SINGLE AUDIT REPORT

The MetroHealth System

December 31, 2003

Auditor of State
Betty Montgomery

Board of Trustees
MetroHealth System
2500 MetroHealth Drive
Cleveland, Ohio 44109

We have reviewed the Independent Auditor's Report of the MetroHealth System, Cuyahoga County, prepared by Ernst & Young LLP, for the audit period January 1, 2003 through December 31, 2003. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

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

Betty Montgomery

BETTY MONTGOMERY
Auditor of State

June 8, 2004

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The MetroHealth System

Single Audit Report

December 31, 2003

Contents

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Report of Independent Auditors

Board of Trustees
The MetroHealth System

We have audited the accompanying balance sheets of The MetroHealth System, a component unit of Cuyahoga County, Ohio, as of December 31, 2003 and 2002, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of The MetroHealth System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The MetroHealth System as of December 31, 2003 and 2002, and the changes in its net and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

The Management's Discussion and Analysis on pages 2 through 10 are not a required part of the basic financial statements but is supplementary 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 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 our report dated February 27, 2004, on our consideration of The MetroHealth System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on the financial statements of The MetroHealth System taken as a whole. The accompanying schedule of expenditures of federal awards for the year ended December 31, 2003 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and is not a required part of the 2003 financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 2003 financial statements and, in our opinion, is fairly presented in all material respects in relation to the 2003 financial statements taken as a whole.

Ernst & Young LLP

February 27, 2004

This section of The MetroHealth System's (the System) annual financial report presents management's discussion and analysis of the System's financial performance and provides an overall review of the System's financial position and activities as of and for the years ended December 31, 2003 and 2002. This discussion should be read in conjunction with the accompanying financial statements and footnotes. The discussion and analysis is designed to focus on current activities, resulting change and currently known facts. The financial statements, footnotes, and this discussion and analysis are the responsibility of the System's management.

Overview of the Financial Statements

This annual report consists of 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. The 2002 implementation of GASB Statement No. 34 effected the presentation of net assets, the inclusion of management's discussion and analysis, the direct method presentation of the statements of cash flows and expanded footnote disclosures.

The accompanying financial statements of the System include the MetroHealth Medical Center, a short-term acute care and long-term rehabilitation facility; MetroHealth Clement Center for Family Care, an outpatient community health facility; MetroHealth Centers for Skilled Nursing Care, consisting of the Skilled Nursing Facility East and The Elisabeth Severance Prentiss Center for Skilled Nursing Care; Faculty Business Office, a medical specialty group practice; and several urban and suburban primary care health sites. All significant inter-entity transactions have been eliminated in the financial statements.

The System is the public health care system for Cuyahoga County, Ohio (County), and was created pursuant to Ohio Revised Code Chapter 339. The System is governed by a Board of Trustees appointed jointly by the Board of County Commissioners of the Board of County of Cuyahoga, and the senior judges of the Probate Court and Common Pleas Court.

The balance sheets and the statements of revenues, expenses and changes in net assets, and of cash flows, provide an indication of the System's financial performance and position. The balance sheets include all of the System's assets and liabilities, prepared using the accrual method of accounting, and provides an indication about which assets can be utilized for general purposes and which are restricted as a result of bond agreements or other use restrictions. Net assets are categorized as invested in capital assets, net of related debt; restricted for debt service and projects; restricted for special purpose funds; and unrestricted.

Net assets restricted for special purpose funds include amounts received from grants from third parties or donors with expenditure restrictions. Unrestricted net assets represent those balances from operational activities that have not been restricted by external parties and includes funds that have internal restrictions (e.g. Board of Trustees' designated funds).

The statements of revenue, expenses and changes in net assets represent the revenue and expenses incurred during each year. The statements of cash flows presents information related to cash provided and used by operating, noncapital financing, capital related financing, and investing activities.

Financial and Operating Highlights for 2003

- Inpatient levels of activity decreased from the prior year.
- Outpatient levels of activity increased 4% over last year.
- Emergency room levels of activity decreased 1% over last year.
- Surgery cases decreased 1% over last year.
- Total net assets decreased by $8.7 million over last year.
- Construction in progress increased $43.4 million, which is largely attributed to the construction of the new Critical Care Pavilion.
- Long-term debt increased due to the issuance of $30.5 million Series 2003 Bonds in March. The proceeds are earmarked for the completion of the Critical Care Pavilion and a new administration building.

Financial Analysis of the System at December 31, 2003

Total assets increased by 5.9% to $616.4 million, and total liabilities increased 12.4% to $393.4 million. The System's total net assets declined from $231.7 million to $222.9 million, a 3.8% decrease from a year ago as shown in Table 1.

Table 1
The MetroHealth System
Balance Sheets (000's)

	2003	**2002**
Assets:		
Current assets	**$ 82,317**	$ 75,022
Investments	**233,927**	230,661
Restricted assets	**60,309**	57,928
Capital assets	**233,652**	211,487
Other assets	**6,154**	6,663
Total assets	**$ 616,359**	$ 581,761
Liabilities and net assets:		
Liabilities:		
Current liabilities	**$ 114,084**	$ 93,531
Long-term liabilities	**279,334**	256,550
Total liabilities	**393,418**	350,081
Net assets:		
Invested in capital assets, net of related debt	**43,422**	42,977
Restricted	**57,230**	54,456
Unrestricted	**122,289**	134,247
Total net assets	**222,941**	231,680
Total liabilities and net assets	**$ 616,359**	$ 581,761

Current Assets

Total current assets increased $7.3 million from the previous year. Patient receivables decreased $.3 million from the prior year due to improved patient receivable cash collections; as a result, the allowance for uncollectible accounts decreased $1.8 million. The System participates in a State of Ohio supplemental Medicaid program that provides access to available funding up to 100% of the Medicare Upper Payment Limit for inpatient hospital services. The receivable associated with this program is recorded in other receivables and increased from the previous year by $9.3 million. The insurance premium associated with prepaid insurance for 2003-2004 was paid in December 2003 while the major portion of the 2002-2003 premium was paid January 2003. This resulted in a $3.8 million increase in prepaid expense for 2003. Miscellaneous and interest receivables combined for a decrease from the prior year of $1.0 million.

Investments

Investments increased over the prior year level by $3.3 million. Increased revenue, improved collections of patient accounts receivable and Depreciation Reserve funding requirements account for the increase in unrestricted investments. Restricted assets increased by $2.4 million. Investments increased by $2.2 million as a result of the $30.5 million in proceeds from the Series 2003 Bonds which was decreased by total bond draws of $28.3 million from the Series 1999 and 2003 project funds. The remainder of the increase is due to monies required to fund repayment of the Series 2003 Bonds.

Capital Assets

Capital additions for the year were approximately $50.5 million. Of that amount, $43.4 million pertains to the construction of the new Critical Care Pavilion. This new building will replace current emergency room and perioperative facilities and is scheduled to open in the spring of 2004. In March 2003, the Board of Trustees authorized the issuance and sale of approximately $30.5 million of bonds to finance the new Critical Care Pavilion and administration buildings.

Other major capital outlays for the year included CICU expansion, outpatient pharmacy automation, mammography systems, CT scanner replacement, medical office renovations and helicopter refurbishment. These capital purchases were funded through operations. The System has outstanding commitments on the new Critical Care Pavilion and administration building of approximately $21.8 million and $1.0 million, respectively, at December 31, 2003. Detail information regarding the System's capital assets can be found in Note 4 of the financial statements.

Current Liabilities

Current liabilities increased $20.6 million over the prior year. This increase is due primarily to a $6.7 million increase in accounts payable. The increase reflects $6.1 million in retainage payable for construction invoices primarily related to the Critical Care Pavilion. In 2003, the System chose to finance its excess malpractice insurance premium, which increased current liabilities by $3.4 million. The current portion of self-insurance liabilities increased $4.9 million and the amount payable under the Upper Payment Limit program increased other current liabilities by $5.6 million.

