The MetroHealth System

Financial Statements
for the Years Ended
December 31, 2004 and 2003
and Independent Auditors' Reports

Auditor of State
Betty Montgomery

Board of Trustees
MetroHealth System
2500 MetroHealth Drive
Cleveland, Ohio 44109-1998

We have reviewed the Independent Auditor's Report of the MetroHealth System, Cuyahoga County, prepared by Deloitte & Touche LLP, 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 MetroHealth System is responsible for compliance with these laws and regulations.

Betty Montgomery

BETTY MONTGOMERY
Auditor of State

June 7, 2005

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THE METROHEALTH SYSTEM

TABLE OF CONTENTS
DECEMBER 31, 2004 AND 2003

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
The MetroHealth System

We have audited the accompanying balance sheet of The MetroHealth System (the "System"), a component unit of Cuyahoga County, Ohio, as of December 31, 2004, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the System for the year ended December 31, 2003 were audited by other auditors whose report, dated February 27, 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 general purpose financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements, 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 financial statements referred to above present fairly, in all material respects, the financial position of the System at December 31, 2004, and the results of its changes in net assets 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 on pages 2 through 9 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the System's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2005, on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche, LLP

March 28, 2005

Deloitte.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Trustees
The MetroHealth System
Cleveland, Ohio

We have audited the financial statements of The MetroHealth System (the "System"), as of and for the year ended December 31, 2004, and have issued our report thereon dated March 28, 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 *Governmental Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the System'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 two instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the System in a separate letter dated March 28, 2005.

This report is intended solely for the information and use of the audit committee, management, federal awarding agencies, state funding agencies, pass-through entities, and the Ohio Auditor of State and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche, LLP

March 28, 2005

MANAGEMENT'S DISCUSSION (3-10)

This section of The MetroHealth System's (the "System") annual financial report presents management's discussion and analysis of the System's financial performance and provides an overall review of the System'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 discussion and analysis is designed to focus on current activities, resulting change and currently known facts. The financial statements, footnotes, and this discussion and analysis are the responsibility of the System's management.

Overview of the Financial Statements

This annual report consists of financial statements prepared in accordance with the provisions of Governmental Accounting Standards Board ("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 implementation of GASB Statement No. 34 affected the presentation of net assets, the inclusion of management's discussion and analysis, the direct method presentation of the statements of cash flows and expanded footnote disclosures.

The accompanying financial statements of the System include the MetroHealth Medical Center, a short-term acute care and long-term rehabilitation facility; MetroHealth Centers for Skilled Nursing Care, consisting of the Skilled Nursing Facility East and The Elisabeth Severance Prentiss Center for Skilled Nursing Care; and several urban and suburban primary care health sites. All significant inter-entity transactions have been eliminated in the financial statements.

The System is the public health care system for Cuyahoga County, Ohio, (the "County") and was created pursuant to Ohio Revised Code Chapter 339. The System is governed by a Board of Trustees appointed jointly by the Board of County Commissioners of the Board of County of Cuyahoga, and the senior judges of the Probate Court and Common Pleas Court.

In accordance with GASB Statement No. 14, *The Reporting Entity*, the System's financial statements are included, as a discrete entity, in the County's Consolidated Annual Financial Report (CAFR). A copy of the CAFR can be obtained from Frank Russo, Cuyahoga County Auditor, County Administration Building, 1219 Ontario Street, Cleveland, Ohio 44113.

Financial and Operating Highlights for 2004

- Inpatient levels of activity decreased slightly from the prior year.
- Outpatient levels of activity increased 3.3% from the prior year.
- Emergency room levels of activity increased 3.9% from the prior year.
- Surgery cases increased 2.0% from the prior year.
- Total net assets decreased by $6.6 million over last year.
- The System opened its new Critical Care Pavilion, which houses perioperative facilities and the emergency department, in mid-year. Total cost of the construction was just under $70.0 million.
- The System purchased the former Deaconess Hospital in a bankruptcy auction. The first phase of renovations of this facility will accommodate the System's datacenter and other back office functions. The cost will be $23.4 million with a completion expected in the 4th quarter of 2005.
- The Broadway Medical Center, an outpatient medical facility, opened in July.

Financial and Operating Highlights for 2003

- Inpatient levels of activity decreased from the prior year.
- Outpatient levels of activity increased 4.0% over last year.
- Emergency room levels of activity decreased 1.0% over last year.
- Surgery cases decreased 1.0% over last year.
- Total net assets decreased by $8.7 million over last year.
- Construction in progress increased $43.4 million, which is largely attributed to the construction of the new Critical Care Pavilion.
- Long-term debt increased due to the issuance of $30.5 million Series 2003 Bonds in March. The proceeds are earmarked for the completion of the Critical Care Pavilion and a new administration building.

Financial Analysis of the System at December 31, 2004 and 2003

Total assets decreased by 2.0% to $604.1 million, and total liabilities decreased 1.4% to $387.8 million in 2004. The System's total net assets declined from $222.9 million to $216.3 million in 2004, a 3.0% decrease from a year ago. This represented a slight improvement from the 3.8% decrease from 2002. Table 1 summarizes the balance sheet movement for the last two years.

Table 1
The MetroHealth System
Balance Sheets (000's)

	2004	2003	2002
Assets:			
Current assets	$ 94,406	$ 82,317	$ 75,022
Investments	221,253	233,927	230,661
Restricted assets	33,387	60,309	57,928
Capital assets	251,151	233,652	211,487
Other assets	3,881	6,154	6,663
Total assets	$604,078	$616,359	$581,761
Liabilities and net assets:			
Liabilities:			
Current liabilities	$108,142	$114,084	$ 93,531
Long-term liabilities	279,608	279,334	256,550
Total Liabilities	387,750	393,418	350,081
Net assets:			
Invested in capital assets, net of related debt	40,588	43,422	42,977
Restricted	30,579	57,230	54,456
Unrestricted	145,161	122,289	134,247
Total net assets	216,328	222,941	231,680
Total liabilities and net assets	$604,078	$616,359	$581,761

Current Assets

Total current assets increased $12.0 million in 2004 or 14.7% over the prior year. Cash increased $2.0 million in 2004 from the prior year and is due to higher amounts retained in overnight accounts rather than investment accounts at the end of the year. Patient accounts receivable increased by $10.8 million in 2004 which is attributed to increases in the Self-pay portion of the receivable and a Medicaid pharmacy rebilling that increased the receivable (by $4.6 million) until payments on the corrected billings begin in early 2005. The System participates in a State of Ohio supplemental Medicaid program that provides access to available funding up to 100% of the Medicare Upper Payment Limit for inpatient hospital services. The receivable related to this program decreased $2.4 million in 2004 from the previous year. The remaining movement in 2004 includes a $0.4 million increase in supplies inventory and $0.5 million increase in prepaid medical malpractice insurance premiums. Total current assets increased $7.3 million in 2003, an increase of 9.7% over 2002.

Investments

Investments decreased by $12.7 million in 2004 from the prior year. A $5.5 million increase in funding to the Depreciation reserve fund was offset by decreases in the other investments required to accommodate operational and capital expenditures. The restricted asset decrease of $26.9 million in 2004 was driven by the $27.1 million in draws from the Series 1999 and 2003 Project Funds for Critical Care Pavilion construction. In 2003, investments increased by $3.3 million, mainly as a result of improved collections of accounts receivable and increased Depreciation Reserve funding.

Capital Assets

Capital expenditures for 2004 were $43.6 million. Significant capital outlays included $22.6 million for the completion on the Critical Care Pavilion; $7.9 million for the Broadway and Buckeye medical office facilities; $2.0 million to refurbish two helicopters; $1.3 million for MetroHealth South Campus renovations; and $0.8 million for power house electrical upgrades. The balance was spread among other projects like the Microsoft XP software rollout, PBX replacement and relocation, medical equipment replacements and medical office renovations. Proceeds from the Series 1999 and 2003 Bond issues were used for the Critical Care Pavilion and the remaining was paid with operating funds. Capital additions in 2003 totaled $50.5 million, mainly related to the Critical Care Pavilion.

At December 31, 2004, the System has $14.8 million remaining in commitments on the Critical Care Pavilion, Broadway and Buckeye medical centers and south campus projects that will be paid out of the remaining $1.2 million of bond proceeds and the rest from operating funds. Detail information regarding the System's capital assets can be found in Note 4 of the financial statements.

Current Liabilities

Current liabilities declined by $5.9 million in 2004 from the prior year. Accounts payable declined by $6.0 million. The 2003 accounts payable balance included $7.2 million in accrued invoices and retainage liabilities related to the Critical Care Pavilion construction project where as the similar liability for 2004 amounted to $1.3 million. Accrued payroll increased $2.0 million and is related to the additional day needed to be accrued in 2004 compared to 2003. The current portion of the Self-insurance liability increased from the prior year by $2.0 million due to the results of this year's actuarial study on the medical malpractice reserves indicating increased payouts. Other current liabilities contain the corresponding Upper Payment Limit liability and decreased $1.9 million this year.

Current liabilities increased by $20.6 million in 2003 due primarily to a $6.7 million increase in accounts payable, a $4.9 million increase in the current portion of Self-insurance liabilities, a $3.4 million note payable for self-insurance premium financing and a $5.6 million increase in the Upper Payment Limit Program payable.

Long-Term Liabilities

All of the System's long-term debt relates to acquisition of capital assets. In 2004, the System incurred a loan from Ohio Public Utilities Commission in connection with sewer line replacement at its eastside skilled nursing facility. The note is non-interest bearing and payable over 20 years. The System issued $30.5 million variable interest rate bonds in March 2003 to fund major construction projects. The System's bond indenture and capital lease agreements contain various covenants that the System must maintain. The financial covenants include Days Cash in Hand, Debt Service Coverage and Debt to Capitalization ratios. Additional detail regarding the System's long-term debt can be found in Note 5 of the financial statements.

The two swap agreements that are connected to the Series 1999 Bond issue will only be effective through February 2005. One agreement has been terminated by the counterparty and the other expired. This will have an effect of increasing the System's total interest expense by an estimated $1.8 million in 2005.

Table 2
The MetroHealth System
Statements of Revenues, Expenses and Changes in Net Assets (000's)

	Years ended December 31, 2004	2003	2002
Operating revenue			
Net patient service revenue	$ 498,434	$ 468,598	$ 456,693
Other revenue	21,654	21,693	17,830
Total operating revenue	520,088	490,291	474,523
Operating expenses			
Professional care of patients	339,830	318,359	300,794
Dietary	6,950	6,879	6,308
Household and property	23,295	22,720	22,278
Administrative and general	73,945	69,308	69,407
Employee benefits	71,037	66,373	63,898
Provision for bad debts	6,049	7,528	13,636
Depreciation and amortization	28,804	28,285	30,700
Total operating expenses	549,910	519,452	507,021
Operating loss	(29,822)	(29,161)	(32,498)
Non-operating revenues-net	23,142	20,605	29,829
Grants for capital acquisitions	183	104	44
Decrease in net assets	(6,497)	(8,452)	(2,625)
Total net assets--beginning of the year	222,941	231,680	236,534
Transfer of net assets	(116)	(287)	(2,229)
Total net assets--end of the year	$ 216,328	$ 222,941	$ 231,680

The System's total operating and non-operating revenue in 2004 was $559.6 while expenses were $566.1 million. This resulted in net assets decreasing $6.5 million for the year reflecting a net loss for the year. This was a $2.0 million net improvement from 2003 that had $526.2 million in revenue and $534.6 in expenses.

Net Patient Service Revenue

Net patient service revenue increased $29.9 million or 6.4% in 2004. This is reflective of the slight increases in patient and visit volumes in 2004. Although the gross revenue includes a 4.0% price increase effective January 1, 2004, there was a corresponding increase in contractual allowances. This compares favorably to the $11.9 million or 2.6% increase experienced in 2003. Net patient service revenue also includes revenue the System received as a participant in the State of Ohio Care Assurance (HCAP) ($26.0 million in 2004, $28.0 million in 2003 and $34.0 million in 2002) and Upper Payment Limit (UPL) ($17.0 million in 2004, $16.0 million in 2003 and $12.0 million in 2002) programs. The level of revenue from HCAP and UPL in future years is uncertain.

Charity care increased by $12.8 million to a total of $121.0 million in 2004. This 11.8% increase was greater than the 9.6% increase in 2003 and 1.0% in 2002. The System's level of charity care continues to reflect the System's status as a safety net facility in Cuyahoga County.

Operating Expenses

The System's total operating expenses increased $30.5 million or 5.9% from the prior year. This amount is over twice the increase of $12.4 million from 2002 to 2003. Table 3 summarizes the expenses from the last three years.

Table 3
The MetroHealth System
Expense Detail (000's)

	2004	2003	2002
Operating expenses:			
Salaries and wages	$ 304,150	$ 289,361	$ 274,366
Employee benefits	71,037	66,373	63,898
Medical supplies	30,591	28,137	26,005
Pharmaceuticals	23,291	21,765	20,198
Plant operations	31,671	28,796	27,325
Supplies and other	37,240	35,472	34,427
Liability insurance	17,077	13,735	16,466
Provision for bad debts	6,049	7,528	13,636
Depreciation and amortization	28,804	28,285	30,700
Total operating expenses	$ 549,910	$ 519,452	$ 507,021

Salary and wages increased $14.8 million from 2003 to 2004. This is a similar dollar increase as the change from 2002 to 2003. In 2004, a general rate increase of 3.0% accounts for $8.7 million increase over the prior year. Net FTE growth of 17 (physicians) increased salaries expense $2.8 million. The remaining increases for 2004 related to higher costs associated with sick and vacation time, higher terminating employee costs, and higher physician incentive payouts. The increases from 2002 to 2003 included a 4.0% general wage increase and a 54 FTE increase.

Employee benefits increased $4.7 million from 2004. The System recorded a $3.2 million adjustment to its Workers Compensation liability based on an actuarial analysis of claim activity completed at year end. The remaining $1.6 million reflects the increased per employee health costs (including pharmaceuticals). This is an improvement on the increases for 2002 to 2003 which amounted to $2.4 million.

Medical and pharmaceuticals supplies increased a total of $4.0 million or 8.0% in 2004. A similar 8.0% increase was experienced in 2003.

Plant operation expenses increased $2.9 million or 10.0% in 2004. The primary driver was a $1.2 million increase in construction expenses for the year. The construction expenses are those that were transferred from capital projects that do not meet the criteria for capitalization. These are typically moving expenses, work to existing conditions on the projects that are actually repairs or expenses on proposed projects (planning phase) that did not materialize into an approved project. This year major projects like the Critical Care Pavilion and the Broadway medical building contributed significantly to the increase. Building rental increased $300 thousand (Broadway Medical Center opening) and utility costs increased $1.2 million to round out the 2003 to 2004 increase. Plant operation expenses increased $1.5 million in 2003, an increase of 5.4%.

Medical malpractice insurance expense increased $3.3 million for the year. This increase includes a $1.3 million adjustment to the liability account at year end as a result of the annual actuarial review of claim activity. In the prior year, the similar adjustment was favorable by $2.7 million.

Non-Operating Revenue and Expense

The largest component of non-operating revenue is the amount the System receives from the County as an annual appropriation. The Cuyahoga County Commissioners approved an increase in the System appropriation of nearly $6.0 million from 2003 for a total of $26.8 million in 2004. This is a turnaround from the previous $1.0 decrease in funding that occurred between 2003 and 2002. The citizens of the County approved a health and human service levy in 2003 which allowed the Commissioners to increase funding to the System. The funding by the County is expected to increase again in 2005 by nearly $8.0 million.

Investment income decreased by $1.8 million to $5.3 million in 2004. This decrease reflects the generally low investment rates on investment vehicles in which the System is permitted to participate and a $40.0 million total decrease in investment balances.

Interest expense grew from $7.3 million in 2003 to $8.4 million or 15.0% in 2004. The primary driver was a decrease in the amount of interest capitalized in 2004 which was down $0.9 million. This is a direct result of the amount of qualifying interest based on the completion of construction projects. In 2005, interest expense is expected to increase by another $3.5 million. This is due to a continued decrease in the amount of interest eligible to be capitalized ($1.3 million lost) as part of construction projects and the loss of the favorable effect from the interest swap agreements ($2.2 million lost) no longer in effect during 2005.

Economic Factors and Next Year's Budget

Several factors and uncertainties that are contained in the budget are:

- The System budgeted to receive a $35.0 million appropriation from the County in 2005. This is an increase from the prior year of $8.0 million. The System will continue to explore revenue enhancement and cost reduction (productivity) opportunities.

- At both the Federal and State level, proposed Medicaid funding cuts may harm System revenue and cash flows as it relies on Medicaid for 32.0% of net patient revenues. The System will continue to promote Federal and State policy reforms to provide adequate funding to safety net providers.

