

**MERCER COUNTY JOINT TOWNSHIP COMMUNITY
HOSPITAL**

March 31, 2004

*CONSOLIDATED FINANCIAL STATEMENTS AND INDEPENDENT
AUDITORS' REPORT*



**Auditor of State
Betty Montgomery**

Board of Trustees
Mercer County Joint Township Community Hospital
800 West Main Street
Coldwater, Ohio 45828-1698

We have reviewed the Independent Auditor's Report of the Mercer County Joint Township Community Hospital, Mercer County, prepared by VonLehman & Company Inc., for the audit period April 1, 2003 to March 31, 2004. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

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

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

BETTY MONTGOMERY
Auditor of State

December 13, 2004

This Page is Intentionally Left Blank.

MERCER COUNTY JOINT TOWNSHIP COMMUNITY HOSPITAL

TABLE OF CONTENTS

March 31, 2004

	<u>PAGE</u>
Independent Auditors' Report	
Management's Discussion and Analysis	1 - 4
Consolidated Financial Statements	
Balance Sheets	5
Statements of Operations	6
Statements of Changes in Fund Balances	7
Statements of Cash Flows	8
Statement of Operations – Budget and Actual – General Fund	9
Notes to the Consolidated Financial Statements	10 - 17
Other Information	
Independent Auditors' Report on Compliance and on Internal Control over Financial Reporting Based on an Audit Performed in Accordance with <u>Government Auditing Standards</u>	18
Noncompliance Citations - Ohio Revised Code	19
Status of Prior Audit Citations and Recommendations	20

This Page is Intentionally Left Blank.



INDEPENDENT AUDITORS' REPORT

Board of Trustees
Mercer County Joint Township Community Hospital

We have audited the accompanying consolidated balance sheets of Mercer County Joint Township Community Hospital as of March 31, 2004 and 2003, and the related statements of operations, fund balances, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with U.S. generally accepted auditing standards 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mercer County Joint Township Community Hospital as of March 31, 2004 and 2003, and the results of its operations, and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the financial statements, for the year ended March 31, 2004, the Hospital implemented Statement of Governmental Accounting Standards Board (Statement) No. 34 as amended by Statements No. 37 and 38 and, as a result, reclassified its general purpose financial statements.

The Management's Discussion and Analysis and Budgetary Comparison information are not a required part of the general purpose financial statements, but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with Government Auditing Standards, we have also issued a report dated July 2, 2004, on our consideration of Mercer County Joint Township Community Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audits.

VonLehman and Company Inc.

Fort Mitchell, Kentucky
July 2, 2004

4695 LAKE FOREST DRIVE √ CINCINNATI, OH √ 45242-3745 √ 513-891-5911 √ 513-891-5969 fax

**MERCER COUNTY JOINT TOWNSHIP COMMUNITY HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED MARCH 31, 2004
(UNAUDITED)**

This section of Mercer County Joint Township Community Hospital's (the Hospital) annual financial statements presents background information and management's discussion and analysis (MD&A) of the Hospital's financial performance during the year ended March 31, 2004. This MD&A includes a discussion and analysis of the activities and results of the Hospital.

This MD&A should be read together with the financial statements included in this report.

FINANCIAL HIGHLIGHTS

- The Hospital's fund balance decreased by \$16,576 and includes non-operating income of \$48,381 and extraordinary loss of \$474,305 in 2004.
- During the year, the Hospital's net operating revenue increased 9.2% to \$31.2 million while expenses increased 10.7% to \$30.8 million. The resulting income from operations of \$409,308 is a 44.7% decrease from 2003 operations.
- During the year, the Hospital made the following significant capital acquisitions and improvements:
 - New and upgraded diagnostic capabilities, including new radiology and mammography equipment
 - Upgrades to the Community Medical Center
 - New and upgraded patient record capabilities

The source of funding for these projects was derived from cash flows from operations and funds reserved for capital acquisitions.

