SINGLE AUDIT REPORT

The MetroHealth System

December 31, 2002

Auditor of State
Betty Montgomery

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

We have reviewed the Independent Auditor's Report of the MetroHealth System, Cuyahoga County, prepared by Ernst & Young LLP, for the audit period January 1, 2002 through December 31, 2002. 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

August 18, 2003

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The MetroHealth System

Single Audit Report

December 31, 2002

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Report of Independent Auditors

Board of Trustees
The MetroHealth System

We have audited the accompanying balance sheets of The MetroHealth System, a component unit of Cuyahoga County, Ohio, as of December 31, 2002 and 2001, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of The MetroHealth System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The MetroHealth System as of December 31, 2002 and 2001, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1 to the financial statements, The MetroHealth System implemented a new financial reporting model, as required by 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*, effective January 1, 2002 and restated its financial statements for 2001.

The Management's Discussion and Analysis on pages 2 through 9 are not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 26, 2003 on our consideration of The MetroHealth System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was performed for the purpose of forming an opinion on the financial statements of The MetroHealth System taken as a whole. The accompanying schedule of expenditures of federal awards for the year ended December 31, 2002 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and is not a required part of the 2002 financial statements. Such information has been subjected to the auditing procedures applied in the audit of the 2002 financial statements and, in our opinion, is fairly presented in all material respects in relation to the 2002 financial statements taken as a whole.

Ernst + Young LLP

February 26, 2003

The MetroHealth System

Management's Discussion and Analysis

Year ended December 31, 2002

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, 2002 and 2001. 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 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 effected 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 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, (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.

The balance sheets and the statements of revenues, expenses and changes in net assets, and of cash flows, provide an indication of the System's financial performance and position. The balance sheets include all of the System's assets and liabilities, prepared using the accrual method of accounting, and provides an indication about which assets can be utilized for general purposes and which are restricted as a result of bond agreements or other use restrictions. Net assets are categorized as invested in capital assets, net of related debt; restricted for debt service and projects; restricted for special purpose funds; and unrestricted.

Net assets restricted for special purpose funds include amounts received from grants from third parties or donors with expenditure restrictions. Unrestricted net assets represent those balances from operational activities that have not been restricted by external parties and includes funds that have internal restrictions (Board of Trustees designated funds).

The statements of revenue, expenses and changes in net assets represent the revenue and expenses incurred during each year. The statements of cash flows presents information related to cash provided and used by operating, noncapital financing, capital related financing, and investing activities.

Financial and Operating Highlights for 2002

- Inpatient levels of activity remained at capacity.
- Outpatient levels of activity increased 4.6% over last year.
- Emergency room levels of activity increased 5.6% over last year.
- Surgery cases increased 6.5% over last year.
- Net revenues increased 10.2% or $42.1 million over last year.
- Total net assets decreased by $4.9 million over last year.
- The change in net assets improved $5.6 million over last year.
- Construction in progress increased $12.4 million, which is largely attributed to the construction of the new Critical Care Pavilion.
- Cash and investments increased over the previous year by $14.5 million.

Financial Analysis of the System at December 31, 2002

Total assets decreased less than 1% to $581.8 million, and total liabilities increased less than 1% to $350.0 million. The System's total net assets declined from $236.5 million to $231.7 million, a 2.1% decrease from a year ago. (See Table 1.)

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

	2002	2001
Assets:		
Current assets	**$ 75,022**	$ 81,110
Investments	**230,661**	203,195
Restricted assets	**57,928**	77,386
Capital assets	**211,487**	217,048
Other assets	**6,663**	5,191
Total assets	**$ 581,761**	$ 583,930
Liabilities and net assets:		
Current liabilities	**$ 93,531**	$ 94,576
Long-term liabilities	**256,550**	252,820
Total liabilities	**350,081**	347,396
Net assets:		
Invested in capital assets, net of related debt	**42,977**	53,815
Restricted for debt service and projects	**52,109**	63,151
Restricted for special purpose funds	**2,347**	5,159
Unrestricted	**134,247**	114,409
Total net assets	**231,680**	236,534
Total liabilities and net assets	**$ 581,761**	$ 583,930

Current Assets

Total current assets decreased $6.1 million from the previous year. Net patient receivables remained at last year's level of $45.2 million. The System participates in a state supplemental Medicaid program that provides access to available funding up to 100% of the Medicare Upper Payment Limit for inpatient hospital services. The receivable associated with this program declined from the previous year nearly $8 million and increased cash $6 million. The remaining decline in current assets is attributed to a decrease in prepaid insurance expenses.

