Morrow County Hospital and Affiliate

Combined Financial Report
with Additional Information
December 31, 2004

Auditor of State
Betty Montgomery

Board of Trustees
Morrow County Hospital and Affiliate

We have reviewed the Independent Auditor's Report of the Morrow County Hospital and Affiliate, Morrow 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 Morrow County Hospital and Affiliate is responsible for compliance with these laws and regulations.

Betty Montgomery

BETTY MONTGOMERY
Auditor of State

July 7, 2005

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Morrow County Hospital and Affiliate

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Independent Auditor's Report

To the Board of Directors
Morrow County Hospital and Affiliate

We have audited the accompanying combined balance sheet of Morrow County Hospital and Affiliate as of December 31, 2004 and the related combined statements of revenue, expenses, and changes in net assets and cash flows for the year then ended. These combined financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these combined financial statements based on our audit. The financial statements of Morrow County Hospital and Affiliate as of December 31, 2003 were audited by other auditors, whose report dated February 11, 2004 expressed an unqualified opinion on those statements.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2004 combined financial statements referred to above present fairly, in all material respects, the financial position of Morrow County Hospital and Affiliate at December 31, 2004 and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis is not a required part of the basic financial statements but is supplemental information required by *Government Accounting Standards*. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 25, 2005 on our consideration of the Morrow County Hospital and Affiliate's internal control over financial reporting and on 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.

Plante & Moran, PLLC

February 25, 2005

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Morrow County Hospital, located in Mount Gilead, Ohio, is a county-owned, tax-exempt entity that operates an acute care hospital facility providing quality inpatient, outpatient, skill nursing and home health services to residents of Morrow County and surrounding areas. The reporting entity (Hospital) is comprised of Morrow County Hospital and the Morrow County Hospital Foundation, which provides services exclusively for the benefit of Morrow County Hospital. Morrow County Hospital is operated under Section 339 of the Ohio Revised Code.

This section of the Hospital's annual financial report presents management's discussion and analysis of the Hospital's financial performance and provides an overall review of the Hospital's financial position and activities as of and for the years ended December 31, 2004 and 2003. This discussion should be read in conjunction with the accompanying financial statements and footnotes. The financial statements, footnotes, and this discussion and analysis are the responsibility of the Hospital's management.

Financial and Operating Highlights for 2004

- Excess of Revenue Over Expenses was $924,504, a 48% improvement over 2003.
- Outpatient registrations increased 3% from the prior year.
- Surgery cases increased 17% from the prior year.
- Emergency room visits decreased 4% from last year.
- Inpatient Days, including the Extending Care Facility, were flat compared to 2003.
- The Hospital opened its first off-site facility at Northfield Medical. The facility provides outpatient lab, radiology and physical therapy services.
- The Hospital made significant investments in new technology, installing a 16-slice CT scanner, a PACS radiology system and new cardiac monitors in the emergency department.

Overview of the Financial Statements

This annual report consists of financial statements prepared in accordance with the provisions of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* as amended by GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus* and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. These standards establish comprehensive financial reporting standards for all state and local governments and related entities.

The Balance Sheets, the Statements of Revenues, Expenses, and Changes in Net Assets, and Statements of Cash Flows provide an indication of the Hospital's financial health. The Balance Sheets include the Hospital's assets and liabilities, using the accrual basis of accounting as well as an indication about which assets can be utilized for general purposes and which are restricted for other purposes. The Statements of Revenues, Expenses, and Changes in Net Assets report the revenues and expenses during the time periods indicated. The Statements of Cash Flows report the cash provided and used by operating activities, as well as other cash sources such as investment income and cash payments for repayment of debt and capital asset acquisitions.

Financial Analysis of the Hospital at December 31, 2004

Total assets increased by 8.5% to $21.5 million, and total liabilities increased 8.1% to $10.0 million. The Hospital's total net assets increased from $10.5 million to $11.5 million, an 8.8% improvement from a year ago as shown in the following table:

	Year Ended December 31		Change	
	2004	2003	Amount	Percent
Current assets	$ 6,438,187	$ 5,960,055	$ 478,132	8.0%
Noncurrent assets	3,110,956	2,267,768	843,188	37.2%
Capital assets	11,952,111	11,593,683	358,428	3.1%
Total assets	21,501,254	19,821,506	1,679,748	8.5%
Current liabilities	4,945,070	4,345,207	599,863	13.8%
Long-term liabilities	5,100,730	4,945,349	155,381	3.1%
Total liabilities	10,045,800	9,290,556	755,244	8.1%
Net assets:				
Invested in capital assets - Net of debt	6,237,486	6,109,101	128,385	2.1%
Restricted assets (debt service)	2,625,726	1,875,005	750,721	40.0%
Unrestricted	2,592,242	2,546,844	45,398	1.8%
Total net assets	**$ 11,455,454**	**$ 10,530,950**	**$ 924,504**	8.8%

Current Assets

Total current assets increased by $478,132 from the previous year. Short-term investments increased by $300,000 due to the Hospital's improved cash position. The estimated amount of tax levy receivable rose by $150,000 from the amount at December 31, 2003. Patient accounts receivable increased $78,088 due to increased patient revenues.