FINANCIAL STATEMENTS

The financial statements of the Hospital present information about the Hospital using financial reporting methods similar to those used by private sector companies. These statements offer short-term and long-term financial information. The balance sheets include all of the Hospital's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to Hospital creditors (liabilities). It also provides the basis for computing rate of return, evaluating the capital structure of the Hospital, and assessing the liquidity and financial flexibility of the Hospital. All of the current year's revenues and expenses are accounted for in the Statements of Operations and the Statements of Changes in Fund Balance. These statements measure the financial results of the Hospital's operations and present revenues earned and expenses incurred. The final financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the Hospital's cash flows from operating activities, capital and related financing activities, and investing activities, and provides information on the sources and uses of cash during the year.

FINANCIAL ANALYSIS

The Balance Sheets and Statements of Operations and Changes in Fund Balance report information about the Hospital's fund balance and its changes. Increases or decreases in the Hospital's fund balance are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors, such as changes in economic conditions, population growth (including uninsured and medically indigent individuals and families), new or changed government legislation and the Hospital's strategic plan should also be considered.

A summary of the Hospital's Balance Sheets as of March 31, 2004 and 2003 is presented below (in thousands):

	<u>2004</u>	<u>2003</u>	<u>\$ Change</u>	<u>% Change</u>
Cash and Cash Equivalents	\$ 855	\$ 1,283	\$ (428)	(33.4) %
Capital Assets	11,745	11,369	376	3.3
Other Assets	<u>10,740</u>	<u>10,349</u>	<u>391</u>	<u>3.8</u>
Total Assets	<u>\$ 23,340</u>	<u>\$ 23,001</u>	<u>\$ 339</u>	<u>1.5 %</u>
Current Liabilities	\$ 3,530	\$ 3,325	\$ 205	6.2 %
Long-Term Debt	<u>151</u>	<u>-</u>	<u>151</u>	<u>-</u>
Total Liabilities	3,681	3,325	356	10.7
Fund Balance	<u>19,659</u>	<u>19,676</u>	<u>(17)</u>	<u>(0.1)</u>
Total Liabilities and Fund Balance	<u>\$ 23,340</u>	<u>\$ 23,001</u>	<u>\$ 339</u>	<u>1.5 %</u>

As can be seen in the above, fund balance decreased to \$19.66 million in 2004, down from \$19.68 million in 2003. The change in fund balance resulted primarily from an extraordinary loss due to a flood and related damages.

MERCER COUNTY JOINT TOWNSHIP COMMUNITY HOSPITAL

FINANCIAL ANALYSIS (Continued)

A summary of the Hospital's Statements of Operations and Changes in Fund Balance for the years ended March 31, 2004 and 2003 is presented below (in thousands):

	<u>2004</u>	<u>2003</u>	<u>\$ Change</u>	<u>% Change</u>
Revenues				
Net Patient Service Revenues	\$ 29,976	\$ 27,331	\$ 2,645	
Other	<u>1,235</u>	<u>1,242</u>	<u>(7)</u>	
Total Revenues	<u>31,211</u>	<u>28,573</u>	<u>2,638</u>	<u>9.2 %</u>
Expenses				
Nursing and Other Services	18,144	16,602	1,542	
Administration	10,336	9,096	1,240	
Provision for Bad Debts	1,033	817	216	
Depreciation	<u>1,289</u>	<u>1,316</u>	<u>(27)</u>	
Total Expenses	<u>30,802</u>	<u>27,831</u>	<u>2,971</u>	<u>10.7 %</u>
Income from Operations	<u>409</u>	<u>742</u>	<u>(333)</u>	<u>(44.7) %</u>
Non-Operating (Expenses) Income	<u>(426)</u>	<u>81</u>	<u>(507)</u>	
(Deficit) Excess of Revenues Over Expenses	(17)	823	(840)	<u>102.1 %</u>
Total Fund Balance Beginning of Year	<u>19,676</u>	<u>18,853</u>	<u>823</u>	
Total Fund Balance End of Year	\$ <u>19,659</u>	\$ <u>19,676</u>	\$ <u>(17)</u>	

Sources of Revenues

During 2004, the Hospital derived substantially all of its revenue from patient services and other related activities. Revenues include, among other items, revenues from the Medicare and Medicaid programs, patients, insurance carriers, preferred provide organizations, and managed care programs.

Payer Mix

The Hospital provides care to patients under payment arrangements with Medicare, Medicaid, and various commercial programs. Services provided under those arrangements are paid at predetermined rates and/or reimbursable costs as defined. Provisions have been made in the financial statements for contractual adjustments, which represent the difference between the standard charges for services and the actual or estimated payment.

