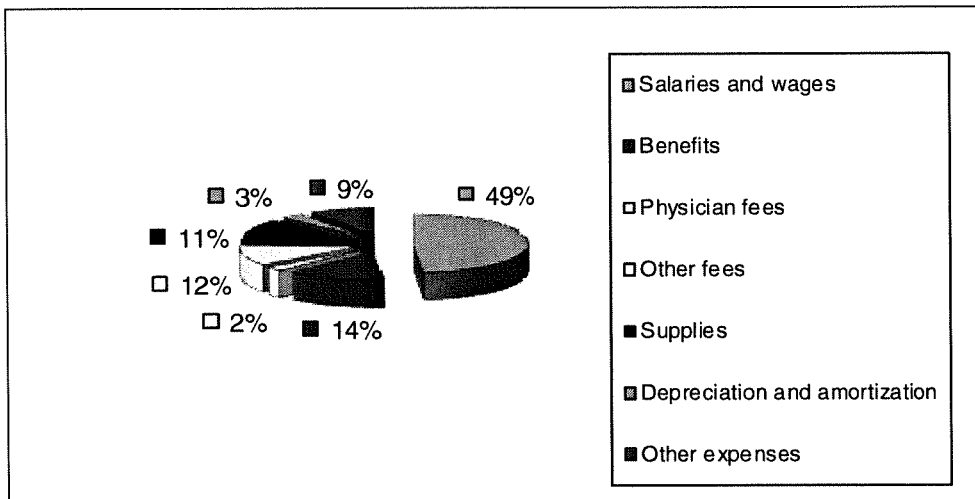
FAYETTE COUNTY MEMORIAL HOSPITAL MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Operating Expenses

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

- Physician fees decreased 49%.
- Other fees increased 24%
- Depreciation and amortization decreased 25%
- Other expenses decreased 58%

The following is a graphic illustration of 2011 operating expenses by type:



Non-Operating Gains - net

Non-operating gains and losses are all sources and uses that are primarily non-exchange in nature. They would consist primarily of income from the operations of the medical office building (rents), investment income (including realized and unrealized gains and losses), grants and contracts and interest expense that do not require any services to be performed. In 2010, the Hospital sold its home health practice proceeds of which are included in this section.

The Hospital receives both capital and operating grants from various sources for specific programs. In 2010, the Hospital received a temporarily restricted contribution of approximately \$285,000 from the Herbert M. Rothrock trust to be used for indigent care. Additionally, in 2010 the Hospital received an unrestricted contribution of approximately \$321,000 from the Dr. Teachnor Hospital Trust.

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

Statement of Cash Flows

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

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

	2011	2010	2009
Cash from			
Operating activities	\$ 2,090,421	\$ 386,725	\$ (210,133)
Capital and related financing activities	(809,535)	(317,903)	(910,980)
Non-capital and related financing activities	375,966	814,844	856,509
Investing activities	(572,335)	(585,357)	(165,548)
Net change in cash and cash equivalents	1,084,517	298,309	(430,152)
Cash - Beginning of year	1,904,827	1,606,518	2,036,670
Cash - End of year	\$ 2,989,344	\$ 1,904,827	\$ 1,606,518

Cash provided by operating activities was \$2,090,421 in 2011 compared to \$386,725 in 2010. Capital purchases were \$782,772 in 2011 compared to \$80,723 in 2010. Cash advanced to physicians was \$544,008 in 2011 compared to \$378,435 in 2010.

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

Capital Assets and Debt Administration

Capital Assets

At December 31, 2011, the Hospital had \$27.1 million invested in capital assets, with an accumulated depreciation of \$17.3 million. Depreciation and amortization totaled \$1.2 million for the current year compared to \$1.6 million last year. Details of these gross capital assets for the past three years are shown below:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Land	\$ 433,225	\$ 519,750	\$ 519,750
Land improvements	624,690	624,690	624,690
Buildings	15,120,395	15,076,977	15,147,687
Fixed equipment	1,827,004	1,749,899	1,790,552
Major movable equipment	8,782,458	8,736,613	9,252,961
Construction in progress	<u>286,870</u>	<u>7,650</u>	<u>26,676</u>
Total	<u>\$ 27,074,642</u>	<u>\$ 26,715,579</u>	<u>\$ 27,362,316</u>

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

Debt

At year-end, the Hospital had \$4,480,841 in debt outstanding, as compared to \$4,422,161 in 2010. The table below summarizes these amounts by type of debt instrument:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Notes payable - 2003 Series	\$ 3,225,000	\$ 3,420,000	\$ 3,605,000
Note payable	616,132	677,121	735,209
Lease obligation	<u>639,709</u>	<u>325,040</u>	<u>456,330</u>
Total notes and leases	<u>\$ 4,480,841</u>	<u>\$ 4,422,161</u>	<u>\$ 4,796,539</u>

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

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

The Hospital is bound by the terms of the Trust Indenture and Reimbursement Agreement to various operations and financial covenants. For quarter ended December 31, 2011, these covenants include maintaining a minimum debt service ratio of 1.25 to 1.00, and minimum days cash on hand of 50. The Hospital was in compliance with the covenants as of December 31, 2011.