- Capital funds needed for replacement of depreciating facilities and equipment and the addition/expansion of vital programs will require use of existing investments or debt as well as anticipated capital funding from the County. The System intends to use $20.0 million from the Depreciation Reserve Fund for operating and capital needs in 2005.

- Medical malpractice costs will continue to exert upward pressure on related expense and claim payouts.

- Ohio's Hospital Care Assurance Program (HCAP) is expected to continue at the 2004 level due to the Medicare Prescription Improvement & Modernization Act of 2003 (MMA). An amendment to Ohio's HCAP is pending and needed in order to maintain funding levels to Ohio's public hospitals.

THE METROHEALTH SYSTEM

BALANCE SHEETS
DECEMBER 31, 2004 AND 2003
(Dollars in Thousands)

	December 31, 2004	December 31, 2003
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 2,287	$ 255
Patient accounts receivable	64,187	53,395
Allowance for uncollectible accounts	(6,146)	(6,632)
	58,041	46,763
Other receivables	21,632	23,820
Supplies	5,392	4,942
Prepaid expenses	7,054	6,537
Total current assets	94,406	82,317
INVESTMENTS:		
Board designated	105,402	119,013
Self-insurance funds	-	2,417
Academic funds	37,589	39,691
Depreciation reserve fund	78,262	72,806
	221,253	233,927
RESTRICTED ASSETS:		
Cash and cash equivalents	140	121
Special purpose investments	5,555	5,539
Under bond indenture agreement	27,692	54,649
	33,387	60,309
CAPITAL ASSETS:		
Land and land improvements	17,463	16,653
Buildings and fixed equipment	445,697	374,189
Equipment	223,037	199,198
	686,197	590,040
Accumulated depreciation	(446,139)	(418,431)
	240,058	171,609
Construction in progress	11,093	62,043
	251,151	233,652
Other assets	3,881	6,154
TOTAL	$ 604,078	$ 616,359
LIABILITIES		
CURRENT LIABILITIES:		
Accounts payable	$ 20,744	$ 26,769
Accrued payroll and related liabilities	16,388	14,730
Public Employees Retirement System liability	9,702	9,085
Accrued interest payable	3,846	4,078
Self-insurance liabilities	21,925	19,954
Estimated amounts due to third-party payors	6,872	9,455
Accrued vacation and sick leave	2,093	1,862
Note payable	4,576	3,400
Current installments of long-term liabilities	6,279	7,558
Other current liabilities	15,717	17,193
Total current liabilities	108,142	114,084
LONG-TERM LIABILITIES, LESS CURRENT INSTALLMENTS:		
Self-insurance liabilities	23,849	21,781
Estimated amounts due to third-party payors	34,563	33,089
Accrued vacation and sick leave	23,060	20,771
Long-term debt	198,136	203,693
Total long-term liabilities	279,608	279,334
Total liabilities	387,750	393,418
NET ASSETS		
Invested in capital assets, net of related debt	40,588	43,422
Restricted for debt service and projects	27,692	54,649
Restricted for special purpose funds	2,887	2,581
Unrestricted	145,161	122,289
Total net assets	216,328	222,941
TOTAL	$ 604,078	$ 616,359

See accompanying notes to financial statements.

THE METROHEALTH SYSTEM

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2004 AND 2003
(Dollars in Thousands)

	Years Ended December 31,	
	2004	2003
OPERATING REVENUES:		
Net patient service revenue	$498,434	$468,598
Other revenue	21,654	21,693
Total operating revenues	520,088	490,291
OPERATING EXPENSES:		
Professional care of patients	339,830	318,359
Dietary	6,950	6,879
Household and property	23,295	22,720
Administrative and general	73,945	69,308
Employee benefits	71,037	66,373
Provision for bad debts	6,049	7,528
Total operating expenses before depreciation and amortization	521,106	491,167
Operating loss before depreciation and amortization	(1,018)	(876)
Depreciation and amortization	28,804	28,285
Operating loss	(29,822)	(29,161)
NON-OPERATING REVENUES (EXPENSES):		
County appropriation	26,762	20,850
Net investment income	1,323	2,966
Other non-operating revenue	3,060	3,595
Specific purpose grants and donations	4,269	4,211
Specific purpose funds expenditures	(3,847)	(3,690)
Interest expense	(8,425)	(7,327)
Total non-operating revenues—net	23,142	20,605
LOSS BEFORE OTHER CHANGES	(6,680)	(8,556)
OTHER CHANGES:		
Grants for capital acquisitions	183	104
Decrease in net assets	(6,497)	(8,452)
Total net assets—beginning of the year	222,941	231,680
Transfer of net assets	(116)	(287)
Total net assets—end of the year	$216,328	$222,941

See accompanying notes to financial statements.

THE METROHEALTH SYSTEM

STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2004 AND 2003
(Dollars in Thousands)

	Years Ended December 31, 2004	Years Ended December 31, 2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Patient service revenue	$ 480,679	$ 452,724
Other operating cash receipts	21,654	21,693
Payments to suppliers	(141,472)	(123,542)
Payments for compensation and benefits	(372,670)	(355,392)
Net cash flows used in operating activities	(11,809)	(4,517)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
County appropriation	26,762	20,850
Proceeds from note payable	4,576	3,400
Principal payments on note payable	(3,400)	-
Interest payments on note payable	(59)	-
Restricted grants and donations	7,512	7,910
Specific purpose funds expenditures	(3,847)	(3,690)
Transfer of net assets	(345)	(221)
Restricted receivables/liabilities	(251)	(1,533)
Net cash flows provided by noncapital financing activities	30,948	26,716
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Deposits in project funds	(40)	(30,143)
Withdrawals from project funds	27,133	28,058
Acquisitions and construction	(43,648)	(40,043)
Proceeds from long-term debt	171	30,165
Principal payments on long-term debt	(7,474)	(7,516)
Interest payments on long-term debt	(9,181)	(9,166)
Net cash flows used in capital and related financing activities	(33,039)	(28,645)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of (purchase of) investments, net	10,666	(7,081)
Interest received and realized gains and losses	5,285	7,115
Net cash flows provided by investing activities	15,951	34
Net increase (decrease) in cash and cash equivalents	2,051	(6,412)
Cash and cash equivalents at beginning of year	376	6,788
Cash and cash equivalents at end of year	$ 2,427	$ 376
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating loss	$ (29,822)	$ (29,161)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	28,804	28,285
Provision for bad debts	6,049	7,528
Changes in assets and liabilities:		
Increase in patient accounts receivable	(17,327)	(9,047)
Decrease (increase) in other assets	1,116	(11,954)
Increase in self-insurance liabilities	4,039	5,068
(Decrease) increase in accounts payable and other liabilities	(8,431)	5,672
Increase (decrease) in long-term liabilities	3,763	(908)
Net cash flows used in operating activities	$ (11,809)	$ (4,517)

See accompanying notes to financial statements.

Overview of the Financial Statements

This annual report consists of financial statements prepared in accordance with the provisions of Governmental Accounting Standards Board ("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 implementation of GASB Statement No. 34 affected the presentation of net assets, the inclusion of management's discussion and analysis, the direct method presentation of the statements of cash flows and expanded footnote disclosures.

The System is the public health care system for Cuyahoga County, Ohio, ("County") and was created pursuant to Ohio Revised Code Chapter 339. The System is governed by a Board of Trustees appointed jointly by the Board of County Commissioners of the Board of County of Cuyahoga, and the senior judges of the Probate Court and Common Pleas Court.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The accompanying financial statements of the MetroHealth System ("System") include the MetroHealth Medical Center, a short-term acute care and long-term rehabilitation facility; MetroHealth Clement Center for Family Care, an outpatient community health facility; MetroHealth Centers for Skilled Nursing Care, consisting of the Skilled Nursing Facility East and The Elisabeth Severance Prentiss Center for Skilled Nursing Care; Faculty Business Office, a medical specialty group practice; and several urban and suburban primary care health sites. All significant inter-entity transactions have been eliminated in the financial statements.

The System is the public health care system for Cuyahoga County, Ohio, and was created pursuant to Ohio Revised Code Chapter 339. The System is governed by a board of trustees appointed jointly by the Board of County Commissioners of the Board of the County of Cuyahoga, and the senior judges of the Probate Court and Common Pleas Court. In order to support the general operations of the System, the County of Cuyahoga, Ohio Commissioners approved an appropriation of $26,762 and $20,850 for 2004 and 2003, respectively. The County has approved an appropriation for 2005 that reflects an increase of $8,003 from the 2004 appropriation amount. The System is exempt from federal income taxes as a governmental entity.

In accordance with GASB Statement No. 14, *The Reporting Entity*, the System's financial statements are included, as a discrete entity, in the County's Consolidated Annual Financial Report (CAFR). A copy of the CAFR can be obtained from Frank Russo, Cuyahoga County Auditor, County Administration Building, 1219 Ontario Street, Cleveland, Ohio 44113.

Basis of Accounting

The System's financial statements are prepared in accordance with 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*. The System follows the "business-type" activities, which provides for the following components of the System's financial statements:

- Management's Discussion and Analysis
- Basic Financial Statements including a Balance Sheet, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flows, for the System as a whole
- Notes to the Financial Statements

Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the System has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), statements and interpretations issued after November 30, 1989 which do not conflict or contradict GASB pronouncements.

The accompanying financial statements of the System are prepared using the economic resources measurement focus and the accrual basis of accounting. Under this basis, revenues and expenses are recognized in the period in which they are earned or incurred. Depreciation of assets, gains, losses, assets and liabilities are also recognized in the period in which the transaction has occurred.

Pursuant to the Ohio Revised Code, the System submits a budget to the County Commissioners for approval by November 1 of each fiscal year. The fundamental purpose of the budget is to plan for an expected level of operations and to provide management with a tool to control deviation from such a plan. The budget is prepared on an accrual basis.

Use of Estimates

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

Statement of Revenues, Expenses, and Changes in Net Assets

The System recognizes as operating revenue those transactions that are major or central to the provision of health care services. Operating revenues include those revenues received for direct patient care, grants received from organizations as reimbursement for patient care and other incidental revenue associated with patient care. Operating expenses include those costs associated with providing patient care including costs of professional care, operating the hospital facilities, administrative expenses, and depreciation and amortization. Non-operating revenues include County appropriation, investment income, specific purpose grants and donations, primarily research, and unrealized gains on investments. Non-operating expenses include interest expense and expenditures from specific purpose funds for research related activities.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. Net patient service revenue is reduced by contractual and retroactive adjustments of $485,083 and $431,733 in 2004 and 2003, respectively.

The System has agreements with third-party payors that provide for payment at amounts different from established rates. A summary of the basis of payment by major third-party payors follows:

Medicare and Medicaid—Inpatient acute care services rendered to Medicare and Medicaid program beneficiaries and Medicare capital costs are paid at prospectively determined rates-per-discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors.

Medicare outpatient claims are reimbursed under the Ambulatory Payment Classification based prospective payment system. As an academic medical center, medical education payments in addition to disproportionate share entitlements are received from Medicare and Medicaid. Medicare utilizes a prospective payment system for inpatient rehabilitation services. The payments are based on patient assessment data classifying patients into one of one hundred case mix groups. Inpatient psychiatric services and certain outpatient services related to Medicare beneficiaries and capital costs for Medicaid beneficiaries are reimbursed based on a cost-based methodology subject to certain limitations. The System is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare and Medicaid fiscal intermediaries. The System's classification of patients under the Medicare and Medicaid programs and the appropriateness of their admission are subject to an independent review by a peer review organization. Differences between the estimated amounts accrued at interim and final settlements are reported in the Statement of Revenues, Expenses, and Changes in Net Assets in the year of settlement. The System recorded a favorable adjustment of $5,092 in 2004 and a favorable adjustment of $9,421 in 2003, due to prior year retroactive adjustments to amounts previously estimated.

Net revenue from the Medicare and Medicaid programs accounted for approximately 24.0% and 32.0%, respectively, of the System's net patient service revenue for the year ended December 31, 2004. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term. Management believes that adequate provision has been made in the financial statements for any adjustments that may result from final settlements.

Other Payors—The System has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes prospectively-determined rates-per-discharge, discounts from established charges, and prospectively-determined per diem rates.

Upper Payment Limit—In September 2001, the State of Ohio Supplemental Upper Payment Limit program for Public Hospitals (UPL) was approved by the Center for Medicare and Medicaid Services. This program provides access to available federal funding up to 100% of the Medicare upper payment limits for inpatient hospital services rendered by Ohio Public Hospitals to Ohio Medicaid consumers. At December 31, 2004 and 2003, $14,000 and $16,360, respectively, were due to the System and recorded on the balance sheets in other receivables; the System's required match to the State of Ohio of $6,508 and $8,467, respectively, is included in other current liabilities. The net amount recorded in net patient service revenue for UPL by the System was $17,353 and $16,174 in 2004 and 2003, respectively.

Disproportionate Share—As a public health care provider, the System renders services to residents of the County and others regardless of ability to pay. The System is classified as a disproportionate share provider by the Medicare and Medicaid programs due to the volume of low income persons it serves and accordingly receives additional payments (including Care Assurance of $26,248 and $27,622 in 2004 and 2003, respectively) from these programs as a result of this status which total payments aggregated $37,122 and $38,191 in 2004 and 2003, respectively, which is included in net patient service revenue. The System also provides major trauma services to the region. The ability to continue these levels of service and programs will be contingent upon the various funding sources.

Charity Care

Throughout the admission, billing and collection processes, certain patients are identified by the System as qualifying for charity care. The System provides care to these patients without charge or at amounts less than its established rates. The charges foregone for charity care provided by the System, totaling $121,019 and $108,224, which represents 11.4% and 11.2% of gross charges in 2004 and 2003, respectively, are not reported as revenue. The System accepts certain indigent Ohio residents and all residents from the County regardless of their ability to pay.

Grants

The System receives financial assistance from federal and state agencies in the United States in the form of grants. The expenditure of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies.

Other such audits could be undertaken by federal and state granting agencies and result in the disallowance of claims and expenditures; however, in the opinion of management, any such disallowed claims or expenditures will not have a material effect on the overall financial position of the System.

Cash and Cash Equivalents

The System considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents are stated at cost which approximates fair value excluding amounts limited as to use or restricted by board designation.

Supplies

Supplies are stated at the lower of average cost or market.

Investments

The System records its investments at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Unrealized gains and losses on investments are recorded as non-operating revenue-net in the statement of revenues, expenses, and changes in net assets.

The GASB issued Statement No. 40, *Deposit and Investment Risk Disclosure* which amends portions of Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements* for certain investment risk disclosures. The System implemented GASB Statement No. 40 beginning with the period ended December 31, 2003.

The System pools certain of its investments for investment purposes. Investment income for these pooled investments is allocated to the proper investment classification based on each investments fair value to the total fair value of all pooled investments.

The net realized gain of $140 in 2004 and net realized loss of $69 in 2003 on investments is the difference between the proceeds received and the amortized cost of investments sold and is included in investment income in the statement of revenues, expenses, and changes in net assets.

Restricted Assets

Restricted assets are cash and investments whose use is limited by legal requirements. Investments under bond indenture agreement represent amounts required by debt instruments to pay bond principal and interest and projects. Restricted cash and specific purpose investments represent monies received from donors or grantors to be used for specific purposes, primarily research. The System has elected to use restricted assets before unrestricted assets when an expense is incurred for a purpose for which both resources are available.

Capital Assets

Capital assets are stated at cost. Expenditures that substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation and amortization of assets recorded under capital lease (straight-line method) are provided in amounts sufficient to amortize the cost of the related assets over their estimated useful lives. The following are the most commonly used estimated useful lives:

Buildings	25-40 years
Building improvements	5-20 years
Equipment	3-15 years
Land improvements	5-15 years
Vehicles	4 years

Half of a year's depreciation is taken the first year the asset is placed in service. The asset and accumulated depreciation are removed from the related accounts when the asset is disposed of. Any gain or loss resulting from this disposal is recorded in the statement of revenues, expenses, and changes in net assets.

Deferred Compensation Plans

The System offers eligible employees a deferred compensation plan adopted under the provisions of Internal Revenue Code Section 457. The plan permits participating employees to defer a portion of their salary until future years. The deferred compensation is available to employees upon termination of employment, retirement, disability, death, or unforeseeable emergency. The System may at any time amend or terminate the plan with or without consent of the participants.

In accordance with the provisions of GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans,* the System created a trust for the assets of the plan for which the System has no fiduciary responsibility. The System has no recorded assets or liabilities relating to this plan.

