

MORROW COUNTY HOSPITAL
FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002



**Auditor of State
Betty Montgomery**

Board of Trustees
Morrow County Hospital
651 West Marion Road
Mt. Gilead, Ohio 43338

We have reviewed the Independent Auditor's Report of the Morrow County Hospital prepared by Holbrook & Manter, CPAs, for the audit period January 1, 2003 to 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 Morrow County Hospital is responsible for compliance with these laws and regulations.

Betty Montgomery

BETTY MONTGOMERY
Auditor of State

August 3, 2004

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INDEPENDENT AUDITORS' REPORT

The Board of Trustees
Morrow County Hospital
Mt. Gilead, Ohio

We have audited the accompanying combined balance sheets of Morrow County Hospital (the Hospital) (a component unit of Morrow County, Ohio) as of and for the years ended December 31, 2003 and 2002, and the related combined statements of revenues, expenses, and changes in fund balances and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of December 31, 2003 and 2002, and the results of its operations and changes in fund balances and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. The supplementary information is the responsibility of the Hospital's management. We 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 we do not express an opinion on it.

In accordance with Government Auditing Standards, we have also issued our report dated February 11, 2004 on our consideration of the Hospital's internal control over financial reporting, and our test 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.

Holbrook & Manter

Certified Public Accountants

February 11, 2004

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MORROW COUNTY HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS
UNAUDITED

Morrow County Hospital (MCH) is a critical access hospital, serving Morrow County and the surrounding area. MCH provides inpatient, outpatient, surgical care and operates a 38 bed extended care unit, pain center, wound clinic, home health department and has a medical specialty clinic where various specialists see patients. MCH is associated with OhioHealth and is governed by a Board of Trustees appointed by the Morrow County Commissioners. MCH is accredited by the Joint Commission on Accreditation of Health Care Organizations and its extended care unit is monitored by the Ohio Department of Health.

To meet community needs, MCH has increased services in recent years adding the pain clinic, wound center, and several surgical procedures previously not performed at our facility.

An analysis and discussion of specific financial information for fiscal years 2003 and 2002 is below.

Operating Revenues – Operating revenues increased from \$21,861,656 for the year ended December 31, 2002 to \$24,545,758 for the year ended December 31, 2003. This increase of \$2,684,102 or 12.3% is attributable to several factors. An overall price increase of 5% was implemented effective January 1, 2003. Outpatient revenue increased by \$5,164,385 or 26.4% from 2002. Outpatient registrations increased by 5.9% from 2002. The number of surgery patients increased by 13.3% from 2002, and we performed significantly more orthopedic and pain procedures in 2003. As a result, outpatient surgery revenue increased by \$1,909,756 or 63% from 2002. Emergency department visits increased by 6.1% over 2002. Inpatient revenue decreased by \$139,930 or 1.5% from 2002. Hospital days decreased by 582 days or 18.0% from 2002. Hospital admissions declined by 17.8% from 2002, while average length of stay decreased from 3.229 in 2002 to 3.225 in 2003. Extended care days increased by 542 days or 4.4% from 2002. Contractual adjustments were 32.0% of gross patient revenue in 2003 compared to 29.4% in 2002. This increase was caused by the 5% rate increase, increased outpatient revenue, and an unfavorable change in our mix of payors. The percentage of hospital revenue derived from Medicaid increased from 12.1% in 2002 to 14.4% in 2003. In addition, the percentage of revenue derived from commercial insurers decreased from 35.3% in 2002 to 32.5% in 2003.

Operating Expenses – Operating expenses increased \$2,517,113 or 10.5% from \$21,509,513 for the year ended December 31, 2002 to \$24,026,626 for the year ended December 31, 2003. Wages, salaries and benefits increased \$1,245,815 or 13% due to the annual pay increase for employees, the addition of thirteen full time equivalents and increased costs associated with MCH's self funded health insurance plan. Supplies and other expenses increased \$1,201,220 or 33.4% due to the increased volume and complexity of our surgery patients. Purchased Services decreased by \$453,811 or 8.8% due to lower volumes in Physical Therapy and the hiring of Respiratory Therapy employees formerly paid on a contract basis prior to July 1, 2003.

Non-Operating Income – Non-operating income primarily consists of investment income and gain (loss) on sale of investments. An FHLB bond with a face value of \$250,000 and a 5.13% interest rate matured on September 30, 2003.

Fund Balances – For the year ended December 31, 2003, our fund balances increased \$625,693. The increase was entirely due to the excess of revenue and income over expenses and losses.

