

Morrow County Hospital and Affiliate

**Combined Financial Report
with Additional Information
December 31, 2006**



Mary Taylor, CPA

Auditor of State

Board of Directors
Morrow County Hospital and Affiliate
651 West Marion Road
Mt. Gilead, Ohio 43338

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

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

Mary Taylor

Mary Taylor, CPA
Auditor of State

May 17, 2007

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Morrow County Hospital and Affiliate

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Independent Auditor's Report

To the Board of Directors
Morrow County Hospital and Affiliate

We have audited the accompanying combined balance sheet of Morrow County Hospital and Affiliate, a component unit of Morrow County, as of December 31, 2006 and 2005 and the related combined statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These combined financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

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

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of Morrow County Hospital and Affiliate at December 31, 2006 and 2005 and the combined results of their operations and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis is not a required part of the basic financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 19, 2007 on our consideration of Morrow County Hospital and Affiliate's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinions on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Plante & Moran, PLLC

March 19, 2007

Morrow County Hospital and Affiliate

Management's Discussion and Analysis

Morrow County Hospital, located in Mount Gilead, Ohio, is a county-owned, tax-exempt entity that operates an acute care hospital facility providing quality inpatient, outpatient, skilled nursing, and home health services to residents of Morrow County and surrounding areas. The reporting entity (the "Hospital") is comprised of Morrow County Hospital and Morrow County Hospital Foundation, which provides services exclusively for the benefit of Morrow County Hospital. The Hospital is a component unit of the County. Morrow County Hospital is operated under Section 339 of the Ohio Revised Code.

This section of the Hospital's annual financial report presents management's discussion and analysis of the Hospital's financial performance and provides an overall review of the Hospital's financial position and activities as of and for the years ended December 31, 2006 and 2005. This discussion should be read in conjunction with the accompanying combined financial statements and footnotes. The combined financial statements, footnotes, and this management's discussion and analysis are the responsibility of the Hospital's management.

Financial and Operating Highlights for 2006

- The increase in net assets was \$953,776, an increase of approximately 8 percent of net assets as of December 31, 2005.
- Acute inpatient days rose 17 percent from 2005.
- Outpatient registrations increased 2 percent from the prior year.
- Emergency room visits increased 3 percent from last year.
- Home health visits increased 24 percent from last year.
- The Hospital initiated a cardiac rehabilitation program and began performing stereotactic breast biopsies.
- Customer and physician satisfaction scores improved significantly, and in some areas, rank among the top 10 percent in the nation.

Overview of the Combined Financial Statements

This annual report consists of combined financial statements prepared in accordance with the provisions of GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments: Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. These standards establish comprehensive financial reporting standards for all state and local governments and related entities.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

The combined balance sheet, statement of revenues, expenses, and changes in net assets, and statement of cash flows provide an indication of the Hospital's financial health. The combined balance sheet includes the Hospital's assets and liabilities, using the accrual basis of accounting as well as an indication about which assets can be utilized for general purposes and which are restricted for other purposes. The combined statement of revenues, expenses, and changes in net assets reports the revenues and expenses during the time periods indicated. The combined statement of cash flows reports the cash provided and used by operating activities, as well as other cash sources, such as investment income, and cash payments for repayment of debt and capital asset acquisitions.

Financial Analysis of the Hospital at December 31, 2006

Total assets increased by 2.0 percent to \$23.2 million, and total liabilities decreased 4.9 percent to \$9.7 million. The Hospital's total net assets increased from \$12.5 million to \$13.5 million, a 7.6 percent improvement from a year ago as shown in the following table:

	2004	2005	2006	2005 to 2006 Change	
				Amount	Percent
Assets					
Current assets	\$ 6,740,095	\$ 8,334,287	\$ 8,723,221	\$ 388,934	4.7
Noncurrent assets	3,110,956	3,348,613	3,961,373	612,760	18.3
Capital assets	<u>11,952,111</u>	<u>11,062,017</u>	<u>10,509,736</u>	<u>(552,281)</u>	(5.0)
Total assets	21,803,162	22,744,917	23,194,330	449,413	2.0
Liabilities					
Current liabilities	5,246,978	5,820,935	6,003,540	182,605	3.1
Long-term liabilities	<u>5,100,730</u>	<u>4,377,048</u>	<u>3,690,080</u>	<u>(686,968)</u>	(15.7)
Total liabilities	<u>10,347,708</u>	<u>10,197,983</u>	<u>9,693,620</u>	<u>(504,363)</u>	(4.9)
Net Assets					
Invested in capital assets -					
Net of debt	6,237,486	6,295,196	6,487,071	191,875	3.0
Restricted assets (debt service)	2,625,726	2,904,207	3,502,450	598,243	20.6
Unrestricted	<u>2,592,242</u>	<u>3,347,531</u>	<u>3,511,189</u>	<u>163,658</u>	4.9
Total net assets	<u>\$ 11,455,454</u>	<u>\$ 12,546,934</u>	<u>\$ 13,500,710</u>	<u>\$ 953,776</u>	7.6

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

Current Assets

Total current assets increased by \$388,934 from the previous year. Cash and cash equivalents increased \$539,251 due to the Hospital's improved financial position. Patient accounts receivable decreased \$179,940 due to improved collections of receivables related to the Hospital's nursing home facility. Inventory increased by \$116,641 due primarily to increased surgical supplies.