OPERATING AND FINANCIAL PERFORMANCE

The Hospital's performance was very comparable from 2004 to 2003. This section will discuss highlights of 2004 operations and changes in activity.

Revenues

Net patient service revenues increased \$2.6 million in 2004 primarily due to a 'charge-per-episode' increase and an increase in outpatient ancillary services.

Expenses

Total operating expenses increased \$3.0 million in 2004 which was attributed to an increase in personnel costs, costs for other services, costs for supplies and drugs, utilities and bad debt expense.

PROPERTY, PLANT AND EQUIPMENT

During 2004, the Hospital invested \$1.5 million in a broad range of property, plant and equipment included in the table below (in thousands):

	<u>2004</u>	<u>2003</u>	<u>\$ Change</u>	<u>% Change</u>
Land and Improvements	\$ 44	\$ 44	\$ -	
Buildings and Improvements	20,666	27,331	340	
Equipment	<u>10,481</u>	<u>10,633</u>	<u>(152)</u>	
Total Property, Plant and Equipment	31,191	31,003	188	<u>0.6 %</u>
Less Accumulated Depreciation	<u>(19,446)</u>	<u>(19,635)</u>	<u>(189)</u>	
Property, Plant and Equipment - Net	<u>\$ 11,745</u>	<u>\$ 11,368</u>	<u>\$ 377</u>	<u>3.3 %</u>

Property, plant and equipment have increased due to the fact that the Hospital has expanded its patient service capacity to meet the needs of the community. Additionally, the Hospital continues to replace equipment as it becomes obsolete as well as upgrade the capabilities of its information systems.

ECONOMIC FACTORS AND 2005 BUDGET

The Hospital's Board and management considered many factors when setting the 2005 budget. Of primary importance in setting the budget was the status of the economy, which takes into account market focus and other environmental factors such as the following:

- Demographics and impact areas of population growth and the expanding need for services
- Continuously increasing expectations for quality improvement
- Advances in medical equipment technology and the need to replace obsolete equipment
- Privacy legislation – Health Insurance Portability and Accountability Act (HIPAA)
- Increasing emphasis on the integrity of financial information
- Increasing number of uninsured
- Increasing cost of medical supplies
- Access to additional capital
- Increasing drug costs

The focus of management is to implement a multi-year plan that will emphasize expanded services to all areas of Mercer County, continuous quality improvement, cost control, capital requirements, and financing in support of balance sheet improvement.

**MERCER COUNTY JOINT TOWNSHIP COMMUNITY HOSPITAL
BALANCE SHEETS**

ASSETS

	March 31,	
	2004	2003
Current Assets		
Cash and Cash Equivalents	\$ 854,681	\$ 1,283,064
Patient Accounts Receivable, Net of Estimated Uncollectibles (2004 - \$704,636; 2003 - \$401,516)	5,552,147	4,858,788
Inventories	743,846	734,415
Prepaid Expenses	257,512	276,477
 Total Current Assets	 7,408,186	 7,152,744
 Cash and Cash Equivalents Whose Use is Limited		
Board Designated for Future Capital Purposes	3,963,348	4,255,843
 Property, Plant and Equipment, Net	 11,745,330	 11,368,823
 Other Assets	 223,366	 223,366
 Total Assets	 \$ 23,340,230	 \$ 23,000,776

See accompanying notes.

LIABILITIES AND FUND BALANCE

	March 31,	
	<u>2004</u>	<u>2003</u>
Current Liabilities		
Accounts Payable	\$ 1,152,034	\$ 1,132,469
Accrued Expenses	2,334,124	2,192,246
Capital Lease Obligation - Current Portion	<u>44,052</u>	<u>-</u>
Total Current Liabilities	3,530,210	3,324,715
Capital Lease Obligation - Long Term Portion	<u>150,535</u>	<u>-</u>
Total Liabilities	<u>3,680,745</u>	<u>3,324,715</u>
Fund Balance		
Unrestricted	<u>19,659,485</u>	<u>19,676,061</u>
Total Liabilities and Fund Balance	<u>\$ 23,340,230</u>	<u>\$ 23,000,776</u>