MORROW COUNTY HOSPITAL
MANAGEMENT'S DISCUSSION AND ANALYSIS
UNAUDITED

Assets – Total assets of the organization increased \$431,538 to \$19,984,257 as of December 31, 2003 from \$19,552,719 as of December 31, 2002. Current assets increased by \$469,568 primarily due to an increase in patient accounts receivable of \$382,078, or 12% from 2002. This increase corresponds with the increase in net patient revenue of 13% from 2002. Assets Whose Use Is Limited consists of funds designated for the purchase of property and equipment or the repayment of long-term debt. Net Property and Equipment decreased \$236,175 during 2003. This decrease is the result of depreciation expense offset by capital purchases and new construction in progress. In 2003, we purchased \$907,801 of new property and equipment, consisting mostly of expanded or renovated office space, diagnostic equipment and computer related items.

Liabilities – Total liabilities decreased \$194,515 to \$9,453,307 as of December 31, 2003 from \$9,647,462 as of December 31, 2002. Current liabilities increased by \$433,750 due to an increase in the current portion of long-term debt and increased reserves for cost report settlements with Medicare. These were offset by a decrease in accrued interest payable due to the timing of debt payments. Long-term debt decreased by \$627,905 due to repayments of note and capital lease obligations of \$701,778. New capital leases totaling \$170,585 were issued to finance the purchase of new ultrasound and sleep lab equipment.

Cash Flows – For the year ended December 31, 2003, Cash and Cash Equivalents increased by \$321,537. Net cash provided from operating activities was \$1,682,651 and consisted primarily of net income adjusted for non-cash expenses such as depreciation. Net cash provided by non-capital activities was \$28,808, which was comprised of donations. Net cash used by capital and related financing activities was \$1,467,675. This cash was used primarily for the purchase of property and equipment (\$907,801), and the repayment of note and capital lease obligations (\$701,778). Net cash provided by investing activities, including investment income and loss on sale of investments, was \$77,753.

MORROW COUNTY HOSPITAL
COMBINED BALANCE SHEETS
DECEMBER 31, 2003 AND 2002

CURRENT ASSETS:	2003	2002
Cash and cash equivalents	\$ 733,021	\$ 655,389
Patient accounts receivable, less allowance of \$2,949,000 and \$2,546,300, respectively	3,658,167	3,276,089
Levied taxes receivable	1,150,000	1,150,000
Other receivable	32,141	17,604
Current portion of notes receivable	119,798	47,487
Medicare and Medicaid third party settlement	0	67,793
Inventory	292,543	376,943
Prepaid expenses	228,446	153,243
 Total current assets	 6,214,116	 5,744,548
ASSETS WHOSE USE IS LIMITED: (Note 1)		
Cash and cash equivalents	1,551,467	1,307,562
Investments	309,235	577,719
Interest receivable	14,303	10,845
 Total Assets Whose Use is Limited	 1,875,005	 1,896,126
PROPERTY & EQUIPMENT - NET, (Note 5)		
	11,605,683	11,841,858
OTHER ASSETS:		
Notes receivable	286,599	67,333
Investments	2,854	2,854
Total Other Assets	289,453	70,187
 TOTAL ASSETS	 \$ 19,984,257	 \$ 19,552,719

See Accompanying Notes to Combined Financial Statements.

CURRENT LIABILITIES:	2003	2002
Current portion of long-term debt	\$ 610,228	\$ 296,221
Current portion of capital lease obligation	310,613	352,544
Accounts payable	1,049,916	1,170,317
Deferred revenue for levied taxes	1,150,000	1,150,000
Accrued payroll and related liabilities	1,212,958	1,095,058
Medicare and Medicaid third party settlement	355,829	0
Accrued interest	25,269	216,923
Total current liabilities	4,714,813	4,281,063
LONG-TERM DEBT:		
Notes payable - (Note 6)	4,394,488	4,853,963
Capital lease obligations - (Note 7)	344,006	512,436
Total Long-Term Debt	4,738,494	5,366,399
Total liabilities	9,453,307	9,647,462
FUND BALANCES		
Invested in capital assets - net of related debt	5,946,348	5,826,694
Restricted for capital improvements and debt service	1,875,005	1,896,126
Unrestricted	2,709,597	2,182,437
Total fund balances	10,530,950	9,905,257
TOTAL LIABILITIES AND FUND BALANCES	\$ 19,984,257	\$ 19,552,719

