

Morrow County Hospital and Affiliate

**Combined Financial Report
with Additional Information
December 31, 2005**



**Auditor of State
Betty Montgomery**

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

We have reviewed the *Independent Auditor's Report* of the Morrow County Hospital and Affiliate, prepared by Plante & Moran, PLLC, for the audit period January 1, 2005 through December 31, 2005. Based upon this review, we have accepted these reports in lieu of the audit required by Section 117.11, Revised Code. The Auditor of State did not audit the accompanying financial statements and, accordingly, we are unable to express, and do not express an opinion on them.

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

A handwritten signature in black ink that reads "Betty Montgomery".

BETTY MONTGOMERY
Auditor of State

June 6, 2006

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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, a component unit of Morrow County, as of December 31, 2005 and 2004 and the related combined statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These combined financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these combined 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 Morrow County Hospital and Affiliate at December 31, 2005 and 2004 and the combined results of its operations and cash flows for the years 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 the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management, regarding the methods of measurement and presentation of the required 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 10, 2005 on our consideration of 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 10, 2006



A worldwide association of independent accounting firms

Morrow County Hospital and Affiliate

Management's Discussion and Analysis

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, skilled nursing, and home health services to residents of Morrow County and surrounding areas. The reporting entity (the "Hospital") is comprised of Morrow County Hospital and the Morrow County Hospital Foundation, which provides services exclusively for the benefit of Morrow County Hospital. The Hospital is a component unit of the County. 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, 2005, 2004, and 2003. This discussion should be read in conjunction with the accompanying combined financial statements and footnotes. The combined financial statements, footnotes, and this management's discussion and analysis are the responsibility of the Hospital's management.

Financial and Operating Highlights for 2005

- The increase in net assets was \$1,091,480, an 18 percent improvement over 2004.
- Outpatient registrations increased 16 percent from the prior year.
- Emergency room visits increased 5 percent from last year.
- Acute inpatient days rose 4 percent from 2004.
- In November, the voters of Morrow County approved a five-year renewal of the Hospital's 2.5 mill operating levy.
- The Hospital made significant investments in new technology, including new cardiac monitors, improved mammography equipment and software, a new pharmacy information system, and an updated automated drug dispensing system.

Overview of the Combined Financial Statements

This annual report consists of combined 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.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

The combined balance sheet, statement of revenues, expenses, and changes in net assets, and statement of cash flows provide an indication of the Hospital's financial health. The combined balance sheet includes 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 combined statement of revenues, expenses, and changes in net assets reports the revenues and expenses during the time periods indicated. The combined statement of cash flows reports 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, 2005

Total assets increased by 4.3 percent to \$22.7 million, and total liabilities decreased 1.4 percent to \$10.2 million. The Hospital's total net assets increased from \$11.5 million to \$12.5 million, a 9.5 percent improvement from a year ago as shown in the following table:

	Year Ended December 31			2004 to 2005	
	2003	2004	2005	Change Amount	Percent
Assets:					
Current assets	\$ 5,960,055	\$ 6,740,095	\$ 8,334,287	\$ 1,594,192	23.7
Noncurrent assets	2,267,768	3,110,956	3,348,613	237,657	7.6
Capital assets	11,593,683	11,952,111	11,062,017	(890,094)	(7.4)
Total assets	19,821,506	21,803,162	22,744,917	941,755	4.3
Liabilities:					
Current liabilities	4,345,207	5,246,978	5,820,935	573,957	10.9
Long-term liabilities	4,945,349	5,100,730	4,377,048	(723,682)	(14.2)
Total liabilities	9,290,556	10,347,708	10,197,983	(149,725)	(1.4)
Net assets:					
Invested in capital assets -					
Net of debt	6,109,101	6,237,486	6,295,196	57,710	0.9
Restricted assets (debt service)	1,875,005	2,625,726	2,904,207	278,481	10.6
Unrestricted	2,546,844	2,592,242	3,347,531	755,289	29.1
Total net assets	\$ 10,530,950	\$ 11,455,454	\$ 12,546,934	\$ 1,091,480	9.5

Current Assets

Total current assets increased by \$1,594,192 from the previous year. Cash and cash equivalents increased \$423,720 and short-term investments increased by \$300,000 due to the Hospital's improved financial position. Patient accounts receivable increased \$390,593 due to increased patient revenues. Prepaid expenses increased by \$368,851 due primarily to the recognition of \$350,000 in anticipated income from the Hospital Care Assurance Program.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

Noncurrent Assets

Noncurrent assets, which consist primarily of limited use investments, general long-term investments, and physician advances receivable increased by \$237,657, or 7.6 percent. Limited use investments increased by \$278,481. The increase was due to improved cash flow enabling the transfer of additional amounts to funded depreciation, a fund used to save for future capital purchases.