**MERCER COUNTY JOINT TOWNSHIP COMMUNITY HOSPITAL
STATEMENTS OF OPERATIONS**

	Years Ended March 31,	
	2004	2003
Net Patient Service Revenues	\$ 29,976,513	\$ 27,331,496
Other Operating Revenues	1,234,739	1,241,906
Total Operating Revenues	31,211,252	28,573,402
Operating Expenses		
Nursing Services	7,291,253	6,684,379
Medical Professional Services	7,874,609	7,084,286
General Services	2,978,006	2,832,569
Administrative Services	10,336,416	9,095,944
Depreciation	1,289,023	1,316,343
Provision for Bad Debts	1,032,597	817,076
Total Operating Expenses	30,801,904	27,830,597
Income from Operations	409,348	742,805
Non-Operating Revenues		
Investment Earnings	27,364	52,962
Unrestricted Gifts	21,017	27,640
Total Non-Operating Revenues	48,381	80,602
Income Before Extraordinary Item	457,729	823,407
Extraordinary Item - Losses from Flood and Related Damages, Net of Insurance Proceeds	(474,305)	-
(Deficit) Excess of Revenues Over Expenses	\$ (16,576)	\$ 823,407

See accompanying notes.

**MERCER COUNTY JOINT TOWNSHIP COMMUNITY HOSPITAL
STATEMENTS OF CHANGES IN FUND BALANCE**

	<u>2004</u>	<u>2003</u>
Balance - Beginning of Year	\$ 19,676,061	\$ 18,852,654
(Deficit) Excess of Revenues Over Expenses	<u>(16,576)</u>	<u>823,407</u>
Balance - End of Year	<u><u>\$ 19,659,485</u></u>	<u><u>\$ 19,676,061</u></u>

See accompanying notes.

**MERCER COUNTY JOINT TOWNSHIP COMMUNITY HOSPITAL
STATEMENTS OF CASH FLOWS**

	March 31,	
	2004	2003
Cash Flows from Operating Activities		
Cash Received from Customers	\$ 29,283,154	\$ 27,205,901
Cash Payments to Suppliers for Goods and Services	(17,659,093)	(14,570,258)
Cash Payments to Employees for Services	(11,632,953)	(11,768,340)
Other Operating Revenues	1,234,739	1,241,906
Net Cash Provided by Operating Activities	1,225,847	2,109,209
Cash Flows from Non-Capital Financing Activities		
Non-Operating Revenues	48,381	80,602
Extraordinary Item - Losses from Flood and Related Damages, Net of Insurance Proceeds	(474,305)	-
Net Cash (Used) Provided by Non-Capital Financing Activities	(425,924)	80,602
Cash Flows from Capital and Related Financing Activities		
Proceeds from Sale of Property, Plant and Equipment	4,388	-
Acquisition of Property, Plant and Equipment	(1,525,189)	(868,706)
Change in Cash and Cash Equivalents Whose Use is Limited	292,495	(862,018)
Net Cash Used by Capital and Related Financing Activities	(1,228,306)	(1,730,724)
Net Increase in Cash and Cash Equivalents	(428,383)	459,087
Cash and Cash Equivalents at Beginning of Year	1,283,064	823,977
Cash and Cash Equivalents at End of Year	\$ 854,681	\$ 1,283,064
Reconciliation of Income from Operations to Net Cash Provided by Operating Activities		
Income from Operations	\$ 409,348	\$ 742,805
Adjustments to Reconcile Income from Operations to Net Cash Provided by Operating Activities		
Depreciation	1,289,023	1,316,343
Provision for Bad Debts	1,032,597	817,076
Loss on Disposal of Property, Plant and Equipment	49,858	4,713
Changes in		
Patient Accounts Receivable	(1,725,956)	(942,671)
Inventories	(9,431)	(111,303)
Prepaid Expenses	18,965	(127,543)
Accounts Payable	19,565	284,313
Accrued Expenses	141,878	125,476
Total Adjustments	816,499	1,366,404
Net Cash Provided by Operating Activities	\$ 1,225,847	\$ 2,109,209

See accompanying notes.