Noncurrent Assets

Noncurrent assets, which consist primarily of limited use investments, general long-term investments, and physician advances receivable increased by \$612,760, or 18.3 percent. Limited use investments increased by \$598,243. The increase was due to improved cash flow enabling the transfer of additional amounts to funded depreciation, a fund used to save for future capital purchases.

Capital Assets

Capital assets decreased by \$552,281 or 5.0 percent. The decrease was due to depreciation expense of \$1,336,451 offset by additions of \$784,170.

Current Liabilities

Current liabilities increased \$182,605 over the prior year. Accounts payable decreased by \$211,384 due to the timing of payments to vendors. Accrued compensation increased by \$104,512 due to increased salaries and the timing of payments to employees. Cost report settlements payable increased by \$344,150 due to a decrease in the estimated per diem receivable from Medicare for inpatient care.

Long-term Liabilities

Long-term liabilities decreased by \$686,968. Long-term debt decreased by \$746,731 from 2005 due to \$744,156 in principal payments. Additional detail regarding the Hospital's long-term debt can be found in Note 7 of the combined financial statements.

Net Assets

Total net assets increased by \$953,776, or 7.6 percent, due entirely to excess revenue over expenses.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

Revenue and Expenses

The following table shows the changes in revenues and expenses for 2006 compared to 2005.

	2004	2005	2006	Change	
				Amount	Percent
Operating Revenue					
Net patient service revenue	\$ 22,817,794	\$ 25,293,111	\$ 26,488,740	\$ 1,195,629	4.7%
Other	584,123	550,055	713,639	163,584	29.7%
Total operating revenue	23,401,917	25,843,166	27,202,379	1,359,213	5.3%
Operating Expenses					
Salaries and benefits	11,313,518	12,329,039	13,231,636	902,597	7.3%
Operating supplies and expenses	4,370,626	5,081,308	5,241,826	160,518	3.2%
Purchased services	5,170,985	5,538,478	5,999,809	461,331	8.3%
Insurance	218,512	173,955	155,743	(18,212)	-10.5%
Utilities	528,826	633,800	685,203	51,403	8.1%
Rental	386,262	509,451	751,459	242,008	47.5%
Depreciation and amortization	1,363,271	1,465,771	1,336,451	(129,320)	-8.8%
Total operating expenses	23,352,000	25,731,802	27,402,127	1,670,325	6.5%
Operating Income (Loss)	49,917	111,364	(199,748)	(311,112)	-279.4%
Nonoperating Income (Expense)					
Investment income	43,938	90,942	198,094	107,152	117.8%
Loss on disposal of assets	(92,570)	-	-	-	
Property taxes	1,238,209	1,240,000	1,240,176	176	0.0%
Interest expense	(314,990)	(350,826)	(284,746)	66,080	-18.8%
Total nonoperating income	874,587	980,116	1,153,524	173,408	17.7%
Excess of Revenue Over Expenses/ Increase in Net Assets	924,504	1,091,480	953,776	\$ (137,704)	-12.6%
Net Assets - Beginning of year	10,530,950	11,455,454	12,546,934		
Net Assets - End of year	\$ 11,455,454	\$ 12,546,934	\$ 13,500,710		

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

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, and the cafeteria. In addition, certain federal, state, and private grants are considered operating if they are not utilized 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 \$1,195,629, or 4.7 percent, from 2005. Gross patient revenue increased by \$2,990,100, or 7.2 percent. The Hospital board of trustees approved an 8 percent rate increase effective January 1, 2006. Gross patient revenue is reduced by revenue deductions. These deductions are the amounts that are not paid to the Hospital under contractual arrangements with Medicare, Medicaid, and other payors. These revenue deductions increased from 39.3 percent to 40.7 percent as a percentage of gross revenue.

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:

- Salaries and benefits increased 7.3 percent due to annual raises, a 2.9 percent increase in the number of FTEs, the additional OPERS expense associated with the salary increase, and an increase in the employer contribution rate for OPERS.
- Operating supplies and expenses increased 3.2 percent due to increased outpatient volumes and the greater number of surgical procedures requiring the use of implants.
- Purchased services increased 8.3 percent due to increased contract services for physicians providing hospitalist services, as well as the use of agency nursing.
- Utilities increased 8.1 percent due to the increase in the cost of natural gas.
- Rental increased by 47.5 percent due to a full year of expense associated with pharmacy equipment leased near the end of 2005.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

The following is a summary of 2006 operating expenses by type:

	<u>Percent</u>	<u>Amount</u>
Operating Expenses		
Salaries and benefits	48.29%	\$13,231,636
Operating supplies and expenses	19.13%	5,241,826
Purchased services	21.89%	5,999,809
Insurance	0.57%	155,743
Utilities	2.50%	685,203
Rental	2.74%	751,459
Depreciation and amortization	4.88%	1,336,451
Total	100.00%	\$27,402,127

Nonoperating Gains (Losses)

Nonoperating revenue and expenses are all sources and uses that are primarily nonexchange in nature. At Morrow County Hospital, these consist primarily of property tax levy funds and interest expense.

Significant changes to nonoperating income (expense) were the result of the following factors:

- Investment income increased by \$107,152, or 117.8 percent, due to the Hospital's improved cash position and higher interest rates.
- Interest expense decreased by \$66,080, or 18.8 percent, due to the payoff of four capital leases during 2006 and the normal paydown of the Hospital's master lease and purchase agreement.