Bond Discounts and Bond Issuance Costs

Deferred financing costs represent debt issuance expenditures on long-term debt obligations and are amortized over the period the bonds are outstanding on a straight-line basis. The amortization for deferred bond financing costs was $125 in 2004 and $126 in 2003. Amortization expense related to bond discounts was $127 in 2004 and $125 in 2003. These amounts are included in interest expense in the statement of revenues, expenses, and changes in net assets.

Cost of Borrowing

Interest costs associated with funds borrowed and used to finance the construction or acquisition of assets are capitalized as a component of the cost of acquiring those assets. The capitalized interest amount is calculated by taking the difference between the interest expense incurred over the term life of the bonds and the interest earned on the invested proceeds of specific purpose tax exempt bonds, which cover the same period of time. Capitalized interest income and interest expense on the Series 1999 and 2003 Bonds totaled $188 and $1,321 in 2004, respectively; $507 and $2,485 in 2003, respectively. Amortization of capitalized interest is included in depreciation expense.

The System has entered into three interest-rate swap agreements. These derivative instruments are not designated as hedging instruments, therefore gains and losses are recognized in the statement of revenues, expenses, and changes in net assets during the period of change. Net amounts periodically receivable or payable as a result of swap agreements are recorded as adjustments to interest expense on the related debt (see Note 6).

Concentrations of Credit Risk

Financial instruments that potentially subject the System to concentrations of credit risk consist principally of cash and cash equivalents, patient accounts receivable, and investments.

The System places its cash and cash equivalents with high credit quality financial institutions. The System's investments include money market funds, U.S. Treasury bills and notes, U.S. agency obligations, and repurchase agreements.

Concentration of credit risk relating to patient accounts receivable is limited to some extent by the diversity and number of the System's patients and payors. Patient accounts receivable consist of amounts due from government programs, commercial insurance companies, private pay patients, and other group insurance programs. Excluding governmental programs, no payor source represents more than 10.0% of the System's patient accounts receivable. The System maintains an allowance for losses based on the expected collectibility of patient accounts receivable.

2. CHANGES IN ACCOUNTING PRINCIPLES

The GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, which establishes criteria to determine if organizations that are legally separate, tax exempt entities should be discretely presented as component units if significant. Application of this standard is required for fiscal 2004. The System has not included the MetroHealth Foundation in these financial statements as they were considered not significant.

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement requires governmental units to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. A capital asset generally would be considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset. Impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government should be measured using the method that best reflects the diminished service utility of the capital asset. The provisions of this Statement are effective for financial statements for fiscal periods beginning after December 15, 2004. The system has not determined the impact, if any, that this statement will have on its financial statements.

3. DEPOSITS AND INVESTMENTS

Deposits

All monies are deposited to the System's banks or trust companies designated by the Board of Trustees. Funds not needed for immediate expenditure may be deposited in interest bearing or non-interest bearing accounts or U.S. government obligations. Banks or trust companies shall furnish security for all such deposits, whether interest bearing or non-interest bearing, except that no such security is required for U.S. government obligations.

Custodial risk is the risk that, in the event of bank failure, the System's deposits might not be recovered. The System's bank deposits at December 31, 2004 and 2003 totaled $8,066 and $7,671, respectively, and were subject to the following categories of custodial risk:

	2004	2003
Uncollateralized	$ 7,798	$ 7,396
Collateralized with securities held by the pledging institution's trust department, but not in the System's name	68	75
Total amount subject to custodial risk	7,866	7,471
Amount insured	200	200
Total bank balances	$ 8,066	$ 7,671

Investments

As of December 31, 2004 and 2003, the fair value of the System's investments were as follows:

	2004	2003
Cash and cash equivalents	$ 153,809	$ 216,069
U.S. Treasuries	727	9,397
U.S. Governments	-	1,148
U.S. Government Agencies	79,430	47,784
Federal National Mortgage Association and Federal Home Loan Mortgage Corporation (Federal Pools)	8,810	9,840
Collateralized Mortgage Obligations	1,596	2,476
Corporates	4,189	-
Total investments	$ 248,561	$ 286,714

The System's carrying amounts of the deposits and investments at December 31, 2004 and 2003 are as follows:

	2004	2003
Deposits	$ 8,366	$ 7,777
Investments	248,561	286,714
Total deposits and investments	$ 256,927	$ 294,491

The difference between bank balances and financial statement carrying amounts represent outstanding checks payable and normal reconciling items.

Interest Rate Risk. The System's investment policies limit investment portfolio to maturities of five years or less. All of the System's investments at December 31, 2004 have effective maturity dates of less than five years.

Credit Risk. All of the System's investments are rated AAA by Standard and Poor's. The System's investment policies are governed by State of Ohio statutes that authorize the System to invest in U. S. government obligations. The Collateralized Mortgage Obligations and Federal Mortgage pools are investments that are grandfathered from previous statutes that allowed such investments. These investments have an effective maturity date of less than one year.

Custodial Credit Risk. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Of the System's investments, only the repurchase agreements are exposed to custodial risk. Repurchase agreements (included in the U.S. Government Agencies) at December 31, 2004 totaling $9,015 are uninsured, are not registered in the System's name and are held by the financial institution's trust department.

4. CAPITAL ASSETS

The following summarizes the capital assets of the System for the years ended December 31, 2004 and 2003:

2004	Beginning Balance	Additions	Reductions/ Transfers	Ending Balance
Capital assets not being depreciated:				
Land	$ 8,954	$ 680	$ -	$ 9,634
Construction in progress	62,043	37,302	(88,252)	11,093
Total non-depreciated capital assets	70,997	37,982	(88,252)	20,727
Depreciable capital assets:				
Land improvements	7,699	130	-	7,829
Buildings and fixed equipment	374,189	71,508	-	445,697
Equipment	199,198	24,941	(1,102)	223,037
Total depreciable capital assets	581,086	96,579	(1,102)	676,563
Less accumulated depreciation:				
Land improvements	(6,656)	(204)	-	(6,860)
Buildings and fixed equipment	(247,713)	(17,449)	-	(265,162)
Equipment	(164,062)	(11,151)	1,096	(174,117)
Total accumulated depreciation	(418,431)	(28,804)	1,096	(446,139)
Total depreciable capital assets, net	162,655	67,775	(6)	230,424
Total capital assets—net	$ 233,652	$ 105,757	$ (88,258)	$ 251,151

2003	Beginning Balance	Additions	Reductions/ Transfers	Ending Balance
Capital assets not being depreciated:				
Land	$ 8,954	$ -	$ -	$ 8,954
Construction in progress	18,667	46,242	(2,866)	62,043
Total non-depreciated capital assets	27,621	46,242	(2,866)	70,997
Depreciable capital assets:				
Land improvements	7,699	-	-	7,699
Buildings and fixed equipment	372,032	2,157	-	374,189
Equipment	194,739	4,930	(471)	199,198
Total depreciable capital assets	574,470	7,087	(471)	581,086
Less accumulated depreciation:				
Land improvements	(6,384)	(272)	-	(6,656)
Buildings and fixed equipment	(230,422)	(17,313)	22	(247,713)
Equipment	(153,798)	(10,700)	436	(164,062)
Total accumulated depreciation	(390,604)	(28,285)	458	(418,431)
Total depreciable capital assets, net	183,866	(21,198)	(13)	162,655
Total capital assets—net	$ 211,487	$ 25,044	$ (2,879)	$ 233,652

Total depreciation and amortization expense related to capital assets for 2004 and 2003 was $28,804 and $28,285, respectively.

5. LONG-TERM DEBT

Changes in long-term debt for 2004 and 2003 are as follows:

	2004				
	Beginning Balance	Additions	Payments/ Reductions	Ending Balance	Due Within One Year
Hospital Improvement and Refunding Revenue Bonds, Series 1997, bear interest at rates ranging from 3.9% to 5.8% and mature in varying amounts through 2027	$ 52,085	$ -	$ (4,400)	$ 47,685	$ 4,615
Hospital Refunding Revenue Bonds, Series 1997A, bear interest at rates ranging from 4.1% to 5.5% and mature in varying amounts through 2019	76,415	-	(255)	76,160	265
Hospital Improvement Revenue Bonds, Series 1999, bear interest at rates ranging from 6.1% to 6.2% and mature in varying amounts through 2029	56,995	-	-	56,995	-
Hospital Improvement Revenue Bonds, Series 2003, bear variable interest rates and mature in varying amounts through 2033	30,545	-	(535)	30,010	580
Equipment obligation, GE Leasing, as defined in the respective lease agreement at an interest rate of 4.9% and matures through 2007	3,631	-	(1,337)	2,294	812
Equipment obligation, Banc One Leasing, as defined in the respective lease agreement at an interest rate of 4.9% and matures through 2004	818	-	(818)	-	-
Equipment obligation, IBM Credit Corporation as defined in the respective lease agreement at interest rates ranging from 4.0% to 4.9% and matures through 2004	89	-	(89)	-	-
Loan obligation, Cuyahoga County Sanitary Engineering, as defined in the respective loan agreement, matures through 2018	-	131	(40)	91	7
	220,578	131	(7,474)	213,235	6,279
Unamortized discount and loss	(9,327)	-	507	(8,820)	-
	211,251	131	(6,967)	204,415	6,279
Current installments	(7,558)	(6,279)	7,558	(6,279)	-
Long-term debt	$ 203,693	$ (6,148)	$ 591	$ 198,136	$ 6,279

	2003				
	Beginning Balance	Additions	Payments/ Reductions	Ending Balance	Due Within One Year
Hospital Improvement and Refunding Revenue Bonds, Series 1997, bear interest at rates ranging from 3.9% to 5.8% and mature in varying amounts through 2027	$ 56,280	$ -	$ (4,195)	$ 52,085	$ 4,400
Hospital Refunding Revenue Bonds, Series 1997A, bear interest at rates ranging from 4.1% to 5.5% and mature in varying amounts through 2019	76,655	-	(240)	76,415	255
Hospital Improvement Revenue Bonds, Series 1999, bear interest at rates ranging from 6.1% to 6.2% and mature in varying amounts through 2029	56,995	-	-	56,995	-
Hospital Improvement Revenue Bonds, Series 2003, bear variable interest rates and mature in varying amounts through 2033	-	30,545	-	30,545	535
Equipment obligation, GE Leasing, as defined in the respective lease agreement at an interest rate of 4.9% and matures through 2007	5,022	-	(1,391)	3,631	1,461
Equipment obligation, Banc One Leasing, as defined in the respective lease agreement at an interest rate of 4.9% and matures through 2004	2,166	-	(1,348)	818	818
Equipment obligation, IBM Credit Corporation, as defined in the respective lease agreement at interest rates ranging from 4.0% to 4.9% and matures through 2004	431	-	(342)	89	89
	197,549	30,545	(7,516)	220,578	7,558
Unamortized discount and loss	(9,829)	-	502	(9,327)	-
	187,720	30,545	(7,014)	211,251	7,558
Current installments	(7,516)	(7,558)	7,516	(7,558)	-
Long-term debt	$ 180,204	$ 22,987	$ 502	$ 203,693	$ 7,558

Effective February 1, 1997, the County issued $70,000 of Hospital Improvement and Refunding Revenue Bonds Series 1997 (The MetroHealth System Project) (Series 1997). The proceeds of the Series 1997 Bonds were used to refund $20,900 of Series 1989 Bonds; to finance the construction of various improvements and additions to The MetroHealth Medical Center; and to pay costs of issuance of the Series 1997 Bonds.

Effective November 1, 1997, the County issued $77,525 of Hospital Refunding Revenue Bonds, Series 1997A (The MetroHealth System Project) (Series 1997A). The proceeds of the Series 1997A Bonds were used to refund $73,725 of Series 1989 Bonds scheduled to mature on February 15, 2019. The 1997 refundings resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $9,753. The unamortized difference ($7,092 at December 31, 2004), reported in the accompanying financial statements, as a reduction from long-term debt, is included as an increase to interest expense through the year 2019 using the effective interest method.

Effective September 1, 1999, the County issued $56,995 of Hospital Improvement Revenue Bonds, Series 1999 (The MetroHealth System Project) (Series 1999 Bonds). The proceeds of the Series 1999 Bonds are being used to finance the construction of a 150-bed long-term care facility and acquire, construct, renovate, equip, and improve operating rooms and other hospital facilities.

Effective March 13, 2003, the County issued $30,545 of Hospital Improvement Variable Rate Demand Revenue Bonds, Series 2003 (The MetroHealth System Project) (Series 2003 Bonds). The proceeds of the Series 2003 Bonds are being used to pay costs of constructing and equipping the Critical Care Pavilion and an administrative building. The bonds bear interest at a variable rate (not to exceed 10.0%) determined weekly as established by the Remarketing Agent based on current market values for similar bond offerings and are due at various dates until 2033. The rate at December 31, 2004 was 2.04%.

In connection with the issuance of the Series 2003 Bonds, the System entered into a Reimbursement Agreement with a bank. Under the terms of the Reimbursement Agreement, the System entered into an Irrevocable Letter of Credit (Letter of Credit) issued by a local bank that expires on March 22, 2008. Under the terms of the Letter of Credit, the Trustee will be entitled to draw amounts necessary to make principal and interest payments. The Letter of Credit is subject to various financial covenants.

The Series 1997, 1997A, 1999 and 2003 Bonds were issued pursuant to a master trust indenture between the County, acting by and through the System's Board of Trustees, and the bond trustee. The Series 1997, 1997A, 1999 and 2003 Bonds are special obligations of the County payable solely from the revenue derived from the operation of the System and other monies available to the System's Board of Trustees, and are secured by the revenue and real property of the System. Accordingly, the bond proceeds and indebtedness have been recorded as assets and liabilities of the System.

The terms of the master trust bond indenture agreement provide for the establishment of a depreciation reserve fund and maintenance of certain special funds, which are maintained under the control of the bond trustee and are used for payment of principal and interest on the bonds when due. The revenue bonds and lease obligation payment requirements for fiscal years subsequent to December 31, 2004 are as follows:

	Total Lease and Loan Obligations			Total Hospital Revenue Bonds		
	Principal	Interest	Total	Principal	Interest	Total
2005	$ 818	$ 102	$ 920	$ 5,460	$ 9,888	$ 15,348
2006	729	57	786	5,700	9,646	15,346
2007	765	20	785	5,985	9,386	15,371
2008	7	-	7	6,270	9,118	15,388
2009	7	-	7	6,575	8,821	15,396
2010-2014	33	-	33	38,405	38,852	77,257
2015-2019	26	-	26	49,320	28,470	77,790
2020-2024	-	-	-	37,475	17,822	55,297
2025-2029	-	-	-	49,325	6,786	56,111
2030-2033	-	-	-	6,335	-	6,335
	$ 2,385	$ 179	$ 2,564	210,850	$ 138,789	$ 349,639
Unamortized discount				(1,728)		
Unamortized difference between reacquisition price and the net carrying amount of old debt				(7,092)		
Total hospital revenue bonds—net				$ 202,030		

The Bond Reserve Fund required under the Trust Indenture has been established with the Trustee. The balance as of December 31, 2004 and 2003 was $18,526 and $18,507, respectively. The cost value of Hospital Revenue Bonds was $209,122 at December 31, 2004. The fair value of Hospital Revenue Bonds ($218,151 at December 31, 2004) is estimated using discounted cash flow analyses based on current borrowing rates for similar types of borrowing arrangements.

6. DERIVATIVE INSTRUMENTS

The System's objectives of its derivative instruments include managing the risk of increased debt service resulting from rising market interest rates, the risk of decreased surplus returns resulting from falling interest rates, and the management of the risk of an increase in the fair value of outstanding fixed rate obligations resulting from declining market interest rates. Consistent with its interest rate risk management objectives, the System entered into various interest rate swap agreements with a total outstanding notional amount of $142,000 and $142,500 at December 31, 2004 and 2003, respectively. The System pays a rate equal to the Bond Market Association Municipal Index (the BMA SWAP Index), an index of seven-day high-grade tax-exempt variable rate demand obligations or a fixed rate of 1.5% or 3.5%. In return, the System receives a fixed rate of 5.4% or a rate based on the BMA SWAP Index or 75.0% of LIBOR. The interest rate swap arrangement with an effective date of March 2003 and a notional amount of $30,545 million includes an option whereby the counterparty can terminate the transaction. The BMA index rates in 2004 ranged from 0.8% to 1.9% (1.9% at December 31, 2004). The 1-Month LIBOR Index in 2004 ranged from 1.1% to 2.4% (2.4% at December 31, 2004).

The fair value of the swap agreements based on current settlement prices at December 31, 2004 is $1,424 due from the counterparty and is included in other assets. Net interest savings for 2004 and 2003 was $1,480 and $1,638, respectively and is included as a reduction to interest expense. The decrease of $2,148 in fair value of the net swap assets during 2004 is recorded as unrealized losses on investment in the statement of revenues, expenses, and changes in net assets.