Other Economic Factors

There are many outside factors that may affect the Hospital in 2012 and future years including:

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

Contacting the Hospital's Management

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

FAYETTE COUNTY MEMORIAL HOSPITAL

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2011 AND 2010

ASSETS

	<u>2011</u>	<u>2010</u>
Current assets		
Cash and cash equivalents	\$ 1,852,580	\$ 1,285,425
Patient accounts receivable, net of uncollectible accounts of \$1,896,000 in 2011 and \$1,294,000 in 2010	5,305,146	4,775,126
Current portion of notes receivable	517,218	234,299
Inventories	558,600	548,292
Prepaid expenses and other current assets	87,549	204,871
Total current assets	<u>8,321,093</u>	<u>7,048,013</u>
Other assets		
Assets limited as to use - restricted	492,915	523,062
Notes receivable	714,655	125,000
Investments	4,552,226	4,350,259
Investments-trustee held	500,000	0
Capital assets, net	9,757,567	10,262,555
Total other assets	<u>16,017,363</u>	<u>15,260,876</u>
 Total assets	 <u>\$ 24,338,456</u>	 <u>\$ 22,308,889</u>

See accompanying notes to consolidated financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2011 AND 2010

LIABILITIES AND NET ASSETS

	<u>2011</u>	<u>2010</u>
Current liabilities		
Current portion of long-term debt	\$ 406,285	\$ 441,270
Accounts payable	1,143,522	537,568
Accrued payroll and related benefits	1,910,559	1,756,359
Other accrued expenses	1,575,742	1,615,127
Current portion of physician recruitment liability	315,854	234,299
Estimated third-party settlements	610,000	377,653
Total current liabilities	<u>5,961,962</u>	<u>4,962,276</u>
Long-term liabilities		
Physician recruitment liability	247,011	-
Long-term debt	4,074,556	3,980,891
Fair value of interest rate swap agreement	114,311	173,444
Total long-term liabilities	<u>4,435,878</u>	<u>4,154,335</u>
Total liabilities	10,397,840	9,116,611
Net assets		
Unrestricted	8,170,975	6,828,822
Invested in capital assets - net of related debt	5,276,726	5,840,394
Restricted:		
Expendable for capital expenditures and other purposes	<u>492,915</u>	<u>523,062</u>
Total net assets	<u>13,940,616</u>	<u>13,192,278</u>
Total liabilities and net assets	<u>\$ 24,338,456</u>	<u>\$ 22,308,889</u>

See accompanying notes to consolidated financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
Operating revenue		
Net patient service revenue	\$ 37,009,529	\$ 33,611,880
Other operating revenue	109,787	175,731
Total operating revenues	37,119,316	33,787,611
Operating expenses		
Salaries and wages	17,870,686	16,074,819
Employee benefits	5,039,642	4,920,045
Physician fees	775,557	1,517,091
Other fees	4,303,306	3,469,973
Supplies	4,169,134	4,154,332
Utilities	804,235	809,713
Maintenance and repairs	1,286,982	1,256,327
Leases and rentals	348,693	290,154
Insurance	512,078	468,523
Depreciation and amortization	1,193,170	1,589,465
Other expenses	448,692	1,077,856
Total operating expenses	36,752,175	35,628,298
Operating gain (loss)	367,141	(1,840,687)
Non-operating gains - net	381,197	1,216,443
Change in net assets	748,338	(624,244)
Net assets, beginning of year	13,192,278	13,816,522
Net assets, end of year	\$ 13,940,616	\$ 13,192,278

See accompanying notes to consolidated financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2011 AND 2010