**MERCER COUNTY JOINT TOWNSHIP COMMUNITY HOSPITAL
STATEMENT OF OPERATIONS - BUDGET AND ACTUAL
Year Ended March 31, 2004**

	Budgeted Amounts (Unaudited)		Actual
	<u>Original</u>	<u>Final</u>	
Net Patient Service Revenues	\$ 28,731,654	\$ 28,731,654	\$ 29,976,513
Other Operating Revenues	<u>605,620</u>	<u>605,620</u>	<u>1,234,739</u>
Total Operating Revenues	<u>29,337,274</u>	<u>29,337,274</u>	<u>31,211,252</u>
Operating Expenses			
Nursing Services	7,349,823	7,349,823	7,291,253
Medical Professional Services	7,505,948	7,505,948	7,874,609
General Services	4,280,914	4,280,914	2,978,006
Administrative Services	7,392,930	7,392,930	10,336,416
Depreciation	1,337,160	1,337,160	1,289,023
Provision for Bad Debts	<u>960,000</u>	<u>960,000</u>	<u>1,032,597</u>
Total Operating Expenses	<u>28,826,775</u>	<u>28,826,775</u>	<u>30,801,904</u>
Income from Operations	510,499	510,499	409,348
Non-Operating Revenues	<u>52,800</u>	<u>52,800</u>	<u>48,381</u>
Income Before Extraordinary Item	563,299	563,299	457,729
Extraordinary Item - Losses From Flood and Related Damages, Net of Insurance Proceeds	<u>-</u>	<u>-</u>	<u>(474,305)</u>
(Deficit) Excess of Revenues Over Expenses	<u>\$ 563,299</u>	<u>\$ 563,299</u>	<u>\$ (16,576)</u>

See accompanying notes.

**MERCER COUNTY JOINT TOWNSHIP COMMUNITY HOSPITAL
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 1 – ACCOUNTING POLICIES

Mercer County Joint Township Community Hospital (the Hospital) is a 76-bed facility, located in Mercer County, Ohio and operates under the direction of an eleven member board of governors pursuant to the authority of the Joint Township Hospital Board of Trustees with representatives from Butler, Franklin, Gibson, Granville, Marion, Recovery, Washington and Jefferson Townships. The Medical and Educational Development Foundation (MEDF) Physician Corporation is a not for profit, non-governmental entity. MEDF manages physician practices. The Hospital is deemed to have control over MEDF. The financial statements of MEDF have been consolidated with the Hospital's financial statements. All material intercompany balances and transactions have been eliminated in the consolidation.

Nature of Operations

The Hospital's operations consist almost exclusively of providing healthcare services to the residents of Mercer County, Ohio, and the surrounding area.

Basis of Accounting

The Hospital utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that do not conflict with or contradict GASB pronouncements, including those issued after November 30, 1989.

Funds

The Hospital segregates its accounting records into the following funds:

General Fund

This fund is used to account for all the revenues derived and expenses incurred in the day-to-day activities of the Hospital together with all unrestricted donor contributions.

Restricted Funds

These funds are used to account for the receipts and disbursements of donor-restricted contributions.

Estimates

The process of preparing financial statements in conformity with U.S. generally accepted accounting principles requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Certain estimates relate to unsettled transactions and events as of the date of the financial statements. Other estimates relate to assumptions about the ongoing operations and may impact future periods. Accordingly, upon settlement, actual results may differ from estimated amounts.

NOTE 1 – ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

Cash and cash equivalents are deposited in financial institutions as authorized and directed by State statutes. All deposits are collateralized by pledged securities of the financial institutions up to or exceeding the value of the deposits, as specified by State statutes.

For cash flow purposes, cash and cash equivalents are defined as those unrestricted and undesignated funds on deposit which have maturities of three months or less.

Cash and Cash Equivalents Whose Use is Limited

Cash and cash equivalents whose use is limited include assets set aside by the Board of Trustees for future capital improvements, over which the Board of Trustees retains control and may at its discretion subsequently use for other purposes.

Inventories

Inventories consist primarily of supplies and drugs and are valued at the lower of cost under the first-in, first-out (FIFO) method, or market.