Long-Term Liabilities

The System is self-insured for both workers compensation and medical malpractice insurance. The System utilizes actuarial studies to determine its year-end liabilities. The total long-term self-insurance liability remained about the same as the prior year. Long-term balances due third-party payors decreased approximately $3.0 million related to settlement transactions.

All of the System's long-term debt relates to acquisition of capital assets. The System issued $30.5 million in variable rate interest bonds in March. The System's bond indenture and capital lease agreements contain various covenants that the System must maintain. The financial covenants include Days Cash on Hand, Debt Service Coverage and Debt to Capitalization Ratios. Additional detail regarding the System's long-term debt can be found in Note 5 of the financial statements.

Table 2
The MetroHealth System
Statements of Revenues, Expenses and Changes in Net Assets (000's)

	Years ended December 31 2003	2002
Operating revenue:		
Net patient service revenue	**$ 468,598**	$ 456,693
Other revenue	**21,693**	17,830
Total operating revenue	**490,291**	474,523
Operating expenses:		
Professional care of patients	**318,359**	300,794
Dietary	**6,879**	6,308
Household and property	**22,720**	22,278
Administrative and general	**69,308**	69,407
Employee benefits	**66,373**	63,898
Provision for bad debts	**7,528**	13,636
Depreciation and amortization	**28,285**	30,700
Total operating expenses	**519,452**	507,021
Operating loss	**(29,161)**	(32,498)
Non-operating revenues—net	**20,605**	29,829
Grants for capital acquisitions	**104**	44
Decrease in net assets	**(8,452)**	(2,625)
Total net assets—beginning of the year	**231,680**	236,534
Transfer of net assets	**(287)**	(2,229)
Total net assets—end of the year	**$ 222,941**	$ 231,680

The System's total operating and nonoperating revenue for the year was $526.2 million while expenses were $534.6 million. This resulted in net assets decreasing by $8.4 million for the year reflecting a loss on operations.

Net Patient Service Revenue

Net patient service revenue increased from the prior year by $11.9 million, or 2.6%. Although gross revenue includes a 3.0% price increase effective January 1, 2003, there was a corresponding increase in contractual allowances. Net patient revenue also includes revenue the System received as a participant in the State of Ohio Care Assurance (HCAP) ($28 million in 2003 and $34 million in 2002) and Upper Payment Limit (UPL) ($16 million in 2003 and $12 million in 2002) programs. The level of revenue from HCAP and UPL in future years is uncertain.

Charity care of $108 million increased from the prior year by $9.4 million or 9.6%. The System's level of charity care continues to reflect the System's status as a safety net facility.

The System's total expenses increased $12.4 million or 2.5% for the prior year. A summary of the expenses is shown below in Table 3.

Table 3
The MetroHealth System
Expense Detail (000's)

			Change	
	2003	**2002**	**Amount**	**Percent**
Operating expenses:				
Salaries and wages	**$ 289,361**	$ 274,366	**$ 14,995**	**5.5%**
Employee benefits	**66,373**	63,898	**2,475**	**3.8**
Medical supplies	**28,137**	26,005	**2,132**	**8.1**
Pharmaceuticals	**21,765**	20,198	**1,567**	**7.8**
Plant operations	**28,796**	27,325	**1,471**	**5.3**
Supplies and other	**35,472**	34,427	**1,045**	**3.0**
Liability insurance	**13,735**	16,466	**(2,731)**	**(16.6)**
Provision for bad debts	**7,528**	13,636	**(6,108)**	**(44.8)**
Depreciation and amortization	**28,285**	30,700	**(2,415)**	**(7.9)**
Total operating expenses	**$ 519,452**	$ 507,021	**$ 12,431**	**2.5%**

Operating Expenses

Salaries and wages, which represent approximately 56% of total operating expenses, account for a $15 million increase over 2002. During 2003, the System increased its salary and wage rates 4% representing an increase of $11 million in salaries and wages expense. Additionally, FTE's for the year increased by 52 related to the expansion of the System's ambulatory surgical center and specific satellite medical offices, along with other new patient programs.

Benefits rose by $2.5 million. Higher FTEs, increased healthcare costs per employee and higher employee utilization in medical and prescription services accounted for the increase in benefits.

Medical supplies and pharmaceuticals increased by $3.7 million or 8% and are related to increased prices for supplies and drugs.

Bad debt expenses decreased $6.1 million from the previous year. The bad debt expense for 2002 included additional provision of $4.8 million related to providing for certain managed care organizations. No such provisions were required in 2003.

The actuarial study analyzing the System's medical malpractice reserves resulted in a lower than expected provision for malpractice claims. This resulted in $2.7 million less in liability insurance expense for the year.

Non-Operating Income/Revenue

The biggest component of non-operating revenue is the County appropriation. The Cuyahoga County Commissioners approved an appropriation to the System for $20.8 million in 2003, a decrease of $1 million over the previous year. The System expects 2004 funding to increase due to the passing of a countywide health and human services levy.

In addition, unrealized gains (losses) decreased $7,461 due to declining interest rates which caused the fair value of the System interest rate swaps to decline by $763 and unrealized losses related to the System's investment portfolio. As many of the long-term investments matured during the year, a reversal of prior unrealized gains occurred. These investments were earning interest at rates much higher rates than the current market rates, which drove their market values higher. However, as the investments approached their maturity dates, the investments lost their previous gains in market value.

Net Asset Transfer

The System transferred $287 thousand and $2.2 million to The MetroHealth Foundation, Inc. in 2003 and 2002, respectively. The funds represent residual monies from completed clinical trials and donations. See Note 10 in the financial statements for more information.

Economic Factors and Next Year's Budget

Several factors and uncertainties that are contained in the budget are:

- The System budgeted to receive a $36 million appropriation from the County in 2004, which is an increase of nearly $15 million. The budget approved by the Cuyahoga County Commissioners for 2004 reflects an increase of $6 million over last year's appropriated amount of $20.8 million. The System will continue to explore all revenue and cost improvement measures.

- Restoration of the 1997 Balanced Budget Medicare cuts has not occurred. This will have and estimated $2.6 million negative annual impact on earnings.

- The State of Ohio is facing considerable budget shortfall. Medicaid funding on both acute and long-term care providers may be affected in the process to balance the budget. Medicaid currently accounts for 32% of the System's net patient service revenue. Ohio's Medicaid Upper Payment Limit program is receiving increased scrutiny from the Center for Medicare and Medicaid Services. This may reduce amounts available in subsequent years.

- The ability to accommodate increasing demands by the community when the current facility is at capacity will require use of the System's investments or additional debt to acquire more capacity. It is estimated that the System will use close to $20 million out of the Depreciation Reserve Fund to fund approved capital projects in 2004.

- The costs associated with medical malpractice insurance premiums and claims are expected to increase in the next year and require more funding.

The MetroHealth System

Balance Sheets

(Dollars in Thousands)

	December 31	
	2003	**2002**
Assets		
Current assets:		
Cash and cash equivalents	**$ 255**	$ 6,534
Patient accounts receivable	**53,395**	53,688
Allowance for uncollectible accounts	**(6,632)**	(8,444)
	46,763	45,244
Other receivables	**23,820**	15,727
Supplies	**4,942**	4,796
Prepaid expenses	**6,537**	2,721
Total current assets	**82,317**	75,022
Investments:		
Board designated	**119,013**	117,349
Self-insurance funds	**2,417**	9,834
Academic funds	**39,691**	33,346
Depreciation reserve fund	**72,806**	70,132
	233,927	230,661
Restricted assets:		
Cash and cash equivalents	**121**	254
Special purpose investments	**5,539**	5,565
Under bond indenture agreement	**54,649**	52,109
	60,309	57,928
Capital assets:		
Land and land improvements	**16,653**	16,653
Buildings and fixed equipment	**374,189**	372,032
Equipment	**199,198**	194,739
	590,040	583,424
Accumulated depreciation	**(418,431)**	(390,604)
	171,609	192,820
Construction in progress	**62,043**	18,667
	233,652	211,487
Other assets	**6,154**	6,663
	$ 616,359	$ 581,761