Statement of Cash Flows

The combined statement of cash flows provides relevant information about the Hospital's cash receipts and cash payments. The combined statement of cash flows also helps assess:

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

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

The following table shows condensed cash flow information for the years 2006, 2005, and 2004:

	2004	2005	2006	Increase (Decrease)
Cash Provided (Used) By				
Operating activities	\$ 1,870,400	\$ 1,652,919	\$ 1,615,874	\$ (37,045)
Capital and related financing activities	(674,292)	(634,307)	(575,456)	58,851
Investing activities	(1,108,274)	(440,277)	130,559	570,836
Net Increase in Cash	87,834	578,335	1,170,977	592,642
Cash - Beginning of year	900,491	988,325	1,566,660	578,335
Cash - End of year	<u>\$ 988,325</u>	<u>\$ 1,566,660</u>	<u>\$ 2,737,637</u>	<u>\$ 1,170,977</u>

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

Net cash provided by operating activities decreased \$37,045 over the prior year due to an increase of \$987,485 in payments to our vendors for supplies and services and an additional \$979,306 paid to employees for wages and benefits, offset by an increase of \$1,766,162 received from our patients and third-party payors.

Net cash used in capital and related financing activities decreased slightly from 2005 due to the paydown of capital leases and long-term debt, offset by a \$210,908 increase in the acquisition and construction of capital assets.

Investing activities provided \$570,836 more cash in 2006 than in 2005. This was due primarily to a \$370,622 decrease in the net purchase/sale of investments compared to 2005 and \$107,152 in additional investment income.

Economic Factors and Next Year's Budget

The board of trustees approved the 2007 operating budget at its October 2006 meeting and the Morrow County Commissioners subsequently approved it. The budget calls for gross revenue of \$47 million, total operating expenses of \$30.2 million, and excess revenue over expense of \$1.1 million. The board of trustees approved an average increase of 7 percent in the patient charge structure for the upcoming fiscal year.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

There are several factors and uncertainties that may affect the Hospital during 2007 and future years including:

- There are pressures at both the federal and state levels to decrease funding for the Medicaid program. This could negatively affect the Hospital's reimbursement for its acute care and skilled nursing facilities. Likewise, the federal government's Upper Payment Limit Program, which provides additional reimbursement to public hospitals for Medicaid inpatients, faces an uncertain future.
- The economic position of the Hospital is influenced by the local economy. Compared to other Ohio counties, Morrow County is growing at a faster rate, but has higher than average unemployment.
- The success of the Hospital is closely tied to that of its medical staff. The Hospital occasionally faces pressures on its relationship with its physicians due to external factors such as changes in reimbursement, the cost of malpractice insurance, and the implementation of new technologies.
- Due to its rural location, the Hospital must occasionally address physician shortages including family practitioners and specialists (such as surgeons). Effective April 2007, the Hospital has attained the services of a full-time orthopedic surgeon and will offer the services of a physician anesthesiologist two days a week. The 2007 budget assumes increased surgery revenue due to these additions.
- The Hospital's strategic plan calls for the expansion and renovation of its facility. The timing and financial impact of this project is uncertain as of the report date.

Contacting the Hospital's Management

This financial report is intended to provide the people of Morrow County, state and federal governments, and our debt holders with a general overview of the Hospital's finances. In addition, this report discloses the uses of the money received from services provided and county property taxes. If you have questions about this report or need additional information, please contact me.

Joseph Schueler
Chief Financial Officer

Morrow County Hospital and Affiliate

Combined Balance Sheet

	December 31, 2006	December 31, 2005
Assets		
Current Assets		
Cash and cash equivalents (Note 4)	\$ 1,394,131	\$ 854,880
Short-term investments (Note 4)	610,376	600,000
Patient accounts receivable (Note 3)	4,287,816	4,467,756
Levied taxes receivable	1,250,000	1,350,000
Cost report settlements (Note 6)	-	108,850
Prepaid expenses and other	661,981	556,714
Inventory	397,981	281,340
Other current assets - Physician advances	120,936	114,747
Total current assets	8,723,221	8,334,287
Assets Limited as to Use (Note 4)	3,502,450	2,904,207
General Long-term Investments (Note 4)	351,843	336,351
Capital Assets (Note 5)	10,509,736	11,062,017
Other Assets - Physician advances	107,080	108,055
Total assets	<u>\$ 23,194,330</u>	<u>\$ 22,744,917</u>

Morrow County Hospital and Affiliate

Combined Balance Sheet (Continued)

	December 31, 2006	December 31, 2005
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 7)	\$ 746,733	\$ 744,158
Accounts payable	1,741,810	1,953,194
Cost report settlements payable (Note 6)	344,150	-
Accrued liabilities and other:		
Accrued compensation	1,397,445	1,292,933
Accrued interest	18,020	20,580
Deferred revenue for levied taxes	1,250,000	1,350,000
Other accrued liabilities	505,382	460,070
Total current liabilities	6,003,540	5,820,935
Long-term Debt (Note 7)	3,275,932	4,022,663
Other Liabilities - Compensated absences (Note 7)	414,148	354,385
Total liabilities	9,693,620	10,197,983
Net Assets		
Invested in capital assets - Net of related debt	6,487,071	6,295,196
Unrestricted	7,013,639	6,251,738
Total net assets	13,500,710	12,546,934
Total liabilities and net assets	\$ 23,194,330	\$ 22,744,917