MORROW COUNTY HOSPITAL
COMBINED STATEMENTS OF REVENUES, EXPENSES
AND CHANGES IN FUND BALANCES
YEARS ENDED DECEMBER 31, 2003 AND 2002

OPERATING REVENUES:	2003	%	2002	%
Net patient service revenue	\$ 23,003,084	93.72%	\$ 20,373,255	93.19%
Other operating revenues	1,542,674	6.28%	1,488,401	6.81%
Total operating revenues	<u>24,545,758</u>	100.00%	<u>21,861,656</u>	100.00%
OPERATING EXPENSES:				
Wages, salaries and benefits	10,577,814	43.09%	9,331,999	42.69%
Purchased services	4,694,912	19.13%	5,148,723	23.55%
Supplies and other	4,799,610	19.55%	3,598,390	16.46%
Provision for bad debts	1,714,233	6.98%	1,401,375	6.41%
Depreciation	1,321,470	5.38%	1,106,611	5.06%
Insurance	215,149	0.88%	169,074	0.77%
Rental	331,516	1.35%	322,493	1.48%
Interest expense	371,922	1.52%	430,848	1.97%
Total operating expenses	<u>24,026,626</u>	97.88%	<u>21,509,513</u>	98.39%
INCOME (LOSS) FROM OPERATIONS	519,132	2.12%	352,143	1.61%
NONOPERATING INCOME (LOSS):				
Contributions	28,808	0.12%	20,585	0.09%
Investment income	103,127	0.42%	127,204	0.58%
Loss on disposal of assets	0	0.00%	(34,043)	(0.16%)
Gain (loss) on sale of investments	(25,374)	(0.10%)	(6,563)	(0.03%)
Net nonoperating income	<u>106,561</u>	0.44%	<u>107,183</u>	0.48%
EXCESS OF REVENUE AND INCOME OVER EXPENSES AND LOSSES	625,693	<u>2.56%</u>	459,326	<u>2.09%</u>
FUND BALANCES AT BEGINNING OF YEAR	<u>9,905,257</u>		<u>9,445,931</u>	
FUND BALANCES AT END OF YEAR	<u>\$ 10,530,950</u>		<u>\$ 9,905,257</u>	

See Accompanying Notes to Combined Financial Statements.

MORROW COUNTY HOSPITAL
COMBINED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2003 AND 2002

CASH FLOWS FROM OPERATING ACTIVITIES:	2003	2002
Cash received from patients and third-party payors	\$ 21,330,395	\$ 18,203,962
Cash payments to suppliers for services and goods	(10,152,391)	(8,902,164)
Cash payments to employees for services	(10,459,914)	(8,939,014)
Other operating revenue received	1,528,137	1,489,963
Interest paid	(563,576)	(298,406)
Net cash provided by operating activities	<u>1,682,651</u>	<u>1,554,341</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from investments	0	257,110
Investment income	103,127	127,204
Gain (loss) on sale of investments	(25,374)	(6,563)
Assets limited as to use	<u>265,026</u>	<u>(445)</u>
Net cash provided by investing activities	<u>342,779</u>	<u>377,306</u>
CASH FLOWS FROM NON-CAPITAL AND RELATED FINANCING ACTIVITIES:		
Proceeds from non-capital contributions	<u>28,808</u>	<u>20,585</u>
Net cash provided by non-capital activities	<u>28,808</u>	<u>20,585</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of property and equipment	(907,801)	(2,557,308)
Construction in progress	(177,494)	(191,170)
Net proceeds (advances) on notes receivable	(291,577)	11,814
Proceeds from notes	175,364	0
Proceeds from capital lease obligations	170,585	46,129
Repayment of note and capital lease obligations	<u>(701,778)</u>	<u>(410,897)</u>
Net cash used by capital and related financing activities	<u>(1,732,701)</u>	<u>(3,101,432)</u>
Net increase (decrease) in Cash and Cash Equivalents	<u>321,537</u>	<u>(1,149,200)</u>
Cash and Cash Equivalents at Beginning of Year	<u>1,962,951</u>	<u>3,112,151</u>
Cash and Cash Equivalents at End of Year	<u>\$ 2,284,488</u>	<u>\$ 1,962,951</u>
Cash and cash equivalents - current assets	\$ 733,021	\$ 655,389
Cash and cash equivalents whose use is limited	<u>1,551,467</u>	<u>1,307,562</u>
Total Cash and Cash Equivalents	<u>\$ 2,284,488</u>	<u>\$ 1,962,951</u>
RECONCILIATION - OPERATING INCOME TO NET OPERATING CASH FLOWS		
Income from operations	\$ 519,132	\$ 352,143
Adjustments to reconcile income from operations to net cash provided by operating activities		
Depreciation	1,321,470	1,106,611
Cash provided by (used for) operating assets and liabilities		
Patient accounts receivable	(382,078)	(564,669)
Levied taxes receivable	0	(200,000)
Other accounts receivable	(14,537)	1,562
Inventories	84,400	(169,294)
Prepaid expenses	(75,203)	(29,348)
Accounts payable	(120,401)	535,158
Deferred revenue for levied taxes	0	200,000
Accrued expenses	117,900	392,985
Accrued Medicare and Medicaid third party settlements	355,829	0
Accrued interest	(191,654)	132,442
Medicare and Medicaid third party settlements	<u>67,793</u>	<u>(203,249)</u>
Net cash provided by operating activities	<u>\$ 1,682,651</u>	<u>\$ 1,554,341</u>

