

HOCKING VALLEY COMMUNITY HOSPITAL

FINANCIAL STATEMENTS

DECEMBER 31, 2005 AND 2004



**Auditor of State
Betty Montgomery**

Board of Trustees
Hocking Valley Community Hospital
P. O. Box 966
Logan, Ohio 43138

We have reviewed the *Report of Independent Auditors* of the Hocking Valley Community Hospital, Hocking County, prepared by Blue & Co., LLC, for the audit period January 1, 2005 through December 31, 2005. 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 Hocking Valley 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

July 5, 2006

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HOCKING VALLEY COMMUNITY HOSPITAL

TABLE OF CONTENTS DECEMBER 31, 2005 AND 2004

	Page
Report of Independent Auditors	1
Required Supplementary Information	
Management's Discussion and Analysis (unaudited).....	i-vi
Financial Statements	
Balance Sheets.....	3
Statements of Operations and Changes in Net Assets.....	5
Statements of Cash Flows.....	6
Notes to Financial Statements.....	7

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REPORT OF INDEPENDENT AUDITORS

Board of Trustees
HOCKING VALLEY COMMUNITY HOSPITAL
Logan, Ohio

We have audited the accompanying balance sheets of Hocking Valley Community Hospital (the Hospital), a component unit of Hocking County, Ohio, as of December 31, 2005 and 2004, and the related statements of operations and changes in net assets 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 auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Hocking Valley Community Hospital as of December 31, 2005 and 2004, and the results of its operations, changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Board of Trustees
HOCKING VALLEY COMMUNITY HOSPITAL

As discussed in Note 11 to the financial statements, the Hospital identified certain errors in the market value of an investment resulting in an overstatement of previously reported investments as of December 31, 2004. Accordingly, the Hospital's 2004 financial statements have been restated and an adjustment has been made to net assets as of December 31, 2004 to correct the error.

Management's discussion and analysis on pages i through vi is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. 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, under separate cover, a report dated March 10, 2006, on our consideration of Hocking Valley Community Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Audit Standards* and should be read in conjunction with this report when considering the results of our audit.

Blue & Co., LLC

March 10, 2006

Hocking Valley Community Hospital

A Component Unit of Hocking County, State of Ohio
Management's Discussion and Analysis

The discussion and analysis of Hocking Valley Community Hospital (Hospital's) financial performance provides an overview of the Hospital's financial activities for the fiscal years ended December 31, 2005 and 2004. Please read it in conjunction with the Hospital's financial statements, which begin on page 3. Unless otherwise indicated, amounts are in thousands.

Financial Highlights

- The Hospital's net assets increased in each of the past two years with a \$1,187 or 12% increase in 2005.
- The Hospital reported operating gains \$1,275 and \$228 in 2005 and 2004, respectively.
- Total revenues increased from 2004 to 2005 by \$549 or 2%.

Using This Annual Report

The Hospital's financial statements consist of three statements—a Balance Sheet; a Statement of Operations and Changes in Net Assets; and a Statement of Cash Flows. These financial statements and related notes provide information about the activities of the Hospital.

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

The analysis of the Hospital finances begins on page ii. One of the most important questions asked about the Hospital's finances is, "Is the Hospital as a whole better or worse off as a result of the year's activities?" The Balance Sheet and the Statement of Operations and Changes in Net Assets report information about the Hospital's resources and its activities in a way that helps answer this question. These statements include all restricted and unrestricted assets and all liabilities using the accrual basis of accounting. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the Hospital's net assets and related changes. You can think of the Hospital's net assets—the difference between assets and liabilities—as one way to measure the Hospital's financial health, or financial position. Over time, increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the Hospital's patient base and measures of the quality of service it provides to the community, as well as local economic factors to assess the overall health of the Hospital.

Hocking Valley Community Hospital

A Component Unit of Hocking County, State of Ohio
Management's Discussion and Analysis

Statement of Cash Flows

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

Net Assets

The Hospital's net assets are the difference between its assets and liabilities reported in the Balance Sheet on page 3. The Hospital's net assets increased by \$1,187 or 12% in 2005 as you can see from Table 1.