Investments

Unrestricted investments increased over the prior year level by $27.5 million. Increased revenue, improved collections of patient accounts receivable and increased revenue collected related to the Upper Payment monies from 2001 and 2002 account for the increase in unrestricted investments. Restricted investments decreased by $19.5 million primarily related to draws on the Series 1999 bond proceeds of approximately $11.0 million. The remaining decrease represents a transfer of funds to the operating fund of $8.4 million.

Capital Assets

Capital additions for the year were approximately $24 million. Of that amount, $14.8 million pertains to the construction of the new Critical Care Pavilion. This new building will replace current emergency room and perioperative facilities and is scheduled to open in the Spring of 2004. In March 2003, the Board of Trustees authorized the issuance and sale of approximately $31 million of bonds to finance the new Critical Care Pavilion and business administration buildings.

Other major capital outlays for the year included SICU renovation, PET Scanner, mammography system, PBX replacement and completion of the Clinical Data Base rollout to satellite locations. These capital purchases were funded through operations. The System has outstanding commitments on the new Critical Care Pavilion of approximately $54 million. Detailed information regarding the System's capital assets can be found in Note 4 of the financial statements.

Current Liabilities

Current liabilities decreased $1.0 million over the prior year. Accounts payable decreased nearly $4.4 million, however, this decline was offset by increases in various payroll accruals within current liabilities.

Long-Term Liabilities

The System is self-insured for both workers compensation and medical malpractice insurance. The System utilizes actuarial studies to determine its year-end liabilities. The total long-term self-insurance liability increased by $6.8 million, primarily related to medical malpractice. Long-term balances due third-party payors increased slightly.

All of the System's long-term debt relates to acquisition of capital assets. The System issued no new long-term debt during the year. The System's bond indenture and capital lease agreements contain various covenants that the System must maintain. The financial covenants include Days Cash on Hand, Debt Service Ratio and Debt to Capitalization Ratios. The System is in compliance with all bond covenants. Additional detail regarding the System's long-term debt can be found in Note 5 of the financial statements.

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

	2002	2001
Operating revenues:		
Net patient service revenue	**$ 456,693**	$ 414,580
Other revenue	**17,830**	14,892
Total operating revenue	**474,523**	429,472
Operating expenses:		
Professional care of patients	**300,794**	283,723
Dietary	**6,308**	6,257
Household and property	**22,278**	21,123
Administrative and general	**69,407**	65,694
Employee benefits	**63,898**	56,094
Provision for bad debts	**13,636**	10,749
Depreciation and amortization	**30,700**	32,300
Total operating expenses	**507,021**	475,940
Operating loss	**(32,498)**	(46,468)
Non operating revenues—net	**29,829**	36,823
Grants for capital acquisitions	**44**	1,456
Decrease in net assets	**(2,625)**	(8,189)
Total net assets—beginning of year	**236,534**	244,723
Transfer of net assets	**(2,229)**	-
Total net assets—end of year	**$ 231,680**	$ 236,534

The System's total operating and nonoperating revenue for the year was $516.7 million while expenses were $519.3 million. This resulted in net assets decreasing by $2.6 million for the year reflecting a loss on operations. This is an improvement of $5.4 million over the previous year.

Net Patient Service Revenue

Net patient service revenue increased from the prior year by $42.1 million, or 10.2%. Although gross revenue includes a 3.5% price increase effective January 1, 2002, this price increase had a corresponding increase in contractual allowances. Net patient revenue also includes revenue the System received as a participant in Care Assurance ($34 million in 2002 and $37.4 in 2001) and Upper Payment Limit ($12 million in 2002 and $9.3 in 2001) programs. The level of revenue from HCAP and UPL in future years is uncertain. Other increases in net patient service revenue are primarily related to increased volumes in 2002 over 2001.

Charity care of $98.8 million increased from the prior year by $2.8 million or 2.8%. The System's level of charity care continues to reflect the System's status as a safety net facility.

The System's total expenses increased $31.1 million or 6.5% for the prior year. A summary of the expenses is shown below in Table 3.

