Memorial Hospital of Union County and Affiliates

Combined Financial Report with Additional Information December 31, 2004

Auditor of State
Betty Montgomery

Board of Trustees
Memorial Hospital of Union County and Affiliates

We have reviewed the Independent Auditor's Report of the Memorial Hospital of Union County and Affiliates, Union County, prepared by Plante & Moran, PLLC for the audit period January 1, 2004 through December 31, 2004. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

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

Betty Montgomery

BETTY MONTGOMERY
Auditor of State

June 17, 2005

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Memorial Hospital of Union County and Affiliates

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Independent Auditor's Report

To the Board of Trustees
Memorial Hospital of Union County and Affiliates

We have audited the accompanying combined financial statements of Memorial Hospital of Union County and Affiliates as of December 31, 2004 and 2003 and for the years then ended, as listed in the table of contents. These combined financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these combined and combining 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 Memorial Hospital of Union County and Affiliates as of December 2004 and 2003 and the changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 15, 2005 on our consideration of the Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide opinions on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be considered in assessing the results of our audit.

The management's discussion and analysis is not a required part of the financial statements but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and, accordingly, do not express an opinion theron.

Plante & Moran, PLLC

March 15, 2005

The management's discussion and analysis of Memorial Hospital of Union County, the Gables at Green Pastures, and Union County Health System (collectively, the "Hospital"), provides an overview of the combined financial activities for the year ended December 31, 2004. Management is responsible for the completeness and fairness of the combined financial statements and the related footnote disclosures along with the management's discussion and analysis.

Using this Annual Report

The combined financial statements consist of three statements - a balance sheet, a statement of revenues, expenses, and changes in net assets, and a statement of cash flows. The combined financial statements and related notes provide information about activities of the Hospital, including resources held by the Hospital but restricted by specific purpose by contributors, bond indenture, grantors, or enabling legislation.

In June 1999, the GASB released statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. Changes in Statement No. 34 require a comprehensive one-line look at the entity as a whole.

The major changes from the fund basis financial statements presented by the Hospital in the past and the "one-line look at the entity as a whole" are as follows:

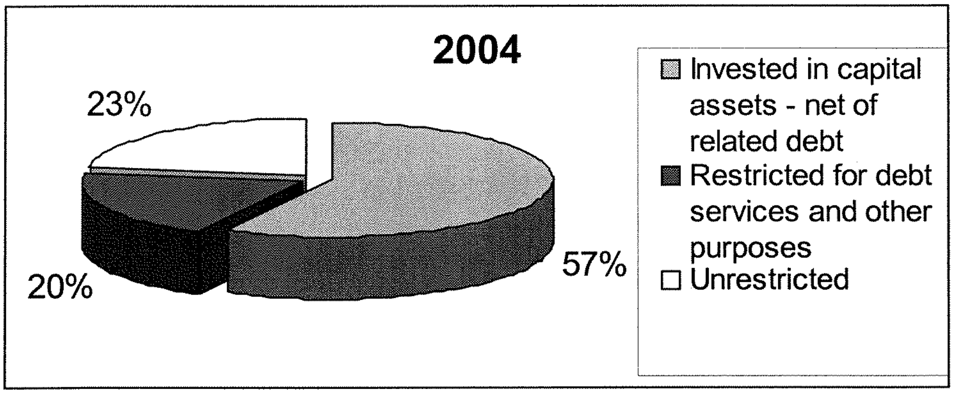
- New reporting standards - Statement of net assets, statement of revenues, expenses, and changes in net assets, and statement of cash flows
- Establishing an operating and nonoperating basis of reporting whereby revenues that are charges for services are recorded as operating revenue. Essentially, all other types of revenue are nonoperating or other revenue.
- Reporting net assets versus fund balance by donor classification

This annual combined financial report includes the report of independent auditors, this management's discussion and analysis, the combined financial statements in the above referred format, notes to the combined financial statements, and supplemental information.

Financial Highlights

The combined financial position of the Hospital improved in 2004. In total, the Hospital's net assets increased by $1.2 million in 2004. Operating revenues of $56.3 million exceeded operating expenses of $54.0 million, producing income from operations of $2.3 million. Other nonoperating expenses totaled $1.1 million. Cash and equivalents increased by $3.5 million, capital assets increased by $2.2 million, and long-term liabilities decreased by $1.5 million from 2003.

The following chart provides a breakdown of net assets by category for the year ended December 31, 2004:



In the year ended December 31, 2004, operating revenues exceeded operating expenses and nonoperating losses, creating an increase in net assets of $1,183,246 (compared to a $286,752 increase in the previous year).

The Balance Sheet and the Statement of Revenues, Expenses, and Changes in Net Assets

One of the most important questions asked about the finances of the Hospital is, "Is the Hospital as a whole better off or worse off as a result of the year's activities?" The balance sheet and statement of revenues, expenses, and changes in net assets report information on its activities in a way that helps answer this question. When revenues and other support exceed expenses, the result is an increase in net assets. When the reverse occurs, the result is a decrease in net assets. The relationship between revenues and expenses may be thought of as the Hospital's operating results.

These two statements report the Hospital's net assets and changes in them. You can think of the Hospital's net assets - the difference between assets and liabilities - as one way to measure the facility's financial health, or financial position. Over time, increases or decreases in net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider many other nonfinancial factors, such as the trend in patient days, outpatient visits, state and federal regulatory issues, conditions of the buildings, and strength of the medical staff, to fully assess Hospital's overall health.

The statements include all assets and 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.

Condensed Financial Information

The following is a comparative analysis of the major components of the balance sheet of the Hospital as of December 31, 2004:

	Year Ended December 31		Change	
	2004	2003	Amount	Percent
Assets:				
Current assets	$15,505,699	$17,894,836	$(2,389,137)	13.3%
Noncurrent assets	2,635,747	3,425,090	(789,343)	-23.0%
Capital assets	35,743,623	33,565,547	2,178,076	6.5%
Total assets	53,885,069	54,885,473	(1,000,404)	-1.8%
Liabilities:				
Current liabilities	5,950,080	6,697,121	(747,041)	-11.2%
Long-term liabilities	23,414,411	24,851,020	(1,436,609)	-5.8%
Total liabilities	29,364,491	31,548,141	(2,183,650)	-6.9%
Net assets:				
Invested in capital assets - Net of debt	14,170,638	9,524,285	4,646,353	48.8%
Restricted assets	4,827,773	8,933,332	(4,105,559)	-46.0%
Unrestricted	5,522,167	4,879,715	642,452	-13.2%
Total net assets	$24,520,578	$23,337,332	$ 1,183,246	5.1%

Current assets increased 16.9 percent, driven by an increase in cash as mentioned above, while capital assets increased 6.5 percent. Noncurrent assets decreased $5.4 million, primarily due to the use of the 2003 debt proceeds. Total liabilities decreased 6.9 percent during the year due to the refunding, refinancing, and retirement of debt. Net assets invested in capital assets increased $4.6 million and net restricted assets decreased $4.1 million, due to the use of the debt proceeds mentioned above. Unrestricted net assets increased 13.2 percent, due primarily to operating results and donor contributions.