See Accompanying Notes to Combined Financial Statements.

MORROW COUNTY HOSPITAL
NOTES TO COMBINED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002

NOTE 1 – GENERAL STATEMENT AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:-

General Statement

Morrow County Hospital (the Hospital) is an acute and extended care hospital facility, owned by Morrow County, Ohio and operated and governed by a Board of Trustees pursuant to the powers and duties provided in Section 339.03 of the Ohio Revised Code. Members of the Board of Trustees are appointed by the County Commissioners. The Hospital is included as part of the general purpose financial statements of Morrow County, Ohio and is considered part of the primary government.

Morrow County Hospital Foundation (“the Foundation”) is a non-profit organization, founded during 1997, to operate exclusively for the benefit and support of the Hospital.

Summary of Significant Accounting Policies

The accompanying financial statements comply with the provisions of GASB Statement No. 14, *The Financial Reporting Entity*, and GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*. The Foundation is considered a component unit based on the nature and significance of the relationship between the Hospital and the Foundation. For financial reporting purposes, the accounts of the Hospital and the Foundation have been combined.

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.

Proprietary Fund Accounting

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

Accounting Standards

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

Charity Care

The Hospital maintains a policy whereby patients in need of medical services are treated without regard to their ability to pay for such services. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenue.

Income Taxes

The Hospital is a political subdivision of Morrow County and is exempt from Federal income tax. The Internal Revenue Service has ruled that the Foundation is exempt under Section 501(a) as an organization described in Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for federal income taxes has been made in the financial statements.

MORROW COUNTY HOSPITAL
NOTES TO COMBINED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002

NOTE 1 – GENERAL STATEMENT AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:- (continued)

Inventories

Inventories are determined by physical counts and are stated at the lower of cost or net realizable value using the first-in, first-out method of valuation.

Cash and Cash Equivalents

Cash and cash equivalents reported as current assets and as assets whose use is limited, include cash on hand and on deposit and investments in highly liquid debt instruments with an original maturity of three months or less.

Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for contractual payments to the Hospital. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. 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.

Property and Equipment

Acquisitions of property and equipment are stated at cost or at fair market value if received as a donation. The carrying value of assets sold, retired, or otherwise disposed of, and the related allowances for depreciation are eliminated from the accounts and any resulting gain or loss is included in nonoperating income and losses. Repairs and maintenance are charged to operations when incurred. The Hospital's policy is to capitalize additions exceeding \$500 with an estimated useful life of two years or more.

Depreciation of property and equipment is provided by annual charges to expense on a straight-line basis over the expected useful lives of the assets. The ranges of useful lives used in computing depreciation are 5-25 years for land improvements and equipment and 10-50 years for buildings.

County Tax Levy

In 1986, a tax levy was passed in Morrow County to provide the Hospital with unrestricted operating funds through 1991. The levy was renewed in 1991, 1996, and 2001 providing unrestricted operating funds through 2006. Proceeds from the 2.5 mill tax levy have been included in other operating revenue in the accompanying financial statements. Pursuant to GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, the Hospital has reflected the tax levy amount due in 2004 of \$1,150,000 as a levied taxes receivable with a corresponding deferred revenue for levied taxes at December 31, 2003.

Risk Management

The Hospital is exposed to various risks of loss from medical malpractice; torts; theft of, damage to, and destruction of assets; business interruption; competition; errors and omissions; employee and community injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. In addition to insurance provided by the County, where available the hospital purchases commercial insurance coverage for claims arising from such matters. Settlement claims have not exceeded this commercial coverage in any of the three preceding years.