Morrow County Hospital and Affiliate

Combined Statement of Revenues, Expenses, and Changes in Net Assets

	Year Ended	
	December 31, 2006	December 31, 2005
Operating Revenues		
Net patient service revenue	\$ 26,488,740	\$ 25,293,111
Other	713,639	550,055
Total operating revenues	27,202,379	25,843,166
Operating Expenses		
Salaries and wages	9,476,745	8,691,689
Employee benefits and payroll taxes	3,754,891	3,637,350
Operating supplies and expenses	5,241,826	5,081,308
Purchased services	5,999,809	5,538,478
Insurance	155,743	173,955
Utilities	685,203	633,800
Rental	751,459	509,451
Depreciation and amortization	1,336,451	1,465,771
Total operating expenses	27,402,127	25,731,802
Operating (Loss) Income	(199,748)	111,364
Nonoperating Income (Expense)		
Investment income	198,094	90,942
Property taxes	1,240,176	1,240,000
Interest expense	(284,746)	(350,826)
Total nonoperating income	1,153,524	980,116
Increase in Net Assets	953,776	1,091,480
Net Assets - Beginning of year	12,546,934	11,455,454
Net Assets - End of year	\$ 13,500,710	\$ 12,546,934

Morrow County Hospital and Affiliate

Combined Statement of Cash Flows

	Year Ended	
	December 31, 2006	December 31, 2005
Cash Flows from Operating Activities		
Cash received from patients and third-party payors	\$ 27,121,680	\$ 25,450,018
Cash payments to suppliers for services and goods	(13,092,320)	(12,199,336)
Cash payments to employees for services	(13,127,124)	(12,147,818)
Other receipts from operations	713,639	550,055
Net cash provided by operating activities	1,615,875	1,652,919
Cash Flows from Investing Activities		
Proceeds from sale of investments	784,212	300,000
Investment income	198,094	90,942
Decrease (increase) in assets limited as to use	11,832	(106,197)
Purchase of investments	(788,429)	(674,839)
Advances to physicians	(75,150)	(50,183)
Net cash provided by (used in) investing activities	130,559	(440,277)
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(784,171)	(573,262)
Property tax levy	1,240,176	1,240,000
Interest paid on long-term debt	(287,306)	(353,241)
Principal payments on long-term debt	(744,156)	(947,804)
Net cash used in capital and related financing activities	(575,457)	(634,307)
Net Increase in Cash and Cash Equivalents	1,170,977	578,335
Cash and Cash Equivalents - Beginning of year	1,566,660	988,325
Cash and Cash Equivalents - End of year	\$ 2,737,637	\$ 1,566,660
Supplemental Cash Flow Information		
Included in current assets	\$ 1,394,131	\$ 854,880
Included in assets limited as to use	1,288,249	678,174
Included in general long-term investments	55,257	33,606
Cash and Cash Equivalents - End of year	\$ 2,737,637	\$ 1,566,660

Morrow County Hospital and Affiliate

Combined Statement of Cash Flows (Continued)

A reconciliation of operating loss to net cash from operating activities is as follows:

	Year Ended	
	December 31, 2006	December 31, 2005
Cash Flows from Operating Activities		
Operating (loss) income	\$ (199,748)	\$ 111,364
Adjustments to reconcile operating (loss) income to net cash from operating activities:		
Depreciation and amortization	1,336,451	1,465,771
Provision for bad debts	2,364,511	2,482,785
Forgiveness of physician advances	69,937	183,691
(Increase) decrease in assets:		
Patient accounts receivable	(2,184,571)	(2,873,378)
Third-party settlement receivables	108,850	(547,500)
Inventories	(116,641)	12,308
Other current assets	(105,267)	(368,851)
Increase (decrease) in liabilities:		
Accounts payable	(211,384)	794,286
Accrued expenses	209,587	392,443
Increase in third-party settlement payables	344,150	-
Net cash provided by operating activities	<u>\$ 1,615,875</u>	<u>\$ 1,652,919</u>

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

Note I - Nature of Business and Significant Accounting Policies

Organization - The accompanying combined financial statements include the accounts of Morrow County Hospital and Morrow County Hospital Foundation (collectively, the "Hospital"). All significant intercompany transactions and balances have been eliminated in combination.

Morrow County Hospital is an acute and extended care facility owned by, and is a component unit of, Morrow County, Ohio and operated by a board of trustees. Members of the board of trustees are appointed by the County Commissioners. The Hospital is a political subdivision of the State of Ohio and is therefore exempt from federal income taxes under Section 115 of the Internal Revenue Code. The Hospital was formed under the provisions of the Ohio Revised Code.

During 1997, the Hospital formed the Morrow County Hospital Foundation (the "Foundation"). The purpose of the Foundation is to support the Hospital and community programs to improve the health and well-being of the people served by the Hospital. The Foundation is exempt under Section 501(a) as an organization described in Section 501(c)(3) of the Internal Revenue Code.

Basis of Presentation - The combined financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued in June 1999. The Hospital follows the "business-type" activities reporting requirements of GASB Statement No. 34, which provide a comprehensive look at the Hospital's financial activities. The Foundation is required to be reported in the Hospital's financial statements.