Operating Results for the Year

	2004	2003	Change Amount	Change Percent
Operating Revenue				
Net patient service revenue	$54,589,205	$54,012,949	$ 576,256	1.1%
Other	1,760,239	2,057,891	(297,652)	-14.5%
Total operating revenue	56,349,444	56,070,840	278,604	0.5%
Operating Expenses				
Salaries and wages	25,366,526	25,260,195	106,331	0.4%
Employee benefits and payroll taxes	7,319,187	6,551,776	767,411	11.7%
Supplies and other	9,487,268	10,177,691	(690,423)	-6.8%
Professional services and consultant fees	1,253,795	971,570	282,225	29.0%
Purchased services	6,114,500	6,585,003	(470,503)	-7.1%
Insurance	513,243	544,516	(31,273)	-5.7%
Utilities	1,014,925	973,543	41,382	4.3%
Depreciation and amortization	2,971,246	2,949,029	22,217	0.8%
Total operating expenses	54,040,690	54,013,323	27,367	0.1%
Operating Income	2,308,754	2,057,517	251,237	12.2%
Other Income (Expense)				
Interest income	83,193	141,578	(58,385)	-41.2%
Noncapital grants and contributions	613,455	475,617	137,838	29.0%
Interest expense	(786,342)	(833,258)	46,916	-5.6%
Other revenue (expense)	(1,035,814)	(1,554,702)	518,888	-33.4%
Total other income (expense)	(1,125,508)	(1,770,765)	645,257	
Increase in Net Assets	1,183,246	286,752	$ 896,494	312.6%
Net Assets - Beginning of year	23,337,332	23,050,580		
Net Assets - End of year	$ 24,520,578	$ 23,337,332		

Operating Revenues

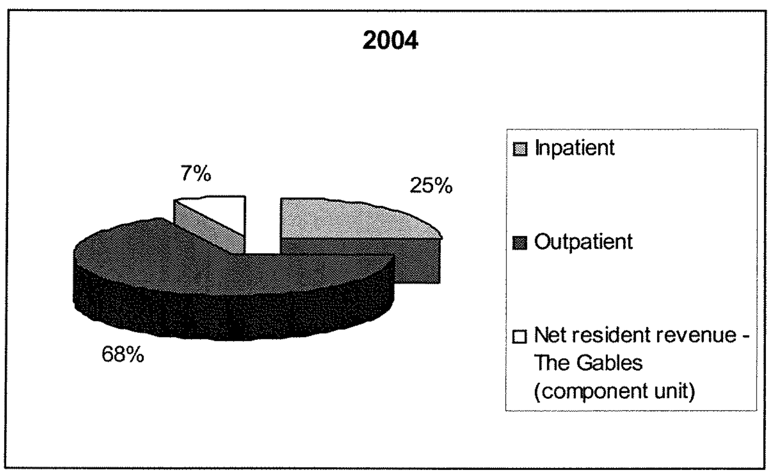
Operating revenues include all transactions that result in the sales and/or receipts from goods and services such as inpatient services, outpatient services, and the cafeteria. In addition, certain federal, state, and private grants are considered operating if they are not utilized for capital purposes and are considered a contract for services.

Operating revenue changes were a result of the following factors:

- Net patient service revenue increased 1.1 percent. This was attributable to an increase in outpatient ancillary services of 3.2 percent and a 4.9 percent increase in Gables' net resident revenue. Gross patient revenue is reduced by revenue deductions. These deductions are the amounts that are not paid to the Hospital under contractual arrangements with Medicare, Medicaid, and other payors. These revenue deductions increased from 42.8 percent to 43.8 percent as a percentage of gross revenue.

- Other operating revenue decreased 14.5 percent from 2003 due to MSO services to MPI (primary care billing), which concluded in July 2003.

The following is a graphic illustration of total patient revenues by source:

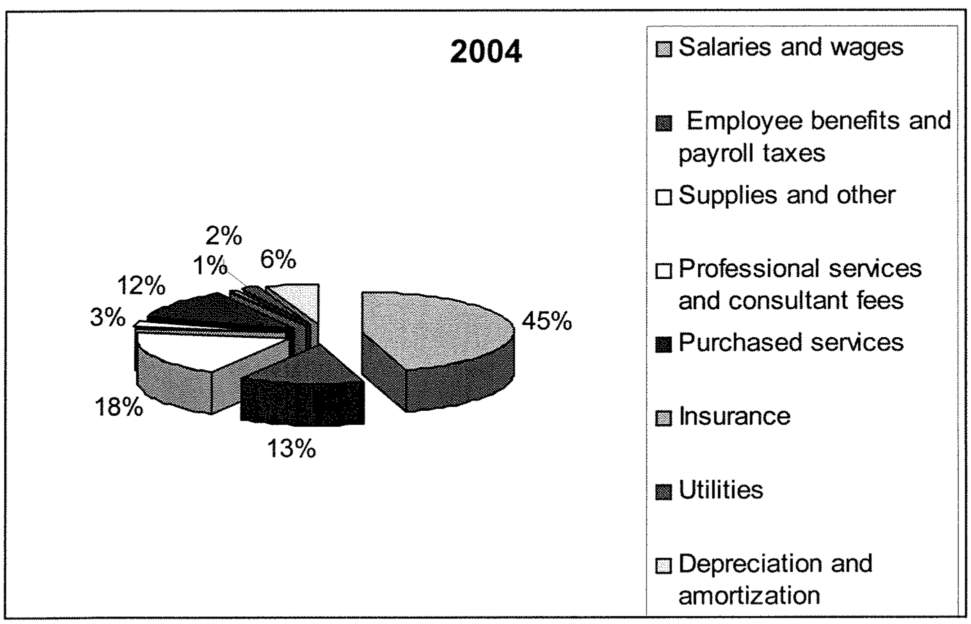


Operating Expenses

Operating expenses are all the costs necessary to perform and conduct the services and primary purposes of the Hospital. The operating expense changes were the result of the following factors:

- Salaries and benefits increased 2.7 percent due to annual wage increases of 4 percent and the rising cost of health insurance.
- Supplies decreased 5.2 percent due to the utilization of drugs and patient items combined with a decrease in general supplies and equipment.
- Professional services and consultant fees increased between years due to a 48.7 percent increase in legal services.
- Purchased services decreased 7.1 percent due to a decrease in purchased nursing and maintenance services with decreases of 72.1 percent and 39.3 percent, respectively.

The following is a graphic illustration of operating expenses by type:



Nonoperating Gains (Losses)

Nonoperating revenue and expenses are all sources and uses that are primarily nonexchange in nature. They consist primarily of gifts and bequests and investment income.

Significant changes to nonoperating gains (losses) were the result of the following factors:

- Expense related to physician income grants increased $381,000 during the year as several physicians reached the end of their initial grant period and entered the forgiveness period of their respective contracts. When a physician satisfies the contractual requirements, the grant balance is systematically forgiven and expense is recorded.
- Memorial Hospital wrote off the uncollectible receivable from UCHS of $1,110,727.
- The Development Council continued its involvement with the community and subsequently showed an increase in collected gifts of $157,004 over 2003.