Noncurrent Assets

Noncurrent assets, which consist primarily of limited use investments, general long-term investments and physician advances receivable, increased by $843,188 or 37.2%. Limited use investments increased by $750,121. The increase was due to improved cash flow enabling the transfer of additional amounts to Funded Deprecation, a fund used to save for future capital purchases.

Capital Assets

Capital assets increased by $358,428 or 3.1%. The increase was due to additions of $1,551,813, offset by depreciation expense of $1,363,271 and retirements of $92,570. Of the additions, $865,199 related to the acquisition of the new CT scanner.

Current Liabilities

Current liabilities increased $599,863 over the prior year. Current portion of long-term debt increased by $118,554 due to new capital leases (see discussion below). Accounts payable increased by $148,803 due to the timing of payments to vendors. Accrued compensation and related increased by $101,959 due to timing of the final payroll period and an increase in the reserve for employee health insurance claims incurred but not reported.

Long-term Liabilities

Long-term liabilities increased by $155,381. Long-term debt rose by $99,488 due to the issuance of $1,296,979 in capital leases less $1,078,937 in debt principal payments. The amount of debt reclassified from long-term to current portion in 2004 was $118,554. The capital leases were used to finance the purchase of a new CT scanner, PACS radiology equipment and a computer server. Additional detail regarding the Hospital's long-term debt can be found in Note 6 of the financial statements.

Net Assets

Total Net Assets increased by $924,504 or 8.8% due entirely to Excess Revenue Over Expenses.

Revenue and Expenses

The following table shows the changes in revenues and expenses for 2004 compared to 2003.

	2004	2003	Change Amount	Change Percent
Operating Revenue				
Net patient service revenue	$ 22,817,794	$ 21,288,852	$ 1,528,942	7.2%
Other	584,123	442,434	141,689	32.0%
Total operating revenue	23,401,917	21,731,286	1,670,631	7.7%
Operating Expenses				
Salaries and benefits	11,313,518	10,577,813	735,705	7.0%
Operating supplies and expenses	4,370,626	4,168,040	202,586	4.9%
Purchased services	5,170,985	4,831,800	339,185	7.0%
Insurance	218,512	215,149	3,363	1.6%
Utilities	528,826	492,308	36,518	7.4%
Rental	386,262	331,516	54,746	16.5%
Depreciation and amortization	1,363,271	1,321,470	41,801	3.2%
Total operating expenses	23,352,000	21,938,096	1,413,904	6.4%
Operating Income (Loss)	49,917	(206,810)	256,727	-124.1%
Nonoperating Gains (Losses)				
Investment income	43,938	34,887	9,051	25.9%
Loss on disposal of assets	(92,570)	(2,375)	(90,195)	3797.7%
Property taxes	1,238,209	1,171,914	66,295	5.7%
Interest expense	(314,990)	(371,922)	56,932	-15.3%
Total nonoperating gains (losses)	874,587	832,504	42,083	5.1%
Excess of Revenue Over Expenses (Increase in Net Assets)	924,504	625,694	**$ 298,810**	47.8%
Net Assets - Beginning of year	10,530,950	9,905,256		
Net Assets - End of year	**$ 11,455,454**	**$ 10,530,950**		

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 $1,528,942 or 7.2% from 2003. Gross patient revenue increased by $3,679,953 or 10.9%. The Hospital Board of Trustees approved a 5% rate increase effective January 1, 2004. 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 37.0% to 39.1 % as a percentage of gross revenue.

- Other operating revenue increased $141,689 or 32.0 % due primarily to increased grants received in 2004.

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 7.0 % due to annual raises, a 6.4 % increase in the number of FTE's and the additional OPERS expense associated with the salary increase.

- Operating supplies and expenses increased 4.9 % due to an increase in outpatient volumes, particularly in surgery, and the increasing cost of drugs and patient chargeable items.

- Purchased services increased 7.0 % due to increased volumes in physical, occupational, and speech therapy. The personnel providing these services are contracted from an outside agency, and are not employees of the Hospital.

The following is a summary of 2004 operating expenses by type:

Operating Expenses		
Salaries and benefits	48.45%	$ 11,313,518
Operating supplies and expenses	18.72%	$ 4,370,626
Purchased services	22.14%	5,170,985
Insurance	0.94%	218,512
Utilities	2.26%	528,826
Rental	1.65%	386,262
Depreciation and amortization	5.84%	1,363,271
	100.00%	$ 23,352,000

Nonoperating Gains (Losses)

Nonoperating revenue and expenses are all sources and uses that are primarily non-exchange in nature. At Morrow County Hospital, these consist primarily of property tax levy funds and interest expense.