The following table describes the terms of the three interest rate swap agreements the System has entered. In all three cases, only the net difference is exchanged with the counterparty and the notional amount is not exchanged. For the Series 2003 agreement, the notional amount changes with the amortization of the bonds.

Notional Amount	Effective Date	Termination Date	The System Pays	Counterparty Pays
$56,000,000	September 1, 1999	February 15, 2014	BMA SWAP Index	Fixed 5.4%
$56,000,000	May 14, 2003	February 15, 2005	Fixed 1.5 %	BMA SWAP Index
$30,010,000	March 13, 2003	March 1, 2033	Fixed 3.5 %	75.0% of LIBOR

7. OTHER LONG TERM LIABILITIES

Amounts Due to Third-Party Payors

The System has agreements with third-party payors that provide for payment of amounts from established rates. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. See Note 1 net patient service revenue.

Accrued Vacation and Sick

System employees earn vacation and sick leave at varying rates depending on job classification and years of service. Employees can accumulate up to three years of vacation leave. All accumulated, unused vacation time is paid upon separation if the employee has at least one year of service with the System. There is no limit on the amount of sick time accrued. Upon retirement, employees with a minimum of 10 years of service have sick leave balances paid out at 50.0% of eligible hours at their current rate of pay. The maximum pay out is 800 hours. As of December 31, 2004 and 2003, the liability for accrued sick and vacation was $25,153 and $22,633, respectively.

Note Payable

The System financed one-year general and professional liability policies with a note payable in 2004 and 2003. The 2004 note payable bears interest at a rate of 3.6%; the 2003 note payable interest rate was 3.8%. At December 31, 2004 and 2003, the note payable balance outstanding was $4,600 and $3,400, respectively.

Other Long term liabilities consist of the following at December 31, 2004 and 2003:

2004	Beginning Balance	Additions	Payments	Ending Balance	Due Within One Year
Amounts due third-party payors	$ 42,544	$ 761	$ (1,870)	$ 41,435	$ 6,872
Accrued vacation and sick leave	22,633	4,552	(2,032)	25,153	2,093
Note payable	3,400	4,576	(3,400)	4,576	4,576
	$ 68,577	$ 9,889	$ (7,302)	$ 71,164	$ 13,541

2003	Beginning Balance	Additions	Payments	Ending Balance	Due Within One Year
Amounts due third-party payors	$ 45,588	$ (440)	$ (2,604)	$ 42,544	$ 9,455
Accrued vacation and sick leave	20,516	3,908	(1,791)	22,633	1,862
Note payable	-	3,400	-	3,400	3,400
	$ 66,104	$ 6,868	$ (4,395)	$ 68,577	$ 14,717

Risk Management

The System is exposed to various risks of loss related to torts; theft of or destruction of assets; errors and omissions; injuries to employees; and natural disasters. The System is self-insured for workers compensation and medical malpractice but maintains commercial insurance policies for property and casualty, automobile, aircraft (helicopter and fixed wing) as well as excess coverage for medical malpractice claims. Settled claims have not exceeded insurance coverage in any of the past three years.

During the normal course of its operations, the System has become a defendant in various legal actions. It is not possible to estimate the outcome of these legal actions; however, in the opinion of legal counsel and the System administration, the disposition of the pending cases will not have a material adverse effect of the financial condition or operations of the System. However, depending on the amount and timing of such resolution, an unfavorable resolution of some or all of these matters could materially affect the System's future results of operations or cash flows in a particular year.

The System is self-insured for the purpose of providing professional and patient care liability and workers' compensation claims. For the professional and patient care liability, professional actuarial insurance consultants have been retained to determine funding requirements. Amounts funded for professional and patient care have been placed in an irrevocable self-insurance trust account, which is being administered by a trustee.

Losses from asserted claims and from unasserted claims identified under the System's incident reporting systems are accrued based on estimates that incorporate the System's past experience, as well as other considerations including the nature of each claim or incident and relevant trend factors. The reserve for estimated self-insured claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported undiscounted for 2004 and 2003.

2004	Beginning Balance	Claims Incurred	Claims Paid	Ending Balance	Due Within One Year
Worker's compensation	$ 6,145	$ 5,312	$ (2,968)	$ 8,489	$ 3,316
Self-insurance	35,590	12,747	(11,052)	37,285	18,609
Employee health insurance	2,881	29,430	(29,518)	2,793	2,793
	$44,616	$47,489	$(43,538)	$48,567	$24,718

2003	Beginning Balance	Claims Incurred	Claims Paid	Ending Balance	Due Within One Year
Worker's compensation	$ 5,951	$ 2,617	$ (2,423)	$ 6,145	$ 2,497
Self-insurance	30,716	10,802	(5,928)	35,590	17,457
Employee health insurance	2,389	27,506	(27,014)	2,881	2,881
	$39,056	$40,925	$(35,365)	$44,616	$22,835

8. OPERATING LEASES

The System has entered into operating lease agreements for a parking facility, medical space, and office space, which expire through 2020. The contracts are generally for five years and contain rent escalation clauses and renewal options for additional periods ranging from one to five years.

Minimum rental commitments under operating leases extending beyond one year at December 31, 2004 are as follows:

2005	$ 1,118
2006	1,029
2007	1,043
2008	1,043
2009	903
2010-2014	3,670
2015-2019	2,009
2020	101
Total	$ 10,916

Rent expense totaled $1,516 in 2004 and $1,365 in 2003. The System leases the Valentine parking garage. The lease had an original five year term with five one year options to renew. Upon the ultimate expiration of the lease, there are several options available to the System regarding the property which results in different amounts possibly due. One of these is an option to purchase the property. The original term has expired and the System's management elected to exercise the first option, which expires November 30, 2005. The cost to purchase the property at the time is $11,500 million. Funds have been allocated within Board Designated investments to make this payment.

9. BENEFIT PLANS

Pension

Employee retirement benefits are available for substantially all employees under three separate retirement plans administered by the Ohio Public Employees Retirement System ("OPERS"). The plans are the Traditional Pension Plan—a cost-sharing, multiple-employer defined benefit pension plan; the Member-Directed Plan—a defined contribution pension plan; and the Combined Plan—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 postretirement healthcare benefits, to the Traditional and Combined Plan members however, healthcare benefits are not statutorily guaranteed. Participants in the Member-Directed Plan do not qualify for ancillary benefits.

The Ohio Public Employees Retirement System issues a stand-alone financial report and may be obtained by writing to OPERS, 277 East Town Street, Columbus, Ohio 43215-4642. The Ohio Revised Code provides statutory authority for employee and employer contributions. The employee contribution rate is 8.5% of covered payroll and the System is required to contribute 13.6% of covered payroll. The System's contributions to OPERS for the years ending December 31, 2004, 2003 and 2002 were $38,024, $36,438 and $34,584, respectively, equal to the required contributions for each year.

Postretirement Benefits

OPERS also provides postretirement health care coverage to age-and-service retirees with 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 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 System's contribution for 2004 and 2003 used to fund postretirement health care benefits was $11,025 and $13,446, respectively, which is included in the System's pension contribution of $38,024 and $36,438 for the years ending December 31, 2004 and 2003, respectively.

Benefits are advance-funded using the entry-age normal actuarial cost method. Significant actuarial assumptions include an investment return of 8.0%; no change in the number of active employees, active employee payroll increases of 4.0% compounded annually and between 0.5% to 6.3% based on additional pay increases; and health care cost increases of 4.0% annually. Health care costs were assumed to increase over the next eight years at a rate ranging between 5.0% and 10.0%, and 4.0% thereafter.

As of December 31, 2003 (the most recent information available), OPERS had $10,500,000 in net assets available for payment of postemployment benefits. The actuarial accrued liability for postemployment benefits and the unfunded actuarial accrued liability were $26,900,000 and $16,400,000, respectively. The number of active contributing participants was 369,885.

On September 9, 2004 the OPERS Retirement Board adopted a Health Care Preservation Plan (HCPP) to improve financial solvency of the fund by restructuring health care coverage. The Plan has an effective date of January 1, 2007. Under HCPP, retirees eligible for health care coverage will received a graded monthly allocation to use for purchasing from a broad range of health care options. Unspent monthly allocations are deposited into a Retirement Medical Account for subsequent health care expenses.

10. RELATED ORGANIZATIONS

The System is the primary beneficiary of The MetroHealth Foundation, Inc. (the Foundation). The Foundation is a separate not-for-profit entity organized for the purpose of supporting the System in the areas of research, community health and continuing professional education. The System does not consolidate the financial activity of the Foundation with that of the System. The Foundation had total net assets of $16,465 and $13,899 for 2004 and 2003, respectively. The System received support from the Foundation in the amount of $1,082 and $1,090 for 2004 and 2003, respectively, and is recorded as grant revenue on the System's statement of revenues, expenses and changes in net assets. The outstanding receivable from the Foundation was $483 and $676 at December 31, 2004 and 2003, respectively.

The System had established restricted funds to differentiate resources, the use of which is restricted by donors or grantors, from resources of general funds on which donors place no restrictions or that arise as a result of the operations of the System. A review of these restricted funds is performed annually to determine that funds related to completed clinical trials and certain donated money should be transferred to The MetroHealth Foundation. The total amounts transferred in 2004 and 2003 were $116 and $287, respectively.

11. COMMITMENTS

As of December 31, 2004, the System has contractual commitments for the construction of the various projects totaling approximately $14,800. These projects are being funded with the remaining bond proceeds ($1,200) and operating funds. The following table lists the construction project and commitment amount at December 31, 2004:

Construction Project	Amount
South Campus Administrative Building	$ 9,734
Buckeye Health Center	2,434
Critical Care Pavilion	2,151
Broadway Medical Center	477
Total commitments	$ 14,796

* * * * * *

The MetroHealth System

Financial Statements
for the Years Ended
December 31, 2004 and 2003,
Supplemental Schedule of Expenditures
of Federal Awards
for the Year Ended December 31, 2004
and Independent Auditors' Reports

THE METROHEALTH SYSTEM

TABLE OF CONTENTS
DECEMBER 31, 2004 AND 2003

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
The MetroHealth System

We have audited the accompanying balance sheet of The MetroHealth System (the "System"), a component unit of Cuyahoga County, Ohio, as of December 31, 2004, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the System for the year ended December 31, 2003 were audited by other auditors whose report, dated February 27, 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 basic financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements, 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 financial statements referred to above present fairly, in all material respects, the financial position of the System at December 31, 2004, and the results of its changes in net assets 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 on pages 2 through 9 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the System's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2005, on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche, LLP

March 28, 2005

MANAGEMENT'S DISCUSSION (2-9)

This section of The MetroHealth System's (the "System") annual financial report presents management's discussion and analysis of the System's financial performance and provides an overall review of the System'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 discussion and analysis is designed to focus on current activities, resulting change and currently known facts. The financial statements, footnotes, and this discussion and analysis are the responsibility of the System's management.

Overview of the Financial Statements

This annual report consists of financial statements prepared in accordance with the provisions of Governmental Accounting Standards Board ("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 implementation of GASB Statement No. 34 affected the presentation of net assets, the inclusion of management's discussion and analysis, the direct method presentation of the statements of cash flows and expanded footnote disclosures.

The accompanying financial statements of the System include the MetroHealth Medical Center, a short-term acute care and long-term rehabilitation facility; MetroHealth Centers for Skilled Nursing Care, consisting of the Skilled Nursing Facility East and The Elisabeth Severance Prentiss Center for Skilled Nursing Care; and several urban and suburban primary care health sites. All significant inter-entity transactions have been eliminated in the financial statements.

The System is the public health care system for Cuyahoga County, Ohio, (the "County") and was created pursuant to Ohio Revised Code Chapter 339. The System is governed by a Board of Trustees appointed jointly by the Board of County Commissioners of the Board of County of Cuyahoga, and the senior judges of the Probate Court and Common Pleas Court.

In accordance with GASB Statement No. 14, *The Reporting Entity*, the System's financial statements are included, as a discrete entity, in the County's Consolidated Annual Financial Report (CAFR). A copy of the CAFR can be obtained from Frank Russo, Cuyahoga County Auditor, County Administration Building, 1219 Ontario Street, Cleveland, Ohio 44113.

Financial and Operating Highlights for 2004

- Inpatient levels of activity decreased slightly from the prior year.
- Outpatient levels of activity increased 3.3% from the prior year.
- Emergency room levels of activity increased 3.9% from the prior year.
- Surgery cases increased 2.0% from the prior year.
- Total net assets decreased by $6.6 million over last year.
- The System opened its new Critical Care Pavilion, which houses perioperative facilities and the emergency department, in mid-year. Total cost of the construction was just under $70.0 million.
- The System purchased the former Deaconess Hospital in a bankruptcy auction. The first phase of renovations of this facility will accommodate the System's datacenter and other back office functions. The cost will be $23.4 million with a completion expected in the 4th quarter of 2005.
- The Broadway Medical Center, an outpatient medical facility, opened in July.

Financial and Operating Highlights for 2003

- Inpatient levels of activity decreased from the prior year.
- Outpatient levels of activity increased 4.0% over last year.
- Emergency room levels of activity decreased 1.0% over last year.
- Surgery cases decreased 1.0% over last year.
- Total net assets decreased by $8.7 million over last year.
- Construction in progress increased $43.4 million, which is largely attributed to the construction of the new Critical Care Pavilion.
- Long-term debt increased due to the issuance of $30.5 million Series 2003 Bonds in March. The proceeds are earmarked for the completion of the Critical Care Pavilion and a new administration building.

Financial Analysis of the System at December 31, 2004 and 2003

Total assets decreased by 2.0% to $604.1 million, and total liabilities decreased 1.4% to $387.8 million in 2004. The System's total net assets declined from $222.9 million to $216.3 million in 2004, a 3.0% decrease from a year ago. This represented a slight improvement from the 3.8% decrease from 2002. Table 1 summarizes the balance sheet movement for the last two years.

Table 1
The MetroHealth System
Balance Sheets (000's)

	2004	2003	2002
Assets:			
Current assets	$ 94,406	$ 82,317	$ 75,022
Investments	221,253	233,927	230,661
Restricted assets	33,387	60,309	57,928
Capital assets	251,151	233,652	211,487
Other assets	3,881	6,154	6,663
Total assets	$604,078	$616,359	$581,761
Liabilities and net assets:			
Liabilities:			
Current liabilities	$108,142	$114,084	$ 93,531
Long-term liabilities	279,608	279,334	256,550
Total Liabilities	387,750	393,418	350,081
Net assets:			
Invested in capital assets, net of related debt	40,588	43,422	42,977
Restricted	30,579	57,230	54,456
Unrestricted	145,161	122,289	134,247
Total net assets	216,328	222,941	231,680
Total liabilities and net assets	$604,078	$616,359	$581,761

Current Assets

Total current assets increased $12.0 million in 2004 or 14.7% over the prior year. Cash increased $2.0 million in 2004 from the prior year and is due to higher amounts retained in overnight accounts rather than investment accounts at the end of the year. Patient accounts receivable increased by $10.8 million in 2004 which is attributed to increases in the Self-pay portion of the receivable and a Medicaid pharmacy rebilling that increased the receivable (by $4.6 million) until payments on the corrected billings begin in early 2005. The System participates in a State of Ohio supplemental Medicaid program that provides access to available funding up to 100% of the Medicare Upper Payment Limit for inpatient hospital services. The receivable related to this program decreased $2.4 million in 2004 from the previous year. The remaining movement in 2004 includes a $0.4 million increase in supplies inventory and $0.5 million increase in prepaid medical malpractice insurance premiums. Total current assets increased $7.3 million in 2003, an increase of 9.7% over 2002.

Investments

Investments decreased by $12.7 million in 2004 from the prior year. A $5.5 million increase in funding to the Depreciation reserve fund was offset by decreases in the other investments required to accommodate operational and capital expenditures. The restricted asset decrease of $26.9 million in 2004 was driven by the $27.1 million in draws from the Series 1999 and 2003 Project Funds for Critical Care Pavilion construction. In 2003, investments increased by $3.3 million, mainly as a result of improved collections of accounts receivable and increased Depreciation Reserve funding.

Capital Assets

Capital expenditures for 2004 were $43.6 million. Significant capital outlays included $22.6 million for the completion on the Critical Care Pavilion; $7.9 million for the Broadway and Buckeye medical office facilities; $2.0 million to refurbish two helicopters; $1.3 million for MetroHealth South Campus renovations; and $0.8 million for power house electrical upgrades. The balance was spread among other projects like the Microsoft XP software rollout, PBX replacement and relocation, medical equipment replacements and medical office renovations. Proceeds from the Series 1999 and 2003 Bond issues were used for the Critical Care Pavilion and the remaining was paid with operating funds. Capital additions in 2003 totaled $50.5 million, mainly related to the Critical Care Pavilion.