MORROW COUNTY HOSPITAL
NOTES TO COMBINED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002

NOTE 1 – GENERAL STATEMENT AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:- (continued)

Compensated Absences

Vacation benefits are accrued as a liability as the benefits are earned if the employee's right to receive compensation is attributable to services already rendered and it is probable that the employer will compensate the employee for the benefits through paid time off or some other means. Sick leave benefits are accrued as a liability using the vesting method. Accumulated, unused sick leave is paid at varying rates depending on length of service and age. The criteria for determining the vacation liability is derived from accounting principles generally accepted in the United States of America.

Assets Whose Use is Limited

Assets whose use is limited consists of cash and cash equivalents and invested funds designated by the Hospital's Board of Trustees for the replacement, improvement, and expansion of the Hospital's facilities and for repayment of long-term debt. Investments consist principally of U.S. Government Securities and are recorded at fair value.

Third Party Reimbursement

The Hospital is a provider of services under contractual arrangements with Medicare and Medicaid programs. In addition, the Hospital has other third-party reimbursement arrangements. Net patient service revenues include amounts estimated by management to be reimbursable by these programs under the provisions of various payment arrangements. Payment arrangements include prospectively determined rates per discharge, reimbursed cost, discounted charges and per diem rates. Amounts received by the Hospital for treatment of patients covered by such programs are less than the established billing rates. The differences between established billing rates and amounts received are deducted in arriving at net patient service revenues.

Beginning in October 2002, the Hospital became a Critical Access Hospital under the Medicare Rural Hospital Flexibility Program. This program, which required meeting several criteria for designation, allows the Hospital to, among other things, receive reimbursement for Medicare patients on a reasonable cost basis rather than a prospective payment system basis.

Amounts earned under the Medicare and Medicaid programs are subject to audit by appropriate government authorities or their agents. 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. At December 31, 2003, final settlements had been reached with Medicare through 2000 and with Medicaid through 1997. The amounts reported in the accompanying financial statements represent the estimated settlements outstanding at December 31, 2003 and 2002, which Hospital management believes will approximate final settlements after audit by the respective agencies.

In the healthcare industry, laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Hospital's management believes that it is in substantial compliance with all applicable laws and regulations, and is not aware of any pending or threatening investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with healthcare industry 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.

Reclassification:-

Certain accounts in the prior year financial statements have been reclassified for comparative purposes to conform with the presentation in the current year combined financial statements.

MORROW COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002

NOTE 1 – GENERAL STATEMENT AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:- (continued)

Malpractice and General Patient Liability Contingencies:-

Because of the nature of its operations, the Hospital is at all times subject to pending and threatened legal actions that arise in the normal course of its activities.

At December 31, 2003, management is aware of certain asserted and unasserted malpractice and general patient liability claims and assessments against the Hospital. These claims are in various stages of processing and their outcome is uncertain. Therefore, future liability of the Hospital related to these claims and assessments is unknown. Accordingly, no amounts have been accrued for malpractice and general patient liability claims.

There may be unknown incidents arising from services provided to patients. However, because the annual insurance policy only covers claims that have been asserted and incidents reported to the insurance carrier, these unknown incidents are not yet covered by insurance. Management has no basis to estimate the ultimate cost, if any, of the settlement of such potential claims and, accordingly, has not accrued for them. In addition, management intends to maintain the current occurrence basis insurance coverage to cover any unknown incidents that may be asserted.

The Hospital purchases, through a commercial carrier, professional liability insurance on an occurrence basis without co-insurance, subject to deductibles, and up to specified policy limits per medical incident and in the aggregate, plus other supplemental protection.

NOTE 2 – CASH AND INVESTMENTS:-

The Hospital maintains a cash and investment pool. Cash and cash equivalents reported as current assets and as assets whose use is limited, include investments in highly liquid debt instruments with an original maturity of three months or less.

Deposits

At December 31, 2003, the carrying amount of the Hospital's book deposits was \$2,284,488 as compared to bank balances of \$2,980,874. The difference in carrying amount and bank balances is caused by outstanding checks and deposits in-transit. Of the bank balances, \$200,000 is covered by Federal Insurance Programs and \$2,780,874, is uninsured but collateralized by pools of securities pledged by the depository banks, or by its trust department or agent but not in the Hospital's name as defined by GASB Statement No. 3, *Deposits With Financial Institutions, Investments (Including Repurchase Agreement), and Reverse Repurchase Agreements*.

Investments

State statutes authorize and direct the permitted types of investments. All investments of the Hospital are held in the Hospital's name by a depository bank that is an agent of the Hospital.