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

- Property tax levy funds received increased by $66,295 or 5.7% from 2003.
- Interest expense decreased by $57,000 or 15.3% due to the scheduled pay-down of long-term debt.
- The disposal of a modular physician office and related improvements led to an increase in loss on disposal of assets of $90,195 over the prior year.

Statement of Cash Flows

The Statement of Cash Flows provides relevant information about the cash receipts and cash payments. The Statement of Cash Flows also helps assess:

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

The following table shows condensed cash flow information for the years 2004 and 2003.

	2004	2003	Increase (Decrease)
Cash provided (used) by:			
Operating activities	$ 1,754,965	$ 1,074,313	$ 680,652
Capital and related financing activities	(674,292)	(1,001,241)	326,949
Investing activities	(992,839)	172,030	(1,164,869)
Net increase (decrease) in cash	87,834	245,102	(157,268)
Cash - Beginning of year	900,491	655,389	245,102
Cash - End of year	**$ 988,325**	**$ 900,491**	**$ 87,834**

The Hospital's liquidity improved during the year. The following discussion amplifies the overview of cash flows presented above.

Net cash provided by operating activities increased $680,652 over the prior year mainly due to an increase of $1.4 million received from our patients and third-party payors, offset by an increase of $260,808 paid to our vendors. The Hospital also paid an additional $695,751 to its employees for wages and benefits as compared to 2003.

Statement of Cash Flows (Cont.)

Net cash used in capital and related financing activities decreased due to purchases of capital assets, payments on long-term debt, offset by property tax levy proceeds.

Investing activities used $1,164,869 more cash in 2004 than in 2003. The improved cash flow of the Hospital enabled it to purchase $306,780 of short-term investments and increase the amount of limited use assets by $634,416.

Economic Factors and Next Year's Budget

The Board of Trustees approved the 2005 operating budget at its October 2004 meeting and the Morrow County Commissioners subsequently approved it. The budget calls for Gross Revenue of $41 million, Total Operating Expenses of $26.7 million and Excess Revenue Over Expense of $938,000. The Board of Trustees approved an average increase of 5 % in the patient charge structure for the upcoming fiscal year.

There are several factors and uncertainties that may affect the Hospital during 2005 and future years including:

- There are pressures at both the federal and state levels to decrease funding for the Medicaid program. This could negatively affect the Hospital's reimbursement for its acute care and skilled nursing facilities.
- The economic position of the Hospital is closely tied to that of the local economy. Compared to other Ohio counties, Morrow County is growing at a faster rate, but has higher than average unemployment.
- The Hospital expanded its charity program in early 2005, instituting a sliding scale that should allow more self-pay patients to receive at least some discount.
- Although the Hospital's financial condition has improved in recent years, it is still dependent on funds received from a county property tax levy. The levy enables the Hospital to obtain modern technology and offer competitive wages and benefits to its staff. The current tax levy expires in 2006.
- The success of the Hospital is closely tied to that of its Medical Staff. The Hospital occasionally faces pressures on its relationship with its physicians due to factors such as changes in reimbursement, the cost of malpractice insurance and physician shortages. The 2005 budget assumes increased surgery revenue due to the addition of another surgeon.

Contacting the Hospital's Management

This financial report is intended to provide the people of Morrow County, the state and federal governments, and our debt-holders with a general overview of the Hospital's finances, and to show the Hospital's accountability for the money it receives from services it provides and county property taxes. If you have questions about this report or need additional information, we welcome you to contact the Chief Financial Officer.

Joseph Schueler
Chief Financial Officer

Morrow County Hospital and Affiliate

Combined Balance Sheet

	December 31, 2004	December 31, 2003
Assets		
Current Assets		
Cash and cash equivalents (Note 2)	$ 431,160	$ 458,723
Short-term investments (Note 2)	300,000	-
Patient accounts receivable (Note 3)	3,775,255	3,697,167
Levied taxes receivable	1,300,000	1,150,000
Prepaid expenses and other	187,863	219,357
Inventory	293,648	292,543
Other current assets - Physician advances receivable	150,261	142,265
Total current assets	6,438,187	5,960,055
Assets Limited as to Use (Note 2)	2,625,726	1,875,005
General Long-term Investments (Note 2)	279,181	274,299
Capital Assets (Note 5)	11,952,111	11,593,683
Other Assets - Physician advances receivable	206,049	118,464
Total assets	**$ 21,501,254**	**$ 19,821,506**

See Notes to Combined Financial Statements.