At December 31, 2004, the System has $14.8 million remaining in commitments on the Critical Care Pavilion, Broadway and Buckeye medical centers and south campus projects that will be paid out of the remaining $1.2 million of bond proceeds and the rest from operating funds. Detail information regarding the System's capital assets can be found in Note 4 of the financial statements.

Current Liabilities

Current liabilities declined by $5.9 million in 2004 from the prior year. Accounts payable declined by $6.0 million. The 2003 accounts payable balance included $7.2 million in accrued invoices and retainage liabilities related to the Critical Care Pavilion construction project where as the similar liability for 2004 amounted to $1.3 million. Accrued payroll increased $2.0 million and is related to the additional day needed to be accrued in 2004 compared to 2003. The current portion of the Self-insurance liability increased from the prior year by $2.0 million due to the results of this year's actuarial study on the medical malpractice reserves indicating increased payouts. Other current liabilities contain the corresponding Upper Payment Limit liability and decreased $1.9 million this year.

Current liabilities increased by $20.6 million in 2003 due primarily to a $6.7 million increase in accounts payable, a $4.9 million increase in the current portion of Self-insurance liabilities and a $5.6 million increase in the Upper Payment Limit Program payable.

Long-Term Liabilities

All of the System's long-term debt relates to acquisition of capital assets. In 2004, the System incurred a loan from Ohio Public Utilities Commission in connection with sewer line replacement at its eastside skilled nursing facility. The note is non-interest bearing and payable over 20 years. The System's bond indenture and capital lease agreements contain various covenants that the System must maintain. The financial covenants include Days Cash in Hand, Debt Service Coverage and Debt to Capitalization ratios. Additional detail regarding the System's long-term debt can be found in Note 5 of the financial statements.

The two swap agreements that are connected to the Series 1999 Bond issue will only be effective through February 2005. One agreement has been terminated by the counterparty and the other expired. This will have an effect of increasing the System's total interest expense by an estimated $1.8 million in 2005.

Table 2
The MetroHealth System
Statements of Revenues, Expenses and Changes in Net Assets (000's)

	Years ended December 31, 2004	2003	2002
Operating revenue			
Net patient service revenue	$ 498,434	$ 468,598	$ 456,693
Other revenue	21,654	21,693	17,830
Total operating revenue	520,088	490,291	474,523
Operating expenses			
Professional care of patients	339,830	318,359	300,794
Dietary	6,950	6,879	6,308
Household and property	23,295	22,720	22,278
Administrative and general	73,945	69,308	69,407
Employee benefits	71,037	66,373	63,898
Provision for bad debts	6,049	7,528	13,636
Depreciation and amortization	28,804	28,285	30,700
Total operating expenses	549,910	519,452	507,021
Operating loss	(29,822)	(29,161)	(32,498)
Non-operating revenues-net	23,142	20,605	29,829
Grants for capital acquisitions	183	104	44
Decrease in net assets	(6,497)	(8,452)	(2,625)
Total net assets--beginning of the year	222,941	231,680	236,534
Transfer of net assets	(116)	(287)	(2,229)
Total net assets--end of the year	$ 216,328	$ 222,941	$ 231,680

The System's total operating and non-operating revenue in 2004 was $559.6 while expenses were $566.1 million. This resulted in net assets decreasing $6.5 million for the year reflecting a net loss for the year. This was a $2.0 million net improvement from 2003 that had $526.2 million in revenue and $534.6 in expenses.

Net Patient Service Revenue

Net patient service revenue increased $29.9 million or 6.4% in 2004. This is reflective of the slight increases in patient and visit volumes in 2004. Although the gross revenue includes a 4.0% price increase effective January 1, 2004, there was a corresponding increase in contractual allowances. This compares favorably to the $11.9 million or 2.6% increase experienced in 2003. Net patient service revenue also includes revenue the System received as a participant in the State of Ohio Care Assurance (HCAP) ($26.0 million in 2004, $28.0 million in 2003 and $34.0 million in 2002) and Upper Payment Limit (UPL) ($17.0 million in 2004, $16.0 million in 2003 and $12.0 million in 2002) programs. The level of revenue from HCAP and UPL in future years is uncertain.

Charity care increased by $12.8 million to a total of $121.0 million in 2004. This 11.8% increase was greater than the 9.6% increase in 2003 and 1.0% in 2002. The System's level of charity care continues to reflect the System's status as a safety net facility in Cuyahoga County.

Operating Expenses

The System's total operating expenses increased $30.5 million or 5.9% from the prior year. This amount is over twice the increase of $12.4 million from 2002 to 2003. Table 3 summarizes the expenses from the last three years.

Table 3
The MetroHealth System
Expense Detail (000's)

	2004	2003	2002
Operating expenses:			
Salaries and wages	$ 304,150	$ 289,361	$ 274,366
Employee benefits	71,037	66,373	63,898
Medical supplies	30,591	28,137	26,005
Pharmaceuticals	23,291	21,765	20,198
Plant operations	31,671	28,796	27,325
Supplies and other	37,240	35,472	34,427
Liability insurance	17,077	13,735	16,466
Provision for bad debts	6,049	7,528	13,636
Depreciation and amortization	28,804	28,285	30,700
Total operating expenses	$ 549,910	$ 519,452	$ 507,021

Salary and wages increased $14.8 million from 2003 to 2004. This is a similar dollar increase as the change from 2002 to 2003. In 2004, a general rate increase of 3.0% accounts for $8.7 million increase over the prior year. Net FTE growth of 17 (physicians) increased salaries expense $2.8 million. The remaining increases for 2004 related to higher costs associated with sick and vacation time, higher terminating employee costs, and higher physician incentive payouts. The increases from 2002 to 2003 included a 4.0% general wage increase and a 54 FTE increase.

Employee benefits increased $4.7 million from 2004. The System recorded a $3.2 million adjustment to its Workers Compensation liability based on an actuarial analysis of claim activity completed at year end. The remaining $1.6 million reflects the increased per employee health costs (including pharmaceuticals). This is an improvement on the increases for 2002 to 2003 which amounted to $2.4 million.

Medical and pharmaceuticals supplies increased a total of $4.0 million or 8.0% in 2004. A similar 8.0% increase was experienced in 2003.

Plant operation expenses increased $2.9 million or 10.0% in 2004. The primary driver was a $1.2 million increase in construction expenses for the year. The construction expenses are those that were transferred from capital projects that do not meet the criteria for capitalization. These are typically moving expenses, work to existing conditions on the projects that are actually repairs or expenses on proposed projects (planning phase) that did not materialize into an approved project. This year major projects like the Critical Care Pavilion and the Broadway medical building contributed significantly to the increase. Building rental increased $300 thousand (Broadway Medical Center opening) and utility costs increased $1.2 million to round out the 2003 to 2004 increase. Plant operation expenses increased $1.5 million in 2003, an increase of 5.4%.

Medical malpractice insurance expense increased $3.3 million for the year. This increase includes a $1.3 million adjustment to the liability account at year end as a result of the annual actuarial review of claim activity. In the prior year, the similar adjustment was favorable by $2.7 million.

Non-Operating Revenue and Expense

The largest component of non-operating revenue is the amount the System receives from the County as an annual appropriation. The Cuyahoga County Commissioners approved an increase in the System appropriation of nearly $6.0 million from 2003 for a total of $26.8 million in 2004. This is a turnaround from the previous $1.0 decrease in funding that occurred between 2003 and 2002. The citizens of the County approved a health and human service levy in 2003 which allowed the Commissioners to increase funding to the System. The funding by the County is expected to increase again in 2005 by nearly $8.0 million.

Investment income decreased by $1.8 million to $5.3 million in 2004. This decrease reflects the generally low investment rates on investment vehicles in which the System is permitted to participate and a $40.0 million total decrease in investment balances.

Interest expense grew from $7.3 million in 2003 to $8.4 million or 15.0% in 2004. The primary driver was a decrease in the amount of interest capitalized in 2004 which was down $0.9 million. This is a direct result of the amount of qualifying interest based on the completion of construction projects. In 2005, interest expense is expected to increase by another $3.5 million. This is due to a continued decrease in the amount of interest eligible to be capitalized ($1.3 million lost) as part of construction projects and the loss of the favorable effect from the interest swap agreements ($2.2 million lost) no longer in effect during 2005.

Economic Factors and Next Year's Budget

Several factors and uncertainties that are contained in the budget are:

- The System budgeted to receive a $35.0 million appropriation from the County in 2005. This is an increase from the prior year of $8.0 million. The System will continue to explore revenue enhancement and cost reduction (productivity) opportunities.

- At both the Federal and State level, proposed Medicaid funding cuts may harm System revenue and cash flows as it relies on Medicaid for 32.0% of net patient revenues. The System will continue to promote Federal and State policy reforms to provide adequate funding to safety net providers.

- Capital funds needed for replacement of depreciating facilities and equipment and the addition/expansion of vital programs will require use of existing investments or debt as well as anticipated capital funding from the County. The System intends to use $20.0 million from the Depreciation Reserve Fund for operating and capital needs in 2005.

- Medical malpractice costs will continue to exert upward pressure on related expense and claim payouts.

- Ohio's Hospital Care Assurance Program (HCAP) is expected to continue at the 2004 level due to the Medicare Prescription Improvement & Modernization Act of 2003 (MMA). An amendment to Ohio's HCAP is pending and needed in order to maintain funding levels to Ohio's public hospitals.

THE METROHEALTH SYSTEM

BALANCE SHEETS
DECEMBER 31, 2004 AND 2003
(Dollars in Thousands)

	December 31, 2004	December 31, 2003
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 2,287	$ 255
Patient accounts receivable	64,187	53,395
Allowance for uncollectible accounts	(6,146)	(6,632)
	58,041	46,763
Other receivables	21,632	23,820
Supplies	5,392	4,942
Prepaid expenses	7,054	6,537
Total current assets	94,406	82,317
INVESTMENTS:		
Board designated	105,402	119,013
Self-insurance funds	-	2,417
Academic funds	37,589	39,691
Depreciation reserve fund	78,262	72,806
	221,253	233,927
RESTRICTED ASSETS:		
Cash and cash equivalents	140	121
Special purpose investments	5,555	5,539
Under bond indenture agreement	27,692	54,649
	33,387	60,309
CAPITAL ASSETS:		
Land and land improvements	17,463	16,653
Buildings and fixed equipment	445,697	374,189
Equipment	223,037	199,198
	686,197	590,040
Accumulated depreciation	(446,139)	(418,431)
	240,058	171,609
Construction in progress	11,093	62,043
	251,151	233,652
Other assets	3,881	6,154
TOTAL	$ 604,078	$ 616,359
LIABILITIES		
CURRENT LIABILITIES:		
Accounts payable	$ 20,744	$ 26,769
Accrued payroll and related liabilities	16,388	14,730
Public Employees Retirement System liability	9,702	9,085
Accrued interest payable	3,846	4,078
Self-insurance liabilities	21,925	19,954
Estimated amounts due to third-party payors	6,872	9,455
Accrued vacation and sick leave	2,093	1,862
Note payable	4,576	3,400
Current installments of long-term liabilities	6,279	7,558
Other current liabilities	15,717	17,193
Total current liabilities	108,142	114,084
LONG-TERM LIABILITIES, LESS CURRENT INSTALLMENTS:		
Self-insurance liabilities	23,849	21,781
Estimated amounts due to third-party payors	34,563	33,089
Accrued vacation and sick leave	23,060	20,771
Long-term debt	198,136	203,693
Total long-term liabilities	279,608	279,334
Total liabilities	387,750	393,418
NET ASSETS		
Invested in capital assets, net of related debt	40,588	43,422
Restricted for debt service and projects	27,692	54,649
Restricted for special purpose funds	2,887	2,581
Unrestricted	145,161	122,289
Total net assets	216,328	222,941
TOTAL	$ 604,078	$ 616,359

See accompanying notes to financial statements.

THE METROHEALTH SYSTEM

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2004 AND 2003
(Dollars in Thousands)

	Years Ended December 31,	
	2004	2003
OPERATING REVENUES:		
Net patient service revenue	$498,434	$468,598
Other revenue	21,654	21,693
Total operating revenues	520,088	490,291
OPERATING EXPENSES:		
Professional care of patients	339,830	318,359
Dietary	6,950	6,879
Household and property	23,295	22,720
Administrative and general	73,945	69,308
Employee benefits	71,037	66,373
Provision for bad debts	6,049	7,528
Total operating expenses before depreciation and amortization	521,106	491,167
Operating loss before depreciation and amortization	(1,018)	(876)
Depreciation and amortization	28,804	28,285
Operating loss	(29,822)	(29,161)
NON-OPERATING REVENUES (EXPENSES):		
County appropriation	26,762	20,850
Net investment income	1,323	2,966
Other non-operating revenue	3,060	3,595
Specific purpose grants and donations	4,269	4,211
Specific purpose funds expenditures	(3,847)	(3,690)
Interest expense	(8,425)	(7,327)
Total non-operating revenues—net	23,142	20,605
LOSS BEFORE OTHER CHANGES	(6,680)	(8,556)
OTHER CHANGES:		
Grants for capital acquisitions	183	104
Decrease in net assets	(6,497)	(8,452)
Total net assets—beginning of the year	222,941	231,680
Transfer of net assets	(116)	(287)
Total net assets—end of the year	$216,328	$222,941

See accompanying notes to financial statements.

THE METROHEALTH SYSTEM

STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2004 AND 2003
(Dollars in Thousands)

	Years Ended December 31, 2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Patient service revenue	$ 480,679	$ 452,724
Other operating cash receipts	21,654	21,693
Payments to suppliers	(141,472)	(123,542)
Payments for compensation and benefits	(372,670)	(355,392)
Net cash flows used in operating activities	(11,809)	(4,517)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
County appropriation	26,762	20,850
Proceeds from note payable	4,576	3,400
Principal payments on note payable	(3,400)	-
Interest payments on note payable	(59)	-
Restricted grants and donations	7,512	7,910
Specific purpose funds expenditures	(3,847)	(3,690)
Transfer of net assets	(345)	(221)
Restricted receivables/liabilities	(251)	(1,533)
Net cash flows provided by noncapital financing activities	30,948	26,716
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Deposits in project funds	(40)	(30,143)
Withdrawals from project funds	27,133	28,058
Acquisitions and construction	(43,648)	(40,043)
Proceeds from long-term debt	171	30,165
Principal payments on long-term debt	(7,474)	(7,516)
Interest payments on long-term debt	(9,181)	(9,166)
Net cash flows used in capital and related financing activities	(33,039)	(28,645)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of (purchase of) investments, net	10,666	(7,081)
Interest received and realized gains and losses	5,285	7,115
Net cash flows provided by investing activities	15,951	34
Net increase (decrease) in cash and cash equivalents	2,051	(6,412)
Cash and cash equivalents at beginning of year	376	6,788
Cash and cash equivalents at end of year	$ 2,427	$ 376
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating loss	$ (29,822)	$ (29,161)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	28,804	28,285
Provision for bad debts	6,049	7,528
Changes in assets and liabilities:		
Increase in patient accounts receivable	(17,327)	(9,047)
Decrease (increase) in other assets	1,116	(11,954)
Increase in self-insurance liabilities	4,039	5,068
(Decrease) increase in accounts payable and other liabilities	(8,431)	5,672
Increase (decrease) in long-term liabilities	3,763	(908)
Net cash flows used in operating activities	$ (11,809)	$ (4,517)

See accompanying notes to financial statements.

Overview of the Financial Statements

This annual report consists of financial statements prepared in accordance with the provisions of Governmental Accounting Standards Board ("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 implementation of GASB Statement No. 34 affected the presentation of net assets, the inclusion of management's discussion and analysis, the direct method presentation of the statements of cash flows and expanded footnote disclosures.

The System is the public health care system for Cuyahoga County, Ohio, ("County") and was created pursuant to Ohio Revised Code Chapter 339. The System is governed by a Board of Trustees appointed jointly by the Board of County Commissioners of the Board of County of Cuyahoga, and the senior judges of the Probate Court and Common Pleas Court.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The accompanying financial statements of the MetroHealth System ("System") include the MetroHealth Medical Center, a short-term acute care and long-term rehabilitation facility; MetroHealth Clement Center for Family Care, an outpatient community health facility; MetroHealth Centers for Skilled Nursing Care, consisting of the Skilled Nursing Facility East and The Elisabeth Severance Prentiss Center for Skilled Nursing Care; Faculty Business Office, a medical specialty group practice; and several urban and suburban primary care health sites. All significant inter-entity transactions have been eliminated in the financial statements.