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

			Change	
	2002	**2001**	**Amount**	**Percent**
Operating expenses:				
Salaries and wages	**$ 274,366**	$ 254,618	**$ 19,748**	**7.8%**
Employee benefits	**63,898**	56,094	**7,804**	**13.9**
Medical supplies	**26,005**	25,764	**241**	**0.9**
Pharmaceuticals	**20,198**	18,399	**1,799**	**9.8**
Plant operations	**27,325**	25,747	**1,578**	**6.1**
Supplies and other	**34,427**	35,752	**(1,325)**	**(3.7)**
Liability insurance	**16,466**	16,517	**(51)**	**(0.3)**
Provision for bad debts	**13,636**	10,749	**2,887**	**26.9**
Depreciation and amortization	**30,700**	32,300	**(1,600)**	**(5.0)**
Total operating expense	**$ 507,021**	$ 475,940	**$ 31,081**	**6.5%**

Operating Expenses

Salaries and wages, which represent 55% of total operating expenses, account for a $19.7 million increase over 2001. During 2002, the System increased salaries and wages 3% representing an increase of $7.6 million in salaries and wages expense. Additionally, FTE's for the year increased by 193 related to the expansion of the System's ambulatory surgical center and specific satellite medical offices, along with other new patient programs.

Benefits rose by $7.7 million. Higher FTEs, increased healthcare costs per employee and higher employee utilization in medical and prescription services accounted for the increase in benefits.

Medical supplies and pharmaceuticals increased by $2.0 million or 4.5% and is related to increased patient volume.

Non-Operating Income/Revenue

The biggest component of non-operating revenue is the County appropriation. The Cuyahoga County Commissioners approved an appropriation to the System for $21.9 million in 2002. County support decreased $3.2 million over the previous year as a result of the County's 10% across the board budget reduction. The System expects 2003 funding to be similiar to 2002.

Net Asset Transfer

The System transferred $2.2 million to The MetroHealth Foundation, Inc. in 2002. The funds represent residual monies from completed clinical trials and donations. See Note 9 in the financial statements for more information.

Economic Factors and Next Year's Budget

The Cuyahoga County Commissioners approved the System's 2003 budget. The System's budget reflects a net reduction of approximately $3 million in County Appropriation from the 2001 appropriated amount of $24 million. Several factors and uncertainties that are contained in the budget are:

- It is estimated there will be a $44 million federal reduction to Ohio HCAP funds. Historically, the System's share of these funds has been around 10%.

- The debate continues in Washington related to restoration of the 1997 Balanced Budget Act cuts. Restoration of the cuts made would bring additional Medicare funds to the System.

- The State of Ohio is facing considerable budget shortfall. Medicaid funding on both acute and long term care providers may be effected in the process to balance the budget. Medicaid currently accounts for 32% of the System's net patient service revenue. A cut or freeze in the State's funding of the Medicaid program will have an adverse effect on the System's operating income.

- The ability to accommodate increasing demands by the community when the current facility is at capacity will require use of the System's investments or additional debt to acquire more capacity.

- The costs associated with medical malpractice insurance premiums and claims are expected to increase in the next year and require more funding.

- Operating losses and funding demands make it difficult to generate adequate working capital to meet debt service and capital replacement needs.

The MetroHealth System

Balance Sheets

(Dollars in Thousands)

	December 31	
	2002	**2001**
Assets		
Current assets:		
Cash and cash equivalents	**$ 6,534**	$ 74
Patient accounts receivable	**53,688**	52,455
Allowance for uncollectible accounts	**(8,444)**	(7,286)
	45,244	45,169
Other receivables	**15,727**	25,610
Supplies	**4,796**	4,648
Prepaid expenses	**2,721**	5,609
Total current assets	**75,022**	81,110
Investments:		
Board designated	**117,349**	92,299
Self-insurance funds	**9,834**	15,525
Academic funds	**33,346**	33,501
Depreciation reserve fund	**70,132**	61,870
	230,661	203,195
Restricted assets:		
Cash and cash equivalents	**254**	270
Special purpose investments	**5,565**	13,965
Under bond indenture agreement	**52,109**	63,151
	57,928	77,386
Capital assets:		
Land and land improvements	**16,653**	17,131
Buildings and fixed equipment	**372,032**	369,451
Equipment	**194,739**	185,431
	583,424	572,013
Accumulated depreciation	**(390,604)**	(361,235)
	192,820	210,778
Construction in progress	**18,667**	6,270
	211,487	217,048
Other assets	**6,663**	5,191
	$ 581,761	$ 583,930