	2011	2010
Operating activities		
Cash received from patients and third party payors	\$ 36,711,856	\$ 33,031,951
Cash payments to suppliers for services and goods	(11,975,094)	(11,709,471)
Cash payments to employees for services	(22,756,128)	(21,111,486)
Other operating revenue received	109,787	175,731
Net cash flow from operating activities	2,090,421	386,725
Non-capital and related financing activities		
Donations and other	375,966	814,844
Capital and related financing activities		
Proceeds from the sale of home health	-	500,000
Acquisition and construction of capital assets	(782,772)	(80,723)
(Gain)/Loss on disposal of capital assets	94,590	(88,664)
Interest paid	(180,033)	(199,139)
Borrowings on long-term debt	500,000	-
Principal payments on long-term debt	(441,320)	(449,377)
Net cash flow from capital and related financing activities	(809,535)	(317,903)
Investing activities		
Change in advances to physicians	(544,008)	(378,435)
Change in investments, net	(221,339)	(390,221)
Interest received on investments	193,012	183,299
Net cash flow from investing activities	(572,335)	(585,357)
Net change in cash and cash equivalents	1,084,517	298,309
Cash and cash equivalents, beginning of year	1,904,827	1,606,518
Cash, cash and cash equivalents, end of year	\$ 2,989,344	\$ 1,904,827
Balance sheet classification of cash and cash equivalents		
Current assets	\$ 1,852,580	\$ 1,285,425
Investments	903,792	393,017
Assets limited as to use	232,972	226,385
Total cash and cash equivalents	\$ 2,989,344	\$ 1,904,827

See accompanying notes to consolidated financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

CONSOLIDATED STATEMENTS OF CASH FLOWS (continued) YEARS ENDED DECEMBER 31, 2011 AND 2010

A reconciliation of operating gain (loss) to net cash flows from operating activities follows:

	2011	2010
Cash flows from operating activities		
Operating gain (loss)	\$ 367,141	\$ (1,840,687)
Adjustments to reconcile operating gain (loss) to net cash from operating activities:		
Bad debts	5,479,726	4,746,995
Depreciation and amortization	1,193,170	1,589,465
Write-off of advances to physicians	-	732,232
Changes in assets and liabilities		
Patient accounts receivable	(6,009,746)	(5,163,547)
Inventories	(10,308)	187,404
Prepaid expenses and other assets	117,322	22,344
Estimated third-party settlements	232,347	(163,377)
Accounts payable	605,954	133,623
Other accrued expenses	114,815	142,273
Net cash flow from operating activities	\$ 2,090,421	\$ 386,725
 Noncash investing and financing transactions:		
Capital assets acquired under capital leases	\$ -	\$ 74,999
Note receivable from sale of home health	\$ -	\$ 125,000

See accompanying notes to consolidated financial statements.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

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

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

Blended Component Unit

As required by the accounting principles generally accepted in the United States of America, the accompanying consolidated financial statements present the Hospital and one blended component unit for which the Hospital is financially accountable, the Fayette County Memorial Hospital Foundation, Inc. (the Foundation). The Foundation is a separate not-for-profit entity that was organized during 2010 to support the operations of the Hospital. All significant intercompany transactions have been eliminated for financial reporting purposes.

Enterprise Fund Accounting

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

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Cash and Cash Equivalents

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

Inventories

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

Investments

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

Assets Limited as to Use

Assets limited as to use include assets temporarily restricted by donor. Investments with readily determinable fair values are measured at fair value as determined by quoted market prices.

Capital Assets

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

Compensated Absences

Paid time off is charged to operations when earned. The earned and unused benefits are recorded as a current liability in the financial statements. Employees accumulate vacation days at varying rates depending on years of service, and may carry over to the next year up to 2 times the number of hours eligible to be earned during the year, or up to 120 hours for part-time employees. Employees also earn sick leave benefits at a Hospital-determined rate for all employees. Employees are not paid for accumulated sick leave if they leave before retirement. However, employees who retire from the Hospital may convert accumulated sick leave to termination payments equal to one-fourth of the accumulated balance calculated at the employee's base pay rate as of the retirement date.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

There is no limit on the number of sick leave hours that an employee may accumulate; however, employees are only eligible to receive termination payments on one-fourth of the accumulated sick leave balance up to a maximum of 240 hours. Employees accumulate holidays at a Hospital determined rate for all employees.

Restricted Resources

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

Classification of Net Assets

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

Net Patient Service Revenue and Accounts Receivable

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

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

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

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Contributions

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

Operating Gain (Loss)

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.

Gain on Sale of Home Health and Closing of the Obstetrics Department

In 2010, the Hospital closed the obstetrics department and sold Home Health. The Home Health sale resulted in a gain of \$625,000 which is included as non-operating gains in the 2010 consolidated statements of operations. It is not practical to segregate the accounts of the obstetrics department or Home Health as they are comingled with those of the Hospital.