In accordance with GASB Statement No. 3, the Hospital categorized investments in the following table to give an indication of the level of risk assumed by the entity at December 31, 2003. Category 1 includes investments that are insured or registered, or for which securities are held by the Hospital or its agent in the name of the Hospital. Category 2 includes uninsured and unregistered investments for which securities are held by the broker's or dealer's trust department or agent in the name of the Hospital. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by its trust department or agent but not in the Hospital's name. As discussed in Note 1, the Hospital's investments generally are carried at fair value.

MORROW COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002

NOTE 2 – CASH AND INVESTMENTS:- (continued)

	<u>Category</u>			<u>Carrying Amount</u>	<u>Market Value</u>
	<u>1</u>	<u>2</u>	<u>3</u>		
Investments	\$ 2,854	\$ 0	\$ 0	\$ 2,854	\$ 2,854
Investments Whose Use is Limited	<u>309,235</u>	<u>0</u>	<u>0</u>	<u>309,235</u>	<u>309,235</u>
Total	<u>\$ 312,089</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 312,089</u>	<u>\$ 312,089</u>

NOTE 3 – CHARITY CARE:-

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 this charity care policy. Charity care, based on estimated rates, totaled approximately \$223,923 and \$151,032 during the years ended December 31, 2003 and 2002, respectively.

NOTE 4 – OPERATING REVENUE:-

The Hospital provides services to certain patients covered by various third party payor arrangements that provide for payments to the Hospital at amounts different than its established rates. Gross patient service revenue and adjustments to reconcile to net patient services revenue for the years ended December 31, 2003 and 2002 are as follows:

	<u>2003</u>	<u>2002</u>
Gross patient service revenue	\$ 33,779,798	\$ 28,735,362
Less contractual adjustments:-		
Medicare	5,923,357	5,222,323
Medicaid and other	<u>4,853,357</u>	<u>3,139,784</u>
Total Contractual Adjustments	<u>10,776,714</u>	<u>8,362,107</u>
Net patient service revenue	<u>\$ 23,003,084</u>	<u>\$ 20,373,255</u>

NOTE 5 – PROPERTY AND EQUIPMENT-NET:-

Property and equipment consists of the following at December 31:

	<u>2003</u>	<u>2002</u>
Land and improvements	\$ 609,671	\$ 576,852
Buildings	5,624,710	5,249,544
Equipment	15,455,407	14,955,591
Construction in progress	<u>411,081</u>	<u>233,587</u>
	22,100,869	21,015,574
Accumulated depreciation	<u>(10,495,186)</u>	<u>(9,173,716)</u>
Property and equipment - net	<u>\$ 11,605,683</u>	<u>\$ 11,841,858</u>

MORROW COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002

NOTE 6 – NOTES PAYABLE:-

Following is a summary of the long-term notes payable at December 31:

	2003	2002
Hospital facilities refunding revenue note, series 1999, sixty monthly payments of \$8,332 includes principal and interest at 5.90%. Secured by the receipts of the Hospital.	\$ 96,851	\$ 188,184
Under a master lease and purchase agreement, the Hospital borrowed under an arrangement with a finance company \$4,950,000 to finance the construction of facility improvements. The financing was provided by the issuance of 10 year tax-exempt hospital bonds maturing August 28, 2012 with interest at 5.89%. The lease and purchase agreement provides, among other things, for certain covenants and payoff options which allow for early retirement of the debt by the Hospital for applicable fees.	4,745,113	4,950,000
\$83,131 note payable with a financial institution bearing interest at a fixed rate of 4.875% per annum to finance an independent physician contract. The note requires monthly payments of \$3,628 principal and interest with the final payment due on July 21, 2005.	66,205	0
\$92,233 note payable with a financial institution bearing interest at a fixed rate of 4.875% per annum to finance an independent physician contract. The note requires monthly payments of \$4,025 principal and interest with the final payment due on October 11, 2005.	84,547	0
Deed restriction for donation of land. Payments based on fulfillment of a physician contract and disposal of land by the Hospital Foundation. Land is restricted to the use of a medical building.	12,000	12,000
	5,004,716	5,150,184
Current maturities	(610,228)	(296,221)
Long-term portion	\$ 4,394,488	\$ 4,853,963

Future maturities of the long-term debt are as follows:

<u>Year</u>	<u>Amount</u>
2004	\$ 610,228
2005	517,833
2006	480,783
2007	509,738
2008	539,982
Thereafter	2,346,152
	\$ 5,004,716

MORROW COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002

NOTE 7 - LEASES:-

At December 31, 2003, the Hospital has capital leases for a computer hardware and software system, a CT scanner system, and other medical equipment. The obligations under these capital leases have been recorded at the present value of future minimum lease payments, discounted at appropriate interest rates. The capitalized costs of \$1,867,222 less accumulated depreciation of \$1,267,295 are included in property and equipment. The Hospital also has operating leases for various medical equipment and a vehicle.