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 Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Cash and Cash Equivalents - Cash and cash equivalents include cash and investments in highly liquid investments purchased with an original maturity of three months or less. Cash and cash equivalents included in assets limited as to use and general long-term investments are considered cash and cash equivalents for the purpose of the combined statement of cash flows.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

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

Investments - Investments include certificates of deposit and government securities and are recorded at fair value in the combined balance sheet. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in nonoperating revenue when earned.

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

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

Assets Limited as to Use - Assets limited as to use consist of invested funds designated by the Hospital's board of trustees for operations.

Capital Assets - Property and equipment amounts are recorded at cost, or if donated, at fair value at the date of receipt. Depreciation is computed principally on the straight-line basis over the estimated useful lives of the assets. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment. Such amortization is included in depreciation and amortization in the combined financial statements. Costs of maintenance and repairs are charged to expense when incurred.

Compensated Absences - Paid time-off is charged to operations when earned. Unused and earned benefits are recorded as a liability in the combined financial statements. Employees accumulate vacation days and sick leave benefits at varying rates depending on years of service. 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, up to a maximum of 240 hours, calculated at the employee's base pay rate as of the retirement date.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

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

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 noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees as required by debt service arrangements. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

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

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

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

Contributions - The Hospital reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Hospital reports the expiration of donor restrictions when the assets are placed in service.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

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

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

Property Taxes - The Hospital received approximately 4 percent in 2006 and 2005 of its financial support from property taxes. These funds were used as follows:

	2007	2006
Used to support operations	\$ 1,240,176	\$ 1,240,000
Levied for debt service	-	-

Property taxes are levied by the County on the Hospital's behalf on January 1 and are intended to finance the Hospital's activities of the same calendar year. Amounts levied are based on assessed property values as of the preceding July 1. The property tax calendar includes these dates:

Levy date	January 1
Lien date	January 1
Tax bill mailed	January 20
First installment payment due	February 15
Second installment payment due	July 15

Property taxes are considered delinquent on the day following each payment due date.

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

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. During 2006 and 2005, the Hospital provided charity care of approximately \$340,000 and 347,000, respectively.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

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

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.

Note 2 - Deposits and Investments

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

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

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

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

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

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

Note 2 - Deposits and Investments (Continued)

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

1. Bonds, notes, or other obligations guaranteed by the United States, or those for which the faith of the United States is pledged for the payment of principal and interest
2. Bonds, notes debentures, or other obligations or securities issued by any federal governmental agency
3. No-load money market mutual funds consisting exclusively of obligations described in (1) or (2) above and repurchase agreements secured by such obligations, provided that investments in securities described in this division are made only through eligible institutions
4. Interim deposits in the eligible institutions applying for interim funds to be evidenced by time certificates of deposit maturing not more than one year from date of deposit, or by savings or deposit accounts, including but not limited to, passbook accounts
5. Bonds and other obligations of the State of Ohio
6. The Ohio State Treasurer's investment pool (STAR Ohio)
7. Commercial paper and bankers' acceptances which meet the requirements established by Ohio Revised Code, SEC 135.142
8. Under limited circumstances, corporate debt interest in either of the two highest rating classifications by at least two nationally recognized rating agencies

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

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

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

Note 2 - Deposits and Investments (Continued)

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

Custodial Credit Risk of Bank Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories. At year end, all Hospital bank deposits (certificates of deposit, checking, and savings accounts) were fully collateralized.

Custodial Credit Risk of Investments

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Hospital does not have a policy for custodial credit risk. At year end, the following investment securities were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the Hospital's name:

Type of Investment	Carrying Value	How Held
2006 U.S. government bonds	\$ 2,510,787	Counterparty
2005 U.S. government bonds	2,528,778	Counterparty

Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Hospital does not have an investment policy that addresses interest rate risk. At year end, the average maturities of investments are as follows:

Investment	Fair Value	Weighted Average Maturity
2006 U.S. government bonds	\$ 2,510,787	2.25 years
2005 U.S. government bonds	2,528,778	0.81 years

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	<u>2006</u>	<u>2005</u>
Patient accounts receivable	\$ 7,791,816	\$ 7,973,756
Less:		
Allowance for uncollectible accounts	(1,537,000)	(1,521,000)
Allowance for contractual adjustments	<u>(1,967,000)</u>	<u>(1,985,000)</u>
Net accounts receivable	<u>\$ 4,287,816</u>	<u>\$ 4,467,756</u>

The Hospital grants credit without collateral to patients, most of whom are local residents and are insured under third-party payor agreements. The composition of receivables from patients and third-party payors was as follows:

	<u>Percent</u>	
	<u>2006</u>	<u>2005</u>
Medicare	30	28
Medicaid	7	10
Commercial insurance and HMOs	38	42
Self-pay	<u>25</u>	<u>20</u>
Total	<u>100</u>	<u>100</u>

Note 4 - Assets Limited as to Use and Investments

Cash deposits, assets whose use is limited, and investments of the Hospital are composed of the following:

	<u>Fair Value</u>	
	<u>2006</u>	<u>2005</u>
Demand deposits and money market accounts	\$ 2,737,637	\$ 1,566,660
Certificates of deposit	610,376	600,000
U.S. government obligations	<u>2,510,787</u>	<u>2,528,778</u>
Total	<u>\$ 5,858,800</u>	<u>\$ 4,695,438</u>

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

Note 4 - Assets Limited as to Use and Investments (Continued)