	December 31 2002	2001
Liabilities		
Current liabilities:		
Accounts payable	**$ 20,084**	$ 24,422
Accrued payroll and related liabilities	**15,068**	13,726
Public Employees Retirement System liability	**8,641**	10,256
Accrued interest payable	**3,959**	4,032
Self-insurance liabilities	**15,089**	14,700
Estimated amounts due to third-party payors	**9,441**	11,122
Accrued vacation and sick leave	**1,895**	1,805
Current installments of long-term liabilities	**7,516**	7,175
Other current liabilities	**11,838**	7,338
Total current liabilities	**93,531**	94,576
Long-term liabilities, less current installments:		
Self-insurance liabilities	**21,578**	14,771
Estimated amounts due to third-party payors	**36,147**	34,282
Accrued vacation and sick leave	**18,621**	16,561
Long-term debt	**180,204**	187,206
Total long-term liabilities	**256,550**	252,820
Total liabilities	**350,081**	347,396
Net assets		
Invested in capital assets, net of related debt	**42,977**	53,815
Restricted for debt service and projects	**52,109**	63,151
Restricted for special purpose funds	**2,347**	5,159
Unrestricted	**134,247**	114,409
Total net assets	**231,680**	236,534
	$ 581,761	$ 583,930

See accompanying notes to financial statements.

The MetroHealth System

Statements of Revenues, Expenses, and Changes in Net Assets

(Dollars in Thousands)

	Years ended December 31	
	2002	**2001**
Operating revenues		
Net patient service revenue	**$ 456,693**	$ 414,580
Other revenue	**17,830**	14,892
Total operating revenues	**474,523**	429,472
Operating expenses		
Professional care of patients	**300,794**	283,723
Dietary	**6,308**	6,257
Household and property	**22,278**	21,123
Administrative and general	**69,407**	65,694
Employee benefits	**63,898**	56,094
Provision for bad debts	**13,636**	10,749
Total operating expenses before depreciation and amortization	**476,321**	443,640
Operating loss before depreciation and amortization	**(1,798)**	(14,168)
Depreciation and amortization	**30,700**	32,300
Operating loss	**(32,498)**	(46,468)
Non-operating revenues (expenses)		
County appropriation	**21,850**	25,050
Investment income	**9,269**	11,700
Unrealized gains on investments	**3,312**	5,346
Other non-operating revenue	**3,054**	3,307
Specific purpose grants and donations	**4,692**	5,829
Specific purpose funds expenditures	**(5,274)**	(6,330)
Interest expense	**(7,074)**	(8,079)
Total non-operating revenues—net	**29,829**	36,823
Loss before other changes	**(2,669)**	(9,645)
Other changes		
Grants for capital acquisitions	**44**	1,456
Decrease in net assets	**(2,625)**	(8,189)
Total net assets—beginning of the year	**236,534**	244,723
Transfer of net assets *(Note 9)*	**(2,229)**	-
Total net assets—end of the year	**$ 231,680**	$ 236,534

See accompanying notes to financial statements.

The MetroHealth System

Statements of Cash Flows

(Dollars in Thousands)

	Years ended December 31 2002	2001
Cash flows from operating activities		
Patient service revenue	$ **452,016**	$ 405,224
Other operating cash receipts	**18,580**	14,892
Payments to suppliers	**(114,476)**	(113,710)
Payments for compensation and benefits	**(338,491)**	(310,073)
Net cash flows provided by (used in) operating activities	**17,629**	(3,667)
Cash flows from noncapital financing activities		
County appropriation	**21,850**	25,050
Restricted grants and donations	**7,790**	10,592
Specific purpose funds expenditures	**(5,274)**	(6,330)
Transfer of net assets	**(603)**	-
Restricted receivables/liabilities	**1,757**	780
Net cash flows provided by noncapital financing activities	**25,520**	30,092
Cash flows from capital and related financing activities		
Withdrawals from project funds	**10,776**	3,459
Acquisitions and construction	**(22,913)**	(18,991)
Principal payments on long-term debt	**(7,175)**	(6,753)
Interest payments on long-term debt	**(8,835)**	(7,349)
Net cash flows used in capital and related financing activites	**(28,147)**	(29,634)
Cash flows from investing activities		
Payments for investments	**(17,827)**	(12,129)
Interest received and realized gains and losses	**9,269**	11,700
Net cash flows used in investing activities	**(8,558)**	(429)
Net increase (decrease) in cash and cash equivalents	**6,444**	(3,638)
Cash and cash equivalents at beginning of year	**344**	3,982
Cash and cash equivalents at end of year	$ **6,788**	$ 344