Capital Assets

Capital assets decreased by \$890,094, or 7.4 percent. The decrease was due to depreciation expense of \$1,465,771 offset by additions of \$575,677.

Current Liabilities

Current liabilities increased \$573,957 over the prior year. Current portion of long-term debt decreased by \$204,884 due to capital lease and debt principal payments. Accounts payable increased by \$794,286 due to the timing of payments to vendors. Cost report settlements payable decreased by \$547,500 due to the favorable settlement of the 2003 Medicare cost report and adjustments to the estimated liabilities for remaining open cost reports. Other accrued liabilities increased by \$394,913 due primarily to the recognition of \$350,000 in anticipated income from the Hospital Care Assurance Program.

Long-term Liabilities

Long-term liabilities decreased by \$723,682. Long-term debt decreased by \$742,920 from 2004 due to \$947,804 in principal payments and the reclassification of \$204,884 of long-term debt to current debt. Additional detail regarding the Hospital's long-term debt can be found in Note 7 of the financial statements.

Net Assets

Total net assets increased by \$1,091,480, or 9.5 percent, due entirely to excess revenue over expenses.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

Revenue and Expenses

The following table shows the changes in revenues and expenses for 2005 compared to 2004.

	2003	2004	2005	Change	
				Amount	Percent
Operating Revenue					
Net patient service revenue	\$ 21,288,852	\$ 22,817,794	\$ 25,293,111	\$ 2,475,317	10.8%
Other	442,434	584,123	550,055	(34,068)	-5.8%
Total operating revenue	21,731,286	23,401,917	25,843,166	2,441,249	10.4%
Operating Expenses					
Salaries and benefits	10,577,813	11,313,518	12,329,039	1,015,521	9.0%
Operating supplies and expenses	4,168,040	4,370,626	5,081,308	710,682	16.3%
Purchased services	4,831,800	5,170,985	5,538,478	367,493	7.1%
Insurance	215,149	218,512	173,955	(44,557)	-20.4%
Utilities	492,308	528,826	633,800	104,974	19.9%
Rental	331,516	386,262	509,451	123,189	31.9%
Depreciation and amortization	1,321,470	1,363,271	1,465,771	102,500	7.5%
Total operating expenses	21,938,096	23,352,000	25,731,802	2,379,802	10.2%
Operating Income (Loss)	(206,810)	49,917	111,364	61,447	123.1%
Nonoperating Gains (Losses)					
Investment income	34,887	43,938	90,942	47,004	107.0%
Loss on disposal of assets	(2,375)	(92,570)	-	92,570	-100.0%
Property taxes	1,171,914	1,238,209	1,240,000	1,791	0.1%
Interest expense	(371,922)	(314,990)	(350,826)	(35,836)	11.4%
Total nonoperating gains (losses)	832,504	874,587	980,116	105,529	12.1%
Excess of Revenue Over Expenses/ Increase in Net Assets	625,694	924,504	1,091,480	\$ 166,976	18.1%
Net Assets - Beginning of year	9,905,256	10,530,950	11,455,454		
Net Assets - End of year	\$ 10,530,950	\$ 11,455,454	\$ 12,546,934		

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

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 \$2,475,317, or 10.8 percent, from 2004. Gross patient revenue increased by \$4,207,848, or 11.2 percent. The Hospital board of trustees approved a 5 percent rate increase effective January 1, 2005. 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 39.1 percent to 39.3 percent as a percentage of gross revenue.