Statement of Cash Flows

Another way to assess the financial health of the Hospital is to look at the statement of cash flows. Its primary purpose is to provide relevant information about the cash receipts and cash payments of the entity during a period. The statement of cash flows also helps assess:

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

	2004	2003	Increase (Decrease)
Cash provided by (used in):			
Operating activities	$ 7,320,121	$ 4,406,934	$ 2,913,187
Capital and related financing activities	(7,392,905)	1,621,799	(9,014,704)
Investing activities	(529,357)	(353,981)	(175,376)
Net Increase (Decrease) in Cash	(602,141)	5,674,752	(6,276,893)
Cash - Beginning of year	9,352,681	3,677,929	5,674,752
Cash - End of year	**$ 8,750,540**	**$ 9,352,681**	**$ (602,141)**

The following discussion amplifies the overview of cash flows presented above.

Net cash provided by operating activities increased $2.9 million over the prior year, mainly due to an increase of $3.0 million received from our patients and third-party payors. During the year, the Hospital paid an additional $704,000 to its employees for wages and benefits.

Net cash provided by capital and related financing activities decreased due to the use of debt proceeds for capital items combined with the refunding, refinancing, and retirement of general obligation bonds and notes.

Capital Asset and Debt Administration

Capital Assets

At December 31, 2004, the Hospital had $35.7 million invested in capital assets, net of accumulated depreciation of $27.7 million. Depreciation and amortization totaled $3.0 million for the current year compared to $2.9 million in 2003. A summary of these assets for the past two years is shown below.

	2004	2003	Increase (Decrease)
Land and land improvements	$ 2,904,568	$ 1,565,342	$ 1,339,226
Buildings and fixed equipment	20,792,770	20,861,469	(68,669)
Major movable equipment	4,880,886	5,324,048	(443,162)
Property under capital leases	1,335,000	1,761,281	(426,281)
Construction in progress	5,830,399	4,053,407	1,776,992
Total	$ 35,743,623	$ 33,565,547	$ 2,178,076

Debt

At year end, the Hospital had $17.0 million in long-term debt and capital lease obligations outstanding as compared to $19.3 million the previous year. The table below summarizes these amounts by year.

	2004	2003	Increase (Decrease)
Total leases and bonds	$ 16,973,375	$ 19,304,190	$(2,330,815)

The Hospital has made strides to pay down its financial obligations and has done so in alignment with its prescribed debt schedules. More detailed information about the Hospital's long-term liabilities is presented in the notes to the financial statements.

Economic Factors That Will Affect the Future

The economic position of the Hospital is tied to that of the local economy. In addition, the board of trustees approved an average increase of 6 percent in the charge structure for the upcoming fiscal year.

The current financial and capital plans of the Hospital indicate that the infusion of additional financial resources from the foregoing actions will enable it to maintain its present level of service.

Factors affecting the Hospital during 2005 and future years will be the ambulatory surgery center (opened in September 2004) and the 2007 opening of OhioHealth's facility in Dublin. To offset any potential financial impacts, the Hospital has implemented its 2005 strategic plan. The plan focuses on expanding and retaining our physician base, developing comprehensive service lines in cardiology, oncology, and surgery, increasing the marketability of our facility, and improving our quality and customer service initiatives.

Contacting the Hospital's Management

This financial report is intended to provide the users with a general overview of the Hospital's finances, and to demonstrate the overall Hospital's accountability. If you have questions about this report or need additional information, please feel free to contact me.

Jeff Ehlers
Chief Financial Officer

Memorial Hospital of Union County and Affiliates

Combined Balance Sheet

	December 31, 2004	December 31, 2003
Assets		
Current Assets		
Cash and cash equivalents (Note 2)	$ 3,840,907	$ 292,470
Patient accounts receivable (Note 3)	5,629,586	7,271,707
Assets limited as to use (Notes 2 and 4)	4,909,633	9,060,211
Prepaid expenses and other	380,046	355,061
Inventory	479,337	563,760
Other current assets	266,190	351,627
Total current assets	15,505,699	17,894,836
Capital Assets (Note 6)	35,743,623	33,565,547
Other Assets		
Physician advances receivable	1,753,850	2,378,230
Investment in joint ventures	435,339	542,788
Bond issue costs	446,558	504,072
Total assets	**$ 53,885,069**	**$ 54,885,473**
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 8)	$ 1,257,005	$ 2,037,073
Accounts payable	2,401,139	2,433,594
Cost report settlements payable	849,294	988,294
Salaries, wages, and related accruals (Note 7)	1,442,642	1,238,160
Total current liabilities	5,950,080	6,697,121
Long-term Debt (Note 8)	21,048,375	22,004,190
Other Liabilities		
Accrued compensated absences	1,851,996	1,850,995
Other long-term liabilities	514,040	995,835
Total liabilities	29,364,491	31,548,141
Net Assets		
Invested in capital assets - Net of related debt	14,170,638	9,524,285
Restricted:		
Nonexpendable permanent endowments	25,000	25,000
Restricted for debt service and capital acquisitions	4,802,773	8,908,332
Unrestricted	5,522,167	4,879,715
Total net assets	24,520,578	23,337,332
Total liabilities and net assets	**$ 53,885,069**	**$ 54,885,473**

See Notes to Combined Financial Statements.

Memorial Hospital of Union County and Affiliates

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

	Year Ended December 31, 2004	Year Ended December 31, 2003
Operating Revenues		
Net patient service revenue (Note 9)	$ 54,589,205	$ 54,012,949
Other	1,760,239	2,057,891
Total operating revenues	56,349,444	56,070,840
Operating Expenses		
Salaries and wages	25,366,526	25,260,195
Employee benefits and payroll taxes	7,319,187	6,551,776
Supplies and other	9,487,268	10,177,691
Professional services and consultant fees	1,253,795	971,570
Purchased services	6,114,500	6,585,003
Insurance	513,243	544,516
Utilities	1,014,925	973,543
Depreciation and amortization	2,971,246	2,949,029
Total operating expenses	54,040,690	54,013,323
Operating Income	2,308,754	2,057,517
Other Income (Expenses)		
Interest income	83,193	141,578
Noncapital grants and contributions	613,455	475,617
Interest expense	(786,342)	(833,258)
Other expense	(1,035,814)	(1,554,702)
Total other expenses	(1,125,508)	(1,770,765)
Increase in Net Assets	1,183,246	286,752
Net Assets - Beginning of year	23,337,332	23,050,580
Net Assets - End of year	**$ 24,520,578**	**$ 23,337,332**

See Notes to Combined Financial Statements.

Memorial Hospital of Union County and Affiliates

Combined Statement of Cash Flows

	Year Ended December 31, 2004	Year Ended December 31, 2003
Cash Flows from Operating and Nonoperating Activities		
Cash received from patients and third-party payors	$ 56,231,326	$ 53,133,472
Cash payments to suppliers for services and goods	(17,098,325)	(17,983,383)
Cash payments to employees for services	(32,804,787)	(32,100,500)
Other receipts from operations	1,760,239	2,115,940
Cash paid for interest	(768,332)	(758,595)
Net cash provided by operating activities	7,320,121	4,406,934
Cash Flows from Investing Activities		
Proceeds from other investments	83,193	141,578
Cash paid for other investments	(401,442)	(362,561)
Advances to physicians - Net of forgiveness	(211,108)	(118,956)
Net cash used in investing activities	(529,357)	(339,939)
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(5,657,025)	(5,657,828)
Issuance of long-term debt	1,805,000	8,740,000
Principal payments on long-term debt	(3,139,615)	(828,198)
Principal payments on capital leases	(401,265)	(646,217)
Net cash (used in) provided by capital and related financing activities	(7,392,905)	1,607,757
Net (Decrease) Increase in Cash and Cash Equivalents	(602,141)	5,674,752
Cash and Cash Equivalents - Beginning of year	9,352,681	3,677,929
Cash and Cash Equivalents - End of year	**$ 8,750,540**	**$ 9,352,681**

See Notes to Combined Financial Statements.