The System is the public health care system for Cuyahoga County, Ohio, and was created pursuant to Ohio Revised Code Chapter 339. The System is governed by a board of trustees appointed jointly by the Board of County Commissioners of the Board of the County of Cuyahoga, and the senior judges of the Probate Court and Common Pleas Court. In order to support the general operations of the System, the County of Cuyahoga, Ohio Commissioners approved an appropriation of $26,762 and $20,850 for 2004 and 2003, respectively. The County has approved an appropriation for 2005 that reflects an increase of $8,003 from the 2004 appropriation amount. The System is exempt from federal income taxes as a governmental entity.

In accordance with GASB Statement No. 14, *The Reporting Entity*, the System's financial statements are included, as a discrete entity, in the County's Consolidated Annual Financial Report (CAFR). A copy of the CAFR can be obtained from Frank Russo, Cuyahoga County Auditor, County Administration Building, 1219 Ontario Street, Cleveland, Ohio 44113.

Basis of Accounting

The System's financial statements are prepared in accordance with 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*. The System follows the "business-type" activities, which provides for the following components of the System's financial statements:

- Management's Discussion and Analysis
- Basic Financial Statements including a Balance Sheet, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flows, for the System as a whole
- Notes to the Financial Statements

Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the System has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), statements and interpretations issued after November 30, 1989 which do not conflict or contradict GASB pronouncements.

The accompanying financial statements of the System are prepared using the economic resources measurement focus and the accrual basis of accounting. Under this basis, revenues and expenses are recognized in the period in which they are earned or incurred. Depreciation of assets, gains, losses, assets and liabilities are also recognized in the period in which the transaction has occurred.

Pursuant to the Ohio Revised Code, the System submits a budget to the County Commissioners for approval by November 1 of each fiscal year. The fundamental purpose of the budget is to plan for an expected level of operations and to provide management with a tool to control deviation from such a plan. The budget is prepared on an accrual basis.

Use of Estimates

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

Statement of Revenues, Expenses, and Changes in Net Assets

The System recognizes as operating revenue those transactions that are major or central to the provision of health care services. Operating revenues include those revenues received for direct patient care, grants received from organizations as reimbursement for patient care and other incidental revenue associated with patient care. Operating expenses include those costs associated with providing patient care including costs of professional care, operating the hospital facilities, administrative expenses, and depreciation and amortization. Non-operating revenues include County appropriation, investment income, specific purpose grants and donations, primarily research, and unrealized gains on investments. Non-operating expenses include interest expense and expenditures from specific purpose funds for research related activities.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. Net patient service revenue is reduced by contractual and retroactive adjustments of $485,083 and $431,733 in 2004 and 2003, respectively.

The System has agreements with third-party payors that provide for payment at amounts different from established rates. A summary of the basis of payment by major third-party payors follows:

Medicare and Medicaid—Inpatient acute care services rendered to Medicare and Medicaid program beneficiaries and Medicare capital costs are paid at prospectively determined rates-per-discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors.

Medicare outpatient claims are reimbursed under the Ambulatory Payment Classification based prospective payment system. As an academic medical center, medical education payments in addition to disproportionate share entitlements are received from Medicare and Medicaid. Medicare utilizes a prospective payment system for inpatient rehabilitation services. The payments are based on patient assessment data classifying patients into one of one hundred case mix groups. Inpatient psychiatric services and certain outpatient services related to Medicare beneficiaries and capital costs for Medicaid beneficiaries are reimbursed based on a cost-based methodology subject to certain limitations. The System is reimbursed for cost reimbursable items at tentative rates with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare and Medicaid fiscal intermediaries. The System's classification of patients under the Medicare and Medicaid programs and the appropriateness of their admission are subject to an independent review by a peer review organization. Differences between the estimated amounts accrued at interim and final settlements are reported in the Statement of Revenues, Expenses, and Changes in Net Assets in the year of settlement. The System recorded a favorable adjustment of $5,092 in 2004 and a favorable adjustment of $9,421 in 2003, due to prior year retroactive adjustments to amounts previously estimated.

Net revenue from the Medicare and Medicaid programs accounted for approximately 24.0% and 32.0%, respectively, of the System's net patient service revenue for the year ended December 31, 2004. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties and exclusion from the Medicare and Medicaid programs. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term. Management believes that adequate provision has been made in the financial statements for any adjustments that may result from final settlements.

Other Payors—The System has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes prospectively-determined rates-per-discharge, discounts from established charges, and prospectively-determined per diem rates.

Upper Payment Limit—In September 2001, the State of Ohio Supplemental Upper Payment Limit program for Public Hospitals (UPL) was approved by the Center for Medicare and Medicaid Services. This program provides access to available federal funding up to 100% of the Medicare upper payment limits for inpatient hospital services rendered by Ohio Public Hospitals to Ohio Medicaid consumers. At December 31, 2004 and 2003, $14,000 and $16,360, respectively, were due to the System and recorded on the balance sheets in other receivables; the System's required match to the State of Ohio of $6,508 and $8,467, respectively, is included in other current liabilities. The net amount recorded in net patient service revenue for UPL by the System was $17,353 and $16,174 in 2004 and 2003, respectively.

Disproportionate Share—As a public health care provider, the System renders services to residents of the County and others regardless of ability to pay. The System is classified as a disproportionate share provider by the Medicare and Medicaid programs due to the volume of low income persons it serves and accordingly receives additional payments (including Care Assurance of $26,248 and $27,622 in 2004 and 2003, respectively) from these programs as a result of this status which total payments aggregated $37,122 and $38,191 in 2004 and 2003, respectively, which is included in net patient service revenue. The System also provides major trauma services to the region. The ability to continue these levels of service and programs will be contingent upon the various funding sources.

Charity Care

Throughout the admission, billing and collection processes, certain patients are identified by the System as qualifying for charity care. The System provides care to these patients without charge or at amounts less than its established rates. The charges foregone for charity care provided by the System, totaling $121,019 and $108,224, which represents 11.4% and 11.2% of gross charges in 2004 and 2003, respectively, are not reported as revenue. The System accepts certain indigent Ohio residents and all residents from the County regardless of their ability to pay.

Grants

The System receives financial assistance from federal and state agencies in the United States in the form of grants. The expenditure of funds received under these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies.

Other such audits could be undertaken by federal and state granting agencies and result in the disallowance of claims and expenditures; however, in the opinion of management, any such disallowed claims or expenditures will not have a material effect on the overall financial position of the System.

Cash and Cash Equivalents

The System considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents are stated at cost which approximates fair value excluding amounts limited as to use or restricted by board designation.

Supplies

Supplies are stated at the lower of average cost or market.

Investments

The System records its investments at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Unrealized gains and losses on investments are recorded as non-operating revenue-net in the statement of revenues, expenses, and changes in net assets.

The GASB issued Statement No. 40, *Deposit and Investment Risk Disclosure* which amends portions of Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements* for certain investment risk disclosures. The System implemented GASB Statement No. 40 beginning with the period ended December 31, 2003.

The System pools certain of its investments for investment purposes. Investment income for these pooled investments is allocated to the proper investment classification based on each investments fair value to the total fair value of all pooled investments.

The net realized gain of $140 in 2004 and net realized loss of $69 in 2003 on investments is the difference between the proceeds received and the amortized cost of investments sold and is included in investment income in the statement of revenues, expenses, and changes in net assets.

Restricted Assets

Restricted assets are cash and investments whose use is limited by legal requirements. Investments under bond indenture agreement represent amounts required by debt instruments to pay bond principal and interest and projects. Restricted cash and specific purpose investments represent monies received from donors or grantors to be used for specific purposes, primarily research. The System has elected to use restricted assets before unrestricted assets when an expense is incurred for a purpose for which both resources are available.

Capital Assets

Capital assets are stated at cost. Expenditures that substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation and amortization of assets recorded under capital lease (straight-line method) are provided in amounts sufficient to amortize the cost of the related assets over their estimated useful lives. The following are the most commonly used estimated useful lives:

Buildings	25-40 years
Building improvements	5-20 years
Equipment	3-15 years
Land improvements	5-15 years
Vehicles	4 years

Half of a year's depreciation is taken the first year the asset is placed in service. The asset and accumulated depreciation are removed from the related accounts when the asset is disposed of. Any gain or loss resulting from this disposal is recorded in the statement of revenues, expenses, and changes in net assets.

Deferred Compensation Plans

The System offers eligible employees a deferred compensation plan adopted under the provisions of Internal Revenue Code Section 457. The plan permits participating employees to defer a portion of their salary until future years. The deferred compensation is available to employees upon termination of employment, retirement, disability, death, or unforeseeable emergency. The System may at any time amend or terminate the plan with or without consent of the participants.

In accordance with the provisions of GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans,* the System created a trust for the assets of the plan for which the System has no fiduciary responsibility. The System has no recorded assets or liabilities relating to this plan.

Bond Discounts and Bond Issuance Costs

Deferred financing costs represent debt issuance expenditures on long-term debt obligations and are amortized over the period the bonds are outstanding on a straight-line basis. The amortization for deferred bond financing costs was $125 in 2004 and $126 in 2003. Amortization expense related to bond discounts was $127 in 2004 and $125 in 2003. These amounts are included in interest expense in the statement of revenues, expenses, and changes in net assets.

Cost of Borrowing

Interest costs associated with funds borrowed and used to finance the construction or acquisition of assets are capitalized as a component of the cost of acquiring those assets. The capitalized interest amount is calculated by taking the difference between the interest expense incurred over the term life of the bonds and the interest earned on the invested proceeds of specific purpose tax exempt bonds, which cover the same period of time. Capitalized interest income and interest expense on the Series 1999 and 2003 Bonds totaled $188 and $1,321 in 2004, respectively; $507 and $2,485 in 2003, respectively. Amortization of capitalized interest is included in depreciation expense.

The System has entered into three interest-rate swap agreements. These derivative instruments are not designated as hedging instruments, therefore gains and losses are recognized in the statement of revenues, expenses, and changes in net assets during the period of change. Net amounts periodically receivable or payable as a result of swap agreements are recorded as adjustments to interest expense on the related debt (see Note 6).

Concentrations of Credit Risk

Financial instruments that potentially subject the System to concentrations of credit risk consist principally of cash and cash equivalents, patient accounts receivable, and investments.

The System places its cash and cash equivalents with high credit quality financial institutions. The System's investments include money market funds, U.S. Treasury bills and notes, U.S. agency obligations, and repurchase agreements.

Concentration of credit risk relating to patient accounts receivable is limited to some extent by the diversity and number of the System's patients and payors. Patient accounts receivable consist of amounts due from government programs, commercial insurance companies, private pay patients, and other group insurance programs. Excluding governmental programs, no payor source represents more than 10.0% of the System's patient accounts receivable. The System maintains an allowance for losses based on the expected collectibility of patient accounts receivable.

2. CHANGES IN ACCOUNTING PRINCIPLES

The GASB issued Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, which establishes criteria to determine if organizations that are legally separate, tax exempt entities should be discretely presented as component units if significant. Application of this standard is required for fiscal 2004. The System has not included the MetroHealth Foundation in these financial statements as they were considered not significant.

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement requires governmental units to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. A capital asset generally would be considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset. Impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government should be measured using the method that best reflects the diminished service utility of the capital asset. The provisions of this Statement are effective for financial statements for fiscal periods beginning after December 15, 2004. The system has not determined the impact, if any, that this statement will have on its financial statements.

3. DEPOSITS AND INVESTMENTS

Deposits

All monies are deposited to the System's banks or trust companies designated by the Board of Trustees. Funds not needed for immediate expenditure may be deposited in interest bearing or non-interest bearing accounts or U.S. government obligations. Banks or trust companies shall furnish security for all such deposits, whether interest bearing or non-interest bearing, except that no such security is required for U.S. government obligations.

Custodial risk is the risk that, in the event of bank failure, the System's deposits might not be recovered. The System's bank deposits at December 31, 2004 and 2003 totaled \$8,066 and \$7,671, respectively, and were subject to the following categories of custodial risk:

	2004	2003
Uncollateralized	$ 7,798	$ 7,396
Collateralized with securities held by the pledging institution's trust department, but not in the System's name	68	75
Total amount subject to custodial risk	7,866	7,471
Amount insured	200	200
Total bank balances	$ 8,066	$ 7,671

Investments

As of December 31, 2004 and 2003, the fair value of the System's investments were as follows:

	2004	2003
Cash and cash equivalents	$153,809	$216,069
U.S. Treasuries	727	9,397
U.S. Governments	-	1,148
U.S. Government Agencies	79,430	47,784
Federal National Mortgage Association and Federal Home Loan Mortgage Corporation (Federal Pools)	8,810	9,840
Collateralized Mortgage Obligations	1,596	2,476
Corporates	4,189	-
Total investments	$248,561	$286,714

The System's carrying amounts of the deposits and investments at December 31, 2004 and 2003 are as follows:

	2004	2003
Deposits	$ 8,366	$ 7,777
Investments	248,561	286,714
Total deposits and investments	$256,927	$294,491

The difference between bank balances and financial statement carrying amounts represent outstanding checks payable and normal reconciling items.

Interest Rate Risk. The System's investment policies limit investment portfolio to maturities of five years or less. All of the System's investments at December 31, 2004 have effective maturity dates of less than five years.

Credit Risk. All of the System's investments are rated AAA by Standard and Poor's. The System's investment policies are governed by State of Ohio statutes that authorize the System to invest in U. S. government obligations. The Collateralized Mortgage Obligations and Federal Mortgage pools are investments that are grandfathered from previous statutes that allowed such investments. These investments have an effective maturity date of less than one year.

Custodial Credit Risk. For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Of the System's investments, only the repurchase agreements are exposed to custodial risk. Repurchase agreements (included in the U.S. Government Agencies) at December 31, 2004 totaling $9,015 are uninsured, are not registered in the System's name and are held by the financial institution's trust department.

4. CAPITAL ASSETS

The following summarizes the capital assets of the System for the years ended December 31, 2004 and 2003:

2004	Beginning Balance	Additions	Reductions/ Transfers	Ending Balance
Capital assets not being depreciated:				
Land	$ 8,954	$ 680	$ -	$ 9,634
Construction in progress	62,043	37,302	(88,252)	11,093
Total non-depreciated capital assets	70,997	37,982	(88,252)	20,727
Depreciable capital assets:				
Land improvements	7,699	130	-	7,829
Buildings and fixed equipment	374,189	71,508	-	445,697
Equipment	199,198	24,941	(1,102)	223,037
Total depreciable capital assets	581,086	96,579	(1,102)	676,563
Less accumulated depreciation:				
Land improvements	(6,656)	(204)	-	(6,860)
Buildings and fixed equipment	(247,713)	(17,449)	-	(265,162)
Equipment	(164,062)	(11,151)	1,096	(174,117)
Total accumulated depreciation	(418,431)	(28,804)	1,096	(446,139)
Total depreciable capital assets, net	162,655	67,775	(6)	230,424
Total capital assets—net	$ 233,652	$ 105,757	$ (88,258)	$ 251,151

2003	Beginning Balance	Additions	Reductions/ Transfers	Ending Balance
Capital assets not being depreciated:				
Land	$ 8,954	$ -	$ -	$ 8,954
Construction in progress	18,667	46,242	(2,866)	62,043
Total non-depreciated capital assets	27,621	46,242	(2,866)	70,997
Depreciable capital assets:				
Land improvements	7,699	-	-	7,699
Buildings and fixed equipment	372,032	2,157	-	374,189
Equipment	194,739	4,930	(471)	199,198
Total depreciable capital assets	574,470	7,087	(471)	581,086
Less accumulated depreciation:				
Land improvements	(6,384)	(272)	-	(6,656)
Buildings and fixed equipment	(230,422)	(17,313)	22	(247,713)
Equipment	(153,798)	(10,700)	436	(164,062)
Total accumulated depreciation	(390,604)	(28,285)	458	(418,431)
Total depreciable capital assets, net	183,866	(21,198)	(13)	162,655
Total capital assets—net	$ 211,487	$ 25,044	$ (2,879)	$ 233,652

Total depreciation and amortization expense related to capital assets for 2004 and 2003 was $28,804 and $28,285, respectively.