Property, Plant and Equipment

Property, plant and equipment is recorded at cost or at fair market value at the date received if acquired by gift. It is the Hospital's policy to capitalize acquired property, plant and equipment with a cost or fair market value of \$500 or greater. Expenditures for maintenance and repairs, which do not extend the life of the applicable assets, are charged to expense as incurred. Depreciation is computed using the straight line method over the estimated useful lives of the depreciable assets as follows:

Land Improvements	5 - 20 Years
Buildings and Fixed Equipment	5 - 40 Years
Major Movable Equipment	2 - 20 Years

Compensated Absences

Vacation and sick pay is expensed to operations when earned. Unused and earned benefits are recorded as a current liability in the financial statements.

Net Patient Service Revenues

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare. Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient non-acute services are paid at a prospectively determined rate per day based on clinical, diagnostic and other factors. Outpatient services are reimbursed on a prospective rate scale based on Ambulatory Patient Classifications (APC's). Home Health Services are reimbursed on a prospective basis for episodes of care spanning 60 days. There are exceptions which could adjust the 60-day payment period. The payment rates are based on a clinical assessment system called OASIS (the Outcome and Assessment Information Set). Final settlements are determined upon submission of the annual cost report by the Hospital and audits thereof by the Medicare Fiscal Intermediary.

NOTE 1 – ACCOUNTING POLICIES (Continued)

Medicaid. Inpatient services rendered to Medicaid program beneficiaries are reimbursed on a rate per discharge basis. Outpatient services rendered to Medicaid program beneficiaries are reimbursed on a fee schedule basis. Inpatient capital costs are reimbursed at a tentative rate with a final settlement to be determined after submission of the annual cost report by the Hospital and audits thereof by the Medicaid Fiscal Intermediary.

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.

New Pronouncement

In the fiscal year ended March 31, 2004, the Hospital implemented Statement of Governmental Accounting Standards Board (Statement) No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments", as amended by Statement No.'s 37 and 38. These statements established new financial reporting requirements for state and local governments. As a result, certain prior year amounts have been reclassified to conform to the current year's presentation.

Charity Care

The Hospital provides care to patients who meet 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 revenues.

NOTE 2 – CASH AND CASH EQUIVALENTS

Legal Requirements

State statutes require the classification of monies held by the Hospital into three categories:

Category 1 consists of "active" monies, those monies required to be kept in a "cash" or "near-cash" status for current demands. Such monies must be maintained either as cash or in depository accounts payable or withdrawable on demand, including negotiable order of withdrawal (NOW) accounts.

Category 2 consists of "inactive" monies, those monies not required for use within the current two year period of designation of depositories. Inactive monies may be deposited or invested only as certificates of deposit maturing no later than the end of the current period of designation of depositories.

Category 3 consists of "interim" monies; those monies which are not needed for immediate use, but will be needed before the end of the current period. Interim monies may be invested or deposited in the following securities:

Bonds, notes, or other obligations of or guaranteed by the United States, or those for which the full faith and credit of the United States is pledged for the payment of principal and interest;

Bonds, notes, debentures, or other obligations or securities issued by a federal government agency or instrumentality. The securities fall into three categories: obligations of the federal government, federal agencies, and federal instruments;

NOTE 2 – CASH AND CASH EQUIVALENTS (Continued)

Time certificates of deposit or savings or deposit accounts, including, but not limited to passbook accounts in any eligible institution mentioned in Section 135.32 of the Ohio Revised Code having an office located within the territorial limits of the county;

Bonds or other obligations of the State of Ohio, its political subdivisions, or other units or agencies of this state or its political subdivisions;

Effective October 7, 1993, no load money market funds consisting exclusively of obligations described as "active" and "inactive" monies above, and repurchase agreements secured by such obligations so long as they are made through eligible institutions mentioned in Section 135.32 of the Ohio Revised Code;

The State Treasurer's investment pool.

The investing authority may also enter into a written repurchase agreement under the terms of which agreement the investing authority purchases and the seller agrees unconditionally to repurchase any of the securities listed in categories 1 and 2 above. He also may sell any of such securities owned by the county under the same terms and conditions for repurchase.

The Governmental Accounting Standards Board has established risk categories for deposits as follows:

Insured or collateralized with securities held by the entity or by its agent in the entity's name;

Collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name;

Uncollateralized. (This includes any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the entity's name).