Combined Balance Sheet (Continued)

	December 31, 2004	December 31, 2003
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 6)	$ 949,042	$ 830,488
Accounts payable	1,198,719	1,049,916
Cost report settlements payable (Note 4)	438,650	355,829
Accrued liabilities and other:		
Accrued compensation and related	1,035,664	933,705
Accrued interest	22,995	25,269
Deferred revenue for levied taxes	1,300,000	1,150,000
Total current liabilities	4,945,070	4,345,207
Long-term Debt (Note 6)	4,765,583	4,666,096
Compensated Absences (Note 6)	335,147	279,253
Total liabilities	10,045,800	9,290,556
Net Assets		
Invested in capital assets - Net of related debt	6,237,486	6,109,101
Restricted for debt service	2,625,726	1,875,005
Unrestricted	2,592,242	2,546,844
Total net assets	11,455,454	10,530,950
Total liabilities and net assets	**$ 21,501,254**	**$ 19,821,506**

See Notes to Combined Financial Statements.

Morrow County Hospital and Affiliate

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)	$ 22,817,794	$ 21,288,852
Other	584,123	442,434
Total operating revenues	23,401,917	21,731,286
Operating Expenses		
Salaries and wages	8,119,144	7,461,771
Employee benefits and payroll taxes	3,194,374	3,116,042
Operating supplies and expenses	4,370,626	4,168,040
Purchased services	5,170,985	4,831,800
Insurance	218,512	215,149
Utilities	528,826	492,308
Rental	386,262	331,516
Depreciation and amortization	1,363,271	1,321,470
Total operating expenses	23,352,000	21,938,096
Income (Loss) from Operations	49,917	(206,810)
Nonoperating Gains (Losses)		
Investment income	43,938	34,887
Loss on disposal of assets	(92,570)	(2,375)
Property taxes	1,238,209	1,171,914
Interest expense	(314,990)	(371,922)
Total nonoperating gains	874,587	832,504
Excess of Revenue Over Expenses (Increase in Net Assets)	924,504	625,694
Net Assets - Beginning of year	10,530,950	9,905,256
Net Assets - End of year	**$ 11,455,454**	**$ 10,530,950**

See Notes to Combined Financial Statements.

Morrow County Hospital and Affiliate

Combined Statement of Cash Flows

	Year Ended December 31, 2004	Year Ended December 31, 2003
Cash Flows from Operating Activities		
Cash received from patients and third-party payors	$ 22,739,706	$ 21,330,395
Cash payments to suppliers for services and goods	(10,413,199)	(10,152,391)
Cash payments to employees for services	(11,155,665)	(10,459,914)
Other receipts from operations	584,123	356,223
Net cash provided by operating activities	1,754,965	1,074,313
Cash Flows from Investing Activities		
Investment income	43,938	103,127
Increase (decrease) in assets limited as to use	(634,416)	68,903
Purchase of investments	(306,780)	-
Advances to physicians - Net of forgiveness	(95,581)	-
Net cash (used in) provided by investing activities	(992,839)	172,030
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(517,290)	(907,801)
Property tax levy	1,238,209	1,171,914
Interest paid on long-term debt	(316,274)	(563,576)
Principal payments on long-term debt	(1,078,937)	(701,778)
Net cash used in capital and related financing activities	(674,292)	(1,001,241)
Net Increase in Cash and Cash Equivalents	87,834	245,102
Cash and Cash Equivalents - Beginning of year	900,491	655,389
Cash and Cash Equivalents - End of year	**$ 988,325**	**$ 900,491**
Cash and Cash Equivalents		
Included in current assets	$ 431,160	$ 458,723
Included in assets limited as to use	505,890	389,585
Included in general long-term investments	51,275	52,183

See Notes to Combined Financial Statements.

A reconciliation of income (loss) from operations to net cash from operating activities is as follows:

	Year Ended December 31, 2004	Year Ended December 31, 2003
Cash Flows from Operating Activities		
Income (loss) from operations	$ 49,917	$ (206,810)
Adjustments to reconcile income (loss) from operations to net cash from operating activities:		
Depreciation	1,363,271	1,321,470
Provision for bad debts	2,299,227	1,714,233
(Increase) decrease in assets:		
Patient accounts receivable	(2,377,315)	(2,096,311)
Third-party settlements	82,821	355,829
Inventories	(1,105)	84,400
Other current assets	31,494	(89,740)
Increase (decrease) in liabilities:		
Accounts payable	148,802	(120,401)
Other accrued expenses	157,853	111,643
Net cash provided by operating activities	**$ 1,754,965**	**$ 1,074,313**

Significant Noncash Investing, Capital, and Financing Activities - The Hospital entered into capital lease obligations of $1,296,979 for new equipment in 2004.

Note 1 - Nature of Business and Significant Accounting Policies

Organization - The accompanying combined financial statements include the accounts of Morrow County Hospital and Morrow County Hospital Foundation (collectively, the "Hospital"). All significant intercompany transactions and balances have been eliminated in combination.