5. LONG-TERM DEBT

Changes in long-term debt for 2004 and 2003 are as follows:

	2004				
	Beginning Balance	Additions	Payments/ Reductions	Ending Balance	Due Within One Year
Hospital Improvement and Refunding Revenue Bonds, Series 1997, bear interest at rates ranging from 3.9% to 5.8% and mature in varying amounts through 2027	$ 52,085	$ -	$ (4,400)	$ 47,685	$ 4,615
Hospital Refunding Revenue Bonds, Series 1997A, bear interest at rates ranging from 4.1% to 5.5% and mature in varying amounts through 2019	76,415	-	(255)	76,160	265
Hospital Improvement Revenue Bonds, Series 1999, bear interest at rates ranging from 6.1% to 6.2% and mature in varying amounts through 2029	56,995	-	-	56,995	-
Hospital Improvement Revenue Bonds, Series 2003, bear variable interest rates and mature in varying amounts through 2033	30,545	-	(535)	30,010	580
Equipment obligation, GE Leasing, as defined in the respective lease agreement at an interest rate of 4.9% and matures through 2007	3,631	-	(1,337)	2,294	812
Equipment obligation, Banc One Leasing, as defined in the respective lease agreement at an interest rate of 4.9% and matures through 2004	818	-	(818)	-	-
Equipment obligation, IBM Credit Corporation as defined in the respective lease agreement at interest rates ranging from 4.0% to 4.9% and matures through 2004	89	-	(89)	-	-
Loan obligation, Cuyahoga County Sanitary Engineering, as defined in the respective loan agreement, matures through 2018	-	131	(40)	91	7
	220,578	131	(7,474)	213,235	6,279
Unamortized discount and loss	(9,327)	-	507	(8,820)	-
	211,251	131	(6,967)	204,415	6,279
Current installments	(7,558)	(6,279)	7,558	(6,279)	-
Long-term debt	$ 203,693	$ (6,148)	$ 591	$ 198,136	$ 6,279

	2003				
	Beginning Balance	Additions	Payments/ Reductions	Ending Balance	Due Within One Year
Hospital Improvement and Refunding Revenue Bonds, Series 1997, bear interest at rates ranging from 3.9% to 5.8% and mature in varying amounts through 2027	$ 56,280	$ -	$ (4,195)	$ 52,085	$ 4,400
Hospital Refunding Revenue Bonds, Series 1997A, bear interest at rates ranging from 4.1% to 5.5% and mature in varying amounts through 2019	76,655	-	(240)	76,415	255
Hospital Improvement Revenue Bonds, Series 1999, bear interest at rates ranging from 6.1% to 6.2% and mature in varying amounts through 2029	56,995	-	-	56,995	-
Hospital Improvement Revenue Bonds, Series 2003, bear variable interest rates and mature in varying amounts through 2033	-	30,545	-	30,545	535
Equipment obligation, GE Leasing, as defined in the respective lease agreement at an interest rate of 4.9% and matures through 2007	5,022	-	(1,391)	3,631	1,461
Equipment obligation, Banc One Leasing, as defined in the respective lease agreement at an interest rate of 4.9% and matures through 2004	2,166	-	(1,348)	818	818
Equipment obligation, IBM Credit Corporation, as defined in the respective lease agreement at interest rates ranging from 4.0% to 4.9% and matures through 2004	431	-	(342)	89	89
	197,549	30,545	(7,516)	220,578	7,558
Unamortized discount and loss	(9,829)	-	502	(9,327)	-
	187,720	30,545	(7,014)	211,251	7,558
Current installments	(7,516)	(7,558)	7,516	(7,558)	-
Long-term debt	$ 180,204	$ 22,987	$ 502	$ 203,693	$ 7,558

Effective February 1, 1997, the County issued $70,000 of Hospital Improvement and Refunding Revenue Bonds Series 1997 (The MetroHealth System Project) (Series 1997). The proceeds of the Series 1997 Bonds were used to refund $20,900 of Series 1989 Bonds; to finance the construction of various improvements and additions to The MetroHealth Medical Center; and to pay costs of issuance of the Series 1997 Bonds.

Effective November 1, 1997, the County issued $77,525 of Hospital Refunding Revenue Bonds, Series 1997A (The MetroHealth System Project) (Series 1997A). The proceeds of the Series 1997A Bonds were used to refund $73,725 of Series 1989 Bonds scheduled to mature on February 15, 2019. The 1997 refundings resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $9,753. The unamortized difference ($7,092 at December 31, 2004), reported in the accompanying financial statements, as a reduction from long-term debt, is included as an increase to interest expense through the year 2019 using the effective interest method.

Effective September 1, 1999, the County issued $56,995 of Hospital Improvement Revenue Bonds, Series 1999 (The MetroHealth System Project) (Series 1999 Bonds). The proceeds of the Series 1999 Bonds are being used to finance the construction of a 150-bed long-term care facility and acquire, construct, renovate, equip, and improve operating rooms and other hospital facilities.

Effective March 13, 2003, the County issued $30,545 of Hospital Improvement Variable Rate Demand Revenue Bonds, Series 2003 (The MetroHealth System Project) (Series 2003 Bonds). The proceeds of the Series 2003 Bonds are being used to pay costs of constructing and equipping the Critical Care Pavilion and an administrative building. The bonds bear interest at a variable rate (not to exceed 10.0%) determined weekly as established by the Remarketing Agent based on current market values for similar bond offerings and are due at various dates until 2033. The rate at December 31, 2004 was 2.04%.

In connection with the issuance of the Series 2003 Bonds, the System entered into a Reimbursement Agreement with a bank. Under the terms of the Reimbursement Agreement, the System entered into an Irrevocable Letter of Credit (Letter of Credit) issued by a local bank that expires on March 22, 2008. Under the terms of the Letter of Credit, the Trustee will be entitled to draw amounts necessary to make principal and interest payments. The Letter of Credit is subject to various financial covenants.

The Series 1997, 1997A, 1999 and 2003 Bonds were issued pursuant to a master trust indenture between the County, acting by and through the System's Board of Trustees, and the bond trustee. The Series 1997, 1997A, 1999 and 2003 Bonds are special obligations of the County payable solely from the revenue derived from the operation of the System and other monies available to the System's Board of Trustees, and are secured by the revenue and real property of the System. Accordingly, the bond proceeds and indebtedness have been recorded as assets and liabilities of the System.

The terms of the master trust bond indenture agreement provide for the establishment of a depreciation reserve fund and maintenance of certain special funds, which are maintained under the control of the bond trustee and are used for payment of principal and interest on the bonds when due. The revenue bonds and lease obligation payment requirements for fiscal years subsequent to December 31, 2004 are as follows:

	Total Lease and Loan Obligations			Total Hospital Revenue Bonds		
	Principal	Interest	Total	Principal	Interest	Total
2005	$ 818	$ 102	$ 920	$ 5,460	$ 9,888	$ 15,348
2006	729	57	786	5,700	9,646	15,346
2007	765	20	785	5,985	9,386	15,371
2008	7	-	7	6,270	9,118	15,388
2009	7	-	7	6,575	8,821	15,396
2010-2014	33	-	33	38,405	38,852	77,257
2015-2019	26	-	26	49,320	28,470	77,790
2020-2024	-	-	-	37,475	17,822	55,297
2025-2029	-	-	-	49,325	6,786	56,111
2030-2033	-	-	-	6,335	-	6,335
	$ 2,385	$ 179	$ 2,564	210,850	$ 138,789	$ 349,639
Unamortized discount				(1,728)		
Unamortized difference between reacquisition price and the net carrying amount of old debt				(7,092)		
Total hospital revenue bonds—net				$ 202,030		

The Bond Reserve Fund required under the Trust Indenture has been established with the Trustee. The balance as of December 31, 2004 and 2003 was $18,526 and $18,507, respectively. The cost value of Hospital Revenue Bonds was $209,122 at December 31, 2004. The fair value of Hospital Revenue Bonds ($218,151 at December 31, 2004) is estimated using discounted cash flow analyses based on current borrowing rates for similar types of borrowing arrangements.

6. DERIVATIVE INSTRUMENTS

The System's objectives of its derivative instruments include managing the risk of increased debt service resulting from rising market interest rates, the risk of decreased surplus returns resulting from falling interest rates, and the management of the risk of an increase in the fair value of outstanding fixed rate obligations resulting from declining market interest rates. Consistent with its interest rate risk management objectives, the System entered into various interest rate swap agreements with a total outstanding notional amount of $142,000 and $142,500 at December 31, 2004 and 2003, respectively. The System pays a rate equal to the Bond Market Association Municipal Index (the BMA SWAP Index), an index of seven-day high-grade tax-exempt variable rate demand obligations or a fixed rate of 1.5% or 3.5%. In return, the System receives a fixed rate of 5.4% or a rate based on the BMA SWAP Index or 75.0% of LIBOR. The interest rate swap arrangement with an effective date of March 2003 and a notional amount of $30,545 million includes an option whereby the counterparty can terminate the transaction. The BMA index rates in 2004 ranged from 0.8% to 1.9% (1.9% at December 31, 2004). The 1-Month LIBOR Index in 2004 ranged from 1.1% to 2.4% (2.4% at December 31, 2004).

The fair value of the swap agreements based on current settlement prices at December 31, 2004 is $1,424 due from the counterparty and is included in other assets. Net interest savings for 2004 and 2003 was $1,480 and $1,638, respectively and is included as a reduction to interest expense. The decrease of $2,148 in fair value of the net swap assets during 2004 is recorded as unrealized losses on investment in the statement of revenues, expenses, and changes in net assets.

The following table describes the terms of the three interest rate swap agreements the System has entered. In all three cases, only the net difference is exchanged with the counterparty and the notional amount is not exchanged. For the Series 2003 agreement, the notional amount changes with the amortization of the bonds.

Notional Amount	Effective Date	Termination Date	The System Pays	Counterparty Pays
$56,000,000	September 1, 1999	February 15, 2014	BMA SWAP Index	Fixed 5.4%
$56,000,000	May 14, 2003	February 15, 2005	Fixed 1.5 %	BMA SWAP Index
$30,010,000	March 13, 2003	March 1, 2033	Fixed 3.5 %	75.0% of LIBOR

7. OTHER LONG TERM LIABILITIES

Amounts Due to Third-Party Payors

The System has agreements with third-party payors that provide for payment of amounts from established rates. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. See Note 1 net patient service revenue.

Accrued Vacation and Sick

System employees earn vacation and sick leave at varying rates depending on job classification and years of service. Employees can accumulate up to three years of vacation leave. All accumulated, unused vacation time is paid upon separation if the employee has at least one year of service with the System. There is no limit on the amount of sick time accrued. Upon retirement, employees with a minimum of 10 years of service have sick leave balances paid out at 50.0% of eligible hours at their current rate of pay. The maximum pay out is 800 hours. As of December 31, 2004 and 2003, the liability for accrued sick and vacation was $25,153 and $22,633, respectively.

Note Payable

The System financed one-year general and professional liability policies with a note payable in 2004 and 2003. The 2004 note payable bears interest at a rate of 3.6%; the 2003 note payable interest rate was 3.8%. At December 31, 2004 and 2003, the note payable balance outstanding was $4,600 and $3,400, respectively.

Other Long term liabilities consist of the following at December 31, 2004 and 2003:

2004	Beginning Balance	Additions	Payments	Ending Balance	Due Within One Year
Amounts due third-party payors	$ 42,544	$ 761	$ (1,870)	$ 41,435	$ 6,872
Accrued vacation and sick leave	22,633	4,552	(2,032)	25,153	2,093
Note payable	3,400	4,576	(3,400)	4,576	4,576
	$ 68,577	$ 9,889	$ (7,302)	$ 71,164	$ 13,541

2003	Beginning Balance	Additions	Payments	Ending Balance	Due Within One Year
Amounts due third-party payors	$ 45,588	$ (440)	$ (2,604)	$ 42,544	$ 9,455
Accrued vacation and sick leave	20,516	3,908	(1,791)	22,633	1,862
Note payable	-	3,400	-	3,400	3,400
	$ 66,104	$ 6,868	$ (4,395)	$ 68,577	$ 14,717

Risk Management

The System is exposed to various risks of loss related to torts; theft of or destruction of assets; errors and omissions; injuries to employees; and natural disasters. The System is self-insured for workers compensation and medical malpractice but maintains commercial insurance policies for property and casualty, automobile, aircraft (helicopter and fixed wing) as well as excess coverage for medical malpractice claims. Settled claims have not exceeded insurance coverage in any of the past three years.

During the normal course of its operations, the System has become a defendant in various legal actions. It is not possible to estimate the outcome of these legal actions; however, in the opinion of legal counsel and the System administration, the disposition of the pending cases will not have a material adverse effect of the financial condition or operations of the System. However, depending on the amount and timing of such resolution, an unfavorable resolution of some or all of these matters could materially affect the System's future results of operations or cash flows in a particular year.

The System is self-insured for the purpose of providing professional and patient care liability and workers' compensation claims. For the professional and patient care liability, professional actuarial insurance consultants have been retained to determine funding requirements. Amounts funded for professional and patient care have been placed in an irrevocable self-insurance trust account, which is being administered by a trustee.

Losses from asserted claims and from unasserted claims identified under the System's incident reporting systems are accrued based on estimates that incorporate the System's past experience, as well as other considerations including the nature of each claim or incident and relevant trend factors. The reserve for estimated self-insured claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported undiscounted for 2004 and 2003.

2004	Beginning Balance	Claims Incurred	Claims Paid	Ending Balance	Due Within One Year
Worker's compensation	$ 6,145	$ 5,312	$ (2,968)	$ 8,489	$ 3,316
Self-insurance	35,590	12,747	(11,052)	37,285	18,609
Employee health insurance	2,881	29,430	(29,518)	2,793	2,793
	$44,616	$47,489	$(43,538)	$48,567	$24,718

2003	Beginning Balance	Claims Incurred	Claims Paid	Ending Balance	Due Within One Year
Worker's compensation	$ 5,951	$ 2,617	$ (2,423)	$ 6,145	$ 2,497
Self-insurance	30,716	10,802	(5,928)	35,590	17,457
Employee health insurance	2,389	27,506	(27,014)	2,881	2,881
	$39,056	$40,925	$(35,365)	$44,616	$22,835

8. OPERATING LEASES

The System has entered into operating lease agreements for a parking facility, medical space, and office space, which expire through 2020. The contracts are generally for five years and contain rent escalation clauses and renewal options for additional periods ranging from one to five years.

Minimum rental commitments under operating leases extending beyond one year at December 31, 2004 are as follows:

2005	$ 1,118
2006	1,029
2007	1,043
2008	1,043
2009	903
2010-2014	3,670
2015-2019	2,009
2020	101
Total	$ 10,916

Rent expense totaled $1,516 in 2004 and $1,365 in 2003. The System leases the Valentine parking garage. The lease had an original five year term with five one year options to renew. Upon the ultimate expiration of the lease, there are several options available to the System regarding the property which results in different amounts possibly due. One of these is an option to purchase the property. The original term has expired and the System's management elected to exercise the first option, which expires November 30, 2005. The cost to purchase the property at the time is $11,500 million. Funds have been allocated within Board Designated investments to make this payment.

9. BENEFIT PLANS

Pension

Employee retirement benefits are available for substantially all employees under three separate retirement plans administered by the Ohio Public Employees Retirement System ("OPERS"). The plans are the Traditional Pension Plan—a cost-sharing, multiple-employer defined benefit pension plan; the Member-Directed Plan—a defined contribution pension plan; and the Combined Plan—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 postretirement healthcare benefits, to the Traditional and Combined Plan members however, healthcare benefits are not statutorily guaranteed. Participants in the Member-Directed Plan do not qualify for ancillary benefits.

The Ohio Public Employees Retirement System issues a stand-alone financial report and may be obtained by writing to OPERS, 277 East Town Street, Columbus, Ohio 43215-4642. The Ohio Revised Code provides statutory authority for employee and employer contributions. The employee contribution rate is 8.5% of covered payroll and the System is required to contribute 13.6% of covered payroll. The System's contributions to OPERS for the years ending December 31, 2004, 2003 and 2002 were $38,024, $36,438 and $34,584, respectively, equal to the required contributions for each year.

Postretirement Benefits

OPERS also provides postretirement health care coverage to age-and-service retirees with 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 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 System's contribution for 2004 and 2003 used to fund postretirement health care benefits was $11,025 and $13,446, respectively, which is included in the System's pension contribution of $38,024 and $36,438 for the years ending December 31, 2004 and 2003, respectively.

Benefits are advance-funded using the entry-age normal actuarial cost method. Significant actuarial assumptions include an investment return of 8.0%; no change in the number of active employees, active employee payroll increases of 4.0% compounded annually and between 0.5% to 6.3% based on additional pay increases; and health care cost increases of 4.0% annually. Health care costs were assumed to increase over the next eight years at a rate ranging between 5.0% and 10.0%, and 4.0% thereafter.

As of December 31, 2003 (the most recent information available), OPERS had $10,500,000 in net assets available for payment of postemployment benefits. The actuarial accrued liability for postemployment benefits and the unfunded actuarial accrued liability were $26,900,000 and $16,400,000, respectively. The number of active contributing participants was 369,885.

On September 9, 2004 the OPERS Retirement Board adopted a Health Care Preservation Plan (HCPP) to improve financial solvency of the fund by restructuring health care coverage. The Plan has an effective date of January 1, 2007. Under HCPP, retirees eligible for health care coverage will received a graded monthly allocation to use for purchasing from a broad range of health care options. Unspent monthly allocations are deposited into a Retirement Medical Account for subsequent health care expenses.