Table 1: Assets, Liabilities, and Net Assets

	2005	2004	\$ Change	% Change
Assets				
Current assets	\$ 7,066	\$ 6,475	\$ 591	9.1%
Capital assets, net	9,607	9,891	(284)	-2.9%
Restricted and limited use assets	330	330	-	0.0%
Other noncurrent assets	72	148	(76)	-51.4%
Total current assets	<u>\$ 17,075</u>	<u>\$ 16,844</u>	<u>\$ 231</u>	<u>1.4%</u>
Liabilities				
Long - term obligations	\$ 3,232	\$ 3,622	\$ (390)	-10.8%
Current liabilities	3,091	3,657	(566)	-15.5%
Total liabilities	<u>6,323</u>	<u>7,279</u>	<u>(956)</u>	<u>-13.1%</u>
Net assets				
Unrestricted	4,446	3,693	753	20.4%
Invested in capital assets, net of related debt	5,976	5,542	434	7.8%
Restricted by bond indenture agreement	330	330	-	0.0%
Total net assets	<u>\$ 10,752</u>	<u>\$ 9,565</u>	<u>\$ 1,187</u>	<u>12.4%</u>

Hocking Valley Community Hospital

A Component Unit of Hocking County, State of Ohio
Management's Discussion and Analysis

A significant component of the change in the Hospital's assets is the increase in cash and cash equivalents. Cash and cash equivalents increased \$1,020 or 170% from 2004 to 2005. During 2005, the Hospital generated an operating income of \$1,275. During 2005, the Hospital repaid \$474 on its long-term debt and capital lease obligations.

Operating Results and Changes in the Hospital's Net Assets

In 2005, the Hospital's net assets increased by \$1,187, as shown in Table 2. This increase is made up of different components.

Table 2: Operating Results and Changes in Net Assets

	2005	2004	\$ Change	% Change
Revenue:				
Net patient service revenue	\$ 26,165	\$ 25,616	\$ 549	2.1%
Other	128	127	1	0.8%
Total operating revenue	26,293	25,743	550	2.1%
Expenses:				
Salaries and wages	9,950	9,665	285	2.9%
Employee benefits	3,161	3,204	(43)	-1.3%
Supplies and other	5,951	6,595	(644)	-9.8%
Professional fees and services	4,636	4,633	3	0.1%
Depreciation and amortization	1,048	1,143	(95)	-8.3%
Insurance	272	275	(3)	-1.1%
Total expenses	25,018	25,515	(497)	-1.9%
Operating income	1,275	228	1,047	459.2%
Non operating gains (losses)	(88)	(165)	77	-46.7%
Revenue and gains over expenses	\$ 1,187	\$ 63	\$ 1,124	1784.1%

Hocking Valley Community Hospital

A Component Unit of Hocking County, State of Ohio
Management's Discussion and Analysis

Sources of Revenue

During 2005 the Hospital derived substantially all of its revenue from patient service and other related activities. Revenue includes, among other items, revenue from the Medicare and Medicaid programs, patients, insurance carriers, preferred provider organizations, and managed care programs.

The table below presents the percentages of Gross revenue for patient services by payer, for the years ended December 31, 2005 and 2004, respectively.

	2005	2004
Payer Mix		
Medicare	43%	45%
Medicaid	16%	16%
Self-Pay	6%	6%
Commercial and other	35%	33%
	<hr/>	
	100%	100%

The Hospital provides care to patients under payment arrangement with Medicare, Medicaid, and various managed care 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 Gains

The first component of the overall change in the Hospital's net assets is its operating income gain, generally the difference between net patient service revenue and the expenses incurred to perform those services. In each of the past two years, the Hospital has reported an operating gain. Operating gains in 2005 increased by \$1,047 or 495% from 2004.

Hocking Valley Community Hospital

A Component Unit of Hocking County, State of Ohio
Management's Discussion and Analysis

The increase in the Hospital's total operating revenue in 2005 of \$549 or 2% from 2004 is the result of a rate increase and conversion to critical access. During 2005, the Hospital increased gross charge rates 3% compared to 2004. Excluded from net patient service revenue are charges for patient service waived under the Hospital's charity care policy. Charity care represents unreimbursed charges incurred by the Hospital in providing uncompensated care to indigent patients. Based on established rates, charges of \$526 were waived during 2005.

The Hospital provides care for patients who have little or no health insurance or other means of repayment. This service to the community is consistent with the goals established for the Hospital when it was established. Because there is no expectation of repayment, charity care is not reported as patient service revenues of the Hospital.