Combined Statement of Cash Flows (Continued)

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

	Year Ended December 31, 2004	Year Ended December 31, 2003
Cash Flows from Operating Activities		
Operating income	$ 2,308,754	$ 2,057,517
Adjustments to reconcile operating income to net cash from operating activities:		
Depreciation	2,971,246	2,949,029
Provision for bad debts	3,311,665	3,274,752
(Increase) decrease in assets:		
Patient accounts receivable	(1,669,544)	(4,078,892)
Other current assets	42,639	(700,051)
Increase (decrease) in liabilities:		
Accounts payable	(59,951)	786,111
Accrued expenses	415,312	118,468
Net cash provided by operating activities	**$ 7,320,121**	**$ 4,406,934**

Note 1 - Nature of Business and Significant Accounting Policies

Organization and Principles of Combination - Memorial Hospital of Union County ("Memorial") is an acute care hospital owned by Union County, Ohio and operated by a board of trustees (the "Trustees"). Members of the board of trustees are appointed by the county commissioners and county judges. Memorial is considered a political subdivision of a state and is therefore exempt from federal income taxes under Section 115 of the Internal Revenue Code.

In 1994, the board of trustees formed Union County Health System (UCHS) in order to provide a corporate structure under which the Hospital can enter into joint ventures with other institutions and health care providers to provide an integrated delivery system.

In 1994, the Board of County Commissioners of Union County (the "Board") passed a resolution to transfer the management and operations of Union Manor (a nursing home) to the Trustees on January 1, 1995. Pursuant to this resolution, the Trustees accepted control over the assets of Union Manor. Under the terms of the transfer, the Board indicated their support of the Trustees in Union Manor's future efforts to secure financing for renovation and expansion.

The combined financial statements for the years ended December 31, 2004 and 2003 included herein consist of the financial positions, results of operations, changes in net assets, and cash flows of Memorial Hospital of Union County, UCHS, and The Gables/Union Manor (collectively, the "Hospital"). All intercompany accounts and transactions between all entities have been eliminated.

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

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

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

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

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

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

Assets Limited as to Use - Assets whose use is limited consist of invested funds designated by the Trustees for the replacement, improvement, and expansion of the Hospital's facilities, self-insured health insurance, and workers' compensation plans and the Hospital's Section 125 Cafeteria Plan and invested funds held by a trustee in connection with the Hospital's bonds. Assets limited as to use also include funds whose use is specified by the donor, as well as permanently restricted endowments, the earnings of which can be used for certain purposes as specified by the donor.

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

Physician Advances Receivable - The Hospital advances monies to physicians under various cash flow support and loan arrangements. These loans are unsecured and are forgiven systematically in accordance with the loan agreements. Should the arrangement between the Hospital and the physician be terminated prior to the end date agreed upon by both parties, the Hospital will pursue collection of any outstanding advances.

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

Debt Issuance Costs - Costs incurred in obtaining long-term debt financing are being amortized over the term of the obligations using the straight-line method. Amortization expense totaled $72,042 and $29,871 in 2004 and 2003, respectively.

Compensated Absences - Paid time off is charged to operations when earned. The unused and earned benefits are recorded as a liability in the financial statements. Employees accumulate vacation days at varying rates depending on years of service, and may carry over accumulated hours to the next year. Employees also earn sick leave benefits at a Hospital-determined rate, which are capped at various levels. Employees are not paid for accumulated sick leave if they leave before retirement. However, employees who retire from the Hospital may convert accumulated sick leave to termination payments equal to the accumulated balance calculated at the employee's base pay rate as of the retirement date. There is no limit on the number of sick leave hours that an employee may accumulate; however, employees are only eligible to receive termination payments on accumulated sick leave balance up to a maximum of 240 hours. Employees accumulate holidays at a Hospital-determined rate for all employees.

Restricted Resources - When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

Classification of Net Assets - Net assets of the Hospital are classified in four components. (1) 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. (2) Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees as required by revenue note indentures. (3) Restricted nonexpendable net assets equal the principal portion of permanent endowments. (4) Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

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

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

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

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

Contributions - Contributions of cash and other assets, including unconditional promises to give in the future, are reported as revenue when received, measured at fair value. Contributions with donor-imposed time or purpose restrictions are reported as restricted support. All other contributions are reported as unrestricted support.

Income from Operations - For the purpose of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as operating revenue and expenses. Peripheral or incidental transactions are reported as nonoperating gains and losses.

Charity Care - The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

Pension Plan - Substantially all of the Hospital's employees are eligible to participate in a defined benefit pension plan sponsored by the Ohio Public Employees' Retirement System (OPERS). The Hospital funds pension costs accrued, based on contribution rates determined by OPERS.

Reclassification - Certain 2003 amounts have been reclassified to conform to the 2004 presentation.

Note 2 - Deposits and Investments

The Hospital's deposits and investments are included on the balance sheet under the following classifications:

2004	Cash and Cash Equivalents	Assets Limited as to Use	Total
Deposits	$ 3,840,907	$ 3,415,662	$ 7,256,569
Money market	-	1,493,971	1,493,971
Total	$ 3,840,907	$ 4,909,633	$ 8,750,540

2003	Cash and Cash Equivalents	Assets Limited as to Use	Total
Deposits	$ 292,470	$ 7,592,977	$ 7,885,447
Money market	-	1,467,234	1,467,234
Total	$ 292,470	$ 9,060,211	$ 9,352,681

The above deposits were reflected in the accounts of the bank (without recognition of checks written but not cleared or of deposits in transit) at approximately $10,189,000 and $10,948,000 at December 31, 2004 and 2003, respectively. Of those amounts, $300,000 and $670,061 was covered by federal depository insurance for 2004 and 2003, respectively, and the remainder was collateralized by pools of securities pledged by the depository banks and held in the name of the respective banks.