Income Taxes

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

Charity Care

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

Of the Hospital's total reported expenses (approximately \$36,752,000 and \$35,628,000 during 2011 and 2010, respectively), an estimated \$1,485,000 and \$1,532,000 arose from providing services to charity patients during 2011 and 2010, respectively. The estimated costs of providing charity services are based on a calculation which applies a ratio of costs to charges to the gross uncompensated charges associated with providing care to charity patients. The ratio of cost to charges is calculated based on the Hospital's total expenses divided by gross patient service revenue. The Hospital participates in the Hospital Care Assurance Program (HCAP) which provides for additional payments to hospitals that provide a disproportionate share of uncompensated services to the indigent and uninsured.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Net amounts received through this program totaled approximately \$817,405 and \$392,347 for 2011 and 2010, respectively.

Pension Plan

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

Physician Recruitment Agreements and Physician Advances Receivable

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

Should the arrangement between the Hospital and the physician be terminated prior to the end date agreed upon by both parties, the Hospital will pursue collection of any outstanding advances.

The Hospital recorded a liability of \$562,865 and \$234,299 at December 31, 2011 and 2010, respectively, for the estimated obligation to the Hospital under these agreements with an offsetting asset recorded within the accompanying balance sheet.

Use of Estimates

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

Subsequent Events

The Hospital has evaluated events or transactions occurring subsequent to the balance sheet date for recognition and disclosure in the accompanying financial statements through the date the financial statements are issued, which is April 27, 2012.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

2. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2011 are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:				
Mutual Funds:				
Mid-Cap	\$ 36,907	\$ -	\$ -	\$ 36,907
Large-Cap	27,224	-	-	27,224
Small-Cap	87,252	-	-	87,252
Bonds:				
Financial Services	-	9,050	-	9,050
Equities:				
Real Estate	13,747	-	-	13,747
Energy	97,941	-	-	97,941
Financial Services	70,472	-	-	70,472
US Government Securities	-	4,065,784	-	4,065,784
	<u>\$ 333,543</u>	<u>\$ 4,074,834</u>	<u>\$ -</u>	<u>\$ 4,408,377</u>
Liabilities:				
Interest rate swap	<u>\$ -</u>	<u>\$ 114,311</u>	<u>\$ -</u>	<u>\$ 114,311</u>

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 are as follows:

	Level 1	Level 2	Level 3	Total
Assets:				
Mutual funds	\$ 147,930	\$ -	\$ -	\$ 147,930
Fixed income	-	118,345	-	118,345
Equities	101,674	-	-	101,674
Total US Government Securities	-	3,885,970	-	3,885,970
	<u>\$ 249,604</u>	<u>\$ 4,004,315</u>	<u>\$ -</u>	<u>\$ 4,253,919</u>
Liabilities:				
Interest rate swap	\$ -	\$ 173,444	\$ -	\$ 173,444

3. DEPOSITS AND INVESTMENTS

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

2011	Cash and Cash Equivalents	Investments	Assets Limited as to Use
Deposits	\$ 1,852,580	\$ 903,792	\$ 232,972
Bonds	-	-	9,050
Mutual funds	-	-	151,383
Equities	-	82,650	99,510
United States government and agency obligations	-	4,065,784	-
Total	<u>\$ 1,852,580</u>	<u>\$ 5,052,226</u>	<u>\$ 492,915</u>
2010	Cash and Cash Equivalents	Investments	Assets Limited as to Use
Deposits	\$ 1,285,425	\$ 393,017	\$ 226,385
Fixed income	-	-	118,345
Mutual funds	-	-	147,930
Equities	-	71,272	30,402
United States government and agency obligations	-	3,885,970	-
Total	<u>\$ 1,285,425</u>	<u>\$ 4,350,259</u>	<u>\$ 523,062</u>

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

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

Deposits	2011	2010
Amount of deposits reflected on the accounts of the bank (without recognition of checks written but not yet cleared, or of deposits in transit)	\$ 2,960,517	\$ 2,125,148
Amount of deposits covered by federal depository insurance	954,928	2,026,201
Amounts of deposits uninsured	\$ 2,005,589	\$ 98,947

Amounts uninsured are collateralized with securities held by the financial institution or by its trust department or agent but not in the Hospital's name.

The Hospital had the following investments and maturities, all of which are held in the Hospital's name by custodial banks that are agents of the Hospital:

	Carrying amount	Maturities			
		< than 1 year	1-5 years	6-10 years	> than 10 years
December 31, 2011					
Certificates of deposit	\$ 410,777	\$ 157,851	\$ 252,926	\$ -	\$ -
Fixed income	9,050	-	-	9,050	-
United States government and agency obligations	\$ 4,065,784	\$ 616,698	\$ 2,880,308	\$ 3,580	\$ 565,198
December 31, 2010					
Certificates of deposit	\$ 410,217	\$ 87,844	\$ 322,373	\$ -	\$ -
Fixed income	118,345	-	-	118,345	-
United States government and agency obligations	\$ 3,885,970	\$ -	\$ 3,396,550	\$ 247	\$ 489,173