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 9.0 percent due to annual raises, a 4.9 percent increase in the number of FTEs, the additional OPERS expense associated with the salary increase, and increased health insurance costs.
- Operating supplies and expenses increased 16.3 percent due to an increase in outpatient volumes, and the increasing cost of drugs and patient chargeable items.
- Purchased services increased 7.1 percent due to increased contract services for physicians, nursing, pharmacy, radiology, and nursing.
- Utilities increased 19.9 percent due to the increase in the cost of natural gas.
- Rental increased by 31.9 percent due to the lease of equipment and software in the radiology, lab, and pharmacy departments.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

The following is a summary of 2005 operating expenses by type:

Operating Expenses		
Salaries and benefits	47.91%	\$ 12,329,039
Operating supplies and expenses	19.75%	5,081,308
Purchased services	21.52%	5,538,478
Insurance	0.68%	173,955
Utilities	2.46%	633,800
Rental	1.98%	509,451
Depreciation and amortization	5.70%	1,465,771
Total	100.00%	\$ 25,731,802

Nonoperating Gains (Losses)

Nonoperating revenue and expenses are all sources and uses that are primarily nonexchange 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:

- Investment income increased by \$47,004, or 107 percent, due to the Hospital's improved cash position and the increase in interest rates.
- Interest expense increased by \$35,836, or 11.4 percent, due to the capital lease for the new CT scanner acquired in December 2004.
- The disposal of a modular physician office and related improvements led to a loss on disposal of assets of \$92,570 in 2004.

Statement of Cash Flows

The combined statement of cash flows provides relevant information about the cash receipts and cash payments. The combined 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

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

The following table shows condensed cash flow information for the years 2005, 2004, and 2003.

	2003	2004	2005	Increase (Decrease)
Cash provided (used) by:				
Operating activities	\$ 1,074,313	\$ 1,870,400	\$ 1,652,919	\$ (217,481)
Capital and related financing activities	(1,001,241)	(674,292)	(634,307)	39,985
Investing activities	172,030	(1,108,274)	(440,277)	667,997
Net increase (decrease) in cash	245,102	87,834	578,335	490,501
Cash - Beginning of year	655,389	900,491	988,325	87,834
Cash - End of year	<u>\$ 900,491</u>	<u>\$ 988,325</u>	<u>\$ 1,566,660</u>	<u>\$ 578,335</u>

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 decreased \$217,481 over the prior year due to an increase of \$1,238,637 in payments to our vendors for supplies and services and an additional \$1,141,656 paid to employees for wages and benefits, offset by an increase of \$2,162,812 received from our patients and third-party payors.

Net cash used in capital and related financing activities decreased slightly from 2004 due to the paydown of capital leases and long-term debt.

Investing activities used \$736,253 less cash in 2005 than in 2004. This was due primarily to limited use assets increasing by only \$106,197 in 2005 compared to a \$634,416 increase in 2004.

Economic Factors and Next Year's Budget

The board of trustees approved the 2006 operating budget at its October 2005 meeting and the Morrow County Commissioners subsequently approved it. The budget calls for gross revenue of \$47 million, total operating expenses of \$29.7 million, and excess revenue over expense of \$1,007,000. The board of trustees approved an average increase of 8 percent in the patient charge structure for the upcoming fiscal year.

There are several factors and uncertainties that may affect the Hospital during 2006 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.

Morrow County Hospital and Affiliate

Management's Discussion and Analysis (Continued)

- 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 2005, instituting a sliding scale that should allow more self-pay patients to receive at least some discount.
- 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 external factors such as changes in reimbursement and the cost of malpractice insurance. Due to its rural location, the Hospital must occasionally address physician shortages including family practitioners and specialists (such as surgeons). In late 2005 and early 2006, the Hospital retained three additional general surgeons. The 2006 budget assumes increased surgery revenue due to these additions.
- In November 2005, the Hospital initiated a hospitalist program, whereby the Hospital pays a small group of physicians to provide inpatient care. The program was developed to address medical staff concerns regarding call rotation and unattached patients. We are uncertain of the program's financial impact in 2006.

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, 2005	December 31, 2004
Assets		
Current Assets		
Cash and cash equivalents (Note 2)	\$ 854,880	\$ 431,160
Short-term investments (Note 2)	600,000	300,000
Patient accounts receivable (Note 3)	4,467,756	4,077,163
Levied taxes receivable	1,350,000	1,300,000
Cost report settlements (Note 5)	108,850	-
Prepaid expenses and other	556,714	187,863
Inventory	281,340	293,648
Other current assets - Physician advances	114,747	150,261
Total current assets	8,334,287	6,740,095
Assets Limited as to Use (Note 2)	2,904,207	2,625,726
General Long-term Investments (Note 2)	336,351	279,181
Capital Assets (Note 10)	11,062,017	11,952,111
Other Assets - Physician advances	108,055	206,049
Total assets	<u>\$ 22,744,917</u>	<u>\$ 21,803,162</u>

Morrow County Hospital and Affiliate

Combined Balance Sheet (Continued)