Non-operating Income (Expenses)

Non operating gains (losses) are the result of changes in the Hospital's investment gain (loss) and donations. The Hospital's investment income resulted in a gain of \$55 in 2005. The Hospital received contributions in 2005 of approximately \$75 versus \$158 in 2004. The Hospital also incurred interest expense of \$219 and \$262 during 2005 and 2004 respectively.

Hocking Valley Community Hospital

A Component Unit of Hocking County, State of Ohio
Management's Discussion and Analysis

Cash Flows

Changes in the Hospital's cash flows are consistent with changes in operating gains and non-operating income and expenses as discussed earlier. Non cash expenses such as depreciation and bad debt expense represent primary reasons the net cash from operating activities is greater than the change in net assets. The Hospital generated cash in 2005 of \$1,020.

Capital Asset and Debt Administration

Capital assets

At the end of 2005, the Hospital had \$9,607 invested in capital assets, net of accumulated depreciation, as detailed in the financial statements. The Hospital acquired or constructed capital assets in the amount of \$757 and \$517 during 2005 and 2004, respectively.

Debt

At year-end, the Hospital had \$3,875 in bonds and capital lease obligations outstanding in addition to a line of credit of \$300.

Contacting the Hospital's Financial Management

This financial report is designed to provide our patients, suppliers, taxpayers, and creditors with a general overview of the Hospital's finances and to show the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Hospital Chief Financial Officer's Office, 601 State Route 664, P.O. Box 966, Logan, OH 43138.

HOCKING VALLEY COMMUNITY HOSPITAL

BALANCE SHEETS DECEMBER 31, 2005 AND 2004

ASSETS

	<u>2005</u>	<u>2004</u>
Current assets		
Cash and cash equivalents	\$ 1,621,283	\$ 601,101
Short-term investments	187,774	187,339
Patient accounts receivable, less allowance for doubtful accounts of \$214,000 in 2005 and \$249,000 in 2004	4,978,925	5,457,634
Inventories	154,137	212,131
Third-party settlements	77,360	-
Prepaid expenses and other assets	46,244	16,490
Total current assets	<u>7,065,723</u>	<u>6,474,695</u>
Asset whose use is limited		
Under bond indenture agreement	330,000	330,000
Property, plant and equipment, net	9,607,324	9,890,999
Other assets		
Long-term investments	-	69,723
Deferred financing costs, net	71,501	78,465
Total other assets	<u>71,501</u>	<u>148,188</u>
Total assets	<u>\$ 17,074,548</u>	<u>\$ 16,843,882</u>

See accompanying notes to financial statements.

HOCKING VALLEY COMMUNITY HOSPITAL

BALANCE SHEETS DECEMBER 31, 2005 AND 2004

LIABILITIES AND NET ASSETS

	<u>2005</u>	<u>2004</u>
Current liabilities		
Current portion of capital lease obligations	\$ 241,292	\$ 387,882
Current portion of long-term debt	401,222	338,500
Line-of-credit	300,000	-
Accounts payable and accrued expenses	663,523	1,470,533
Accrued salaries, wages and employee benefits	1,485,435	1,368,788
Third-party settlements	-	91,565
	<u>3,091,472</u>	<u>3,657,268</u>
Capital lease obligations, less current portion	270,697	479,942
Long-term debt, less current portion	<u>2,961,293</u>	<u>3,142,383</u>
	6,323,462	7,279,593
Net assets		
Unrestricted	4,445,266	3,691,997
Invested in capital assets, net of related debt	5,975,820	5,542,292
Restricted by bond indenture agreement	330,000	330,000
	<u>10,751,086</u>	<u>9,564,289</u>
Total liabilities and net assets	<u>\$ 17,074,548</u>	<u>\$ 16,843,882</u>

See accompanying notes to financial statements.

HOCKING VALLEY COMMUNITY HOSPITAL

STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2005 AND 2004

	2005	2004
Revenues		
Net patient service revenue	\$ 26,165,448	\$ 25,616,182
Other operating income	127,519	127,207
	26,292,967	25,743,389
Operating expenses		
Salaries and wages	9,950,536	9,664,642
Employee benefits	3,160,501	3,204,111
Supplies and other	5,951,373	6,595,041
Professional fees and services	4,636,048	4,633,859
Depreciation and amortization	1,047,416	1,143,891
Insurance	271,666	274,977
	25,017,540	25,516,521
Operating income	1,275,427	226,868
Nonoperating gains (losses)		
Investment income (losses)	54,812	(59,925)
Interest expense	(218,923)	(262,982)
Other	75,481	158,106
	(88,630)	(164,801)
Revenues and gains over expenses (as restated for 2004)	1,186,797	62,067
Net assets beginning of year	9,564,289	9,502,222
Net assets, end of year	\$ 10,751,086	\$ 9,564,289

See accompanying notes to financial statements.