	Fair Value	
	2006	2005
Amounts summarized by fund type -		
General funds:		
Cash and cash equivalents	\$ 1,394,131	\$ 854,880
Short-term investments	610,376	600,000
Board designated	3,502,450	2,904,207
General long-term investments	351,843	336,351
Total	<u>\$ 5,858,800</u>	<u>\$ 4,695,438</u>

Note 5 - Capital Assets

Cost of capital assets and related depreciable lives for December 31, 2006 are summarized below:

	2005	Additions	Transfers	Retirements	2006	Depreciable Life - Years
Land and land improvements	\$ 536,904	\$ 46,507	\$ -	\$ (37,352)	\$ 546,059	5-25
Building	5,372,006	101,880	33,927	(457,924)	5,049,889	10-40
Equipment	14,993,987	502,512	246,014	(1,322,992)	14,419,521	5-20
Construction in progress	280,507	133,272	(279,941)	-	133,838	
Total	21,183,404	784,171	-	(1,818,268)	20,149,307	
Less accumulated depreciation:						
Land and land improvements	335,114	29,214	-	(37,352)	326,976	
Building	2,622,758	226,046	-	(457,924)	2,390,880	
Equipment	7,163,515	1,081,192	-	(1,322,992)	6,921,715	
Total	10,121,387	1,336,452	-	(1,818,268)	9,639,571	
Net carrying amount	<u>\$11,062,017</u>	<u>\$ (552,281)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$10,509,736</u>	

Cost of capital assets and related depreciable lives for December 31, 2005 are summarized below:

	2004	Additions	Transfers	Retirements	2005	Depreciable Life - Years
Land and land improvements	\$ 528,023	\$ 8,881	\$ -	\$ -	\$ 536,904	5-25
Building	5,329,981	42,025	-	-	5,372,006	10-40
Equipment	14,570,296	362,107	61,584	-	14,993,987	5-20
Construction in progress	179,427	162,664	(61,584)	-	280,507	
Total	20,607,727	575,677	-	-	21,183,404	
Less accumulated depreciation:						
Land and land improvements	302,435	32,679	-	-	335,114	
Building	2,379,791	242,967	-	-	2,622,758	
Equipment	5,973,390	1,190,125	-	-	7,163,515	
Total	8,655,616	1,465,771	-	-	10,121,387	
Net carrying amount	<u>\$11,952,111</u>	<u>\$ (890,094)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$11,062,017</u>	

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

Note 6 - Cost Report Settlements

Approximately 60 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 these reimbursement programs represent the difference between the Hospital's established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with these third-party payors follows:

Medicare - Effective October 1, 2002, the Hospital received full accreditation from the Center for Medicare and Medicaid Services for the critical access hospital designation. As a critical access hospital, the Hospital receives reasonable, cost-based reimbursement for both inpatient and outpatient services provided to Medicare beneficiaries.

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 a 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 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 combined financial statements.

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

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

Note 7 - Long-term Debt and Other Noncurrent Liabilities

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

	2005	Current Year Additions	Current Year Reductions	2006	Amounts Due Within One Year
Master lease and purchase agreement	\$ 3,864,655	\$ -	\$ (480,783)	\$ 3,383,872	\$ 509,738
Capital lease obligations	902,166	-	(263,373)	638,793	236,995
Total long-term debt	4,766,821	-	(744,156)	4,022,665	746,733
Compensated absences	354,385	849,319	(789,556)	414,148	414,148
Total noncurrent liabilities	<u>\$ 5,121,206</u>	<u>\$ 849,319</u>	<u>\$ (1,533,712)</u>	<u>\$ 4,436,813</u>	<u>\$ 1,160,881</u>

Long-term liability activity for the year ended December 31, 2005 was as follows:

	2004	Current Year Additions	Current Year Reductions	2005	Amounts Due Within One Year
Master lease and purchase agreement	\$ 4,318,127	\$ -	\$ (453,472)	\$ 3,864,655	\$ 480,783
Capital lease obligations	1,396,498	-	(494,332)	902,166	263,375
Total long-term debt	5,714,625	-	(947,804)	4,766,821	744,158
Compensated absences	335,147	693,564	(674,326)	354,385	354,385
Total noncurrent liabilities	<u>\$ 6,049,772</u>	<u>\$ 693,564</u>	<u>\$ (1,622,130)</u>	<u>\$ 5,121,206</u>	<u>\$ 1,098,543</u>

The bonds payable are summarized as follows:

- Under a master lease and purchase agreement, the Hospital borrowed \$4,950,000 under an arrangement with a finance company to finance the construction of facilities improvements. The financing was provided by the issuance of a 10-year note maturing August 2012, with interest at 5.89 percent. The debt is collateralized by capital assets purchased with the proceeds. The lease and purchase agreement provides, among other things, for certain covenants and payoff options which allow for early retirement of the debt by the Hospital.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

Note 7 - Long-term Debt and Other Noncurrent Liabilities (Continued)

- The Hospital leases medical and office equipment and furniture and fixtures used in its operations under capital leases which generally require the Hospital to pay insurance and maintenance costs. These capital leases are due in monthly installments including interest at rates ranging from 1.34 percent to 11.52 percent annually. These leases expire at various dates through 2009, and are collateralized by the leased equipment. Capitalized costs at December 31, 2006 and 2005 were approximately \$1,605,000 and \$1,726,000 less accumulated depreciation of \$966,000 and \$825,000, respectively.