Annual minimum lease payments of the capital and operating leases required for the five years subsequent to December 31, 2003 are as follows:

	Capital Leases	Operating Leases
2004	\$ 347,145	\$ 188,987
2005	292,091	173,301
2006	43,851	55,078
2007	23,117	51,328
2008	0	0
Total minimum lease payments	706,204	\$ 468,694
Amounts representing interest	51,585	
Present value of net minimum payments	654,619	
Less current portion	310,613	
Long-term capitalized lease obligations	\$ 344,006	

NOTE 8 - PENSION BENEFIT OBLIGATION:-

All employees of the Hospital participate in the Public Employees Retirement System of Ohio (the "PERS of Ohio"), a cost-sharing multiple employer defined benefit pension plan. PERS of Ohio provides retirement and disability benefits, annual cost-of-living adjustments and death benefits to plan members and beneficiaries. Chapter 145 of the Ohio Revised Code provides statutory authority to establish and amend benefits. The Public Employees Retirement System of Ohio issues a stand-alone financial report that includes financial statements and required supplementary information for the PERS of Ohio. That report may be obtained by writing to PERS, 277 East Town St., Columbus, Ohio 43215-4642.

The Ohio Revised Code provides statutory authority for employee and employer contributions. The contribution rate for employees is 8.5%. The 2003 rate for local government employer units was 13.55% of covered payroll, 9.35% to fund the pension benefit obligation and 4.2% to fund health care. The contribution rates are determined on the advance funded, actuarial method. The Hospital's regular contributions to the PERS of Ohio for the years ending December 31, 2003, 2002 and 2001 were \$1,026,483, \$914,444 and \$756,718, respectively.

NOTE 9 - POST EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS:-

Public Employees Retirement System of Ohio provides post-retirement health care coverage to age and service retirees with ten or more years of qualifying Ohio service credit and to their primary survivor recipients. 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 Post Employment Benefit (OPEB) as described in GASB Statement No. 12. A portion of each employer's contribution to PERS is set aside for the funding of post retirement health care. The Ohio Revised Code provides statutory authority for employer contributions.

MORROW COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002

NOTE 9 - POST EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS:- (continued)

The 2003 employer contribution rate was 13.55% of covered payroll; 4.2% was the portion that was used to fund health care for the year. The Ohio Revised Code provides the statutory authority requiring public employers to fund post retirement health care through their contributions to PERS. The Hospital's regular contributions for the health care portion for the years ending December 31, 2003, 2002 and 2001 were \$318,172, \$283,444 and \$234,555, respectively.

OPEB is advance funded on an actuarially determined basis. The assumption and calculations below were based on the system's latest actuarial review performed as of December 31, 2001. 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 becomes part of the unfunded actuarial accrued liability. All investments are carried at market value. For actuarial valuation purposes, a smoother market approach is used. Under this approach, assets are adjusted annually to reflect 25% of unrealized market appreciation or depreciation on investment assets. The investment assumption rate for 2001 was 8.0%. An annual increase of 4.0% 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 4.0% base increase, were assumed to range from .50% to 6.30%. Health care costs were assumed to increase 4.0% annually. The number of active contributing participants was 402,041. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$16.4 billion and \$4.8 billion, respectively at December 31, 2001.

NOTE 10 - RELATED PARTY TRANSACTIONS:-

Morrow County Hospital Auxiliary was established to solicit contributions from the general public and to support the operations of the Hospital. Funds are distributed to the Hospital as determined by the Auxiliary's Board of Directors. The Auxiliary contributed \$17,500 in 2003 and \$20,000 in 2002 to the Hospital for the purchase of Hospital medical equipment.

The Foundation contributed funds to the Hospital of \$79,265 in 2003 and \$36,540 in 2002.