HOCKING VALLEY COMMUNITY HOSPITAL

STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2005 AND 2004

	2005	2004
Operating activities		
Cash received for patients and third party payors	\$ 26,475,232	\$ 24,961,631
Cash paid to employees for wages and benefits	(13,801,400)	(12,612,683)
Cash paid to vendors for goods and services	(10,830,847)	(11,513,320)
Other receipts, net	127,519	127,207
Net cash from operating activities	1,970,504	962,835
Capital and related financing activities		
Repayment of long-term debt	(118,368)	(318,729)
Repayment of capital lease obligations	(355,835)	(528,647)
Borrowings under line-of-credit	300,000	-
Interest expense	(218,923)	(262,982)
Acquisition of property and equipment	(756,777)	(516,672)
Contributions	75,481	158,106
Net cash from capital and related financing activities	(1,074,422)	(1,468,924)
Investing activities		
Change in investments, net	69,288	(273,102)
Investment income	54,812	303,876
Net cash from investing activities	124,100	30,774
Net change in cash and cash equivalents	1,020,182	(475,315)
Cash and cash equivalents		
Beginning of year	601,101	1,076,416
End of year	\$ 1,621,283	\$ 601,101
Reconciliation of operating income to net cash from operating activities		
Operating income	\$ 1,275,427	\$ 226,868
Adjustment to reconcile operating income to net cash from operating activities		
Depreciation and amortization	1,047,416	1,143,891
Bad debts	2,646,748	2,152,551
Changes in assets and liabilities		
Patient accounts receivable	(2,168,039)	(2,841,135)
Inventories, prepaid expenses and other assets	28,240	(9,443)
Accounts payable and accrued expenses, accrued salaries, wages and employee benefits	(690,363)	256,070
Third-party settlements	(168,925)	34,033
Net cash from operating activities	\$ 1,970,504	\$ 962,835

Supplemental disclosure of cash flow information

The Hospital entered into capital lease obligations in 2004 of \$31,440

See accompanying notes to financial statements.

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Organization

Hocking Valley Community Hospital (the Hospital), located in Hocking County, Logan, Ohio, is organized as a county hospital under provisions of the general statutes of the State of Ohio requiring no specific articles of incorporation. The organization is exempt from Federal income taxes. The Board of Trustees, appointed by the county commissioners and the probate and common pleas court judges, is charged with the management and operation of the Hospital, its finances and staff. The Hospital is considered a component unit of Hocking County, Ohio and is included as a component unit in the general-purpose financial statements of Hocking County.

Enterprise Fund Accounting

The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Use of Estimates

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

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

Charity Care

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy, the estimated cost of those services and supplies and equivalent service statistics. The amount of charity care not recorded as revenue was \$526,241 and \$823,672 in 2005 and 2004, respectively.

Net Patient Service Revenue and Patient Accounts Receivable

Normal billing rates for patient services less contractual adjustments are included in patient service revenue. Patient accounts receivable is adjusted for contractual allowances which are recorded on the basis of preliminary estimates of the amounts to be received from third party payors. Final adjustments are recorded in the period such amounts are finally determined. In 2005 and 2004, approximately 43% and 45%, respectively, of the Hospital's total patient revenue was derived from Medicare payments while 16% was derived from Medicaid.

The remaining revenue was derived primarily from commercial insurance payments and individual self-payments. The Hospital maintains an allowance for doubtful accounts based upon the expected collectibility of patient accounts receivable.

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

Investments

The Hospital's policy is to invest available funds in obligations of the U.S. Government, certificates of deposit, mutual funds and money market funds. Marketable equity securities owned by the Hospital were received through donations. The portfolio is carried at fair value.

Assets Whose Use is Limited

Assets whose use is limited consist of certificates of deposit restricted by the Trustee for maintenance of a minimum operating reserve in connection with the Hospital's Refunding and Improvement Bonds. The certificates are carried at fair value which approximates cost.

Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market.