The following is a schedule by years of bond principal and interest as of December 31, 2006:

Years Ending December 31	Long-term Debt		Capital Lease Obligation	
	Principal	Interest	Principal	Interest
2007	\$ 509,738	\$ 188,182	\$ 236,996	\$ 51,974
2008	539,981	157,939	215,838	32,350
2009	572,958	124,962	185,959	11,493
2009	607,464	90,456	-	-
2010	644,049	53,871	-	-
2011-2015	509,682	15,120	-	-
Total payments	<u>\$ 3,383,872</u>	<u>\$ 630,530</u>	<u>\$ 638,793</u>	<u>\$ 95,817</u>

Note 8 - Medical Malpractice Claims

Based on the nature of its operations, the Hospital is at times subject to pending or threatened legal actions, which arise in the normal course of its activities.

The Hospital is insured against medical malpractice claims under a claims-based policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claims exceeding \$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 \$4,000,000 of coverage.

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

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

Note 8 - Medical Malpractice Claims (Continued)

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

Note 9 - 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 postretirement health care benefits to qualifying members of both the traditional and the combined plans; however, health care benefits are not statutorily guaranteed. Members of the Member-Directed Plan do not qualify for ancillary benefits, including postemployment 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 2006, member and employer contribution rates were consistent across all three plans (TP, MD, and CO), and are actuarially determined. The 2006 member contribution rate for members of local government units was 9.00 percent of their annual covered salary. The 2006, 2005, and 2004 employer contribution rate for local government units was 13.70 percent of covered payroll. The Hospital's contributions to OPERS for the years ended December 31, 2006, 2005, and 2004 were approximately \$1,326,000, \$1,248,000, and \$1,111,000, respectively. Required employer contributions for all plans are equal to 100 percent of employer charges and must be extracted from the employer's records.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

Note 9 - Defined Benefit Pension Plan (Continued)

Postretirement Benefits - In order to qualify for postretirement health care coverage under the TP and CO plans, age and service retirees must have 10 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 postemployment 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 postretirement health care. The Ohio Revised Code provides statutory authority for employer contributions. The 2006 and 2005 employer contribution rate for local government employer units was 13.70 percent of covered payroll. Of this amount, 4.50 percent was the portion that was used to fund health care during both 2006 and 2005. The portion of the employer's contribution used to fund postemployment benefits for 2006 and 2005 was \$436,000 and \$368,000, respectively.

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

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 percent of unrealized market appreciation or depreciation on investment assets annually, not to exceed 12 percent corridor. The investment return assumption rate for 2005 was 6.50 percent. An annual increase of 4.00 percent 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 percent base increase, were assumed to range from 0.50 percent to 6.30 percent. Health care costs were assumed to increase at the projected wage inflation rate plus an additional factor ranging from 0.50 percent to 6.00 percent for the next nine years. In subsequent years (10 and beyond), health care costs were assumed to increase at 4.00 percent (the projected wage inflation rate) annually. These assumptions and calculations are based on the System's latest actuarial review performed as of December 31, 2005.

The number of active contributing participants in the TP and CO plans at December 31, 2005 was 369,214. The number of active contributing participants for both plans used in the December 31, 2005 actuarial valuation was 358,809. As of December 31, 2005, the actuarial value of the retirement system's net assets available for OPEB was \$11.1 billion. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$31.3 billion and \$20.2 billion, respectively.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2006 and 2005

Note 9 - Defined Benefit Pension Plan (Continued)

Health Care Plan - On September 9, 2004, the OPERS retirement board adopted a health care preservation plan (HCPP) with an effective date of January 1, 2007. In addition to the HCPP, OPERS has taken additional action to improve the solvency of the Health Care Fund in 2005 by creating a separate investment pool for health care assets. As an additional component of HCPP, member and employer contribution rates increased as of January 1, 2006 and 2007, which will allow additional funds to be allocated to the health care plan.

Note 10 - Affiliation

The Hospital contracts with OhioHealth for management, information technology, and other support services. OhioHealth employs the Hospital's chief executive and chief financial officers and also appoints one representative to the Hospital's board of directors. Fees for services amounted to approximately \$557,000 and \$480,000 for the years ended December 31, 2006 and 2005, respectively. Amounts due to OhioHealth for services amounted to approximately \$43,000 and \$41,000 at December 31, 2006 and 2005, respectively, and have been included in accounts payable on the combined balance sheet.

Additional Information



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To the Board of Directors
Morrow County Hospital and Affiliate

We have audited the combined financial statements of Morrow County Hospital and Affiliate as of December 31, 2006 and 2005. Our audits were made for the purpose of forming an opinion on the basic combined financial statements taken as a whole. The accompanying combining balance sheet and statement of operations information is presented for the purpose of additional analysis of the basic combined financial statements rather than to present the financial position and results of operations of the individual entities and is not a required part of the basic combined financial statements. The combining information has been subjected to the procedures applied in the audits of the basic combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic combined financial statements taken as a whole.