Morrow County Hospital is an acute and extended care facility owned by Morrow County, Ohio and operated by a Board of Trustees. Members of the Board of Trustees are appointed by the County Commissioners. The Hospital is a political subdivision of the State of Ohio and is therefore exempt from federal income taxes under Section 115 of the Internal Revenue Code. The Hospital was formed under the provisions of the Ohio Revised Code.

During 1997, the Hospital formed the Morrow County Hospital Foundation (the "Foundation"). The purpose of the Foundation is to support the Hospital and community programs to improve the health and well-being of the people served by the Hospital. The Foundation is exempt under Section 501(a) as an organization described in Section 501(c)(3) of the Internal Revenue Code.

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.

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.

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 purposes of the statement of cash flows.

Investments - Investments include certificates of deposit and government securities and are recorded at fair value in the balance sheet. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in nonoperating revenue when earned.

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

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 limited as to use consist of invested funds designated by the Hospital's Board of Trustees for operations.

Capital Assets - Property and equipment amounts 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 leases 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.

Compensated Absences - Paid time off is charged to operations when earned. Unused and earned benefits are recorded as a current liability in the financial statements. Employees accumulate vacation days and sick leave benefits at varying rates depending on years of service. 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 one-fourth of the accumulated balance, up to a maximum of 240 hours, calculated at the employee's base pay rate as of the retirement date.

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

Classification of Net Assets - Net assets of the Hospital are classified in three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted 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 debt service arrangements. 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.

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 - The Hospital reports gifts of property and equipment as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor stipulations about how long those long-lived assets must be maintained, the Hospital reports the expiration of donor restrictions when the assets are placed in service.

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

Income from Operations - For purposes 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 prior year amounts have been reclassified to conform to current year presentation.

Change in Reported Cash and Cash Equivalents - During 2004, the Hospital changed its definition of what constitutes cash and cash equivalents, and now includes only cash and highly liquid investments purchased with maturities of three months or less as cash and cash equivalents. Previously, the Hospital included investments in U.S. government obligations with maturities in excess of three months as cash and cash equivalents. The effect of the change reduced what is defined to be cash and cash equivalents in the statement of cash flows by $1,383,997 for December 31, 2003 and $1,307,562 for January 1, 2003, respectively. The effect of the change also reduced what is defined as cash and equivalents on the balance sheet at December 31, 2003 by $1,383,997. This amount was restated as investments at December 31, 2003.

Note 2 - Deposits and Investments

Cash deposits, assets whose use is limited, and investments (all of which are considered available for sale) of the Hospital are composed of the following:

	2004 Fair Value	2003 Fair Value
Demand deposits and money market accounts	$ 987,335	$ 900,491
Certificates of deposit	300,000	-
U.S. government obligations	2,348,732	1,707,536
Total	$ 3,636,067	$ 2,608,027

	2004	2003
Amounts summarized by fund type -		
General funds:		
Cash and cash equivalents	$ 431,160	$ 458,723
Short-term investments	300,000	-
Assets limited as to use	2,625,726	1,875,005
General long-term investments	279,181	274,299
Total	$ 3,636,067	$ 2,608,027

At December 31, 2004, the bank balance of the Hospital's demand deposits, money market accounts, and certificates of deposits totaled $1,262,000. Of this balance, $311,000 was covered by federal depository insurance and $951,000 was collateralized with securities held in a pooled collateral account at the pledging bank.

Investments in U.S. government obligations were uninsured and held by the Hospital's agent in the Hospital's name.

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below.

	2004	2003
Patient accounts receivable	$ 7,078,255	$ 6,607,167
Less:		
Allowance of uncollectible accounts	(1,658,000)	(1,254,000)
Allowance for contractual adjustments	(1,645,000)	(1,656,000)
Net patient accounts receivable	$ 3,775,255	$ 3,697,167

Note 3 - Patient Accounts Receivable (Continued)

The Hospital grants credit 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:

	Percent	
	2004	2003
Medicare	26	31
Medicaid	6	6
Commercial insurance and HMOs	45	39
Self-pay	23	24
Total	100	100

Note 4 - Cost Report Settlements

Approximately 58 percent of the Hospital's revenues from patient services are 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 these 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 follows:

- **Medicare** - Effective October 1, 2002, the Hospital received full accreditation from the Center for Medicare and Medicaid Services for the Critical Access Hospital designation. As a Critical Access Hospital, the Hospital will receive reasonable, cost-based reimbursement for both inpatient and outpatient services provided to Medicare beneficiaries.
- **Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Capital costs relating to Medicaid inpatients are paid on a cost-reimbursement method. The Hospital is reimbursed for outpatient services on a 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 change in rates, or the payment system itself, could have a material impact on 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. 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.