NOTE 11 - CONCENTRATIONS OF CREDIT RISK:-

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31, 2003 and 2002, was as follows:

	2003	2002
Medicare	29%	34%
Other third-party payors	38%	33%
Patients	24%	23%
Medicaid	9%	10%
	100%	100%

MORROW COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002

NOTE 12 - SELF-INSURANCE:-

Effective June 1, 1990, the Hospital began participating in a self-funded health and dental insurance plan. The self-funded plan is administered by a third party administrator which determines the current funding requirements of participants under the terms of the plan and the liability for claims and assessments that would be payable at any given point in the time. In addition, the Hospital purchases stop-loss insurance that provides coverage of claims in excess of certain amounts on individual claims. In connection therewith, the Hospital charged to operations a provision of \$1,349,981 for 2003 and \$1,100,743 for 2002, which represents the sum of actual claims paid and estimates of liability relating to claims, both asserted and unasserted, resulting from incidents that occurred during the year. In 2002, the provision charged to operations included \$250,000 of claims paid by the Hospital due to the bankruptcy of its' previous stop-loss insurance carrier. As of December 31, 2003 and 2002, the Hospital had estimated its outstanding loss reserves at \$230,937 and \$123,161, respectively, which is reported as a current liability for each year. Subsequent adjustment of insurance plan liabilities based on claims experience is treated as an adjustment to expense. The following summarizes the reserves, expenses and payments for the years 2003 and 2002:

	2003	2002
Beginning reserves	\$ 123,161	\$ 70,000
Expense for year	1,349,981	1,100,743
Payments during year	(1,242,205)	(1,047,582)
Ending reserves	\$ 230,937	\$ 123,161

NOTE 13 - CONTINGENCY:-

The Hospital has received a claim from an insurance company for approximately \$477,000 asserting that the Hospital's charges for certain patient care have exceeded the maximum charge increase allowable under a written agreement between the Hospital and the insurance company. The periods covered under this assertion are from October 1, 2000 through September 30, 2002. Hospital management believes that most of this assertion is without merit and is vigorously challenging this claim, though discovery remains in the early stages. A \$50,000 reserve charged to expense in 2003 has been recorded for estimated legal and settlement costs for this contingency.

NOTE 14 - COMPONENT UNIT FUNDS:-

The following is the condensed balance sheets and the condensed statements of revenue, expense and changes in fund balances for the Foundation as of December 31, 2003 and 2002.

CONDENSED BALANCE SHEETS

	December 31, 2003	December 31, 2002
ASSETS:-		
Cash and cash equivalents	\$ 304,135	\$ 315,202
Accounts receivable	50	50
Property and equipment - net	61,388	66,212
Total assets	\$ 365,573	\$ 381,464
LIABILITIES AND FUND BALANCES:-		
Notes payable	\$ 12,000	\$ 12,000
Total liabilities	12,000	12,000
FUND BALANCES	353,573	369,464
TOTAL LIABILITIES AND FUND BALANCES	\$ 365,573	\$ 381,464

MORROW COUNTY HOSPITAL
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2003 AND 2002

NOTE 14 - COMPONENT UNIT FUNDS:- (continued)

CONDENSED STATEMENTS OF REVENUE, EXPENSE
AND CHANGES IN FUND BALANCES

	<u>December 31, 2003</u>	<u>December 31, 2002</u>
OPERATING REVENUES:-		
Patient service revenues - net	\$ 0	\$ 0
Contributions	28,808	20,585
Other	42,866	49,990
	<u>71,674</u>	<u>70,575</u>
OPERATING EXPENSES:-		
General operating expense	3,476	1,851
Depreciation expense	4,824	4,831
	<u>8,300</u>	<u>6,682</u>
Excess of revenues over expenses	63,374	63,893
Fund balances at beginning of year	369,464	342,111
Residual equity transfer	<u>(79,265)</u>	<u>(36,540)</u>
Fund balances at end of year	<u>\$ 353,573</u>	<u>\$ 369,464</u>



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

To the Board of Trustees
Morrow County Hospital
Mt. Gilead, Ohio

We have audited the combined financial statements of Morrow County Hospital (the Hospital) (a component unit of Morrow County, Ohio) as of and for the years ended December 31, 2003 and 2002 and have issued our report thereon dated February 11, 2004. 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.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audits, we considered the Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the 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 internal controls over financial reporting, which we have reported to management of the Hospital in a separate letter dated February 11, 2004.

This report is intended solely for the information and use of the Board of Directors, management, and others within the Hospital and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in dark ink that reads 'Holbrook & Manter' in a cursive script.

Certified Public Accountants

February 11, 2004

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MEMBERS
AMERICAN INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS
OHIO SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS



**Auditor of State
Betty Montgomery**

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MORROW COUNTY HOSPITAL

MORROW COUNTY

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

**CERTIFIED
AUGUST 17, 2004**