	December 31 2003	2002
Liabilities		
Current liabilities:		
Accounts payable	**$ 26,769**	$ 20,084
Accrued payroll and related liabilities	**14,730**	15,068
Ohio Public Employees Retirement System liability	**9,085**	8,641
Accrued interest payable	**4,078**	3,959
Self-insurance liabilities	**19,954**	15,089
Estimated amounts due to third-party payors	**9,455**	9,441
Accrued vacation and sick leave	**1,862**	1,895
Note payable	**3,400**	-
Current installments of long-term liabilities	**7,558**	7,516
Other current liabilities	**17,193**	11,838
Total current liabilities	**114,084**	93,531
Long-term liabilities, less current installments:		
Self-insurance liabilities	**21,781**	21,578
Estimated amounts due to third-party payors	**33,089**	36,147
Accrued vacation and sick leave	**20,771**	18,621
Long-term debt	**203,693**	180,204
Total long-term liabilities	**279,334**	256,550
Total liabilities	**393,418**	350,081
Net assets		
Invested in capital assets, net of related debt	**43,422**	42,977
Restricted for debt service and projects	**54,649**	52,109
Restricted for special purpose funds	**2,581**	2,347
Unrestricted	**122,289**	134,247
Total net assets	**222,941**	231,680
	$ 616,359	$ 581,761

See accompanying notes to financial statements.

The MetroHealth System

Statements of Revenues, Expenses, and Changes in Net Assets

(Dollars in Thousands)

	Years ended December 31	
	2003	**2002**
Operating revenues		
Net patient service revenue	**$ 468,598**	$ 456,693
Other revenue	**21,693**	17,830
Total operating revenues	**490,291**	474,523
Operating expenses		
Professional care of patients	**318,359**	300,794
Dietary	**6,879**	6,308
Household and property	**22,720**	22,278
Administrative and general	**69,308**	69,407
Employee benefits	**66,373**	63,898
Provision for bad debts	**7,528**	13,636
Total operating expenses before depreciation and amortization	**491,167**	476,321
Operating loss before depreciation and amortization	**(876)**	(1,798)
Depreciation and amortization	**28,285**	30,700
Operating loss	**(29,161)**	(32,498)
Non-operating revenues (expenses)		
County appropriation	**20,850**	21,850
Investment income	**7,115**	9,269
Unrealized (losses) gains on investments	**(4,149)**	3,312
Other non-operating revenue	**3,595**	3,054
Specific purpose grants and donations	**4,211**	4,692
Specific purpose funds expenditures	**(3,690)**	(5,274)
Interest expense	**(7,327)**	(7,074)
Total non-operating revenues (expenses)	**20,605**	29,829
Loss before other changes	**(8,556)**	(2,669)
Other changes		
Grants for capital acquisitions	**104**	44
Decrease in net assets	**(8,452)**	(2,625)
Total net assets—beginning of the year	**231,680**	236,534
Transfer of net assets *(Note 10)*	**(287)**	(2,229)
Total net assets—end of the year	**$ 222,941**	$ 231,680

See accompanying notes to financial statements.

The MetroHealth System

Statements of Cash Flows

(Dollars in Thousands)

	Years ended December 31	
	2003	**2002**
Cash flows from operating activities		
Patient service revenue	**$ 452,724**	$ 452,016
Other operating cash receipts	**21,693**	18,580
Payments to suppliers	**(123,542)**	(114,476)
Payments for compensation and benefits	**(355,392)**	(338,491)
Net cash flows (used in) provided by operating activities	**(4,517)**	17,629
Cash flows from noncapital financing activities		
County appropriation	**20,850**	21,850
Proceeds from note payable	**3,400**	-
Restricted grants and donations	**7,910**	7,790
Specific purpose funds expenditures	**(3,690)**	(5,274)
Transfer of net assets	**(221)**	(603)
Restricted receivables/liabilities	**(1,533)**	1,757
Net cash flows provided by noncapital financing activities	**26,716**	25,520
Cash flows from capital and related financing activities		
Deposits in project funds	**(30,143)**	-
Withdrawals in project funds	**28,058**	10,776
Purchase of capital assets	**(40,043)**	(22,913)
Proceeds from issuance of long-term debt	**30,165**	-
Principal payments on long-term debt	**(7,516)**	(7,175)
Interest payments on long-term debt	**(9,166)**	(8,835)
Net cash flows used in capital and related financing activites	**(28,645)**	(28,147)
Cash flows from investing activities		
Payments for investments, net	**(7,081)**	(17,827)
Interest received and realized gains and losses	**7,115**	9,269
Net cash flows provided by (used in) investing activities	**34**	(8,558)
Net (decrease) increase in cash and cash equivalents	**(6,412)**	6,444
Cash and cash equivalents at beginning of year	**6,788**	344
Cash and cash equivalents at end of year	**$ 376**	$ 6,788

See accompanying notes to financial statements.

The MetroHealth System

Statements of Cash Flows (continued)

(Dollars in Thousands)

	Years ended December 31	
	2003	**2002**
Reconciliation of operating loss to net cash (used in) provided by operating activities		
Operating loss	**$ (29,161)**	$ (32,498)
Adjustments to reconcile operating loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	**28,285**	30,700
Provision for bad debts	**7,528**	13,636
Changes in assets and liabilities:		
Increase in patient accounts receivable	**(9,047)**	(13,711)
(Increase) decrease in other assets	**(11,954)**	13,466
Increase (decrease) in self-insurance liabilities	**5,068**	(610)
Increase (decrease) in accounts payable and other liabilities	**5,672**	(1,538)
(Decrease) increase in long-term liabilities	**(908)**	8,184
Net cash flows (used in) provided by operating activities	**$ (4,517)**	$ 17,629

See accompanying notes to financial statements.

1. Summary of Significant Accounting Policies

Reporting Entity

The accompanying financial statements of The MetroHealth System (the System) include MetroHealth Medical Center, a short-term acute care and long-term rehabilitation facility; MetroHealth Clement Center for Family Care, an outpatient community health facility; MetroHealth Centers for Skilled Nursing Care, Skilled East and The Elisabeth Severance Prentiss Center for Skilled Nursing Care; Faculty Business Office, a medical specialty group practice; and several primary care health sites. All significant inter-entity transactions have been eliminated in the financial statements.

The System is the public health care system for Cuyahoga County, Ohio, (County) and was created pursuant to Ohio Revised Code Chapter 339. The System is governed by a board of trustees appointed jointly by the Board of County Commissioners of the Board of the County of Cuyahoga, and the senior judges of the Probate Court and Common Pleas Court. In order to support the general operations of the System, the County Commissioners approved an appropriation of $20,850 and $21,850 for 2003 and 2002, respectively. The County has approved an appropriation for 2004 that reflects an increase of $5,912 from the 2003 appropriation amount. The System is exempt from federal income taxes as a governmental entity.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 14, *The Reporting Entity*, the System's financial statements are included, as a discrete entity, in the County's Consolidated Annual Financial Report (CAFR). A copy of the CAFR can be obtained from Frank Russo, Cuyahoga County Auditor, County Administration Building, 1219 Ontario Street, Cleveland, Ohio 44113.

1. Summary of Significant Accounting Policies (continued)

Basis of Accounting

The System's financial statements are prepared in accordance with 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*. The System follows the "business-type" activities, which provides for the following components of the System's financial statements:

- Management's Discussion and Analysis
- Basic Financial Statements including a Balance Sheet, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flows, for the System as a whole
- Notes to the Financial Statements

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

The accompanying financial statements of the System are prepared using the economic resources measurement focus and the accrual basis of accounting. Under this basis, revenues and expenses are recognized in the period in which they are earned or incurred. Depreciation of assets, gains, losses, assets and liabilities are also recognized in the period in which the transaction has occurred.

Budgetary Data

Pursuant to the Ohio Revised Code, the System submits a budget to the County Commissioners for approval by November 1 of each fiscal year. The fundamental purpose of the budget is to plan for an expected level of operations and to provide management with a tool to control deviation from such a plan. The budget is prepared on an accrual basis.

1. Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Statement of Revenues, Expenses, and Changes in Net Assets

The System recognizes as operating revenue those transactions that are major or central to the provision of health care services. Operating revenues include those revenues received for direct patient care, grants received from organizations as reimbursement for patient care and other incidental revenue associated with patient care. Operating expenses include those costs associated with providing patient care including costs of professional care, operating the hospital facilities, administrative expenses, and depreciation and amortization. Non-operating revenues include County appropriation, investment income, specific purpose grants and donations, primarily research, and unrealized gains on investments. Non-operating expenses include interest expense and expenditures from specific purpose funds for research related activities.

Net Patient Service Revenue

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. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. Net patient service revenue is reduced by contractual and retroactive adjustments of $431,733 and $377,197 in 2003 and 2002, respectively.

1. Summary of Significant Accounting Policies (continued)

The System has agreements with third-party payors that provide for payment at amounts different from established rates. A summary of the basis of payment by major third-party payors follows:

Medicare and Medicaid—Inpatient acute care services rendered to Medicare and Medicaid program beneficiaries and Medicare capital costs 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.

Medicare outpatient claims are reimbursed under the Ambulatory Payment Classification based prospective payment system. As an academic medical center, medical education payments in addition to disproportionate share entitlements are received from Medicare. Effective January 1, 2002, Medicare implemented a prospective payment system for inpatient rehabilitation services. The payments are based on patient assessment data classifying patients into one of one hundred case mix groups. Inpatient psychiatric services and certain outpatient services related to Medicare beneficiaries and capital costs for Medicaid beneficiaries are reimbursed based on a cost-based methodology subject to certain limitations. The System is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare and Medicaid fiscal intermediaries. The System's classification of patients under the Medicare and Medicaid programs and the appropriateness of their admission are subject to an independent review by a peer review organization. Differences between the estimated amounts accrued at interim and final settlements are reported in the Statement of Revenues, Expenses, and Changes in Net Assets in the year of settlement. The System recorded a favorable adjustment of $9,421 in 2003 and a favorable adjustment of $8,180 in 2002, due to prior year retroactive adjustments to amounts previously estimated.

Net revenue from the Medicare and Medicaid programs accounted for approximately 24% and 32%, respectively, of the System's net patient service revenue for the year ended December 31, 2003. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. Management believes that adequate provision has been made in the financial statements for any adjustments that may result from final settlements.

1. Summary of Significant Accounting Policies (continued)

Other Payors—The System has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes prospectively-determined rates-per-discharge, discounts from established charges, and prospectively-determined per diem rates.

Upper Payment Limit—In September 2001, the State of Ohio Supplemental Upper Payment Limit program for Public Hospitals (UPL) was approved by the Center for Medicare and Medicaid Services. This program provides access to available federal funding up to 100% of the Medicare upper payment limits for inpatient hospital services rendered by Ohio Public Hospitals to Ohio Medicaid consumers. At December 31, 2003 and 2002, $16,360 and $7,000, respectively, were due to the System and recorded on the balance sheets in other receivables; the System's required match to the State of Ohio of $8,467 and $2,885, respectively, is included in other current liabilities. The net amount recorded in net patient service revenue for UPL by the System was $16,174 and $12,109 in 2003 and 2002, respectively.

Disproportionate Share—As a public health care provider, the System renders services to residents of the County and others regardless of ability to pay. The System is classified as a disproportionate share provider by the Medicare and Medicaid programs due to the volume of low income persons it serves and accordingly receives additional payments (including Care Assurance of $27,622 and $33,948 in 2003 and 2002, respectively) from these programs as a result of this status. Total Disproportionate Share payments aggregated $36,993 and $43,183 in 2003 and 2002, respectively, which are included in net patient service revenue. The System also provides major trauma services to the region. The ability to continue these levels of service and programs will be contingent upon the various funding sources.

Charity Care

Throughout the admission, billing and collection processes, certain patients are identified by the System as qualifying for charity care. The System provides care to these patients without charge or at amounts less than its established rates. The charges foregone for charity care provided by the System, totaling $108,224 and $98,785, which represents 11.2% and 11.1% of gross charges in 2003 and 2002, respectively, are not reported as revenue. The System accepts certain indigent Ohio residents and all residents from the County regardless of their ability to pay.

1. Summary of Significant Accounting Policies (continued)

Grants

The System receives financial assistance from federal and state agencies in the United States in the form of grants. The expenditure of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies.

Other such audits could be undertaken by federal and state granting agencies and result in the disallowance of claims and expenditures; however, in the opinion of management, any such disallowed claims or expenditures will not have a material effect on the overall financial position of the System.

Cash and Cash Equivalents

The System considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents are stated at cost which approximates fair value excluding amounts limited as to use or restricted by board designation.

Supplies

Supplies are stated at the lower of average cost or market.

Investments

The System records its investments at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Unrealized gains and losses on investments are recorded as non-operating revenue-net in the statement of revenues, expenses, and changes in net assets.

The GASB issued Statement No. 40, *Deposit and Investment Risk Disclosure* which amends portions of Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements* for certain investment risk disclosures. The effective date of the Statement is for periods beginning after June 15, 2004. The System has elected early application of the Statement in 2003 and made the new disclosures in Note 3.

1. Summary of Significant Accounting Policies (continued)

The System pools certain of its investments for investment purposes. Investment income for these pooled investments is allocated to the proper investment classification based on each investment's fair value to the total fair value of all pooled investments.

The net realized loss of $69 in 2003 and net realized loss of $189 in 2002 on investments is the difference between the proceeds received and the amortized cost of investments sold and is included in investment income in the statement of revenues, expenses, and changes in net assets.

Restricted Assets

Restricted assets are cash and investments whose use is limited by legal requirements. Investments under bond indenture agreement represent amounts required by debt instruments to pay bond principal and interest and projects. Restricted cash and specific purpose investments represent monies received from donors or grantors to be used for specific purposes, primarily research. The System has elected to use restricted assets before unrestricted assets when an expense is incurred for a purpose for which both resources are available.

Capital Assets

Capital assets are stated at cost. Expenditures that substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation and amortization of assets recorded under capital lease (straight-line method) are provided in amounts sufficient to amortize the cost of the related assets over their estimated useful lives. The following are the most commonly used estimated useful lives:

Buildings	25-40 years
Building improvements	5-20 years
Equipment	3-15 years
Land improvements	5-15 years
Vehicles	4 years

Half of a year's depreciation is taken the first year the asset is placed in service. The asset and accumulated depreciation are removed from the related accounts when the asset is disposed of. Any gain or loss resulting from this disposal is recorded in the statement of revenues, expenses, and changes in net assets.

1. Summary of Significant Accounting Policies (continued)

Deferred Compensation Plans

The System offers eligible employees a deferred compensation plan adopted under the provisions of Internal Revenue Code Section 457. The plan permits participating employees to defer a portion of their salary until future years. The deferred compensation is available to employees upon termination of employment, retirement, disability, death, or unforeseeable emergency. The System may at any time amend or terminate the plan with or without consent of the participants.

In accordance with the provisions of GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans,* the System created a trust for the assets of the plan for which the System has no fiduciary responsibility. The System has no recorded asset or liability.

Bond Discounts and Bond Issuance Costs

Deferred financing costs represent debt issuance expenditures on long-term debt obligations and are amortized over the period the bonds are outstanding on a straight-line basis. The amortization of deferred bond financing costs was $126 in 2003 and $116 in 2002. Amortization expense related to bond discounts was $125 in 2003 and $134 in 2002. These amounts are included in interest expense in the statement of revenues, expenses, and changes in net assets.

Cost of Borrowing

Interest costs associated with funds borrowed and used to finance the construction or acquisition of assets are capitalized as a component of the cost of acquiring those assets. The capitalized interest amount is calculated by taking the difference between the interest expense incurred over the term life of the bonds and the interest earned on the invested proceeds of specific purpose tax exempt bonds, which cover the same period of time. Capitalized interest income and interest expense on the Series 1999 and 2003 Bonds totaled $507 and $2,485 in 2003, respectively; $2,073 and $2,223 in 2002, respectively. Amortization of capitalized interest is included in depreciation expense.