Property, Plant and Equipment

Property, plant and equipment are reported on the basis of cost, except for donated items, which are recorded at fair value at the date of the donation. Expenditures which materially increase values, change capacities, or extend useful lives are capitalized. Depreciation is computed using the straight-line method over the expected useful lives of depreciable assets. Equipment under capital leases is amortized using the straight-line method over the lesser of the lease term or the estimated useful life of the equipment. The estimated useful lives are as follows:

Land improvements	15-20 years
Building and improvements	10-40 years
Equipment	3-7 years

Deferred Financing Costs

Deferred financing costs consist primarily of underwriter fees and other costs related to the issuance of the bonds and are being amortized over the life of the bonds based on the straight-line method. Accumulated amortization as of December 31, 2005 and 2004, was \$43,011 and \$36,047, respectively.

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

Cash and Cash Equivalents

The Hospital considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Statements of Operations and Changes in Net Assets

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as revenues and expenses. Peripheral or incidental transactions are reported as gains and losses. The peripheral activities include investment income and are reported as non-operating.

Compensated Absences

Compensated absences are accrued when incurred utilizing the termination method.

Risk Management

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

Net Assets

Net assets of the Hospital are classified in three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted by bond indenture agreement are assets that are set aside for bond repayment purposes, as specified by creditors of the Hospital. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

2. NET PATIENT SERVICE REVENUE

The Hospital has agreements with third-party payors that provide for payment to the Hospital at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospital's billings at established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with major third-party payors follows:

Medicare and Medicaid

The Hospital is a provider of services under the Medicare and Medicaid programs. The Hospital is designated as a critical access facility by the Medicare program. As a result, Medicare inpatient and outpatient services are reimbursed at 101% of the cost of providing those services. Payment for a majority of Medicaid inpatient and outpatient services is based on a prospectively determined amount.

Other Payors

The Hospital has entered into agreements with certain commercial carriers. Reimbursement for services under these agreements includes discounts from established charges and other payment methodologies.

Gross patient service revenue and the allowances to reconcile to net patient service revenue for the years ended December 31, 2004 and 2003, are as follows:

	<u>2005</u>	<u>2004</u>
Gross patient service revenue	\$ 49,334,605	\$ 46,965,569
Less third-party allowances	20,522,409	19,196,836
Less bad debts	2,646,748	2,152,551
Net patient service revenue	<u>\$ 26,165,448</u>	<u>\$ 25,616,182</u>

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

3. DEPOSITS AND INVESTMENTS

Deposits

At December 31, 2005 and 2004, the carrying amount of the Hospital's bank deposits for all funds is \$1,621,283 and \$601,101 as compared to a bank balance of \$2,126,191 and \$870,228, respectively. The differences in carrying amounts and bank balances are caused by outstanding checks and deposits-in-transit. Of the bank balances, at December 31, 2005 and 2004, \$119,161 and \$210,000, respectively is covered by Federal insurance programs and \$2,007,030 and \$660,208, respectively, is collateralized with securities held by the financial institution or by its trust department or agent but not in the Hospital's name.

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

		<u>Maturities</u>	
	Carrying amount	> than 1 year	1-5 years
December 31, 2005			
Certificates of deposit	<u>\$ 517,774</u>	<u>\$ 397,774</u>	<u>\$ 120,000</u>

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

Interest rate risk – The Hospital does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

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

Concentration of credit risk – The Hospital places no limit on the amount it may invest in any one issuer. The Hospital maintains its investments, which at times may exceed federally insured limits. The Hospital has not experienced any losses in such accounts. The Hospital believes that it is not exposed to any significant credit risk on investments. At December 31, 2005 and 2004, the Hospital had 100% and 88%, respectively of its investments invested in certificates of deposits at local banks.

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	12/31/2004	Additions	Retirements/ Transfers	12/31/2005
Land improvements	\$ 282,195	\$ 265,590	\$ -	\$ 547,785
Buildings and improvements	12,338,367	31,053	-	12,369,420
Equipment	11,657,110	460,134	-	12,117,244
Total capital assets	<u>24,277,672</u>	<u>756,777</u>	<u>-</u>	<u>25,034,449</u>
Less accumulated depreciation				
Land improvements	209,674	14,122	-	223,796
Buildings and improvements	4,329,822	370,206	-	4,700,028
Equipment	9,847,177	656,124	-	10,503,301
Total accumulated depreciation	<u>14,386,673</u>	<u>1,040,452</u>	<u>-</u>	<u>15,427,125</u>
Capital assets, net	<u>\$ 9,890,999</u>	<u>\$ (283,675)</u>	<u>\$ -</u>	<u>\$ 9,607,324</u>