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	2004	2003
Patient accounts receivable	$ 11,562,586	$ 14,273,707
Less:		
Allowance for uncollectible accounts	1,923,000	1,743,000
Allowance for contractual adjustments	4,010,000	5,259,000
Total patient accounts receivable	$ 5,629,586	$ 7,271,707

Note 3 - Patient Accounts Receivable (Continued)

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

	2004	2003
	(Percent)	
Medicare	20	24
Medicaid	7	10
Commercial insurance and other	48	48
Self-pay	25	18
Total	100	100

Note 4 - Assets Limited as to Use

Assets limited as to use that are required for obligations classified as current liabilities are reported as current assets. The composition of assets limited as to use at December 31, 2004 and 2003 consists of the following:

	2004	2003
By board of trustees for capital improvements - Cash	$ 728,022	$ 404,609
By board of trustees retirement of indebtness - Cash	456,935	314,665
By board of trustees and self-insurance - Cash	381,196	735,048
Held by Trustee under bond indenture agreement - Cash	1,824,509	6,113,656
Held by trustee under bond indenture agreement - Money market	1,493,971	1,467,233
Total board-designated and trustee held	4,884,633	9,035,211
Principal for permanent endowments	25,000	25,000
Total assets limited as to use	$ 4,909,633	$ 9,060,211

Note 5 - Patient Service Revenue

Approximately 38 percent of the Hospital's net patient service revenue is received from the Medicare and Medicaid programs. The Hospital has agreements with these payors that provide for reimbursement to the Hospital at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospital's established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with these third-party payors is as follows:

Note 5 - Patient Service Revenue (Continued)

- **Medicare** - Inpatient, acute-care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain outpatient services, including ambulatory surgery, radiology, and laboratory services, are reimbursed on an established fee-for-service methodology. Beginning August 1, 2000, reimbursement for most outpatient services is based on the prospectively determined ambulatory payment classification system. However, the Hospital is held harmless until July 31, 2003 under this new outpatient payment system, should it result in less reimbursement than the payment system in place before August 1, 2000. The Medicare Modernization Act of 2003 extended these hold harmless provisions until January 1, 2006. The Hospital has recorded a liability for certain outpatient payments received prior to December 31, 2004, as the county in which the Hospital resides has been reclassified to an urban area and as such, the Hospital would not be eligible for such payments under the hold harmless reimbursement provision.

- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost reimbursement method. Outpatient and physician services are reimbursed on an established fee-for-service methodology.

The Medicaid payment system in Ohio is a prospective one, whereby rates for the following state fiscal year beginning July 1 are based upon filed cost reports for the preceding calendar year. The continuity of this system is subject to the uncertainty of the fiscal health of the State of Ohio, which can directly impact future rates and the methodology currently in place. Any significant changes in rates, or the payment system itself, could have a material impact on the future Medicaid funding to providers.

Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying combined financial statements.

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

Note 6 - Capital Assets

Capital assets activity for the years ended December 31, 2004 and 2003 was as follows:

	2003	Additions	Transfers	Retirements	2004	Depreciable Life - Years
Land and land improvements	$ 2,104,905	$ 188,633	$ 1,515,016	$ (323,374)	$ 3,485,180	10-20
Building	31,686,822	206,138	1,050,652	(192,564)	32,751,048	10-40
Major movable equipment	15,912,295	861,768	57,724	(11,117)	16,820,670	7-15
Property under capital leases	4,524,091	-	-	-	4,524,091	5-15
Construction in progress	4,053,407	4,400,486	(2,623,392)	(102)	5,830,399	
Total	58,281,520	5,657,025	-	(527,157)	63,411,388	
Less accumulated depreciation:						
Land and land improvements	539,563	61,833	(1,330)	(19,454)	580,612	
Building	10,825,353	1,131,595	1,330	-	11,958,278	
Major movable equipment	10,588,247	1,351,537	-	-	11,939,784	
Property under capital leases	2,762,810	426,281	-	-	3,189,091	
Total	24,715,973	2,971,246	-	(19,454)	27,667,765	
Net carrying amount	$ 33,565,547	$ 2,685,779	$ -	$ (507,703)	$ 35,743,623	

	2002	Additions	Transfers	Retirements	2003	Depreciable Life - Years
Land and land improvements	$ 2,050,569	$ 54,336	$ -	$ -	$ 2,104,905	10-20
Building	30,540,432	1,146,390	-	-	31,686,822	10-40
Major movable equipment	14,623,462	1,308,483	-	(19,650)	15,912,295	7-15
Property under capital leases	4,481,619	42,472	-	-	4,524,091	5-15
Construction in progress	947,260	3,106,147	-	-	4,053,407	
Total	52,643,342	5,657,828	-	(19,650)	58,281,520	
Less accumulated depreciation:						
Land and land improvements	507,497	32,066	-	-	539,563	
Building	9,774,099	1,051,254	-	-	10,825,353	
Major movable equipment	9,282,598	1,315,539	-	(9,890)	10,588,247	
Property under capital leases	2,212,640	550,170	-	-	2,762,810	
Total	21,776,834	2,949,029	-	(9,890)	24,715,973	
Net carrying amount	$ 30,866,508	$ 2,708,799	$ -	$ (9,760)	$ 33,565,547	

Depreciation expense totaled $2,971,246 and $2,949,029 in 2004 and 2003, respectively. At December 31, 2004, the Hospital had commitments related to the completion of constructon of the obstetrics unit and various other areas of the Hospital along with software upgrades which total approximately $1,700,000. Remaining costs associated with the projects will be funded via assets limited as to use for capital projects and operations.

Note 7 - Accrued Liabilities

The details of accrued liabilities at December 31, 2004 and 2003 are as follows:

	2004	2003
Payroll and related items	$ 885,642	$ 693,160
Self-insured benefits	557,000	545,000
Total accrued liabilities	$ 1,442,642	$ 1,238,160

Note 8 - Long-term Debt

Long-term debt activity for the year ended December 31, 2004 was as follows:

	2003	Current Year Additions	Current Year Reductions	2004	Amounts Due Within One Year
Serial bonds, 3.5% to 5.10%, payable through 2011, in annual installments ranging from $55,000 to $355,000	$ 3,010,000	$ -	$ (330,000)	$ 2,680,000	$ 350,000
Term bonds, 5.00%, due December 1, 2014, mandatory annual sinking fund redemption beginning December 1, 2012, ranging from $375,000 to $415,000	1,185,000	-	-	1,185,000	-
Term bonds, 5.30%, due December 1, 2019, mandatory annual sinking fund redemption beginning December 1, 2015, ranging from $435,000 to $535,000	2,420,000	-	-	2,420,000	-
Term bonds, 5.25%, due December 1, 2024, mandatory annual sinking fund redemption beginning December 1, 2020, ranging from $565,000 to $690,000	3,135,000	-	-	3,135,000	-
Serial bonds, 3.75% to 5.15%, payable through 2009, in annual installments ranging from $80,000 to $140,000	740,000	-	(110,000)	630,000	115,000
Term bonds, 5.50%, due December 1, 2016, mandatory annual sinking fund redemption beginning December 1, 2010, ranging from $145,000 to $200,000	1,200,000	-	-	1,200,000	-
Serial bonds, 2.50% to 5.25%, payable through 2005, in annual installments ranging from $135,000 to $415,000	810,000	-	(810,000)	-	-
Term bonds, 5.55%, due December 1, 2008, mandatory annual sinking fund redemption beginning December 1, 2006, ranging from $435,000 to $460,000	1,085,000	-	(1,085,000)	-	-
Serial bonds, 1.50% to 5.00%, payable through 2033, in annual installments ranging from $25,000 to $635,000	5,290,000	-	(25,000)	5,265,000	25,000

Note 8 - Long-term Debt (Continued)