As of March 31, 2004 and 2003, the carrying amount of the Hospital's deposits was \$4,818,029 and \$5,538,907, respectively, and the bank balance was \$5,121,802 and \$5,649,394, respectively. Of the bank balance:

At March 31, 2004 and 2003, \$200,000 was covered by federal depository insurance and would belong in the risk category "insured or collateralized"; and

At March 31, 2004 and 2003, \$4,921,802 and \$5,449,394, respectively, was covered by collateral held by third-party trustees pursuant to Section 135.181 of the Ohio Revised Code, in collateral pools securing all public funds on deposit with specific depository institutions, and belongs in the risk category "uncollateralized".

The Hospital had the following non-cash Capital and Related Financing Activities:

	2004	2003
Capital Lease Obligation Incurred for the Purchase of Property, Plant and Equipment	\$ <u>220,284</u>	\$ <u>-</u>

NOTE 3 – 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 illness; natural disasters; 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.

NOTE 4 – COMPONENTS OF PATIENT ACCOUNTS RECEIVABLE

In addition to those patients unable to pay, there are patients receiving services who will not pay. The Hospital has established credit and collection policies to hold this cost to a minimum. Provisions for bad debts are recorded as operating expenses on the financial statements.

The Hospital's net patient accounts receivable (unsecured) were concentrated in the following major payor classes:

	<u>2004</u>	<u>2003</u>
Federal Government: Medicare	\$ 1,584,494	\$ 1,120,280
State of Ohio:		
Medicaid, Workers Compensation	313,283	429,849
Commercial Insurance, Self-Pay and Other	<u>3,654,370</u>	<u>3,308,659</u>
Total	<u>\$ 5,552,147</u>	<u>\$ 4,858,788</u>

NOTE 5 – PROPERTY, PLANT AND EQUIPMENT

Major categories of property, plant and equipment are as follows:

	<u>March 31,</u>	
	<u>2004</u>	<u>2003</u>
Land	\$ 44,300	\$ 44,300
Building and Improvements	15,991,556	15,997,002
Community Medical Center	3,624,566	4,005,264
Equipment	10,481,473	10,633,364
Parking Lot	213,124	213,345
Construction in Progress	<u>836,400</u>	<u>110,701</u>
Total	31,191,419	31,003,976
Less Accumulated Depreciation	<u>(19,446,089)</u>	<u>(19,635,153)</u>
Property, Plant and Equipment, Net	<u>\$ 11,745,330</u>	<u>\$ 11,368,823</u>

NOTE 6 – OTHER ASSETS

The Hospital is a member of the West Central Ohio Regional Healthcare Alliance, Ltd. (WCORHA) along with four other area hospitals. Each hospital loaned \$200,000 to WCORHA. The current project of the WCORHA is the operation of a cancer center. The investment in WCORHA is accounted as a note receivable.

NOTE 7 – OPERATING LEASES

The Hospital has entered into lease agreements for certain buildings under operating lease terms. The following are the net minimum lease payments for these leases:

2005		\$ 64,178
2006		61,670
2007		53,860
2008		53,680
2009		<u>1,395</u>
 Total		 \$ <u>234,783</u>

Total rental expense for operating leases for the years ended March 31, 2004 and 2003 was approximately \$144,000 and \$137,000, respectively.

NOTE 8 – CAPITAL LEASE OBLIGATION

The Hospital has a capital lease obligation for a piece of medical equipment. Minimum payments under this lease are as follows:

2005		\$ 44,052
2006		44,052
2007		44,052
2008		44,052
2009		<u>18,379</u>
 Total Payments		 \$ 194,587
Less Current Portion		<u>44,052</u>
 Long Term Liability		 \$ <u>150,535</u>

Depreciation expense for equipment held under the capital lease obligation is included with other depreciation under operating expenses on the Consolidated Statements of Operations. The asset and related accumulated depreciation under the capital lease obligation at March 31, 2004 is as follows:

Equipment		\$ 220,284
Accumulated Depreciation		<u>(44,057)</u>
 Net Book Value		 \$ <u>176,227</u>

NOTE 9 – PENSION PLAN

The Hospital participates in a state pension plan, the Ohio Public Employees Retirement System (OPERS), which covers substantially all employees.