	December 31, 2005	December 31, 2004
Liabilities and Net Assets		
Current Liabilities		
Current portion of long-term debt (Note 7)	\$ 744,158	\$ 949,042
Accounts payable	1,953,194	1,158,908
Cost report settlements payable (Note 5)	-	438,650
Accrued liabilities and other:		
Accrued compensation	1,292,933	1,312,226
Accrued interest	20,580	22,995
Deferred revenue for levied taxes	1,350,000	1,300,000
Other accrued liabilities	460,070	65,157
Total current liabilities	5,820,935	5,246,978
Long-term Debt (Note 7)	4,022,663	4,765,583
Other Liabilities - Compensated absences (Note 7)	354,385	335,147
Total liabilities	10,197,983	10,347,708
Net Assets		
Invested in capital assets - Net of related debt	6,295,196	6,237,486
Unrestricted	6,251,738	5,217,968
Total net assets	12,546,934	11,455,454
Total liabilities and net assets	<u>\$ 22,744,917</u>	<u>\$ 21,803,162</u>

Morrow County Hospital and Affiliate

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

	Year Ended	
	December 31, 2005	December 31, 2004
Operating Revenues		
Net patient service revenue (Note 6)	\$ 25,293,111	\$ 22,817,794
Other	550,055	584,123
Total operating revenues	25,843,166	23,401,917
Operating Expenses		
Salaries and wages	8,691,689	8,119,144
Employee benefits and payroll taxes	3,637,350	3,194,374
Operating supplies and expenses	5,081,308	4,370,626
Purchased services	5,538,478	5,170,985
Insurance	173,955	218,512
Utilities	633,800	528,826
Rental	509,451	386,262
Depreciation and amortization	1,465,771	1,363,271
Total operating expenses	25,731,802	23,352,000
Operating Income	111,364	49,917
Nonoperating Gains (Losses)		
Investment income	90,942	43,938
Loss on sale of property	-	(92,570)
Property taxes	1,240,000	1,238,209
Interest expense	(350,826)	(314,990)
Total nonoperating gains	980,116	874,587
Increase in Net Assets	1,091,480	924,504
Net Assets - Beginning of year	11,455,454	10,530,950
Net Assets - End of year	\$ 12,546,934	\$ 11,455,454

Morrow County Hospital and Affiliate

Combined Statement of Cash Flows

	Year Ended	
	December 31, 2005	December 31, 2004
Cash Flows from Operating and Nonoperating Activities		
Cash received from patients and third-party payors	\$ 24,902,518	\$ 22,739,706
Cash payments to suppliers for services and goods	(11,651,836)	(10,413,199)
Cash payments to employees for services	(12,147,818)	(11,040,230)
Other receipts from operations	550,055	584,123
Net cash provided by operating activities	1,652,919	1,870,400
Cash Flows from Investing Activities		
Proceeds from sale of investments	300,000	-
Investment income	90,942	43,938
Decrease in assets limited as to use	(106,197)	(634,416)
Purchase of investments	(674,839)	(306,780)
Advances to physicians	(50,183)	(211,016)
Net cash used in investing activities	(440,277)	(1,108,274)
Cash Flows from Capital and Related Financing Activities		
Acquisition and construction of capital assets	(573,262)	(517,290)
Property tax levy	1,240,000	1,238,209
Interest paid on long-term debt	(353,241)	(316,274)
Principal payments on long-term debt	(947,804)	(1,078,937)
Net cash used in capital and related financing activities	(634,307)	(674,292)
Net Increase in Cash and Cash Equivalents	578,335	87,834
Cash and Cash Equivalents - Beginning of year	988,325	900,491
Cash and Cash Equivalents - End of year	\$ 1,566,660	\$ 988,325
Supplemental Cash Flow Information		
Included in current assets	\$ 854,880	\$ 431,160
Included in assets limited as to use	678,174	505,890
Included in general long-term investments	33,606	51,275
Cash and Cash Equivalents - End of year	\$ 1,566,660	\$ 988,325

Morrow County Hospital and Affiliate

Combined Statement of Cash Flows (Continued)

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

	Year Ended	
	December 31, 2005	December 31, 2004
Cash Flows from Operating Activities		
Operating income	\$ 111,364	\$ 49,917
Adjustments to reconcile operating income to net cash from operating activities:		
Depreciation and amortization	1,465,771	1,363,271
Provision for bad debts	2,482,785	2,299,227
Forgiveness of physician advances	183,691	115,435
(Increase) decrease in assets:		
Patient accounts receivable	(2,873,378)	(2,377,315)
Third-party settlement receivables	(547,500)	82,821
Inventories	12,308	(1,105)
Other current assets	(368,851)	31,494
Increase in liabilities:		
Accounts payable	794,286	148,802
Accrued expenses	392,443	157,853
Net cash provided by operating activities	<u>\$ 1,652,919</u>	<u>\$ 1,870,400</u>