	12/31/2003	Additions	Retirements/ Transfers	12/31/2004
Land improvements	\$ 278,495	\$ 3,700	\$ -	\$ 282,195
Buildings and improvements	12,084,587	253,780	-	12,338,367
Equipment	11,366,478	290,632	-	11,657,110
Total capital assets	<u>23,729,560</u>	<u>548,112</u>	<u>-</u>	<u>24,277,672</u>
Less accumulated depreciation				
Land improvements	194,483	15,191	-	209,674
Buildings and improvements	3,989,191	340,631	-	4,329,822
Equipment	9,066,072	781,105	-	9,847,177
Total accumulated depreciation	<u>13,249,746</u>	<u>1,136,927</u>	<u>-</u>	<u>14,386,673</u>
Capital assets, net	<u>\$ 10,479,814</u>	<u>\$ (588,815)</u>	<u>\$ -</u>	<u>\$ 9,890,999</u>

5. MEDICARE AND MEDICAID THIRD-PARTY SETTLEMENTS

Reimbursement for Medicare and Medicaid patients is subject to audit and final settlements by the respective intermediaries. Final settlements have been reached with Medicare through 2003 and with Medicaid through 2001. The amounts reported in the financial statements represent the estimated settlements outstanding at December 31, 2005 and 2004, which Hospital management believes will approximate final settlements after audit by the respective agencies.

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

6. LONG-TERM DEBT AND LEASES

The Hospital has the following debt outstanding at December 31, 2005 and 2004:

- 1993 County Hospital Refunding and Improvement Bonds, Serial Bonds, rates ranging from 3.95% to 4.8%, principal each December 1 through 2003, ranging from \$150,000 to \$185,000, with interest due each June 1 and December 1.
- 1993 County Hospital Refunding and Improvement Bonds, Term Bonds, 5.35% due December 1, 2008, mandatory annual redemption beginning December 1, 2004, in installments ranging from \$195,000 to \$235,000 plus interest.
- 1993 County Hospital Refunding and Improvement Bonds, Term Bonds, 5.45% due December 1, 2013, mandatory annual redemption beginning December 1, 2009, in installments ranging from \$50,000 to \$65,000 plus interest.
- 1999 County Hospital Improvement Bonds, Serial Bonds, rates ranging from 3.3% to 4.65%, principal due each December 1 through 2013, ranging from \$90,000 to \$145,000 with interest due each June 1 and December 1.
- 1999 County Hospital Improvement Bonds, Term Bonds, 4.75% due December 1, 2019, mandatory annual redemption beginning December 1, 2014, in installments ranging from \$150,000 to \$185,000 plus interest.
- Note payable, bi-annual payments of \$14,250 due and payable each June and December through 2009. Collateralized by related building. In March 2005, the Hospital entered into a note payable for \$250,000 that expires March 2010 at an interest rate of 5.25%

	12/31/2004	Additions	Payments	12/31/2005	Amount due within 1 year
1993 bonds, issued July 1, 1993	\$ 1,170,000	\$ -	\$ 205,000	\$ 965,000	\$ 215,000
1999 bonds, issued March 1, 1999	2,140,000	-	105,000	2,035,000	110,000
Bond discount	(57,116)	-	4,768	(52,348)	-
Note payable, December 2003	228,000	-	28,500	199,500	28,500
Note payable, March 2005	-	250,000	34,637	215,363	47,722
Capital leases	867,823	39,750	395,584	511,989	241,292
	<u>\$ 4,348,707</u>	<u>\$ 289,750</u>	<u>\$ 773,489</u>	<u>\$ 3,874,504</u>	<u>\$ 642,514</u>

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

	12/31/2003	Additions	Payments	12/31/2004	Amount due within 1 year
1993 bonds, issued July 1, 1993	\$ 1,365,000	\$ -	\$ 195,000	\$ 1,170,000	\$ 205,000
1999 bonds, issued March 1, 1999	2,240,000	-	100,000	2,140,000	105,000
Bond discount	(61,888)	-	4,772	(57,116)	-
Note payable, December 2003	256,500	-	28,500	228,000	28,500
Capital leases	1,365,031	31,440	528,648	867,823	387,882
	\$ 5,164,643	\$ 31,440	\$ 856,920	\$ 4,348,707	\$ 726,382

In 1993, the Hospital received \$3,300,000 in proceeds from the issuance of Hocking County Hospital Refunding and Improvement Bonds (Refunding and Improvement Bonds) which was used to repay \$2,040,000 Hocking County Hospital Refunding Bonds (Refunding Bonds) before their scheduled maturity, repay a capital lease and construct certain Hospital improvements. The Hospital has agreed with the Hocking County Commissioners, as Trustee for the Refunding and Improvement Bonds, to maintain a minimum operating reserve of \$330,000.