Note 4 - Cost Report Settlements (Continued)

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

Note 5 - Capital Assets

Cost of capital assets and related depreciable lives for December 31, 2004 are summarized below:

	2003	Additions	Transfers	Retirements	2004	Depreciable Life - Years
Land and land improvements	$ 597,671	$ 31,269	$ -	$ (100,917)	$ 528,023	5-25
Building	5,624,710	231,187	(142,634)	(383,282)	5,329,981	10-40
Equipment	15,455,407	1,551,813	374,287	(2,811,211)	14,570,296	5-20
Construction in progress	411,080	-	(231,653)	-	179,427	
Total	22,088,868	1,814,269	-	(3,295,410)	20,607,727	
Less accumulated depreciation:						
Land and land improvements	333,486	28,378	-	(59,429)	302,435	
Building	2,477,141	218,651	10,724	(326,725)	2,379,791	
Equipment	7,684,558	1,116,242	(10,724)	(2,816,686)	5,973,390	
Total	10,495,185	1,363,271	-	(3,202,840)	8,655,616	
Net carrying amount	$ 11,593,683	$ 450,998	$ -	$ (92,570)	$ 11,952,111	

Cost of capital assets and related depreciable lives for December 31, 2003 are summarized below:

	2002	Additions	Transfers	Retirements	2003	Depreciable Life - Years
Land and land improvements	$ 564,852	$ 32,819	$ -	$ -	$ 597,671	5-25
Building	5,249,544	375,166	-	-	5,624,710	10-40
Equipment	14,955,591	499,816	-	-	15,455,407	5-20
Construction in progress	233,587	177,494	-	-	411,081	
Total	21,003,574	1,085,295	-	-	22,088,869	
Less accumulated depreciation:						
Land and land improvements	302,326	31,161	-	-	333,487	
Building	2,254,682	222,459	-	-	2,477,141	
Equipment	6,616,708	1,067,850	-	-	7,684,558	
Total	9,173,716	1,321,470	-	-	10,495,186	
Net carrying amount	$ 11,829,858	$ (236,175)	$ -	$ -	$ 11,593,683	

Depreciation and amortization expense on capital assets totaled $1,363,271 and $1,321,470 in 2004 and 2003, respectively.

Note 6 - Long-term Debt and Other Noncurrent Liabilities

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

	2003	Current Year Additions	Current Year Reductions	2004	Amounts Due Within One Year
Series 1999	$ 96,851	$ -	$ (96,851)	$ -	$ -
Master lease and purchase agreement	4,745,113	-	(426,986)	4,318,127	453,472
Capital lease obligations	654,619	1,296,979	(555,100)	1,396,498	495,570
Total long-term debt	5,496,583	1,296,979	(1,078,937)	5,714,625	949,042
Compensated absences	279,253	649,887	(593,993)	335,147	-
Total long-term debt	$ 5,775,836	$ 1,946,866	$(1,672,930)	$ 6,049,772	$ 949,042

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

	2002	Current Year Additions	Current Year Reductions	2003	Amounts Due Within One Year
Series 1999	$ 188,185	$ -	$ (91,333)	$ 96,852	$ 96,851
Master lease and purchase agreement	4,950,000	-	(204,887)	4,745,113	426,986
Capital lease obligations	864,980	170,585	(380,946)	654,619	306,651
Total long-term debt	6,003,165	170,585	(677,166)	5,496,584	830,488
Compensated absences	265,527	613,777	(600,051)	279,253	-
Total long-term debt	$ 6,268,692	$ 784,362	$(1,277,217)	$ 5,775,837	$ 830,488

Note 6 - Long-term Debt and Other Noncurrent Liabilities (Continued)

The bonds payable are summarized as follows:

- Hospital facilities refunding revenue note, Series 1999, bearing interest at 5.90 percent. The note is due in monthly installments of $8,332 including principal and interest. These notes were collateralized by receipts of the Hospital.
- Under a master lease and purchase agreement, the Hospital borrowed $4,950,000 under an arrangement with a finance company to finance the construction of facilities improvements. The financing was provided by the issuance of a 10-year note maturing August 2012, with interest at 5.89 percent. The debt is collateralized by capital assets purchased with the proceeds. 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.
- The Hospital leases medical and office equipment and 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 1.34 percent to 11.52 percent annually. These leases expire at various dates through 2009, and are collateralized by the leased equipment. Capitalized costs at December 31, 2004 and 2003 were approximately $1,726,000 and $1,867,000 less accumulated depreciation of $331,000 and $1,267,000, respectively.

The following is a schedule by years of bond principal and interest as of December 31, 2004:

Years Ending December 31	Long-term Debt Principal	Long-term Debt Interest	Capital Lease Obligation Principal	Capital Lease Obligation Interest
2005	$ 453,472	$ 244,448	$ 495,570	$ 101,337
2006	480,783	217,137	262,136	71,320
2007	509,738	188,182	236,995	51,974
2008	539,981	157,939	215,838	32,350
2009	572,958	124,962	185,959	11,493
Thereafter	1,761,195	159,447	-	-
Total payments	$ 4,318,127	$1,092,115	$1,396,498	$ 268,474

Note 7 - 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 $1,111,000, $1,026,000, and $914,000, respectively. Required employer contributions for all plans are equal to 100 percent of employer charges and must be extracted from the employer's records.