Significant noncash investing, capital, and financing activities for 2005 and 2004 are as follows:

The Hospital entered into capital lease obligations of \$1,296,979 for new equipment in 2004.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 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, and is a component unit of, 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 combined financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America 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. The Foundation is 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.

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 combined statement of cash flows.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

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

Investments - Investments include certificates of deposit and government securities and are recorded at fair value in the combined 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.

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 lease obligations is amortized on the straight-line method over the shorter period of the lease term or 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.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

Note I - 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 and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those 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 with 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.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

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

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 2004 amounts have been reclassified to conform to the 2005 presentation.

Note 2 - Deposits and Investments

Chapter 135 of the Ohio Uniform Depository Act authorizes local and governmental units to make deposits in any national bank located in the state subject to inspection by the superintendent of financial institutions. Section 135.14 of the Ohio Revised Code allows the local governmental to invest in United States treasury bills, notes, bonds or any other obligation or security issued by the United States Treasury or any other obligation guaranteed as to principal and interest by the United States of America and bonds and other obligations of the State of Ohio. Investments in no-load money market mutual funds, repurchase agreements, commercial paper and bankers acceptances are permitted subject to certain limitations that include completion of additional training, approved by the auditor of state, by the treasurer or governing board investing in these instruments.

The Hospital has designated three banks for the deposit of its funds. An investment policy has not been filed with the auditor of state on behalf of the Hospital. Investment of interim funds is limited to bonds, notes, debentures, or any other obligations or securities issued by any federal government agency or instrumentality, no-load money market mutual funds, and the Ohio subdivision's fund (STAR Ohio).

Statutes require the classification of funds held by the Hospital into three categories:

Active Funds - Those funds required to be kept in a "cash" or "near cash" status for immediate use by the Hospital. Such funds must be maintained either in depository accounts or withdrawable on demand, including negotiable order of withdrawal (NOW) accounts.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

Note 2 - Deposits and Investments (Continued)

Inactive Funds - Those funds not required for use within the current five-year period of designated depositories. Ohio law permits inactive monies to be deposited or invested as certificates of deposit, maturing not later than the end of the current period of designated depositories or as savings or deposit accounts, including, but not limited to passbook accounts.

Interim Funds - Those funds which are not needed for immediate use but will be needed before the end of the current period of designation of deposit. Ohio law permits interim funds to be invested or deposited in the following securities.

1. Bonds, notes, or other obligations guaranteed by the United States, or those for which the faith of the United States is pledged for the payment of principal and interest
2. Bonds, notes debentures, or other obligations or securities issued by any federal governmental agency
3. No-load money market mutual funds consisting exclusively of obligations described in (1) or (2) above and repurchase agreements secured by such obligations, provided that investments in securities described in this division are made only through eligible institutions
4. Interim deposits in the eligible institutions applying for interim funds to be evidenced by time certificates of deposit maturing not more than one year from date of deposit, or by savings or deposit accounts, including but not limited to, passbook accounts
5. Bonds and other obligations of the State of Ohio
6. The Ohio State treasurer's investment pool (STAR Ohio)
7. Commercial paper and banker's acceptances which meet the requirements established by Ohio Revised Code, SEC 135.142
8. Under limited circumstances, corporate debt interest in either of the two highest rating classifications by at least two nationally recognized rating agencies

Protection of the Hospital's deposits is provided by the Federal Deposit Insurance Corporation, by eligible securities pledged by the financial institution as security for repayment, by surety company bonds deposited with the treasurer by the financial institution, or by single collateral pool established by the financial institution to secure the repayment of all public funds deposited with the institution.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

Note 2 - Deposits and Investments (Continued)

Investments in stripped principal or interest obligations, reverse repurchase agreements, and derivatives are prohibited. The issuance or taxable notes for the purpose of arbitrage, the use of leverage, and short selling are also prohibited. An investment must mature within five years from the date of purchase unless matched to a specific obligation or debt of the district, and must be purchased with the expectation that it will be held to maturity.