	2003	Current Year Additions	Current Year Reductions	2004	Amounts Due Within One Year
Limited tax general obligation notes, 1.75%, payable April 15, 2004	$ 3,450,000	$ -	$ (3,450,000)	$ -	$ -
Limited tax general obligation notes, 1.75%, payable April 15, 2005	-	5,255,000	(750,000)	4,505,000	430,000
Note payable, bearing interest at 5.3%, due in monthly installments of $6,242 through July 10, 2020	762,010	-	(29,615)	732,395	31,408
Capital lease obligations	954,253	-	(401,268)	552,985	305,597
Total long-term debt	$ 24,041,263	$ 5,255,000	$ (6,990,883)	$ 22,305,380	$ 1,257,005
Other liabilities - Accrued compensated absence	$ 1,850,995	$ 2,060,300	$ (2,059,299)	$ 1,851,996	$ -

Note 8 - Long-term Debt (Continued)

Long-term debt activity for the year ended December 31, 2003 was as follows:

	2002	Current Year Additions	Current Year Reductions	2003	Amounts Due Within One Year
Serial bonds, 3.5% to 5.10%, payable through 2011, in annual installments ranging from $55,000 to $355,000	$ 3,330,000	$ -	$ (320,000)	$ 3,010,000	$ 330,000
Term bonds, 5.00%, due December 1, 2014, mandatory annual sinking fund redemption beginning December 1, 2012, ranging from $375,000 to $415,000	1,185,000	-	-	1,185,000	-
Term bonds, 5.30%, due December 1, 2019, mandatory annual sinking fund redemption beginning December 1, 2015, ranging from $435,000 to $535,000	2,420,000	-	-	2,420,000	-
Term bonds, 5.25%, due December 1, 2024, mandatory annual sinking fund redemption beginning December 1, 2020, ranging from $565,000 to $690,000	3,135,000	-	-	3,135,000	-
Serial bonds, 3.75% to 5.15%, payable through 2009, in annual installments ranging from $80,000 to $140,000	845,000	-	(105,000)	740,000	110,000
Term bonds, 5.50%, due December 1, 2016, mandatory annual sinking fund redemption beginning December 1, 2010, ranging from $145,000 to $200,000	1,200,000	-	-	1,200,000	-
Serial bonds, 2.50% to 5.25%, payable through 2005, in annual installments ranging from $135,000 to $415,000	1,185,000	-	(375,000)	810,000	395,000
Term bonds, 5.55%, due December 1, 2008, mandatory annual sinking fund redemption beginning December 1, 2006, ranging from $435,000 to $460,000.	1,085,000	-	-	1,085,000	-
Serial bonds, 1.50% to 5.00%, payable through 2033, in annual installments ranging from $25,000 to $635,000	-	5,290,000	-	5,290,000	25,000

Note 8 - Long-term Debt (Continued)

	2002	Current Year Additions	Current Year Reductions	2003	Amounts due Within One Year
Limited tax general obligation notes, 1.75%, payable April 15, 2005	$ -	$ 3,450,000	$ -	$ 3,450,000	$ 750,000
Note payable, bearing interest at 6.3%, due in monthly installments of $6,242 through July 10, 2020.	790,208	-	(28,198)	762,010	29,615
Capital lease obligations	1,524,095	76,375	(646,217)	954,253	397,458
Total long-term debt	$ 16,699,303	$ 8,816,375	$ (1,474,415)	$ 24,041,263	$ 2,037,073
Other liabilities - Accrued compensated absences	$ 1,870,569	$ 1,916,692	$ (1,936,266)	$ 1,850,995	$ 1,433,641

Note 8 - Long-term Debt (Continued)

The bonds and notes payable are summarized as follows:

The 2004 Union County General Obligation Notes, dated April 1, 2004, were issued in the amount of $5,255,000 to refinance the 2003 notes and refund the 1993 bonds.

The 2003 Union County General Obligation Bonds and Notes, dated April 1, 2003, were issued in the amount of $8,740,000 to finance the acquisition and construction of capital improvements to the Hospital's facilities, including re-designing of the obstetrics unit and various other projects.

The 1999 Union County Improvement Bonds, dated July 15, 1999, were issued in the amount of $11,000,000. Proceeds of the 1999 issue were divided 67 percent to The Gables and 33 percent to Memorial. The Gables' portion was utilized to finance the construction of the new nursing home facility. The Hospital's portion was utilized to complete the emergency room, HVAC, and information technology projects.

The 1996 Union County General Obligation Bonds, Series 1996, were issued in the amount of $2,590,000 to finance the acquisition and construction of capital improvements to the Hospital's facilities, including the emergency room, to purchase land for the new Gables site, and to repay the bond anticipation notes, which matured in 1995.

The 1993 Union County Improvement Bonds, dated May 15, 1993, were issued in the amount of $5,170,000. Proceeds of the 1993 issue were deposited into an escrow account with a trustee to advance refund the 1987 general obligation bonds and to provide the Hospital additional funds for improvements of approximately $2,000,000. In 2004, the 1993 bonds were refunded by the 2004 notes.

The Hospital leases medical and office equipment, furniture, and fixtures used in its operations under capital leases which generally require the Hospital to pay insurance and maintenance costs. These capital leases are due in monthly installments including interest at rates ranging from 2.96 percent to 8 percent annually. These leases expire at various dates through 2007 and are collateralized by the equipment leased.

The Hospital has entered into various operating lease agreements for equipment. Rent expense for all operating leases approximated $916,000 in 2004 and $1,254,000 in 2003.

The Hospital has a $500,000 revolving line of credit, the borrowings of which are collateralized by certain Hospital assets. The line bears interest at 65 percent of the bank's prime commercial rate and expires in January 2005. There was no balance outstanding as of December 31, 2004 or 2003.

Note 8 - Long-term Debt (Continued)

The following is a schedule by years of debt principal and interest payments, future minimum lease payments, and operating lease payments as of December 31, 2004:

Years Ending December 31		Long-term Debt Principal	Long-term Debt Interest	Capital Lease Principal	Operating Interest
2005		$ 951,408	$ 919,372	$ 305,597	$ 856,080
2006		4,613,111	808,163	218,599	708,266
2007		559,906	785,558	48,953	430,722
2008		586,798	761,320	-	150,198
2009		618,793	735,308	-	99,400
2010-2014		3,132,883	3,244,098	-	473,909
2015-2019		3,231,773	2,464,303	-	383,327
2020-2024		3,282,723	1,694,458	-	225,314
2025-2029		2,410,000	953,702	-	-
2030-2034		2,365,000	302,750	-	-
	Total	21,752,395	12,669,032	573,149	3,327,216
	Less amounts representing interest on capital leases	-	-	(20,164)	-
	Total	21,752,395	12,669,032	552,985	3,327,216
	Less current portion	951,408	919,372	305,597	856,080
	Total long-term portion	$ 20,800,987	$ 11,749,660	$ 247,388	$ 2,471,136

The Hospital has entered into various operating lease agreements for equipment. Rent expense for all operating leases approximated $916,000 in 2004 and $1,254,000 in 2003.