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

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

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

4. PATIENT ACCOUNTS RECEIVABLE

Patient accounts receivable at December 31, 2011 and 2010 is as follows:

	2011	2010
Total patient accounts receivable	\$ 11,607,719	\$ 9,373,485
Less allowance for:		
Uncollectible accounts	(1,896,173)	(1,294,019)
Contractual adjustments	(4,406,400)	(3,304,340)
Net patient accounts receivable	\$ 5,305,146	\$ 4,775,126

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

	2011		2010	
	Receivables	Revenue	Receivables	Revenue
Medicare	19%	43%	17%	39%
Medicaid	6%	18%	5%	20%
Private insurance	46%	30%	46%	31%
Self pay	29%	9%	32%	10%
	100%	100%	100%	100%

5. NOTES RECEIVABLE

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

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

A note receivable from Caretenders VNA of Ohio, LLC for \$125,000 related to the sale of Home Health is also included in notes receivable. This note is payable to the Hospital on November 1, 2013. The interest rate on this note is 6% and interest is payable quarterly.

A note receivable from Fayette County for \$420,000 relating to the overpayment of property tax is also included in notes receivable. This note is payable to the Hospital through 2016. There is no interest associated with this note.

Notes receivable at December 31, 2011 and 2010 is as follows:

	<u>2011</u>	<u>2010</u>
Physician notes receivable	\$ 41,800	\$ 203,910
Physician guarantee	562,865	234,299
Home health note receivable	125,000	125,000
Fayette County receivable	420,000	-
Other receivables	124,008	-
	<u>1,273,673</u>	<u>563,209</u>
Less allowance	(41,800)	(203,910)
Total notes receivable	<u>\$ 1,231,873</u>	<u>\$ 359,299</u>

6. RESTRICTED FUNDS

Restricted funds are available for the following purposes:

	<u>2011</u>	<u>2010</u>
Community health services	\$ 404,823	\$ 458,634
Capital expenditures	64,428	64,428
Foundation restricted assets	23,664	-
	<u>\$ 492,915</u>	<u>\$ 523,062</u>

7. ESTIMATED THIRD PARTY SETTLEMENTS

Approximately 61 percent and 59 percent of the Hospital's revenues from patient services were received from the Medicare and Medicaid programs for 2011 and 2010, respectively. The Hospital has agreements with these payors that provide for reimbursement to the Hospital at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospital's established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with these third-party payors follows.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Medicare

Effective December 2005, the Hospital was designated as a Critical Access Hospital. As a result, Medicare inpatient and outpatient services are reimbursed at the approximate cost plus 1% of providing those services. Medicare cost reports are final settled through 2008.

Medicaid

Inpatient, acute-care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Capital costs relating to Medicaid inpatients are paid on a cost-reimbursement method. The Hospital is reimbursed for outpatient services on an established fee-for-service methodology. Medicaid cost reports have been final settled through 2006.

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

Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. During the years ended December 31, 2011 and 2010, the Hospital recognized a change in estimate of approximately \$381,000 and (\$67,000), respectively, due to the difference between original estimates and subsequent revisions due to final settlements and changes in allowance methodology.

8. ARRANGEMENTS FOR LEASING TO OTHERS

The Hospital has entered into various leasing agreements. The lease terms range from one to five years through September 2016. These leases are for building space and each contain yearly renewal options. The Hospital collected rental income of \$291,921 and \$291,771 for 2011 and 2010 respectively.

The following schedule shows the aggregate future minimum lease payments required under the lease:

2012	\$ 212,473
2013	51,687
2014	17,861
2015	15,732
2016	11,799
	<u>\$ 309,552</u>

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

9. CAPITAL ASSETS

Capital assets activity for the years ended December 31, 2011 and 2010 follows:

	2010	Additions	Retirements	2011	Depreciable Life - Years
Land	\$ 519,750	\$ -	\$ (86,525)	\$ 433,225	
Land improvements	624,690	-	-	624,690	10-20
Buildings	15,076,977	45,168	(1,750)	15,120,395	15-50
Fixed equipment	1,749,899	77,105	-	1,827,004	5-20
Major movable equipment	8,736,613	381,278	(335,433)	8,782,458	5-25
Construction in progress	7,650	279,220	-	286,870	
Total	26,715,579	782,771	(423,708)	27,074,642	
Less accumulated depreciation					
Land improvements	547,654	10,622	-	558,276	
Buildings	7,458,459	439,000	(1,750)	7,895,709	
Fixed equipment	1,336,225	62,108	-	1,398,333	
Major movable equipment	7,110,685	681,440	(327,368)	7,464,757	
Total	16,453,024	1,193,170	(329,118)	17,317,075	
Net carrying amount	\$ 10,262,555			\$ 9,757,567	
	2009	Additions	Retirements	2010	Depreciable Life - Years
Land	\$ 519,750	\$ -	\$ -	\$ 519,750	
Land improvements	624,690	-	-	624,690	10-20
Buildings	15,147,687	-	(70,710)	15,076,977	15-50
Fixed equipment	1,790,552	-	(40,653)	1,749,899	5-20
Major movable equipment	9,252,961	174,748	(691,096)	8,736,613	5-25
Construction in progress	26,676	(19,026)	-	7,650	
Total	27,362,316	155,722	(802,459)	26,715,579	
Less accumulated depreciation					
Land improvements	534,661	12,993	-	547,654	
Buildings	7,074,961	441,971	(58,472)	7,458,460	
Fixed equipment	1,317,325	59,412	(40,512)	1,336,225	
Major movable equipment	6,697,451	1,075,089	(661,855)	7,110,685	
Total	15,624,398	1,589,465	(760,839)	16,453,024	
Net carrying amount	\$ 11,737,918			\$ 10,262,555	

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

10. LONG-TERM DEBT

Long-term debt activity for the years ended December 31, 2011 and 2010 follows:

2011	Beginning Balance	Current Year Additions	Current Year Reductions	Ending Balance	Current Portion
Leases and notes payable:					
Lease obligations	\$ 325,040	\$ 500,000	\$ (185,331)	\$ 639,709	\$ 141,321
Notes payable - 2003 series	3,420,000	-	(195,000)	3,225,000	64,964
Note payable	677,121	-	(60,989)	616,132	200,000
Total leases and notes payable	<u>\$ 4,422,161</u>	<u>\$ 500,000</u>	<u>\$ (441,320)</u>	<u>\$ 4,480,841</u>	<u>\$ 406,285</u>
2010	Beginning Balance	Current Year Additions	Current Year Reductions	Ending Balance	Current Portion
Leases and notes payable:					
Lease obligations	\$ 456,330	\$ 74,999	\$ (206,289)	\$ 325,040	\$ 185,331
Notes payable - 2003 series	3,605,000	-	(185,000)	3,420,000	195,000
Note payable	735,209	-	(58,088)	677,121	60,939
Total leases and notes payable	<u>\$ 4,796,539</u>	<u>\$ 74,999</u>	<u>\$ (449,377)</u>	<u>\$ 4,422,161</u>	<u>\$ 441,270</u>

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

The Hospital is bound by the terms of the Trust Indenture and Reimbursement Agreement to various operations and financial covenants. These covenants include maintaining a minimum debt service ratio of 1.25 to 1.00, and minimum days cash on hand of 50 for the quarter ended December 31, 2011. The Hospital was in compliance with these covenants as of December 31, 2011.

The Notes are payable semi-annually with principal payments ranging from \$200,000 to \$350,000, in aggregate, maturing on August 1, 2023. The interest rate on the variable rate notes was 0.22 percent at December 31, 2011. The Notes are secured by an irrevocable letter-of-credit with the Trustee bank.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

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

The letter-of-credit expires upon the earliest of August 16, 2014, 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.

During 2009, the Hospital refinanced its line of credit to a note payable to a bank maturing December 2012. In March 2012, this note's maturity was extended through December 21, 2019. The note is unsecured and requires monthly payments of \$7,790 including interest at 5% through maturity.

Using rates as of December 31, 2011, debt service requirements of the variable rate debt and net swap payments of the 2003 Series Bond, assuming current interest rates remain the same for the term of the 2003 bond. As rates vary, variable-rate bond interest payments and net swap payments will vary.

As of December 31, 2011, debt service requirements of the variable-rate debt and note payable for their term were as follows:

Year Ending December 31	Principal Payments on Note Payable	Interest Payments on Note Payable	Principal Payments on 2003 Notes Payable	Interest Payments on 2003 Notes Payable	Interest Rate Swap, Net	Total Payments
2012	\$ 64,964	\$ 28,518	\$ 200,000	\$ 3,457	\$ 84,168	\$ 374,193
2013	67,455	26,026	210,000	3,242	78,797	379,036
2014	70,907	22,575	225,000	6,067	-	324,549
2015	74,534	18,948	235,000	5,572	-	334,054
2016	78,348	15,134	245,000	5,055	-	343,537
2017-2021	259,924	20,522	1,430,000	16,445	-	1,726,891
2022-2026	-	-	680,000	1,898	-	681,898
Total Payments	<u>\$ 616,132</u>	<u>\$ 131,723</u>	<u>\$ 3,225,000</u>	<u>\$ 41,736</u>	<u>\$ 162,965</u>	<u>\$ 4,164,158</u>

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

The Hospital has entered into operating lease agreements for equipment, which expire at various times through 2015. Operating lease expense totaled \$348,693 and \$290,154 in 2011 and 2010, respectively.