1. Summary of Significant Accounting Policies (continued)

The System has entered into three interest-rate swap agreements. These derivative instruments are not designated as hedging instruments, therefore gains and losses are recognized in the statement of revenues, expenses, and changes in net assets during the period of change. Net amounts periodically receivable or payable as a result of swap agreements are recorded as adjustments to interest expense on the related debt (see Note 6).

Concentrations of Credit Risk

Financial instruments that potentially subject the System to concentrations of credit risk consist principally of cash and cash equivalents, patient accounts receivable, and investments.

The System places its cash and cash equivalents with high credit quality financial institutions. The System's investments include money market funds, U.S. Treasury bills and notes, U.S. agency obligations, and repurchase agreements.

Concentration of credit risk relating to patient accounts receivable is limited to some extent by the diversity and number of the System's patients and payors. Patient accounts receivable consist of amounts due from government programs, commercial insurance companies, private pay patients, and other group insurance programs. Excluding governmental programs, no payor source represents more than 10% of the System's patient accounts receivable. The System maintains an allowance for losses based on the expected collectibility of patient accounts receivable.

2. Changes in Accounting Principles

The GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, which establishes criteria to determine if organizations that are legally separate, tax exempt entities should be discretely presented as component units. Application of this standard is required for fiscal 2004. The impact of GASB Statement No. 39 on financial reporting and the results of financial position has not been determined.

(Dollars in Thousands)

3. Deposits and Investments

Deposits

All monies are deposited to the System's banks or trust companies designated by the Board of Trustees. Funds not needed for immediate expenditure may be deposited in interest bearing or non-interest bearing accounts or U.S. government obligations. Banks or trust companies shall furnish security for all such deposits, whether interest bearing or non-interest bearing, except that no such security is required for U.S. government obligations.

Custodial risk is the risk that, in the event of bank failure, the System's deposits might not be recovered. The System's bank deposits at December 31, 2003 totaled $7,671 and were subject to the following categories of custodial risk:

Uncollateralized	**$ 7,396**
Collateralized with securities held by the pledging institution's trust department, but not in the System's name	**75**
Total amount subject to custodial risk	**7,471**
Amount insured	**200**
Total bank balances	**$ 7,671**

At December 31, 2003, the financial statement carrying amount of the System's deposits was $7,777. The difference from the reported amount represents outstanding checks payable and normal reconciling items.

Investments

As of December 31, 2003, the fair value of the System's investments were:

Cash and cash equivalents	**$ 216,069**
U.S. Treasuries	**9,397**
U.S. Governments	**1,148**
U.S. Government Agencies	**47,784**
Federal National Mortgage Association and Federal Home Loan Mortgage Corporation (Federal Pools)	**9,840**
Collateralized Mortgage Obligations	**2,476**
	$ 286,714

3. Deposits and Investments (continued)

Interest Rate Risk. The System's investment policies limit investment portfolio to maturities of five years or less. All of the System's investments at December 31, 2003 have effective maturity dates of less than five years.

Credit Risk. All of the System's investments are rated AAA by Standard and Poor's. The System's investment policies are governed by State of Ohio statutes that authorize the System to invest in U. S. government obligations. The Collateralized Mortgage Obligations and Federal Mortgage pools are investments that are grandfathered from previous statutes that allowed such investments. These investments have an effective maturity date of less than one year.

Custodial Credit Risk. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Of the System's investments, only the repurchase agreements are exposed to custodial risk. Repurchase agreements (included in the Federal Pools) at December 31, 2003 totaling $8,901 are uninsured, are not registered in the System's name and are held by the financial institution's trust department.

(Dollars in Thousands)

4. Capital Assets

The following summarizes the capital assets of the System for the years ended December 31, 2003 and 2002:

2003	Beginning Balance	Additions	Reductions/ Transfers	Ending Balance
Capital assets not being depreciated:				
Land	$ 8,954	$ -	$ -	$ 8,954
Construction in progress	18,667	46,242	(2,866)	62,043
Total non-depreciated capital assets	27,621	46,242	(2,866)	70,997
Depreciable capital assets:				
Land improvements	7,699	-	-	7,699
Buildings and fixed equipment	372,032	2,157	-	374,189
Equipment	194,739	4,930	(471)	199,198
Total depreciable capital assets	574,470	7,087	(471)	581,086
Less accumulated depreciation:				
Land improvements	(6,384)	(272)	-	(6,656)
Buildings and fixed equipment	(230,422)	(17,313)	22	(247,713)
Equipment	(153,798)	(10,700)	436	(164,062)
Total accumulated depreciation	(390,604)	(28,285)	458	(418,431)
Total depreciable capital assets, net	183,866	(21,198)	(13)	162,655
Total capital assets, net	$ 211,487	$ 25,044	$ (2,879)	$ 233,652

(Dollars in Thousands)

4. Capital Assets (continued)

2002	Beginning Balance	Additions	Reductions/ Transfers	Ending Balance
Capital assets not being depreciated:				
Land	$ 8,954	$ -	$ -	$ 8,954
Construction in progress	6,270	18,041	(5,644)	18,667
Total non-depreciated capital assets	15,224	18,041	(5,644)	27,621
Depreciable capital assets:				
Land improvements	8,177	6	(484)	7,699
Buildings and fixed equipment	369,451	2,892	(311)	372,032
Equipment	185,431	9,833	(525)	194,739
Total depreciable capital assets	563,059	12,731	(1,320)	574,470
Less accumulated depreciation:				
Land improvements	(6,337)	(526)	479	(6,384)
Buildings and fixed equipment	(212,452)	(18,281)	311	(230,422)
Equipment	(142,446)	(11,893)	541	(153,798)
Total accumulated depreciation	(361,235)	(30,700)	1,331	(390,604)
Total depreciable capital assets, net	201,824	(17,969)	11	183,866
Total capital assets, net	$ 217,048	$ 72	$ (5,633)	$ 211,487

Total depreciation and amortization expense related to capital assets for 2003 and 2002 was $28,285 and $30,700, respectively.

(Dollars in Thousands)

5. Long-Term Debt

Changes in long-term debt for 2003 and 2002 are as follows:

	2003				
	Beginning Balance	**Additions**	**Payments/ Reductions**	**Ending Balance**	**Due Within One Year**
Hospital Improvement and Refunding Revenue Bonds, Series 1997, bear interest at rates ranging from 3.9% to 5.8% and mature in varying amounts through 2027	**$ 56,280**	**$ -**	**$ (4,195)**	**$ 52,085**	**$ 4,400**
Hospital Refunding Revenue Bonds, Series 1997A, bear interest at rates ranging from 4.1% to 5.5% and mature in varying amounts through 2019	**76,655**	**-**	**(240)**	**76,415**	**255**
Hospital Improvement Revenue Bonds, Series 1999, bear interest at rates ranging from 6.125% to 6.150% and mature in varying amounts through 2029	**56,995**	**-**	**-**	**56,995**	**-**
Hospital Improvement Revenue Bonds, Series 2003, bear variable interest rates and mature in varying amounts through 2033	**-**	**30,545**	**-**	**30,545**	**535**
Equipment obligation, GE Leasing, as defined in the respective lease agreement at an interest rate of 4.96% and matures through 2007	**5,022**	**-**	**(1,391)**	**3,631**	**1,461**
Equipment obligation, Banc One Leasing, as defined in the respective lease agreement at an interest rate of 4.958% and matures through 2004	**2,166**	**-**	**(1,348)**	**818**	**818**
Equipment obligation, IBM Credit Corporation, as defined in the respective lease agreement at interest rates ranging from 4.0% to 4.92% and matures through 2004	**431**	**-**	**(342)**	**89**	**89**
	197,549	**30,545**	**(7,516)**	**220,578**	**7,558**
Unamortized discount and loss	**(9,829)**	**-**	**502**	**(9,327)**	**-**
	187,720	**30,545**	**(7,014)**	**211,251**	**7,558**
Current installments	**(7,516)**	**(7,558)**	**7,516**	**(7,558)**	**-**
Long-term debt	**$ 180,204**	**$ 22,987**	**$ 502**	**$ 203,693**	**$ 7,558**