Note 9 - Net Patient Service Revenue

Net patient service revenue consists of the following:

	2004	2003
Inpatient services:		
Routine services	$ 8,776,869	$ 8,872,895
Ancillary services	15,121,915	15,025,176
Outpatient ancillary services	66,110,860	64,051,435
Net resident revenue	7,074,903	6,741,265
Gross patient revenue	97,084,547	94,690,771

Note 9 - Net Patient Service Revenue (Continued)

	2004	2003
Revenue deductions - Provision for contractual allowances:	$ 39,076,289	$ 36,862,296
Provision for bad debt	3,311,665	3,274,752
Charity care - Net of Hospital Care Assurance received	107,388	540,774
Total revenue deductions	42,495,342	40,677,822
Total	$ 54,589,205	$ 54,012,949

Note 10 - Defined Benefit Pension Plan

Plan Description - The Hospital contributes to the Ohio Public Employees Retirement System of Ohio (OPERS). OPERS administers three separate pension plans: The Traditional Pension Plan (TP) - a cost-sharing multiple-employer defined benefit pension plan; the Member-directed Plan (MD) - a defined contribution plan; and the Combined Plan (CO) - a cost-sharing multiple-employer defined benefit pension plan that has elements of both a defined benefit and defined contribution plan. OPERS provides retirement, disability, survivor and death benefits, annual cost of living adjustments, and postretirement health care benefits to qualifying members of both the Traditional and the Combined Plans; however, health care benefits are not statutorily guaranteed. Members of the Member-directed Plan do not qualify for ancillary benefits, including postemployment health care coverage. Chapter 145 of the Ohio Revised Code assigns authority to establish and amend benefit provisions to the OPERS board of trustees. OPERS issues a stand-alone financial report. Interested parties may obtain a copy by making a written request to Ohio Public Employees Retirement System, 277 East Town Street, Columbus, Ohio 43215-4642 or by calling 614-222-6705 or 1-800-222-PERS (7377).

Funding Policy - The Ohio Revised Code provides statutory authority for member and employer contributions. For 2004, member and employer contribution rates were consistent across all three plans (TP, MD, and CO), and are actuarially determined. The 2004 member contribution rate for members of local government units was 8.50 percent of their annual covered salary. The 2004 employer contribution rate for local government units was 13.55 percent of covered payroll. The Hospital's contributions to OPERS for the years ended December 31, 2004, 2003, and 2002 were approximately $3,376,000, $3,439,000, and $3,126,000, respectively. Required employer contributions for all plans are equal to 100 percent of employer charges and must be extracted from the employer's records.

Note 10 - Defined Benefit Pension Plan (Continued)

Postretirement Benefits - In order to qualify for postretirement health care coverage, age and service retirees must have 10 or more years of qualifying Ohio service credit. Health care coverage for disability recipients and primary survivor recipients is available. The health care coverage provided by the Retirement System is considered an Other Postemployment Benefit (OPEB), as described in GASB Statement No. 12. A portion of each employer's contribution to OPERS is set aside for the funding of postretirement health care. The Ohio Revised Code provides statutory authority for employer contributions. The 2004 and 2003 employer contribution rate for local government employer units was 13.55 percent of covered payroll. Of this amount, 4.0 percent and 5.0 percent was the portion that was used to fund health care during 2004 and 2003, respectively. The portion of the employer's contribution used to fund postemployment benefits for 2004 and 2003 was $997,000 and $1,269,000, respectively. The Ohio Revised Code provides the statutory authority requiring public employers to fund post-retirement health care through their contributions to OPERS.

An entry-age normal actuarial cost method of valuation is used in determining the present value of OPEB. The difference between assumed and actual experience (actuarial gains and losses) becomes part of the unfunded actuarial accrued liability. All investments are carried at market value. For actuarial valuation purposes, a smoothed market approach is used. Under this approach, assets are adjusted to reflect 25 percent of unrealized market appreciation or depreciation on investment assets annually. The investment return assumption rate for 2003 was 8.00 percent. An annual increase of 4.00 percent compounded annually is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally, annual pay increases, over and above the 4.00 percent base increase, were assumed to range from 0.50 percent to 6.30 percent. Health care costs were assumed to increase at the projected wage inflation rate plus an additional factor ranging from 1.00 percent to 6.00 percent for the next eight years. In subsequent years (nine and beyond), health care costs were assumed to increase at 4.00 percent (the projected wage inflation rate) annually. These assumptions and calculations are based on the system's latest actuarial review performed as of December 31, 2003.

The number of active contributing participants in the Traditional and Combined Plans during 2004 was 369,885. As of December 31, 2003, the actuarial value of the retirement system's net assets available for OPEB was $10.5 billion. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were $26.9 billion and $16.4 billion, respectively.

Health Care Plan - On September 9, 2004, the OPERS retirement board adopted a Health Care Preservation Plan (HCPP) with an effective date of January 1, 2007. The HCPP restructures the OPERS's health care coverage to improve the financial solvency of the fund in response to skyrocketing health care costs.

Note 10 - Defined Benefit Pension Plan (Continued)

Under the HCPP, retirees eligible for health care coverage will receive a graded monthly allocation based on their years of service at retirement. The plan incorporates a cafeteria approach, offering a broad range of health care options that allow benefit recipients to use their monthly allocation to purchase health care coverage customized to meet their individual needs. If the monthly allocation exceeds the cost of the options selected, the excess is deposited into a retiree medical account that can be used to fund future health care expenses.

Note 11 - Medical Malpractice Claims

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

The Hospital is insured against medical malpractice claims under a claims-based policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claims exceeding $1,000,000, or aggregate claims exceeding $3,000,000, for claims asserted in the policy year. In addition, the Hospital has an umbrella policy with an additional $9,000,000 of coverage.

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

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

Note 12 - Self-insured Benefits

The Hospital is partially self-insured under a plan covering substantially all employees for health benefits. The plan is covered by a stop-loss policy that covers claims over $90,000 per employee or total claims in excess of $3,226,092. Claims, charged to operations when incurred, were approximately $1,287,000 and $730,000 for the years ended December 31, 2004 and 2003, respectively.

In addition, the Hospital self-insures for workers' compensation. The Hospital has a $400,000 per claim stop-loss policy with a private insurance carrier for workers' compensation.

Note 13 - Deferred Compensation

Any employee of the Hospital may participate in a deferred compensation plan created by the State of Ohio under the provisions of Internal Revenue Code (IRC) Section 457, *Deferred Compensation Plans with Respect to Service for State and Local Governments*. Under the plan, employees may elect to defer a portion of their salaries and avoid paying taxes on the deferred portion until the withdrawal date. The deferred compensation amount is not available for withdrawal by employees until termination, retirement, death, or unforeseeable emergency.

Note 14 - Related Parties

During 1995, Memorial Physicians, Inc. (MPI) was formed, in which UCHS had a 100 percent ownership interest. In 2000, UCHS transferred 50 percent of the ownership interest to a group of physicians. This entity is a professional for-profit corporation organized to bring primary care and other specialty physicians together from multiple sites. Their goals include increasing efficiency, sharing information and resources, and managing the care of their patients throughout the integrated system of care. UCHS has guaranteed certain lease obligations of MPI. Additionally, the Hospital leased employees to staff the MPI offices and provides certain other support services on a contractual basis ending in July 2003. The Hospital charged MPI for these services at cost plus a mark-up percentage and reflects the cost for these services as other operating revenue. Total fees charged to MPI in 2004 and 2003 for these support services were $0 and $56,918, respectively, and are recorded in other operating revenue.