The Hospital leases equipment under capital lease agreements, which generally require the Hospital to pay insurance and maintenance costs. These capital leases are due in monthly installments including interest at rates ranging from approximately 6.3% to 12.2%. They expire at various dates through March 2006 and are collateralized by the equipment leased.

	December 31	
	2005	2004
Cost of equipment under capital lease	\$ 2,499,210	\$ 3,477,000
Accumulated amortization	1,997,794	2,472,080
Net carrying amount	\$ 501,416	\$ 1,004,920

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

Minimum payments on these obligations to maturity as of December 31, 2005 follows:

December 31,	Principal	Interest	Total
2006	\$ 642,514	\$ 171,861	\$ 814,375
2007	626,467	143,609	770,076
2008	479,464	117,476	596,940
2009	260,493	96,804	357,297
2010	235,566	107,196	342,762
2011-2014	605,000	151,273	756,273
2015-2019	835,000	168,150	1,003,150
2020-2024	190,000	9,026	199,026
	<u>\$ 3,874,504</u>	<u>\$ 965,395</u>	<u>\$ 4,839,899</u>

7. LINE OF CREDIT

During 2005 the Hospital established a \$2,000,000 line of credit with a bank. The line of credit bears an interest rate of 5.25% and expires in April 2006. Activity on the line of credit is as follows:

	<u>12/31/2004</u>	<u>Borrowings</u>	<u>Payments</u>	<u>12/31/2005</u>
Line of Credit	\$ -	\$ 300,000	\$ -	\$ 300,000

8. PENSION PLAN

The Hospital contributed to the Ohio Public Employees Retirement System of Ohio, (OPERS). OPERS administers three separate pension plans: The Traditional Pension Plan – a cost sharing multiple-employer defined benefit pension plan; the Member-Directed Plan (MD) – a defined contribution plan; and the Combined Plan (CO) – a cost sharing multiple-employer defined benefit pension plan that has elements of both a defined benefit and defined contribution plan. OPERS provides retirement and disability benefits, annual cost-of-living adjustments, healthcare benefits and death benefits to plan members and beneficiaries. OPERS issues a publicly available comprehensive annual financial report, which includes financial statements and required supplementary information for OPERS. That report may be obtained by writing to Public Employees Retirement System of Ohio, 277 East Town Street, Columbus, Ohio, 43215-4642 or by calling (614) 222-6701 or (800) 222-PERS (7377).

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

Funding Policy

The required, actuarially-determined contribution rates for the Hospital and for employee are 13.55% and 8.5%, respectively. The Hospital's contributions, representing 100% of employer contributions, for the last three years follows:

<u>Year</u>	<u>Contribution</u>
2005	\$ 1,314,267
2004	1,244,705
2003	1,186,566

OPERS also provides post-retirement healthcare coverage to age and service retirees with 10 or more years of qualifying Ohio service credit. Healthcare coverage for disability recipients and primary survivor recipients is available. The healthcare coverage provided by the retirement system is considered an Other Post-employment Benefit (OPEB). A portion of each employer's contribution to OPERS is set aside for the funding of post-retirement healthcare. The Ohio Revised Code provides statutory authority for employer contributions. The portion of the 2005 and 2004 employer contribution rates of 13.55% used to fund healthcare was 4.0%. The Ohio Revised Code provides the statutory authority requiring public employers to fund post-retirement healthcare through their contributions to OPERS.

An entry-age normal actuarial cost method of valuation is used in determining the present value of OPEB. The difference between assumed and actual experience (actuarial gains and losses) becomes part of the unfunded actuarial accrued liability. All investments are carried at market value. For actuarial purposes, a smoothed market approach is used. Under this approach, assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually. The investment return assumption rate for 2004 was 8%. An annual increase of 4% 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% base increase, were assumed to range from .5% to 6.3%. Healthcare costs were assumed to increase at the projected wage inflation rate plus an additional factor ranging from 1% to 6% for the next 8 years. In subsequent years (9 and beyond), healthcare costs were assumed to increase at 4% (the projected wage inflation rate).