Plante & Moran, PLLC

March 19, 2007

Morrow County Hospital and Affiliate

Combining Balance Sheet December 31, 2006

	Morrow County Hospital	Morrow County Hospital Foundation	Eliminating Entries	Total
Assets				
Current Assets				
Cash and cash equivalents	\$ 1,323,872	\$ 70,259	\$ -	\$ 1,394,131
Short-term investments	610,376	-	-	610,376
Patient accounts receivable	4,287,816	-	-	4,287,816
Levied taxes receivable	1,250,000	-	-	1,250,000
Prepaid expenses and other	631,220	30,761	-	661,981
Inventory	397,981	-	-	397,981
Other current assets - Physician advances	120,936	-	-	120,936
Total current assets	8,622,201	101,020	-	8,723,221
Assets Limited as to Use	3,502,450	-	-	3,502,450
General Long-term Investments	-	351,843	-	351,843
Capital Assets	10,509,736	-	-	10,509,736
Other Assets - Physician advances	107,080	-	-	107,080
Total assets	\$ 22,741,467	\$ 452,863	\$ -	\$ 23,194,330

Morrow County Hospital and Affiliate

Combining Balance Sheet (Continued) December 31, 2006

	Morrow County Hospital	Morrow County Hospital Foundation	Eliminating Entries	Total
Liabilities and Net Assets				
Current Liabilities				
Current portion of long-term debt	\$ 746,733	\$ -	\$ -	\$ 746,733
Accounts payable	1,741,810	-	-	1,741,810
Cost report settlements payable	344,150	-	-	344,150
Accrued liabilities and other:				
Accrued compensation	1,397,445	-	-	1,397,445
Accrued interest	18,020	-	-	18,020
Deferred revenue for levied taxes	1,250,000	-	-	1,250,000
Other accrued liabilities	505,382	-	-	505,382
	<u>6,003,540</u>	<u>-</u>	<u>-</u>	<u>6,003,540</u>
Total current liabilities				
	6,003,540	-	-	6,003,540
Long-term Debt	3,275,932	-	-	3,275,932
Other Liabilities - Compensated absences	414,148	-	-	414,148
	<u>9,693,620</u>	<u>-</u>	<u>-</u>	<u>9,693,620</u>
Total liabilities				
	9,693,620	-	-	9,693,620
Net Assets				
Invested in capital assets - Net of related debt	6,487,071	-	-	6,487,071
Unrestricted	6,560,776	452,863	-	7,013,639
	<u>6,560,776</u>	<u>452,863</u>	<u>-</u>	<u>7,013,639</u>
Total liabilities and net assets	<u>\$ 22,741,467</u>	<u>\$ 452,863</u>	<u>\$ -</u>	<u>\$ 23,194,330</u>

Morrow County Hospital and Affiliate

Combining Statement of Operations Year Ended December 31, 2006

	Morrow County Hospital	Morrow County Hospital Foundation	Eliminating Entries	Total
Operating Revenues				
Total patient service revenue	\$ 44,657,700	\$ -	\$ -	\$ 44,657,700
Revenue deductions	(18,168,960)	-	-	(18,168,960)
Net patient service revenue	26,488,740	-	-	26,488,740
Other	623,218	90,421	-	713,639
Total operating revenues	27,111,958	90,421	-	27,202,379
Operating Expenses				
Salaries and wages	9,476,745	-	-	9,476,745
Employee benefits and payroll taxes	3,754,891	-	-	3,754,891
Operating supplies and expenses	5,236,499	5,327	-	5,241,826
Purchased services	5,999,809	-	-	5,999,809
Insurance	155,743	-	-	155,743
Utilities	685,203	-	-	685,203
Rental	751,459	-	-	751,459
Depreciation and amortization	1,336,451	-	-	1,336,451
Total operating expenses	27,396,800	5,327	-	27,402,127
Operating (Loss) Income	(284,842)	85,094	-	(199,748)
Nonoperating Income (Expense)				
Investment income	198,094	-	-	198,094
Property taxes	1,240,176	-	-	1,240,176
Interest expense	(284,746)	-	-	(284,746)
Total nonoperating income	1,153,524	-	-	1,153,524
Excess of Revenue Over Expenses	868,682	85,094	-	953,776
Transfer from (to) Affiliate	47,950	(47,950)	-	-
Increase in Net Assets	\$ 916,632	\$ 37,144	\$ -	\$ 953,776

Report on Internal Control Over Financial Reporting and on Compliance

Report on Internal Control Over Financial Reporting and on Compliance

To the Board of Directors
Morrow County Hospital and Affiliate

We have audited the combined financial statements of Morrow County Hospital and Affiliate as of and for the year ended December 31, 2006 and have issued our report thereon dated March 19, 2007. 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 Morrow County Hospital and Affiliate's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Morrow County Hospital and Affiliate's internal control over financial reporting.

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

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, we noted one matter involving the internal control over payroll reporting and its operations that we consider to be a significant deficiency. The significant deficiency is described below.

To the Board of Directors
Morrow County Hospital and Affiliate

Significant Deficiency

During our testing of the payroll system, we noted that the payroll clerk processes payroll and has access to and makes electronic employee master file changes. We recommend that only human resource personnel have access to employee master files and the ability to make changes to employee master file information, including the addition and deletion of employees to the master files.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Morrow County Hospital and Affiliate's combined financial statements are free of material misstatement, we performed tests of their 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 of Morrow County Hospital and Affiliate in a separate letter dated March 19, 2007.

This report is intended solely for the information and use of the auditor of the State of Ohio, the board of directors of Morrow County Hospital and Affiliate, 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

March 19, 2007



Mary Taylor, CPA
Auditor of State

MORROW COUNTY HOSPITAL AND AFFILIATES

MORROW COUNTY

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
MAY 29, 2007**