The Hospital's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Hospital's deposits may not be returned to it. The Hospital does not have a deposit policy for custodial credit risk. As a result, the Hospital evaluates each financial institution with which it deposits funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories. At year end, all Hospital bank deposits (certificates of deposit, checking, and savings accounts) were fully collateralized.

Custodial Credit Risk of Investments

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Hospital will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Hospital does not have a policy for custodial credit risk. At year end, the following investment securities were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the Hospital's name:

Type of Investment	Carrying Value	How Held
U.S. government bonds	\$ 2,528,778	Counterparty

Interest Rate Risk

Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Hospital does not have an investment policy that addresses interest rate risk. At year end, the average maturities of investments are as follows:

Investment	Fair Value	Weighted Average Maturity
U.S. government bonds	\$ 2,528,778	0.81 Years

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

Note 3 - Patient Accounts Receivable

The details of patient accounts receivable are set forth below:

	2005	2004
Patient accounts receivable	\$ 7,973,756	\$ 7,380,163
Less:		
Allowance for uncollectible accounts	(1,521,000)	(1,658,000)
Allowance for contractual adjustments	(1,985,000)	(1,645,000)
Net accounts receivable	<u>\$ 4,467,756</u>	<u>\$ 4,077,163</u>

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	
	2005	2004
Medicare	28	26
Medicaid	10	6
Commercial insurance and HMOs	42	45
Self-pay	20	23
Total	<u>100</u>	<u>100</u>

Note 4 - Assets Limited as to Use and Investments

Cash deposits, assets whose use is limited, and investments of the Hospital are composed of the following:

	Fair Value	
	2005	2004
Demand deposits and money market accounts	\$ 1,566,660	\$ 988,325
Certificates of deposit	600,000	300,000
U.S. government obligations	2,528,778	2,347,742
Total	<u>\$ 4,695,438</u>	<u>\$ 3,636,067</u>

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

Note 4 - Assets Limited as to Use and Investments (Continued)

	Fair Value	
	2005	2004
Amounts summarized by fund type -		
General funds:		
Cash and cash equivalents	\$ 854,880	\$ 431,160
Short-term investments	600,000	300,000
Board-designated	2,904,207	2,625,726
General long-term investments	336,351	279,181
Total	<u>\$ 4,695,438</u>	<u>\$ 3,636,067</u>

Note 5 - Cost Report Settlements

Approximately 59 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.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

Note 5 - Cost Report Settlements (Continued)

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.

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 6 - Net Patient Service Revenue

Net patient service revenue consists of the following:

	<u>2005</u>	<u>2004</u>
Patient revenue:		
Inpatient services:		
Routine services	\$ 4,116,043	\$ 4,056,741
Ancillary services	5,883,568	4,944,077
Outpatient ancillary services	<u>31,667,988</u>	<u>28,458,933</u>
Total patient revenue	41,667,599	37,459,751
Revenue deductions:		
Provision for contractual allowances	13,902,160	12,412,045
Provision for bad debts	2,482,785	2,299,227
Charity care - Net of Hospital Care Assurance received	<u>(10,457)</u>	<u>(69,315)</u>
Total revenue deductions	<u>16,374,488</u>	<u>14,641,957</u>
Net patient service revenue	<u>\$ 25,293,111</u>	<u>\$ 22,817,794</u>

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

Note 7 - Long-term Debt and Other Noncurrent Liabilities

Long-term liability activity for the year ended December 31, 2005 was as follows:

	2004	Current Year Additions	Current Year Reductions	2005	Amounts Due Within One Year
Master lease and purchase agreement	\$ 4,318,127	\$ -	\$ (453,472)	\$ 3,864,655	\$ 480,783
Capital lease obligations	1,396,498	-	(494,332)	902,166	263,375
Total long-term debt	5,714,625	-	(947,804)	4,766,821	744,158
Compensated absences	335,147	693,564	(674,326)	354,385	354,385
Total noncurrent liabilities	\$ 6,049,772	\$ 693,564	\$ (1,622,130)	\$ 5,121,206	\$ 1,098,543

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 noncurrent liabilities	\$ 5,775,836	\$ 1,946,866	\$ (1,672,930)	\$ 6,049,772	\$ 949,042

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.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

Note 7 - Long-term Debt and Other Noncurrent Liabilities (Continued)

- 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, 2005 and 2004 were approximately \$1,726,000 less accumulated depreciation of \$825,000 and \$331,000, respectively.