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

The Traditional Pension and Combined Plans had 376,109 active contributing participants as of December 31, 2005. The number of active contributing participants for both plans used in the December 31, 2004 actuarial valuation was 355,287.

Hospital contributions made to fund post-employment benefits approximated \$388,000 and \$367,000 for 2005 and 2004, respectively.

The actuarial value of OPERS net assets at December 31, 2004 were \$10.8 million. The actuarially accrued liability and the unfunded actuarial accrued liability for OPEB, based on the actuarial cost method was \$29.5 million and \$18.7 million, respectively.

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

9. DEFERRED COMPENSATION

Employees of the Hospital may elect to participate in the Ohio Public Employees Deferred Compensation Program (Program), a deferred compensation plan under Internal Revenue Code Section 457. Under the Program, employees may elect to defer a portion of their pay until a later date, usually after retirement. The deferred pay and any income earned thereon are not subject to federal and state income taxes until actually received by the employee.

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

10. PROFESSIONAL LIABILITY INSURANCE

The Hospital has professional liability insurance with a commercial carrier. Coverage is \$1,000,000 per occurrence and \$3,000,000 in the aggregate. In addition, the Hospital has umbrella coverage of \$1,000,000 per occurrence and \$1,000,000 in the aggregate. The policy also requires that certain members of the medical staff carry professional liability coverage of no less than \$1,000,000 per occurrence and \$1,000,000 in the aggregate. The Hospital's coverage is on a claims made basis.

11. RELATED PARTIES

The Hocking Valley Community Hospital Memorial Fund, Inc. (Foundation) was organized as a separate not-for-profit membership corporation. The purpose of the Foundation is to solicit gifts for the benefit of the Hospital. The Board of Directors of the Foundation is elected by the Foundation's members. The accompanying financial statements do not include the assets, obligations, revenues or expenses of the Foundation.

Hocking Valley Health Services (HVHS) is a not-for-profit membership corporation located in Logan, Ohio. The purpose of HVHS is to provide healthcare and physician services and to own, lease, operate and/or provide healthcare facilities for the promotion of health in the area served by the Hospital. Additionally, HVHS is to conduct strategic healthcare planning and otherwise operate exclusively for the benefit and support of the Board of Governors of the Hospital. The Board of Trustees of HVHS are elected by HVHS's members of whom fifty percent of the voting rights are controlled by the Board of Governors of the Hospital.

Hocking Valley Medical Group, Inc. (HVMG) was organized as a separate not-for-profit stock professional corporation. The purpose of HVMG is to engage in the practice and to render the professional services, of medicine and to further the charitable purposes of the Foundation and the Hospital. At December 31, 2005 and 2004, the sole shareholder of HVMG has entered into an agreement with the Foundation and HVMG that states the shares of HVMG will be voted as directed by the Foundation. The accompanying financial statements do not include the assets, obligations, revenues or expenses of HVMG.

HOCKING VALLEY COMMUNITY HOSPITAL

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 2005 AND 2004

The Hospital entered into a 10 year non-cancelable lease with the Foundation for the Medical Arts Building. The Hospital is responsible for utilities, taxes, maintenance and insurance in addition to the rental payments of \$6,256 per month. Future minimum rental payments for the years ending December 31 follows:

2006	\$	75,075
2007		75,075
2008		75,075
2009		56,306
Total minimum lease payments	\$	<u>281,531</u>

12. PRIOR PERIOD ADJUSTMENT

The accompanying financial statements for 2004 have been restated to correct an error in the valuation of an investment held at December 31, 2004. The effect of the restatement was to decrease revenues and gains over expenses for 2004 by \$363,801.

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

To the Board of Trustees
Hocking Valley Community Hospital
Logan, Ohio

We have audited the financial statements of Hocking Valley Community Hospital, as of and for the year ended December 31, 2005, and have issued our report thereon dated March 10, 2006. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Hocking Valley 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 an opinion 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 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 caused by error or fraud, 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.

Compliance and Other Matters

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

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 an should not be used by anyone other than those specified parties.

Blue & Co., LLC

March 10, 2006



**Auditor of State
Betty Montgomery**

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**HOCKING VALLEY COMMUNITY HOSPITAL
HOCKING COUNTY**

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
JULY 20, 2006**