The Hospital has entered into various non-cancelable capital lease agreements for equipment. Capital leases have imputed interest rates of 3.25 percent to 8.52 percent. They expire at various times through 2014 and are collateralized by the equipment leased.

Minimum payments on these obligations to maturity as of December 31, 2011 are as follows:

	Capital Leases	Operating Leases	Total
2012	\$ 168,903	\$ 230,637	\$ 399,540
2013	273,012	65,759	338,771
2014	244,159	16,564	260,723
2015	-	7,112	7,112
2016	-	-	-
Thereafter	-	-	-
Total minimum payments	686,074	\$ 320,072	\$ 1,006,146
Less amount representing interest	46,365		
Total	\$ 639,709		
	2011	2010	
Cost of equipment under capital lease	\$ 831,107	\$ 1,166,815	
Less accumulated amortization	641,836	824,187	
Net carrying amount	\$ 189,271	\$ 342,628	

11. DERIVATIVE FINANCIAL INSTRUMENTS – INTEREST RATE SWAPS

Contracts

The Hospital has one interest rate swap agreement in effect at December 31, 2011 for the 2003 Series Bond.

Objectives

As a means to manage the risk associated with interest rate risk on its variable rate bond, the Hospital entered into an interest rate swap in connection with its 2003 Series Bond. The intention of the swap agreement was to effectively change the Hospital's variable interest rate on the bonds to a fixed rate of 5.24%.

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The interest rate swap has been designated by management as a cash flow hedge of variable-rate debt with no hedge effectiveness; therefore, changes in the fair value of the swap are recorded in the change in net assets for the reporting period. Under the agreement, the Hospital will pay or receive the net interest rate amount monthly, which will be included in interest expense.

Terms, Fair Values and Credit Risk

The terms, fair values, and credit ratings of the outstanding swaps as of December 31, 2011 are as follows. As only half of the Series 2003 Notes were hedged, the notional amount of the swap declines with the hedged portion of the debt.

<u>Associated Bond Issue</u>	<u>Notional Amount</u>	<u>Effective Date</u>	<u>Fixed Rate</u>	<u>Variable Rate</u>	<u>Fair Value</u>	<u>Termination Date</u>	<u>Counterparty Credit Rating</u>
2003 Series Bond	\$ 1,725,000	8/1/2003	5.24%	LIBOR	\$ (114,311)	August 1, 2013	Baa1/BBB+/A

As of December 31, 2011, the negative fair values of the agreements may be countered by reductions in total interest payments under the swap agreement should the variable rate on the bonds increase. The variable rate on the swap is based on the London Interbank Offered Rate (LIBOR).

The counterparty carries a guarantee by an entity ("counterparty guarantor") rated Baa1 by Moody's Investors Service (Moody's), BBB+ by Standard and Poor's (S&P), and A by Fitch Ratings (Fitch). To mitigate the potential for credit risk, the fair value of the swap must be collateralized based on a schedule of the counterparty guarantor credit ratings classifications and exposure thresholds as provided in the agreements.

Basis Risk

The swap exposes the Hospital to basis risk should the LIBOR and variable rate on the 2003 Notes converge. The variable rates on the swap were .22 percent and .23 percent at December 31, 2011 and 2010, respectively.

Termination Risk

The Hospital or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. 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.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

Tabular Disclosures

The liability derivative is reported as interest rate swap on the balance sheet. The fair value of the derivative recorded on the balance sheet is as follows:

	Liabilities	
	2011	2010
Interest rate swap	\$ 114,311	\$ 173,444

During 2011 and 2010, the amounts of loss recognized in the statements of operations and changes in net assets are as follows:

<u>Financial Instrument</u>	<u>2011</u>	<u>2010</u>	<u>Location</u>
Interest rate swap agreement	\$ 59,133	\$ 6,103	Non-operating gains
Total gain (loss)	\$ 59,133	\$ 6,103	

12. NET PATIENT SERVICE REVENUE

Net patient service revenue consists of the following:

	2011	2010
Revenue		
Inpatient service		
Routine service	\$ 5,195,077	\$ 3,823,726
Ancillary services	10,383,717	7,980,847
Outpatient ancillary services	73,367,133	65,609,354
Total patient revenue	88,945,927	77,413,927
Revenue deductions		
Provision for contractual allowances	41,761,997	35,105,631
Provision for charity care	3,593,561	3,330,170
Bad debts	5,479,726	4,746,995
Other allowances	1,101,114	619,251
Total revenue deductions	51,936,398	43,802,047
Total net patient service revenue	\$ 37,009,529	\$ 33,611,880