The following is a schedule by years of bond principal and interest as of December 31, 2005:

Year Ending December 31	Long-term Debt		Capital Lease Obligation	
	Principal	Interest	Principal	Interest
2006	\$ 480,783	\$ 217,137	\$ 263,375	\$ 71,337
2007	509,738	188,182	236,996	51,974
2008	539,981	157,939	215,838	32,350
2009	572,958	124,962	185,957	11,493
2010	607,464	90,456	-	-
2011-2015	1,153,731	68,991	-	-
Total payments	\$ 3,864,655	\$ 847,667	\$ 902,166	\$ 167,154

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 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 \$4,000,000 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.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

Note 8 - Medical Malpractice Claims (Continued)

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 9 - 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 2005, member and employer contribution rates were consistent across all three plans (TP, MD, and CO), and are actuarially determined. The 2005 member contribution rate for members of local government units was 8.50 percent of their annual covered salary. The 2005, 2004, and 2003 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, 2005, 2004, and 2003 were approximately \$1,248,000, \$1,111,000, and \$1,026,000, respectively. Required employer contributions for all plans are equal to 100 percent of employer charges and must be extracted from the employer's records.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

Note 9 - Defined Benefit Pension Plan (Continued)

Postretirement Benefits - In order to qualify for postretirement health care coverage under the TP and CO plans, 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 2005 and 2004 employer contribution rate for local government employer units was 13.55 percent of covered payroll. Of this amount, 4.0 percent was the portion that was used to fund health care during both 2005 and 2004. The portion of the employer's contribution used to fund postemployment benefits for 2005 and 2004 was \$368,000 and \$328,000, respectively.

The Ohio Revised Code provides the statutory authority requiring public employers to fund postretirement 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 2004 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 OPERS's latest actuarial review performed as of December 31, 2004.

The number of active contributing participants in the traditional and combined plans at December 31, 2005 was 376,109. The number of active contributing participants for both plans used in the December 31, 2004 actuarial valuation was 355,287. As of December 31, 2004, the actuarial value of OPERS's net assets available for OPEB was \$10.8 billion. The actuarially accrued liability and the unfunded actuarial accrued liability, based on the actuarial cost method used, were \$29.5 billion and \$18.7 billion, respectively.

Morrow County Hospital and Affiliate

Notes to Combined Financial Statements December 31, 2005 and 2004

Note 9 - Defined Benefit Pension Plan (Continued)

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. In addition to the HCPP, OPERS has taken additional action to improve the solvency of the Health Care Fund in 2005 by creating a separate investment pool for health care assets. As an additional component of HCPP, member and employer contribution rates increased as of January 1, 2006, which will allow additional funds to be allocated to the health care plan.

Note 10 - Capital Assets

Cost of capital assets and related depreciable lives for December 31, 2005 are summarized below:

	2004	Additions	Transfers	Retirements	2005	Depreciable Life - Years
Land and land improvements	\$ 528,023	\$ 8,881	\$ -	\$ -	\$ 536,904	5-25
Building	5,329,981	42,025	-	-	5,372,006	10-40
Equipment	14,570,296	362,107	61,584	-	14,993,987	5-20
Construction in progress	179,427	162,664	(61,584)	-	280,507	
Total	20,607,727	575,677	-	-	21,183,404	
Less accumulated depreciation:						
Land and land improvements	302,435	32,679	-	-	335,114	
Building	2,379,791	242,967	-	-	2,622,758	
Equipment	5,973,390	1,190,125	-	-	7,163,515	
Total	8,655,616	1,465,771	-	-	10,121,387	
Net carrying amount	\$11,952,111	\$ (890,094)	\$ -	\$ -	\$11,062,017	

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	

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, 2005 and 2004. Our audits were made for the purpose of forming an opinion on the basic 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 basic combined financial statements rather than to present the financial position and results of operations, of the individual entities 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 basic combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic combined financial statements taken as a whole.