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 Post-Employment 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, 2003, and 2002 was $328,000, $379,000, and $318,000, respectively. The Ohio Revised Code provides the statutory authority requiring public employers to fund postretirement health care through their contributions to OPERS.

Note 7 - Defined Benefit Pension Plan (Continued)

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 4.00 percent annually. These assumptions and calculations are based on the System's latest actuarial review performed as of December 31, 2004.

The number of active contributing participants in the Traditional and Combined Plans during 2003 was $369,885. As of December 31, 2004, the actuarial value of the retirement system's net assets available for OPEB was $10 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.

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 8 - 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 professional liability claims under an occurrence-based policy. The policy covers claims resulting from incidents that occur during the policy terms, regardless of when the claims are reported to the insurance carrier. Under the terms of the policy, the Hospital bears the risk of the ultimate costs of any individual claim exceeding $1,000,000 or aggregate claims exceeding $3,000,000 for claims asserted in the policy year. In addition, the Hospital maintains for all classes of liability coverage an additional "umbrella" excess liability insurance policy of $4,000,000 for each occurrence and in the aggregate.

Should the occurrence-based policy not be renewed or replaced with equivalent insurance, claims based on occurrences subsequent to the policy term will be uninsured.

The Hospital is not aware of any such medical malpractice claims, asserted or unasserted, that would exceed the policy 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. There have been no claims settled in the last three years that have exceeded insured limits.

Note 9 - Net Patient Service Revenue

Net patient service revenue consists of the following:

	2004	2003
Patient revenue:		
Inpatient services:		
Routine services	$ 4,056,741	$ 3,920,941
Ancillary services	4,944,077	5,039,205
Outpatient ancillary services	28,458,933	24,819,652
Total patient revenue	37,459,751	33,779,798
Revenue deductions:		
Provision for contractual allowances	12,412,045	10,800,164
Provision for bad debts	2,299,227	1,714,233
Charity care - Net of Hospital Care Assurance received	(69,315)	(23,451)
Total revenue deductions	14,641,957	12,490,946
Total	$ 22,817,794	$ 21,288,852

Note 10 - Component Unit

The following is the condensed balance sheet and condensed statement of operations for the Foundation as of December 31, 2004 and 2003:

	2004	2003
Balance Sheet		
Assets:		
Cash and investments	$ 363,032	$ 304,135
Capital assets	-	61,388
Other assets	-	50
Total assets	$ 363,032	$ 365,573
Liabilities and net assets:		
Notes payable	$ -	$ 12,000
Net assets	363,032	353,573
Total liabilities and net assets	$ 363,032	$ 365,573
Statement of Operations		
Revenues	$ 64,537	$ 71,674
Expenses	(52,026)	(63,374)
Excess of revenues over expenses	12,511	8,300
Transfers to affiliates	(3,052)	(79,265)

Additional Information

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To the Board of Directors
Morrow County Hospital and Affiliate

We have audited the combined financial statements of Morrow County Hospital and Affiliate as of December 31, 2004. Our audit was made for the purpose of forming an opinion on the combined financial statements taken as a whole. The accompanying combining balance sheet and statement of operations information 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 combined and combining information has been subjected to the procedures applied in the audit 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

February 25, 2005

Combining Balance Sheet
December 31, 2004

	Morrow County Hospital	Morrow County Hospital Foundation	Eliminating Entries	Total
Assets				
Current Assets				
Cash and cash equivalents	$ 347,309	$ 83,851	$ -	$ 431,160
Short-term investments	300,000	-	-	300,000
Patient accounts receivable	3,775,255	-	-	3,775,255
Levied taxes receivable	1,300,000	-	-	1,300,000
Prepaid expenses and other	187,863	-	-	187,863
Inventory	293,648	-	-	293,648
Other current assets - Physician advances receivable	150,261	-	-	150,261
Total current assets	6,354,336	83,851	-	6,438,187
Assets Limited as to Use	2,625,726	-	-	2,625,726
General Long-term Investments	-	279,181	-	279,181
Capital Assets	11,952,111	-	-	11,952,111
Other Assets - Physician advances receivable	206,049	-	-	206,049
Total assets	**$ 21,138,222**	**$ 363,032**	**$ -**	**$ 21,501,254**