(Dollars in Thousands)

5. Long-Term Debt (continued)

	2002				
	Beginning Balance	**Additions**	**Payments/ Reductions**	**Ending Balance**	**Due Within One Year**
Hospital Improvement and Refunding Revenue Bonds, Series 1997, bear interest at rates ranging from 3.90% to 5.80% and mature in varying amounts through 2027	$ 60,290	$ -	$ (4,010)	$ 56,280	$ 4,195
Hospital Refunding Revenue Bonds, Series 1997A, bear interest at rates ranging from 4.1% to 5.5% and mature in varying amounts through 2019	76,885	-	(230)	76,655	240
Hospital Improvement Revenue Bonds, Series 1999, bear interest at rates ranging from 6.125% to 6.150% and mature in varying amounts through 2029	56,995	-	-	56,995	-
Equipment obligation, GE Leasing, as defined in the respective lease agreement at an interest rate of 4.96% and matures through 2007	6,347	-	(1,325)	5,022	1,391
Equipment obligation, Banc One Leasing, as defined in the respective lease agreement at an interest rate of 4.958% and matures through 2004	3,449	-	(1,283)	2,166	1,348
Equipment obligation, IBM Credit Corporation, as defined in the respective lease agreement at interest rates ranging from 4.0% to 4.92% and matures through 2004	758	-	(327)	431	342
	204,724	-	(7,175)	197,549	7,516
Unamortized discount and loss	(10,343)	-	514	(9,829)	-
	194,381	-	(6,661)	187,720	7,516
Current installments	(7,175)	(7,516)	7,175	(7,516)	-
Long-term debt	$ 187,206	$ (7,516)	$ 514	$ 180,204	$ 7,516

5. Long-Term Debt (continued)

Effective February 1, 1997, the County issued $70,000 of Hospital Improvement and Refunding Revenue Bonds Series 1997 (The MetroHealth System Project) (Series 1997). The proceeds of the Series 1997 Bonds were used to refund $20,900 of Series 1989 Bonds; to finance the construction of various improvements and additions to The MetroHealth Medical Center; and to pay costs of issuance of the Series 1997 Bonds.

Effective November 1, 1997, the County issued $77,525 of Hospital Refunding Revenue Bonds, Series 1997A (The MetroHealth System Project) (Series 1997A). The proceeds of the Series 1997A Bonds were used to refund $73,725 of Series 1989 Bonds scheduled to mature on February 15, 2019. The 1997 refundings resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $9,753. The unamortized difference ($7,470 at December 31, 2003), reported in the accompanying financial statements, as a reduction from long-term debt, is included as a reduction to interest expense through the year 2019 using the effective interest method.

Effective September 1, 1999, the County issued $56,995 of Hospital Improvement Revenue Bonds, Series 1999 (The MetroHealth System Project) (Series 1999 Bonds). The proceeds of the Series 1999 Bonds are being used to finance the construction of a 150-bed long-term care facility and acquire, construct, renovate, equip, and improve operating rooms and other hospital facilities.

Effective March 13, 2003, the County issued $30,545 of Hospital Improvement Variable Rate Demand Revenue Bonds, Series 2003 (The MetroHealth System Project) (Series 2003 Bonds). The proceeds of the Series 2003 Bonds are being used to pay costs of constructing and equipping an administrative building and the Critical Care Pavilion. The bonds bear interest at a variable rate (not to exceed 10%) determined weekly as established by the Remarketing Agent based on current market values for similar bond offerings and are due at various dates until 2033. The rate at December 31, 2003 was 1.32%.

In connection with the issuance of the Series 2003 Bonds, the System entered into a Reimbursement Agreement with a bank. Under the terms of the Reimbursement Agreement, the System entered into an Irrevocable Letter of Credit (Letter of Credit) issued by a local bank that expires on March 22, 2008. Under the terms of the Letter of Credit, the Trustee will be entitled to draw amounts necessary to make principal and interest payments. The Letter of Credit is subject to various financial covenants.

(Dollars in Thousands)

5. Long-Term Debt (continued)

The Series 1997, 1997A, 1999 and 2003 Bonds were issued pursuant to a master trust indenture between the County, acting by and through the System's Board of Trustees, and the bond trustee. The Series 1997, 1997A, 1999 and 2003 Bonds are special obligations of the County payable solely from the revenue derived from the operation of the System and other monies available to the System's Board of Trustees, and are secured by the revenue and real property of the System. Accordingly, the bond proceeds and indebtedness have been recorded as assets and liabilities of the System.

The terms of the master trust bond indenture agreement provide for the establishment of a depreciation reserve fund and maintenance of certain special funds, which are maintained under the control of the bond trustee and are used for payment of principal and interest on the bonds when due. The revenue bonds and lease obligation payment requirements for fiscal years subsequent to December 31, 2003 are as follows:

	Total Lease Obligation			Total Hospital Revenue Bonds		
	Principal	**Interest**	**Total**	**Principal**	**Interest**	**Total**
2004	$ 2,368	$ 161	$ 2,529	$ 5,190	$ 10,114	$ 15,304
2005	688	92	780	5,460	9,888	15,348
2006	723	57	780	5,700	9,646	15,346
2007	759	21	780	5,985	9,386	15,371
2008				6,270	9,118	15,388
2009-2013				36,500	40,658	77,158
2014-2018				46,930	30,755	77,685
2019-2023				40,010	20,285	60,295
2024-2028				46,665	10,216	56,881
2029-2033				17,330	588	17,918
	$ 4,538	$ 331	$ 4,869	216,040	$ 150,654	$ 366,694
Unamortized discount				(1,857)		
Unamortized difference between reacquisition price and the net carrying amount of old debt				(7,470)		
Present value of net minimum payments on hospital revenue bonds				$ 206,713		

5. Long-Term Debt (continued)

The Bond Reserve Fund required under the Trust Indenture has been established with the Trustee. The balance as of December 31, 2003 and 2002 was $18,507 and $18,530, respectively. The cost value of Hospital Revenue Bonds was $214,183 at December 31, 2003. The fair value of Hospital Revenue Bonds ($224,895 at December 31, 2003) is estimated using discounted cash flow analyses based on current borrowing rates for similar types of borrowing arrangements.

6. Derivative Instruments

The System's objectives of its derivative instruments include managing the risk of increased debt service resulting from rising market interest rates, the risk of decreased surplus returns resulting from falling interest rates, and the management of the risk of an increase in the fair value of outstanding fixed rate obligations resulting from declining market interest rates. Consistent with its interest rate risk management objectives, the System entered into various interest rate swap agreements with a total outstanding notional amount of $142.5 million and $56.0 million at December 31, 2003 and 2002, respectively. The System pays a rate equal to the Bond Market Association Municipal Index (the BMA SWAP Index), an index of seven-day high-grade tax-exempt variable rate demand obligations or a fixed rate of 1.500% or 3.504%. In return, the System receives a fixed rate of 5.41% or a rate based on the BMA SWAP Index or 75% of LIBOR. The interest rate swap arrangement with an effective date of March 2003 and a notional amount of $30.5 million includes an option whereby the counterparty can terminate the transaction. The BMA index rates in 2003 ranged from 0.70% to 1.36% (1.14% at December 31, 2003). The 1-Month LIBOR Index in 2003 ranged from 1.02% to 1.36% (1.12% at December 31, 2003).

The fair value of the swap agreements based on current settlement prices at December 31, 2003 is $3,572 due from the counterparty and is included in other assets. Net interest savings for 2003 and 2002 was $1,638 and $2,254, respectively and is included as a reduction to interest expense. The decrease of $763 in fair value of the net swap assets during 2003 is recorded as unrealized losses on investment in the statement of revenues, expenses, and changes in net assets.