UCHS wrote down the investment in MPI in 2003 when it was determined to have minimal value. During 2004, the Hospital and UCHS wrote off corresponding receivables and payable related to funding of MPI in previous years, and have recorded this activity in other revenue and expense. In 2004 and 2003, the Hospital provided physician grants to MPI amounting to $398,026 and $609,258, respectively. These grants largely provide recruitment support for physicians. The physician group is not liable to the Hospital for its share of losses incurred by MPI. In 2004 and 2003, UCHS guaranteed a $262,500 note and a $50,000 line of credit between MPI and a local financial institution. In early 2005, the line of credit was paid off and UCHS was released from the guarantee.

Note 15 - Investment in Joint Ventures

During 1996, the Hospital and two other area health care entities formed Health Partners, Ltd. (Health Partners), of which the Hospital has a 33 1/3 percent ownership interest. This corporation was formed to provide management services to the clinic of a major area corporation. In 1996, the Hospital contributed $100,000 to Health Partners through UCHS. During 2004 and 2003, the Hospital received distributions from Health Partners totaling $120,829 and $167,000, respectively, through UCHS.

Additional Information

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To the Board of Trustees
Memorial Hospital of Union County and Affiliates

We have audited the combined financial statements of Memorial Hospital of Union County and Affiliates as of December 31, 2004 and 2003. Our audits were made for the purpose of forming an opinion on the combined financial statements taken as a whole. The combining information in the accompanying schedules is presented for the purpose of additional analysis of the combined financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies and is not a required part of the basic combined financial statements. The combining information has been subjected to the procedures applied in the audits of the combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined financial statements taken as a whole.

Plante & Moran, PLLC

March 15, 2005

Combining Balance Sheet
December 31, 2004

	Memorial Hospital of Union County	The Gables	Union County Health System	Eliminating Entries	Combined Totals
Assets					
Current Assets					
Cash and cash equivalents	$ 3,482,075	$ 345,635	$ 13,197	$ -	$ 3,840,907
Patient accounts receivable	5,042,552	587,034	-	-	5,629,586
Assets limited as to use	4,211,759	697,874	-	-	4,909,633
Prepaid expenses and other	364,917	15,129	-	-	380,046
Inventory	479,337	-	-	-	479,337
Other current assets	266,190	-	-	-	266,190
Total current assets	13,846,830	1,645,672	13,197	-	15,505,699
Capital Assets	27,900,898	7,720,471	122,254	-	35,743,623
Other Assets					
Notes and advances to affiliates	3,928,772	-	732,395	(4,661,167)	-
Physician advances receivable	1,753,850	-	-	-	1,753,850
Investment in joint ventures	-	-	435,339	-	435,339
Bond issue costs	254,501	192,057	-	-	446,558
Total assets	**$ 47,684,851**	**$ 9,558,200**	**$ 1,303,185**	**$ (4,661,167)**	**$ 53,885,069**

Combining Balance Sheet (Continued)
December 31, 2004

	Memorial Hospital of Union County	The Gables	Union County Health System	Eliminating Entries	Combined Totals
Liabilities and Net Assets					
Current Liabilities					
Current portion of long-term debt	$ 975,926	$ 249,671	$ 31,408	$ -	$ 1,257,005
Accounts payable	2,278,856	122,283	-	-	2,401,139
Cost report settlements payable	695,000	154,294	-	-	849,294
Salaries, wages, and related accruals	1,250,392	192,250	-	-	1,442,642
Total current liabilities	5,200,174	718,498	31,408	-	5,950,080
Long-term Debt	14,302,483	6,044,905	700,987	-	21,048,375
Other Liabilities					
Notes and advances to affiliates	732,395	3,804,796	123,976	(4,661,167)	-
Accrued compensated absences	1,646,854	205,142	-	-	1,851,996
Other long-term liabilities	514,040	-	-	-	514,040
Total liabilities	22,395,946	10,773,341	856,371	(4,661,167)	29,364,491
Net Assets					
Invested in capital assets - Net of related debt	12,622,489	1,425,895	122,254	-	14,170,638
Nonexpendable permanent endowments	25,000	-	-	-	25,000
Restricted for debt service and other purposes	4,186,759	616,014	-	-	4,802,773
Unrestricted	8,454,657	(3,257,050)	324,560	-	5,522,167
Total liabilities and net assets	**$ 47,684,851**	**$ 9,558,200**	**$ 1,303,185**	**$ (4,661,167)**	**$ 53,885,069**

Memorial Hospital of Union County and Affiliates

Combining Statement of Revenue, Expenses, and Changes in Net Assets
Year Ended December 31, 2004

	Memorial Hospital of Union County	The Gables	Union County Health System	Eliminations	Combined Totals
Operating Revenue					
Net patient service revenue	$ 47,548,767	$ 7,045,238	$ -	$ (4,800)	$ 54,589,205
Other	1,797,825	-	22,414	(60,000)	1,760,239
Total operating revenue	49,346,592	7,045,238	22,414	(64,800)	56,349,444
Operating Expenses					
Salaries and wages	21,722,416	3,634,110	-	10,000	25,366,526
Employee benefits and payroll taxes	6,351,559	967,628	-	-	7,319,187
Supplies and other	8,742,500	776,370	28,398	(60,000)	9,487,268
Professional services and consultant fees	1,204,790	49,005	-	-	1,253,795
Purchased services	5,917,706	211,594	-	(14,800)	6,114,500
Insurance	433,154	80,089	-	-	513,243
Utilities	835,709	177,842	1,374	-	1,014,925
Depreciation and amortization	2,662,392	301,847	7,007	-	2,971,246
Total operating expenses	47,870,226	6,198,485	36,779	(64,800)	54,040,690
Operating Income (Loss)	1,476,366	846,753	(14,365)	-	2,308,754
Other Income (Expenses)					
Interest income	70,335	12,858	-	-	83,193
Noncapital grants and contributions	608,368	5,087	-	-	613,455
Interest expense	(445,744)	(340,598)	-	-	(786,342)
Other income (loss)	(2,167,307)	11,485	1,120,008	-	(1,035,814)
Total other income (expenses)	(1,934,348)	(311,168)	1,120,008	-	(1,125,508)
Increase (Decrease) in Net Assets	**$ (457,982)**	**$ 535,585**	**$ 1,105,643**	**$ -**	**$ 1,183,246**

Report Letter on Compliance with Laws and Regulations and Internal Control Basic Financial Statements

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Report Letter on Compliance with Laws and Regulations and Internal Control - Basic Financial Statements

To the Board of Trustees
Memorial Hospital of Union County and Affiliates

We have audited the combined financial statements of Memorial Hospital of Union County and Affiliates as of and for the year December 31, 2004 and have issued our report thereon dated March 15, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Memorial Hospital of Union County and Affiliates' internal controls 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 controls over financial reporting. Our consideration of the internal controls over financial reporting would not necessarily disclose all matters in the internal controls 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.

To the Board of Trustees
Memorial Hospital of Union County and Affiliates

We have issued a letter of recommendations to management regarding certain financial operating and efficiency matters. This report is intended solely for the information and use of the auditor of the State of Ohio, the board of trustees, the Board of Governors of Memorial Hospital of Union County and Affiliates, and management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Plante & Moran, PLLC

March 15, 2005

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MEMORIAL HOSPITAL OF UNION COUNTY AND AFFILIATES

UNION COUNTY

CLERK'S CERTIFICATION

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

Susan Babbitt

CLERK OF THE BUREAU

CERTIFIED
JUNE 30, 2005