Plante & Moran, PLLC

February 10, 2006

Morrow County Hospital and Affiliate

Combining Balance Sheet December 31, 2005

	Morrow County Hospital	Morrow County Hospital Foundation	Eliminating Entries	Total
Assets				
Current Assets				
Cash and cash equivalents	\$ 791,414	\$ 63,466	\$ -	\$ 854,880
Short-term investments	600,000	-	-	600,000
Patient accounts receivable	4,467,756	-	-	4,467,756
Levied taxes receivable	1,350,000	-	-	1,350,000
Cost report settlements	108,850	-	-	108,850
Prepaid expenses and other	540,812	15,902	-	556,714
Inventory	281,340	-	-	281,340
Other current assets - Physician advances	114,747	-	-	114,747
Total current assets	8,254,919	79,368	-	8,334,287
Assets Limited as to Use	2,904,207	-	-	2,904,207
General Long-term Investments	-	336,351	-	336,351
Capital Assets	11,062,017	-	-	11,062,017
Other Assets - Physician advances	108,055	-	-	108,055
Total assets	<u>\$ 22,329,198</u>	<u>\$ 415,719</u>	<u>\$ -</u>	<u>\$ 22,744,917</u>

Morrow County Hospital and Affiliate

Combining Balance Sheet (Continued) December 31, 2005

	Morrow County Hospital	Morrow County Hospital Foundation	Eliminating Entries	Total
Liabilities and Net Assets				
Current Liabilities				
Current portion of long-term debt	\$ 744,158	\$ -	\$ -	\$ 744,158
Accounts payable	1,953,194	-	-	1,953,194
Accrued liabilities and other:				
Accrued compensation	1,292,933	-	-	1,292,933
Accrued interest	20,580	-	-	20,580
Deferred revenue for levied taxes	1,350,000	-	-	1,350,000
Other accrued liabilities	460,070	-	-	460,070
Total current liabilities	5,820,935	-	-	5,820,935
Long-term Debt	4,022,663	-	-	4,022,663
Other Liabilities - Compensated absences	354,385	-	-	354,385
Total liabilities	10,197,983	-	-	10,197,983
Net Assets				
Invested in capital assets - Net of related debt	6,295,196	-	-	6,295,196
Unrestricted	5,836,019	415,719	-	6,251,738
Total liabilities and net assets	\$ 22,329,198	\$ 415,719	\$ -	\$ 22,744,917

Morrow County Hospital and Affiliate

Combining Statement of Operations Year Ended December 31, 2005

	Morrow County Hospital	Morrow County Hospital Foundation	Eliminations	Total
Operating Revenues				
Total patient service revenue	\$ 41,667,599	\$ -	\$ -	\$ 41,667,599
Revenue deductions	(16,374,488)	-	-	(16,374,488)
Net patient service revenue	25,293,111	-	-	25,293,111
Other	472,874	77,181	-	550,055
Total operating revenues	25,765,985	77,181	-	25,843,166
Operating Expenses				
Salaries and wages	8,691,689	-	-	8,691,689
Employee benefits and payroll taxes	3,637,350	-	-	3,637,350
Operating supplies and expenses	5,080,079	1,229	-	5,081,308
Purchased services	5,538,478	-	-	5,538,478
Insurance	173,955	-	-	173,955
Utilities	633,800	-	-	633,800
Rental	509,451	-	-	509,451
Depreciation and amortization	1,465,771	-	-	1,465,771
Total operating expenses	25,730,573	1,229	-	25,731,802
Nonoperating Gains (Loss)				
Investment income	90,942	-	-	90,942
Property taxes	1,240,000	-	-	1,240,000
Interest expense	(350,826)	-	-	(350,826)
Total nonoperating gains	980,116	-	-	980,116
Excess of Revenue Over Expenses	1,015,528	75,952	-	1,091,480
Transfer from (to) Affiliate	23,265	(23,265)	-	-
Increase in Net Assets	\$ 1,038,793	\$ 52,687	\$ -	\$ 1,091,480

Report on Internal Control Over Financial Reporting and on Compliance

Report on Internal Control Over Financial Reporting and on Compliance

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 and for the year December 31, 2005 and have issued our report thereon dated February 10, 2006. 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 and Other Matters

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

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 an opinion on the internal control over financial reporting. However, we noted one matter involving the internal control over financial reporting and its operation that we consider to be 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 judgement, 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. The reportable condition is described below.

Reportable Condition

During our testing of the revenue cycle, we noted two instances where patient medical records did not match what was actually billed to patient accounts. In both instances, the medical record documented an emergency room visit, but neither patient was billed for this visit.

To the Board of Directors
Morrow County Hospital and Affiliate

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.

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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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 board of trustees and board of governors of Morrow County Hospital, management, and the auditor of the state of Ohio, and is not intended to be and should not be used by anyone other than these specified parties.

Plante & Moran, PLLC

February 10, 2006



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Betty Montgomery**

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MORROW COUNTY HOSPITAL AND AFFILIATE

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
JUNE 20, 2006**