(Dollars in Thousands)

6. Derivative Instruments (continued)

The following table describes the terms of the three interest rate swap agreements the System has entered. In all three cases, only the net difference is exchanged with the counterparty and the notional amount is not exchanged. For the Series 2003 agreement, the notional amount changes with the amortization of the bonds.

Notional Amount	Effective Date	Termination Date	The System Pays	Counterparty Pays
$ 56,000,000	September 1999	February 2014	BMA SWAP Index	Fixed 5.41%
56,000,000	May 2003	February 2005	Fixed 1.500%	BMA SWAP Index
30,545,000	March 2003	February 2033	Fixed 3.504%	75% of LIBOR

7. Other Long-Term Liabilities

Amounts Due to Third-Party Payors

The System has agreements with third-party payors that provide for payment of amounts from established rates. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. See Note 1 net patient service revenue.

Accrued Vacation and Sick

System employees earn vacation and sick leave at varying rates depending on job classification and years of service. Employees can accumulate up to three years of vacation leave. All accumulated, unused vacation time is paid upon separation if the employee has at least one year of service with the System. There is no limit on the amount of sick time accrued. Upon retirement, employees with a minimum of 10 years of service have sick leave balances paid out at 50% of eligible hours at their current rate of pay. The maximum pay out is 800 hours. As of December 31, 2003 and 2002, the liability for accrued sick and vacation was $22,633 and $20,516, respectively.

(Dollars in Thousands)

7. Other Long-Term Liabilities (continued)

Note Payable

In 2003, the System financed one-year general and professional liability policies with a note payable. The note bears interest at 3.75%. At December 31, 2003, the balance outstanding was $3.4 million.

Other long-term liabilities consists of the following at December 31, 2003 and 2002:

2003	Beginning Balance	Additions	Payments	Ending Balance	Due Within One Year
Amounts due third-party payors	**$ 45,588**	**$ (440)**	**$ (2,604)**	**$ 42,544**	**$ 9,455**
Accrued vacation and sick leave	**20,516**	**3,908**	**(1,791)**	**22,633**	**1,862**
Note payable	**-**	**3,400**	**-**	**3,400**	**3,400**
	$ 66,104	**$ 6,868**	**$ (4,395)**	**$ 68,577**	**$ 14,717**

2002	Beginning Balance	Additions	Payments	Ending Balance	Due Within One Year
Amounts due third-party payors	$ 45,404	$ 815	$ (631)	$ 45,588	$ 9,441
Accrued vacation and sick leave	18,366	3,955	(1,805)	20,516	1,895
	$ 63,770	$ 4,770	$ (2,436)	$ 66,104	$ 11,336

Risk Management

The System is exposed to various risks of loss related to torts; theft of or destruction of assets; errors and omissions; injuries to employees; and natural disasters. The System is self-insured for workers compensation and medical malpractice but maintains commercial insurance policies for property and casualty, automobile, aircraft (helicopter and fixed wing) as well as excess coverage for medical malpractice claims. Settled claims have not exceeded insurance coverage in any of the past three years.

(Dollars in Thousands)

7. Other Long-Term Liabilities (continued)

During the normal course of its operations, the System has become a defendant in various legal actions. It is not possible to estimate the outcome of these legal actions; however, in the opinion of legal counsel and the System administration, the disposition of the pending cases will not have a material adverse effect of the financial condition or operations of the System. However, depending on the amount and timing of such resolution, an unfavorable resolution of some or all of these matters could materially affect the System's future results of operations or cash flows in a particular year.

The System is self-insured for the purpose of providing professional and patient care liability and workers' compensation claims. For the professional and patient care liability, professional actuarial insurance consultants have been retained to determine funding requirements. Amounts funded for professional and patient care have been placed in an irrevocable self-insurance trust account, which is being administered by a trustee.

Losses from asserted claims and from unasserted claims identified under the System's incident reporting systems are accrued based on estimates that incorporate the System's past experience, as well as other considerations including the nature of each claim or incident and relevant trend factors. The reserve for estimated self-insured claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported undiscounted for 2003 and 2002.

2003	Beginning Balance	Claims Incurred	Claims Paid	Ending Balance	Due Within One Year
Worker's compensation	**$ 5,951**	**$ 2,617**	**$ (2,423)**	**$ 6,145**	**$ 2,497**
Self-insurance	**30,716**	**10,802**	**(5,928)**	**35,590**	**17,457**
Employee health insurance	**2,389**	**27,506**	**(27,014)**	**2,881**	**2,881**
	$ 39,056	**$ 40,925**	**$ (35,365)**	**$ 44,616**	**$ 22,835**

2002	Beginning Balance	Claims Incurred	Claims Paid	Ending Balance	Due Within One Year
Worker's compensation	$ 4,050	$ 4,498	$ (2,597)	$ 5,951	$ 2,700
Self-insurance	25,421	16,328	(11,033)	30,716	12,389
Employee health insurance	1,708	26,877	(26,196)	2,389	2,389
	$ 31,179	$ 47,703	$ (39,826)	$ 39,056	$ 17,478

(Dollars in Thousands)

8. Operating Leases

The System has entered into operating lease agreements for a parking facility, medical space, and office space, which expire through 2020. The contracts are generally for five years and contain rent escalation clauses and renewal options for additional periods ranging from two to five years.

Minimum rental commitments under operating leases extending beyond one year at December 31, 2003 are as follows:

2004	$ 1,496
2005	12,299
2006	1,031
2007	1,043
2008	1,043
2009–2020	6,623
Total	$ 23,535

Rent expense totaled $1,365 in 2003 and $1,484 in 2002. In 2005, lease payments totaling $11 million are due related to a parking garage. Funds have been allocated within Board Designated investments to make this payment.

9. Benefit Plans

Pension

Employee retirement benefits are available for substantially all employees under three separate retirement plans administered by the Ohio Public Employees Retirement System (OPERS). The plans are the Traditional Pension Plan—a cost-sharing, multiple-employer defined benefit pension plan; the Member-Directed Plan—a Defined Contribution Pension Plan; and the Combined Plan—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 post-retirement healthcare benefits, to the Traditional and Combined Plan members however, healthcare benefits are not statutorily guaranteed. Participants in the Member-Directed Plan do not qualify for ancillary benefits.

9. Benefit Plans (continued)

The Ohio Public Employees Retirement System's Comprehensive Annual Financial Report for the multi-employee defined benefit plan may be obtained by writing to Public Employees Retirement System of Ohio, 277 East Town Street, Columbus, Ohio 43215-4642. The Ohio Revised Code provides statutory authority for employee and employer contributions. The employee contribution rate is 8.5% of covered payroll and the System is required to contribute 13.55% of covered payroll. The System's contributions to OPERS for the years ending December 31, 2003, 2002 and 2001 were $36,438, $34,584 and $32,505, respectively, equal to the required contributions for each year.

Postretirement Benefits

OPERS also provides postretirement health care coverage to age and service retirees with 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 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 System's contribution for 2003 and 2002 used to fund postretirement health care benefits was $13,446 and $12,761, respectively, which is included in the System's pension contribution of $36,438 and $34,584 for the years ending December 31, 2003 and 2002, respectively.

Benefits are advance-funded using the entry-age normal actuarial cost method. Significant actuarial assumptions include a rate of return on investments of 8.00%; active employee payroll increases of 4.00% compounded annually and between 0.50 to 6.30% based on additional pay increases; and health care cost increases of 4.00% annually.

As of December 31, 2002 (the most recent information available), OPERS had $10 billion in net assets available for payment of postemployment benefits. The actuarial accrued liability for postemployment benefits and the unfunded actuarial accrued liability were $18.7 billion and $8.7 billion, respectively. The number of active contributing participants was 364,881.

10. Related Organizations

The System is the primary beneficiary of The MetroHealth Foundation, Inc. (the Foundation). The Foundation is a separate not-for-profit entity organized for the purpose of supporting the System in the areas of research, community health and continuing professional education. The System does not consolidate the financial activity of the Foundation with that of the System. The Foundation had total net assets of $13,899 and $10,995 for 2003 and 2002, respectively. The System received support from the Foundation in the amount of $1,090 and $361 for 2003 and 2002, respectively, and is recorded as grant revenue on the System's statement of revenues, expenses and changes in net assets. The outstanding receivable from the Foundation was $676 and $380 at December 31, 2003 and 2002, respectively.