Combining Balance Sheet (Continued)
December 31, 2004

	Morrow County Hospital	Morrow County Hospital Foundation	Eliminating Entries	Consolidated Totals
Liabilities and Net Assets				
Current Liabilities				
Current portion of long-term debt	$ 949,042	$ -	$ -	$ 949,042
Accounts payable	1,198,719	-	-	1,198,719
Cost report settlements payable	438,650	-	-	438,650
Accrued liabilities and other:				
Accrued compensation and related	1,035,664	-	-	1,035,664
Accrued interest	22,995	-	-	22,995
Deferred revenue for levied taxes	1,300,000	-	-	1,300,000
Total current liabilities	4,945,070	-	-	4,945,070
Long-term Debt	4,765,583	-	-	4,765,583
Compensated Absences	335,147	-	-	335,147
Total liabilities	10,045,800	-	-	10,045,800
Net Assets				
Invested in capital assets - Net of related debt	6,237,486	-	-	6,237,486
Restricted for debt service	2,625,726	-	-	2,625,726
Unrestricted	2,229,210	363,032	-	2,592,242
Total net assets	11,092,422	363,032	-	11,455,454
Total liabilities and net assets	**$ 21,138,222**	**$ 363,032**	**$ -**	**$ 21,501,254**

Combining Statement of Operations
Year Ended December 31, 2004

	Morrow County Hospital	Morrow County Hospital Foundation	Eliminations	Totals
Operating Revenues				
Total patient service revenue	$ 37,459,751	$ -	$ -	$ 37,459,751
Revenue deductions	(14,641,957)	-	-	(14,641,957)
Net patient service revenue	22,817,794	-	-	22,817,794
Other	519,586	64,537	-	584,123
Total operating revenues	23,337,380	64,537	-	23,401,917
Operating Expenses				
Salaries and wages	8,119,144	-	-	8,119,144
Employee benefits and payroll taxes	3,194,374	-	-	3,194,374
Operating supplies and expenses	4,369,691	935	-	4,370,626
Purchased services	5,170,985	-	-	5,170,985
Insurance	218,512	-	-	218,512
Utilities	528,826	-	-	528,826
Rental	386,262	-	-	386,262
Depreciation and amortization	1,360,523	2,748	-	1,363,271
Total operating expenses	23,348,317	3,683	-	23,352,000
Operating Income (Loss)	(10,937)	60,854	-	49,917
Nonoperating Gains (Losses)				
Investment income	43,938	-	-	43,938
Loss on disposal of assets	(44,227)	(48,343)	-	(92,570)
Property taxes	1,238,209	-	-	1,238,209
Interest expense	(314,990)	-	-	(314,990)
Total nonoperating gains (losses)	922,930	(48,343)	-	874,587
Excess of Revenue Over Expenses	911,993	12,511	-	924,504
Transfer from (to) Affiliate	3,052	(3,052)	-	-
Increase in Net Assets	**$ 915,045**	**$ 9,459**	**$ -**	**$ 924,504**

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

To the Board of Directors
Morrow County Hospital and Affiliate

We have audited the financial statements of Morrow County Hospital and Affiliate as of and for the year ended December 31, 2004, and have issued our report thereon dated February 25, 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Morrow County Hospital and Affiliate'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. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Morrow County Hospital and Affiliate's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and responses.

Reportable Condition

During our testing of the revenue cycle, we noted two instances of service levels provided as documented in the patient's medical record that did not match to the service level billed to the payer. In one instance, the service charged was in excess of the documented service, and in one instance, the services charge was less than the service documented. Upon inquiry of personnel in medical records, we were informed that the errors were caused by keypunch errors.

With heightened scrutiny of surrounding billing, and potential penalties involved with improper billing and coding, particularly with the Medicare and Medicaid programs, we recommend management consider implementing some type of review process whereby charts and bills are reviewed or audited on a regular basis, the results of such review or audit are documented, and an action plan is created to ensure corrective actions are implemented which address any issues identified in the review. Such review should be conducted as part of your corporate compliance program.

To the Board of Directors
Morrow County Hospital and Affiliate

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that the reportable condition described above is a material weakness.

Compliance Over Other Matters

As part of obtaining reasonable assurance about whether Morrow County Hospital and Affiliate's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed one instance of material noncompliance that is required to be reported under *Government Auditing Standards* and which is described below.

Condition - During our testing of compliance with certain laws and regulations, we found that the Hospital's main bank accounts were not properly collateralized.

Criteria - During our testing of Ohio Compliance Supplement, Chapter 5, Part 4, we noted the above condition. This compliance section relates to Ohio Revised Code Sections 135.18 and 135.181.

Recommendation - Management should immediately correct this situation and meet the minimum standards as required under the above-mentioned Ohio Compliance Supplement sections.

In addition, a report was issued to management and the board of directors under separate cover regarding internal control issues and operating efficiencies which we did not consider to be material weaknesses.

This report is intended solely for the information and use of the Auditor of the State of Ohio, the Board of Directors of Morrow County Hospital and Affiliate, 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

February 25, 2005

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Auditor of State
Betty Montgomery

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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 4, 2005