10. RELATED ORGANIZATIONS

The System is the primary beneficiary of The MetroHealth Foundation, Inc. (the Foundation). The Foundation is a separate not-for-profit entity organized for the purpose of supporting the System in the areas of research, community health and continuing professional education. The System does not consolidate the financial activity of the Foundation with that of the System. The Foundation had total net assets of $16,465 and $13,899 for 2004 and 2003, respectively. The System received support from the Foundation in the amount of $1,082 and $1,090 for 2004 and 2003, respectively, and is recorded as grant revenue on the System's statement of revenues, expenses and changes in net assets. The outstanding receivable from the Foundation was $483 and $676 at December 31, 2004 and 2003, respectively.

The System had established restricted funds to differentiate resources, the use of which is restricted by donors or grantors, from resources of general funds on which donors place no restrictions or that arise as a result of the operations of the System. A review of these restricted funds is performed annually to determine that funds related to completed clinical trials and certain donated money should be transferred to The MetroHealth Foundation. The total amounts transferred in 2004 and 2003 were $116 and $287, respectively.

11. COMMITMENTS

As of December 31, 2004, the System has contractual commitments for the construction of the various projects totaling approximately $14,800. These projects are being funded with the remaining bond proceeds ($1,200) and operating funds. The following table lists the construction project and commitment amount at December 31, 2004:

Construction Project	Amount
South Campus Administrative Building	$ 9,734
Buckeye Health Center	2,434
Critical Care Pavilion	2,151
Broadway Medical Center	477
Total commitments	$ 14,796

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THE METROHEALTH SYSTEM

SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED DECEMBER 31, 2004

Federal Grantor/ Pass-Through Grantor	Program Title	Federal CFDA Number	Pass-Through Grantor Number	Federal Expenditures
U.S. Department of Agriculture				
Pass-Through Program From:				
State of Ohio	Special Supplemental Nutrition Program for Women, Infants and Children (WIC)	10.557	18-3-001-1-CL-04; 18-3-001-1-CL-05	$ 4,195,619
			TOTAL - U.S. Department of Agriculture	**4,195,619**
U.S. Department of Health & Human Services				
Pass-Through Programs From:				
Medicaid Assistance Program	Cuyahoga County Community Mental Health Board	93.778	18311-01	64,098
	Alcohol & Drug Addiction Services Board of Cuyahoga County	93.778	129000	750,137
			Subtotal CFDA No. 93.778	814,235
State of Ohio	Maternal & Child Health Services Block Grant - *Division of Family: Bureau of Child & Family Services*	93.994	18-3-001-1-MC-04; 18-3-001-1-MC-05	688,269
	Maternal & Child Health Services Block Grant - *Genetics*	93.994	18-3-01-F-AU; 18-3-01-F-AU-05	36,250
	Maternal & Child Health Services Block Grant - *Cleveland Regional Perinatal Network*	93.994	18-3-002-1-BM-04	45,167
			Subtotal CFDA No. 93.994	769,686
	Acquired Immunodeficiency Syndrome Activity - *TB Prevention and Control/Outreach*	93.118	18-3-001-2-CK-05	218,668
	HIV Care Formula Grants - *Federal HIV Care*	93.917	18-3-001-1-AT-03; 18-3-001-1-AT-04	105,576
Family Planning Services / Center for Community Solutions	Title X/Family Planning	93.217	Public Law 106-113; 5FPHPA050520-28-00	334,782
HIV Emergency Relief Project Grants / Cuyahoga County	Ryan White Title I - Medical/Dental Services	93.914	CE0300129-01; CE0400386-01	1,079,357
Civil Rights and Privacy Rule Compliance / Center for Health Affairs	HRSA Emergency Preparedness / Bioterrorism Grant (FY02 Funding)	93.001	None Available	12,135
	HRSA Emergency Preparedness / Bioterrorism Grant (FY03 Funding)	93.001	None Available	41,532
			Subtotal CFDA No. 93.001	53,667
	Total - U.S. Department of Health & Human Services			**3,375,971**

(Continued)

See notes to supplemental schedule of expenditures of federal awards.

THE METROHEALTH SYSTEM

SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED DECEMBER 31, 2004

Federal Grantor/ Pass-Through Grantor	Program Title	Federal CFDA Number	Pass-Through Grantor Number	Federal Expenditures
U.S. Department of Education				
Pass-Through Programs From:				
State of Ohio	Special Education Grant for Infants & Families with Disabilities - *Early Intervention: Hospital Based Child Find*	84.181	18-3-001-1-DD-04; 18-3-001-1-HB-05	73,225
			Total - U.S. Department of Education	**73,225**
Research & Development Cluster:				
U.S. Department of Health & Human Services				
Direct Programs:				
	Cancer Biology Research - *Regulation of AP-2 and HER-2/NEU Gene Promoters*	93.396		109,681
	Extramural Research Programs in Neuroscience - *Neuronal Migration*	93.853		60,204
	Grants for Residency Training in Primary Care - *Residency Training in General and Pediatric Dentistry*	93.884		98,837
	Heart & Vascular Disease Research - *Chaperones HERG*	93.837		192,072
	Child Health and Human Dev Extramural Research - *Molecular Studies of Brain Malformations*	93.865		145,851
			Subtotal Research & Development Cluster - Direct	606,645
Pass-Through Programs From:				
Rhode Island Hospital	Sonia Study	93.853	R01NS39131	10,307
NINDS/Emory University	Extramural Research Programs in Neuroscience - *Wasid Study*	93.853	R01NS036643-05	69,908
New Jersey	Extramural Research Programs in Neuroscience - *WARCEF*	93.853	1UO1NS43975-01	1,351
Wake Forest	Extramural Research Programs in Neuroscience - *VISP*	93.853	R01NS34447	58,769
			Subtotal CFDA No. 93.853	140,335
NHLBI/Duke University	Heart & Vascular Disease Research - *SCD-Heft*	93.837	R01HL64862	364
Columbia University	Heart & Vascular Disease Research - *CHF & Wave Alternan*	93.837	5R01HL064862-04	11,891
			Subtotal CFDA No. 93.837	12,255

(Continued)

See notes to supplemental schedule of expenditures of federal awards.

THE METROHEALTH SYSTEM

SUPPLEMENTAL SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED DECEMBER 31, 2004

Federal Grantor/ Pass-Through Grantor	Program Title	Federal CFDA Number	Pass-Through Grantor Number	Federal Expenditures
University of Pittsburgh	Microbiology & Infectious Disease Research - *PEACH Study*	93.856	R01HS08358	11,675
Social Security Administration	*LEAP*	*	16-T-10077-5-01	51,072
Duke University	Cancer Treatment Research - *ACOSOG*	93.395	7U10CA76001-4; 7U10CA86004-02	8,430
University of Cincinnati	Center for Disease Control & Prevention - *Acute Stroke Reg*	93.283	U50/CCU520278-01	16,479
Research Triangle Institute	Health & Human Services - *NCI Cancer Cohort Study*	*	RTI# 07587-821	107
Rush Presbyterian	Aging Research - *Physical Restraints*	93.866	5R01AG019715-01A2	70,696
University of Minnesota	Arthritis, Musculoskeletel & Skin Disease Research - *Sprint*	93.846	5R01AR48529-02; 5R01AR48529-03	800
University of Wisconsin	Kidney Diseases, Urology, & Hematology Research - *Find Study*	93.849	04-8898; 05-8388	2,009
NIH	Blood Diseases & Resources Research - *TOVA Study*	93.839	None Available	4,960
	Subtotal Research & Development Cluster - Pass-Through			318,818
	TOTAL - Research & Development Cluster			**925,463**
*CFDA number not available	***TOTAL EXPENDITURES OF FEDERAL AWARDS***			**$ 8,570,278**

(Concluded)

See notes to supplemental schedule of expenditures of federal awards.

THE METROHEALTH SYSTEM

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED DECEMBER 31, 2004

Note A. Summary of Significant Accounting Policies

Basis of Presentation

The supplemental schedule of expenditures of federal awards includes the federal grant activity of The MetroHealth System (the "System") and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

For the purposes of this schedule, federal awards include direct federal awards and pass-through funds received from non-federal organizations made under federally sponsored programs conducted by those organizations.

All programs are classified under the federal department that sponsors the program. Pass-through programs are also presented by the entity through which the System received the federal award. Catalog of Federal Domestic Assistance ("CFDS") numbers are presented when such numbers are available.

Note B. Medicaid Assistance Program

The amount received from Medicaid in 2004 represents only a portion of the total amount billed by the System. The federal expenditure amount reported represents the actual and accrued receipts times the Federal Financial Participation reimbursement rate for service rendered in 2004.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of Trustees
The MetroHealth System
Cleveland, Ohio

We have audited the financial statements of The MetroHealth System (the "System"), as of and for the year ended December 31, 2004, and have issued our report thereon dated March 28, 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 *Governmental Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System'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 on opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System's 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 disclosed two instances of noncompliance that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 04-1 and 04-2.

We noted certain matters that we reported to management of the System in a separate letter dated March 28, 2005.

This report is intended solely for the information and use of the audit committee, management, federal awarding agencies, state funding agencies, pass-through entities, and the Ohio Auditor of State and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche, LLP

March 28, 2005

Deloitte.

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL CONTROL OVER COMPLIANCE APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Board of Trustees
The MetroHealth System
Cleveland, Ohio

Compliance

We have audited the compliance of The MetroHealth System (the "System") with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended December 31, 2004. The System's major federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the System's management. Our responsibility is to express an opinion on City the System's compliance based on our audit.

We conducted our audit of compliance 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; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the System's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the System's compliance with those requirements.

In our opinion, the System complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended December 31, 2004. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying Schedule of Findings and Questioned Costs as items 04-1 and 04-2.

Internal Control Over Compliance

The management of the System is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contract, and grants applicable to federal programs. In planning and performing our audit, we considered the System's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the System's internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of the System, as of and for the year ended December 31, 2004, and have issued our report thereon dated March 28, 2005. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the System. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects when considered in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the audit committee, management, federal awarding agencies, state funding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche, LLP

March 28, 2005

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED DECEMBER 31, 2004

Part I - Summary of Auditor's Results

- The independent auditors' report on the financial statements expressed an unqualified opinion.
- Reportable conditions in internal control over financial reporting – N/A (None reported)
- No instances of noncompliance considered material to the financial statements were disclosed by the audit.
- Reportable conditions in internal control over compliance with requirements applicable to major federal awards programs disclosed by the audit of the financial statements – N/A (None reported).
- The independent auditors' report on compliance with requirements applicable to major federal award programs expressed an unqualified opinion.
- The audit disclosed two findings required to be reported by OMB Circular A-133.
- The System's major Federal Award Programs identified for the Year Ended December 31, 2004:

  U.S. Department of Health and Human Services – Medicaid Assistance Program (CFDA No. 93.778)
  U.S. Department of Health and Human Services – Maternal and Child Health Services Block Grant to the States (CFDA No. 93.994)
  U.S. Department of Agricultural – Special Supplemental Nutrition Program for Women, Infants and Children (CFDA No. 10.557)

- A threshold of $300,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
- The Organization qualified as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II - Financial Statement Findings Section

No matters are reportable.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED DECEMBER 31, 2004

Part III - Federal Award findings and Questioned Cost Section

Finding No: 04-1

Program Name: Medicaid Assistance Program

CFDA #: 93.778

Compliance Area: Allowable Cost

Condition: Certain employees only provide Medicaid services, whether direct or supportive in nature, for a portion of their time. As such, these individuals are deemed to be allowable only to the extent of their specified percentage. Three instances were noted whereby the costs charged by the System exceeded their applicable allocation percentage.

Criteria: According to the *Office of Management and Budget Circular A-133 Compliance Supplement*, for the Medicaid Assistance Program, to be allowable, Medicaid costs for medical services must be: (1) covered by the State plan and waivers, (2) for an allowable service rendered, (3) be properly coded and (4) be paid at the rate allowed by the State plan. In addition, according to the *Ohio Department of Mental Health Guidelines*, allowable costs must be recorded and allocated to specific service categories in a reasonable and consistent manner and must not include unallowable costs as defined in OMB Circular A-133 Compliance Supplements and award documents.

Cause and Effect: The process used by the System to allocate costs to a specific program are subject to human error due to the manual nature in which this information is captured. In each instance, the error was the result of recording salary to the inappropriate accounting unit. The System was unaware that the individuals identified during testing were being allocated to Medicaid at the improper amount. Failure to allocate salaries at the appropriate amount represents a violation of the allowable cost criterion as described above.

Questioned Costs: $50,000

Recommendation: The System should consider the implementation of a different methodology for allocating salary costs to Medicaid, preferably a methodology that would reduce the potential for human error.

Management's Response and Corrective Action Plan: While management does recognize and agree that $50,000 of unallowable costs was erroneously included with the CCCMHB total costs, it should also be noted that the total costs of the Mental Health program exceeded $5.9 million. As such, $50,000 represents less than 1 percent of the total costs of the program. Removing these unallowable costs from the total cost would have had no impact to the unit cost per service and, therefore, no impact to the Federal reimbursement received from the Medicaid assistance program. However, the fact remains that the costs identified were unallowable, indicating a weakness in our internal controls.

To alleviate such errors from occurring in the future, The MetroHealth System is implementing the Lawson Grants Management System in April 2005. This system is fully integrated with the System's automated financial applications and will provide the ability to systematically allocate only the portion of an individual's FTE to the grant's costs as allowed per the budget. The Medicaid Assistance programs will be added to the Grants Management System with the new grant year beginning July 1, 2005. In addition, the System's accounting is reviewing its internal procedures for accumulating allowable costs and incorporating additional controls to ensure the accuracy of FTE allocations prior to July 2005.

Finding No: 04-2

Program Name: Medicaid Assistance Program

CFDA #: 93.778

Compliance Area: Activities Allowed or Unallowed

Condition: The System requests reimbursements based on units of service provided multiplied by the Medicaid contract rate for the type of service rendered. Two instances were noted whereby the System inaccurately billed Medicaid; one overbilling, one underbilling.

Criteria: According to the *Office of Management and Budget A133 Compliance Supplement* for the Medical Assistance Program, to be allowable, Medicaid costs for medical services must be paid at the rate allowed by the State plan.

Cause and Effect: The System's billing process relies on the manual tracking of the number of units of service provided. The failure to record an accurate number of units of service resulted in an overbilling or underbilling to Medicaid, leading to an improper reimbursement amount.

Questioned Costs: None

Recommendation: The system should consider the implementation of changes in the billing process that would reduce the potential for human error. For example, the chart which is utilized by service providers to determine the number of units provided could be embedded within the billing system so that the only thing the service provider has to enter is the number of minutes spent with each patient. In this manner, the number of units would be automatically calculated based on their input of time. The potential for a service provider to erroneously enter the amount of minutes spent with a patient is significantly lower than the potential for a service provider to misinterpret the chart.

Management's Response and Corrective Action Plan: Prior to receiving Deloitte & Touche's CCCMHB billing recommendation, the System researched the possibility of having the provider input the beginning and ending times for CCCMHB patients to automatically calculate the number of units to be billed. Our research indicated that the Epic system does not currently have the capability to incorporate the logic suggested by Deloitte & Touche. Since an electronic solution is not available in Epic electronic medical record and/or billing information system, the System will reeducate CCCMHB providers to stress the importance of choosing the correct number of units for the services provided to CCCMHB patients.

It should be noted that CCCMHB does not follow the *Current Procedural Terminology* (CPT) which is a listing of descriptive terms and identifying codes for reporting medical services and procedures performed by physicians. The purpose of the terminology is to provide a uniform language that will accurately describe medical, surgical, and diagnostic services, and will thereby provide an effective means for reliable nationwide communication among physicians, patients, and third parties.

CPT descriptive terms and identifying codes currently serve a wide variety of important functions in the field of medical nomenclature. The uniform language is also applicable to medical education and outcomes, health services and quality research by providing a useful basis for local, regional and national utilization comparisons. The CPT book is the most widely accepted nomenclature for the reporting of physician procedures and services under government and private health insurance programs. In 2000, the CPT Code Set was designated by the Department of Health and Human Services as the national coding standard for physician and other health care professional services and procedures under the Health Insurance Portability and Accountability Act (HIPAA). This means that for all financial and administrative health care transaction sent electronically, the CPT Code Set will need to be used. Unfortunately, CCCMHB has chosen not to follow the national standards.

THE METROHEALTH SYSTEM

STATUS OF PRIOR YEAR FINDINGS

No significant findings or questioned costs were included in the prior year's report.

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THE METROHEALTH SYSTEM

CUYAHOGA 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 21, 2005