The System had established restricted funds to differentiate resources, the use of which is restricted by donors or grantors, from resources of general funds on which donors place no restrictions or that arise as a result of the operations of the System. A review of these restricted funds is performed annually to determine that funds related to completed clinical trials and certain donated money should be transferred to The MetroHealth Foundation. The total amounts transferred in 2003 and 2002 were $287 and $2,229, respectively.

11. Commitments

As of December 31, 2003, the System has contractual commitments for the construction of the critical care pavilion and administrative building totaling approximately $22.8 million. These projects are being funded with bond proceeds and gifts.

The MetroHealth System

Schedule of Expenditures of Federal Awards

Year ended December 31, 2003

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
Research and Development Cluster			
U.S. Department of Health and Human Services			
Direct Programs:			
Transcriptional Interference & Tumorigenicity	93.396		$ 31,954
Regulation of AP-2 and HER-2/NEU Gene Promoters	93.396		320,710
Race in Opioid Analgesia	93.226		2,290
Neuronal Migration	93.853		214,429
Subtotal Research and Development Cluster—Direct			569,383
Pass-Through Programs From:			
Acute Stroke Reg (University of Cincinnati)	93.283	U50/CCU520278-01	138,490
ACOSOC (Duke University)	93.395	7U10CA76001-4; 7U10CA86004-02	34,506
CHF & Wave Alternan (Columbia University)	93.837	5R01HL064862-04	2,496
SCD-Heft (NHLBI/Duke University)	93.837	R01HL64862	11,701
VISP (Wake Forest)	93.853	R01NS34447	69,260
WARCEF (New Jersey)	93.853	1U01NS43975-01	1,290
Wasid Study (NINDS/Emory University)	93.853	R01NS36643	14,470
Sonia Study (Rhode Island Hospital)	93.854	R01NS39131	1,959
PEACH Study (University of Pittsburgh)	93.856	R01HS08358	8,982
Physical Restraints (Rush Presbyterian)	93.866	AG019715-01A2	30,854
CMV Monoclonal Antibody (NIAID/UAB)	*	N01AI65306	6
LEAP (SSA/LEAP)	*	16-T-10077-5-01	46,276
NCI Cancer Cohort Study (Research Triangle Institute)	*	RTI# 07587-821	3,306
Subtotal Research and Development Cluster—Pass-Through			363,596
Total Research and Development Cluster			932,979
U.S. Department of Agriculture			
Pass-Through Program From:			
State of Ohio:			
Special Supplemental Food Program for Women, Infants and Children	10.557	18-3-001-1-CL-03/04	4,058,341

* CFDA number not available

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
U.S. Department of Health and Human Services			
Direct Program:			
Residency Training in Primary Care	93.884		81,322
Pass-Through Programs From:			
Federation for Community Planning:			
Title X/Family Planning	93.217	05-H-00520-20; 5FPHPA050520	340,437
HIV Emergency Aid-Cluster:			
Cuyahoga County Board of Commissioners:			
Ryan White Title I—Medical/Dental Services	93.914	CE13368-01; CE0300129-01	855,103
Medicaid Assistance Programs:			
Alcohol & Drug Addiction Service Board:			
Chemical Dependency	93.778	18311-01	52,957
Miracle Village	93.778	18408-01	5,209
Cuyahoga County Community Mental Health Board:			
Community Mental Health	93.778	129000	580,605
Total Medicaid Assistance Programs			638,771
Alcohol & Drug Addiction Service Board:			
Federal SAPT Block Grant-Women's Set Aside	93.959	18-06817-00-WOMEN-T-03-970	7,907
State of Ohio:			
TB Prevention and Control/Outreach	93.118	18-3-001-2-CK-04	190,877
Federal HIV Care	93.917	18-3-001-1-AT-02/03	92,501
Division of Family—Bureau of Child & Family Health Services	93.994	18-3-001-1-MC-04	27,203
Genetics	93.994	18-3-001-1-AU-03/04	36,250
Regional Perinatal Outreach	93.994	18-3-002-1-BM-03/04	59,106
Subtotal Pass-Through Programs			2,248,155
Total U.S. Department of Health and Human Services			2,329,477

The MetroHealth System

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
U.S. Department of Education			
Pass-Through Program From:			
State of Ohio:			
Early Intervention—Hospital Based	84.181	18-3-001-1-DD	78,873
Total Expenditures of Federal Awards			$7,399,670

The MetroHealth System

Notes to the Schedule of Expenditures of Federal Awards

Year ended December 31, 2003

Note A. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of The MetroHealth System and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the financial statements.

Note B. Medicaid Assistance Programs

The amount received from Medicaid in 2003 represents only a portion of the total amount billed by The MetroHealth System. The federal expenditure amount reported represents the actual receipts times the Federal Financial Participation reimbursement rate.

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Report of Independent Auditors on Compliance and on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Trustees
The MetroHealth System

We have audited the financial statements of The MetroHealth System as of and for the year ended December 31, 2003, and have issued our report thereon dated February 27, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States 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 The MetroHealth System'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*. However, we noted certain immaterial instances of noncompliance that we have reported to management of The MetroHealth System in a separate letter dated February 27, 2004.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered The MetroHealth System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to the Board of Trustees in a separate letter dated February 27, 2004.

This report is intended solely for the information and use of the Board of Trustees, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

February 27, 2004

Ernst & Young

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Report of Independent Auditors on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

The Board of Trustees
The MetroHealth System

Compliance

We have audited the compliance of The MetroHealth System with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended December 31, 2003. The MetroHealth System's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of The MetroHealth System's management. Our responsibility is to express an opinion on The MetroHealth System's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about The MetroHealth System's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on The MetroHealth System's compliance with those requirements.

In our opinion, The MetroHealth System complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended December 31, 2003.

Internal Control Over Compliance

The management of The MetroHealth System is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered The MetroHealth System's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control 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 noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program 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 compliance 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 federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

February 27, 2004

The MetroHealth System

Schedule of Findings and Questioned Costs

Year Ended December 31, 2003

Part I—Summary of Auditor's Results

Financial Statement Section

Type of auditor's report issued:	Unqualified Opinion			
Internal Control over financial reporting:				
Material weakness(es) identified?		yes	✓	no
Reportable condition(s) identified not considered to be material weaknesses?		yes	✓	none reported
Noncompliance material to financial statement noted?		yes	✓	no

Federal Awards Section

Dollar threshold used to determine Type A programs:	$300,000			
Auditee qualified as low-risk auditee?	✓	yes		no
Type of auditor's report issued on compliance for major programs:	Unqualified Opinion			
Internal Control over major programs:				
Material weakness(es) identified?		yes	✓	no
Reportable condition(s) identified not considered to be material weakness(es)?		yes	✓	none reported
Any audit findings disclosed that are required to be reported in accordance with Circular A-133 (section .510(a))?		yes	✓	no

Part I—Summary of Auditor's Results (continued)

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
Various	Research and Development Cluster
10.557	Special Supplemental Food Program for Women, Infants, and Children
93.778	Medicaid Assistance Programs
93.959	Federal SAPT Block Grant—Women's Set Aside

Part II—Schedule of Financial Statement Findings

This section identifies the reportable conditions, material weaknesses, and instances of noncompliance related to the financial statements that are required to be reported in accordance with Chapter 5.18 of *Government Auditing Standards*.

None.

Part III—Schedule of Federal Award Findings and Questioned Costs

This section identifies the reportable conditions, material weaknesses, and instances of noncompliance, including questioned costs, related to the audit of major federal programs, as required to be reported by Circular A-133 section __.510.

None.

Part IV—Prior Year Schedule of Financial Statement Findings and Federal Award Findings and Questioned Costs

None.

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METROHEALTH SYSTEM

CUYAHOGA COUNTY

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

CERTIFIED
JUNE 22, 2004