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

13. NON-OPERATING GAINS

Non-operating gains consist of the following:

	<u>2011</u>	<u>2010</u>
Donations, gifts and grants	\$ 130,219	\$ 656,945
Investment income	193,012	183,299
Interest expense	(180,033)	(199,139)
Change in fair value of interest rate swap	59,133	6,103
Sale of home health	-	625,000
Other (losses) gains	<u>178,866</u>	<u>(55,765)</u>
Non-operating gains - net	<u>\$ 381,197</u>	<u>\$ 1,216,443</u>

14. 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 in which the member invests both member and employer contributions (employer contributions vest over five years at 20% per year). The Combined Plan (CO) – a cost sharing multiple-employer defined benefit pension plan.

OPERS maintains a cost-sharing multiple employer defined benefit post-employment healthcare plan, which includes a medical plan, prescription drug program and Medicare Part B premium reimbursement, to qualifying members of both the Traditional Pension and the Combined Plans. OPERS provides retirement, disability, survivor and death benefits and annual cost-of living adjustments to members of the Traditional Pension and Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits, including post-employment health care coverage.

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

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

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

The Ohio Revised Code provides statutory authority for member and employer contributions. For 2011, member and employer contribution rates were consistent across all three plans. The 2011 member contribution rates were 10.0% of covered payroll for members in state and local classifications.

OPERS issues a stand-alone financial report. Interested parties may obtain a copy by writing OPERS, 277 East Town Street, Columbus OH 43215-4642, or by calling 614-222-5601 or 800-222-7377.

Funding Policy

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

Employer contribution rates are expressed as a percentage of the covered payroll of active members. In 2011, state and local employers contributed at a rate of 14.0% of covered payroll. The Ohio Revised Code currently limits the employer contribution to a rate not to exceed 14.0% of covered payroll for state and local employer units. Active members do not make contributions to the OPEB Plan.

OPERS' Post Employment Health Care plan was established under, and is administrated in accordance with, Internal Revenue Code 401(h). Each year, the OPERS Retirement Board determines the portion of the employer contribution rate that will be set aside for funding of post-employment health care benefits. The portion of employer contributions allocated to health care for members in the Traditional Plan was 4% during calendar year 2011. The portion of employer contributions allocated to health care for members in the Combined Plan was 6.05% during calendar year 2011. The portion of employer contributions allocated to health care for the calendar year beginning January 1, 2012 remained the same, but they are subject to change based on Board action. Employers will be notified if the portion allocated to health care changes during calendar year 2012. The OPERS Board of Trustees is also authorized to establish rules for the retiree, or their surviving beneficiaries, to pay a portion of the health care benefits provided. Payment amounts vary depending on the number of covered dependents and the coverage selected.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

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

<u>Year</u>	<u>Contribution</u>
2011	\$ 2,272,640
2010	\$ 2,154,137
2009	\$ 2,197,826

The portion of the Hospital's contribution in the above table was made to fund post-employment health care benefits approximated \$649,000, \$782,000, and \$922,000 for 2011, 2010, and 2009, respectively.

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

15. RISK MANAGEMENT

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

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

The Hospital is not aware of any 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.

FAYETTE COUNTY MEMORIAL HOSPITAL

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2011 AND 2010

16. SELF-INSURANCE

The Hospital provides health insurance to participating employees under a plan that is partially self-insured. The plan is covered by a stop-loss policy that covers claims over \$60,000 per employee per annum to an aggregate amount of \$1,000,000. Expenses charged to operations, including an estimate of incurred but unreported claims totaled \$2,109,592 and \$2,212,723 in 2011 and 2010, respectively.



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

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

We have audited the consolidated financial statements of Fayette County Memorial Hospital (the "Hospital") as of and for the year ended December 31, 2011, and have issued our report thereon dated April 27, 2012.

Our report included additional language stating that the accompanying consolidated financial statements of the Hospital are intended to present the financial position and the changes in financial position and, where applicable, cash flows of only that portion of the business-type activities of Fayette County, Ohio ("the County") that is attributable to the transactions of the Hospital. Those financial statements do not purport to, and do not, present fairly the financial position of the County as of December 31, 2011, 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.

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

Internal Control Over Financial Reporting

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

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


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

Compliance and Other Matters

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

We noted certain matters that we reported to management in a separate letter dated April 27, 2012.

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



April 27, 2012



Dave Yost • Auditor of State

FAYETTE COUNTY MEMORIAL HOSPITAL

FAYETTE COUNTY

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

CERTIFIED
JULY 17, 2012