The OPERS plan is a cost sharing, multiple employer, defined benefit, public employee retirement plan. It provides retirement, disability and death benefits to plan members and beneficiaries. The OPERS plan also provides health care benefits to vested retirees. Benefits provided under the plan are established by State Statute.

NOTE 9 – PENSION PLAN (Continued)

The plan issues a separate, publicly available financial report that includes a balance sheet and required supplementary information. This report may be obtained by contacting: Ohio Public Employees Retirement System, 277 East Town Street, Columbus, Ohio 42315, Telephone 1-800-222-7377.

The Ohio Revised Code provides OPERS statutory authority for employer and employee contributions. The required, actuarially-determined contribution rates for the Hospital and for the employee are 13.55% and 8.5%, respectively. The Hospital's contributions, representing 100% of employer contributions, for the last three years were as follows:

<u>Year</u>	<u>Contribution</u>
2004	\$1,519,960
2002	1,567,940
2003	1,457,194

NOTE 10– POSTEMPLOYMENT HEALTHCARE BENEFITS

In addition to the pension benefits described above, OPERS also provides post-retirement health care coverage, commonly referred to as OPEB (Other Post-Employment Benefits). The Ohio Revised Code provides the authority for public employers to fund post-retirement health care through their contributions.

OPERS provides post-retirement health care coverage to age and service retirants and dependents with 10 or more years of qualifying Ohio service credit. Health care coverage for disability recipients and primary survivor recipients is available. The 2003 employer rate for employees' coverage by OPERS was 13.55%, of which 5.0% was used to fund health care.

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

OPEB are advanced-funded on an actuarially-determined basis. The number of active contributing participants at December 31, 2002 was 364,881. The actuarial value of the net assets available for OPEB at the most recent actuarial review performed December 31, 2002 was \$10,000,000,000. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$18,700,000,000 and \$87,000,000, respectively, as of December 31, 2002. The actuarial assumptions used to calculate these amounts are as follows:

- Funding Method – 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 unfunded actuarial accrued liability.
- Assets Valuation Method – All investments are carried at market value. For actuarial valuation purposes, a smoothed market approach is used. Under this approach assets are adjusted annually to reflect 25% of unrealized market appreciation or depreciation on investment assets.
- Investment Return – The investment assumption rate for 2002 was 8.00%.
- Active Employee Total Payroll – An annual increase of 4.00% compounded annually is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally, annual pay increases, over and above the 4.75% base increase, were assumed to range from 0.50% to 6.30%.
- Health Care – Health care costs were assumed to increase 4.00% annually.

NOTE 11 – MALPRACTICE INSURANCE

As of March 31, 2004, the Hospital carried occurrence basis malpractice insurance coverage of \$1,000,000 per claim and \$3,000,000 aggregate, plus excess liability coverage of \$3,000,000.

NOTE 12 – CONCENTRATIONS

Medicare and Medicaid accounted for approximately 34% and 35% of the Hospital's net patient service revenue during the years ended March 31, 2004 and 2003, respectively.

OTHER INFORMATION



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND
ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED
ON AN AUDIT PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Board of Trustees
Mercer County Joint Township Community Hospital

We have audited the financial statements of Mercer County Joint Township Community Hospital as of and for the year ended March 31, 2004, and have issued our report thereon dated July 2, 2004. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Compliance

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

Internal Control over Financial Reporting

In planning and performing our audit, we considered Mercer County Joint Township Community Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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 these specified parties.

VonLehman and Company Inc.

Fort Mitchell, Kentucky
July 2, 2004

**MERCER COUNTY JOINT TOWNSHIP COMMUNITY HOSPITAL
NONCOMPLIANCE CITATIONS - OHIO REVISED CODE
YEAR ENDED MARCH 31, 2004**

NONE

**MERCER COUNTY JOINT TOWNSHIP COMMUNITY HOSPITAL
STATUS OF PRIOR AUDIT CITATIONS AND RECOMMENDATIONS**

NONE



**Auditor of State
Betty Montgomery**

88 East Broad Street
P.O. Box 1140
Columbus, Ohio 43216-1140

Telephone 614-466-4514
800-282-0370

Facsimile 614-466-4490

MERCER COUNTY JOINT TOWNSHIP COMMUNITY HOSPITAL

MERCER 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
DECEMBER 23, 2004**