See accompanying notes to financial statements.

The MetroHealth System

Statements of Cash Flows (continued)

(Dollars in Thousands)

	Years ended December 31	
	2002	**2001**
Reconciliation of operating loss to net cash provided by (used in) operating activities		
Operating loss	**$ (32,498)**	$ (46,468)
Adjustments to reconcile to cash provided by (used in) operating activities:		
Depreciation and amortization	**30,700**	32,300
Provision for bad debts	**13,636**	10,749
Changes in assets and liabilities:		
Increase in patient accounts receivable	**(13,711)**	(5,828)
Decrease (increase) in other assets	**13,466**	(15,258)
Decrease in self-insurance liabilities	**(610)**	(214)
(Decrease) increase in accounts payable and other liabilities	**(1,538)**	9,171
Increase in long-term liabilities	**8,184**	11,881
Net cash flows provided by (used in) operating activities	**$ 17,629**	$ (3,667)

See accompanying notes to financial statements.

1. Summary of Significant Accounting Policies

Reporting Entity

The accompanying financial statements of The MetroHealth System (the System) include 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, Skilled East and The Elisabeth Severance Prentiss Center for Skilled Nursing Care; Faculty Business Office, a medical specialty group practice; and several 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, (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 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 $21,850 and $25,050 for 2002 and 2001, respectively. The County has approved an appropriation for 2003 which reflects a decrease of $6 million from the 2002 appropriation amount. The System is exempt from federal income taxes as a governmental entity.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 14, *The Reporting Entity*, the System's financial statements are included, as a discrete entity, in the County of Cuyahoga, Ohio's (the County) 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

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.

1. Summary of Significant Accounting Policies (continued)

The accompanying financial statements of the System are prepared using the economic resources measurment 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.

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 $381,197 and $344,179 in 2002 and 2001, respectively.

1. Summary of Significant Accounting Policies (continued)

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.

Effective August 2000, Medicare implemented its Ambulatory Payment Classification based outpatient prospective payment system. As an academic medical center, medical education payments in addition to disproportionate share entitlements are received from Medicare. Effective January 1, 2002, Medicare implemented 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 $4,180 in 2002 and an unfavorable adjustment of $1,228 in 2001, due to prior year retroactive adjustments to amounts previously estimated.

1. Summary of Significant Accounting Policies (continued)

Net revenue from the Medicare and Medicaid programs accounted for approximately 24% and 32%, respectively, of the System's net patient service revenue for the year ended December 31, 2002. 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.

Capitation—Prior to March 2001, the System contracted with various insurers to provide comprehensive health care services under capitated managed care arrangements. The cost of services provided or contracted for under these capitated arrangements was accrued in the period in which the services are provided to members of the managed care plans based in part on estimates, including an accrual for medical services provided but not reported to the System. The System also had entered into a stop-loss insurance agreement to limit its potential losses on claims to $125 per member per year.

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. The gross amounts of $7,000 and $15,756 were due to the System at December 31, 2002 and 2001, respectively, and recorded on the balance sheets in other receivables; the System's required match to the State of Ohio of $2,885 and $6,495, respectively, is included in other current liabilities. The net amount recorded in net patient service revenue for UPL by the System was $12,109 and $9,261 in 2002 and 2001, respectively.

1. Summary of Significant Accounting Policies (continued)

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 $33,948 and $37,404 in 2002 and 2001, respectively) from these programs as a result of this status which total payments aggregated $44,473 and $45,136 in 2002 and 2001, 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 $98,785 and $96,012, which represents 11.1% and 11.9% of gross charges in 2002 and 2001, 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 is 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.

1. Summary of Significant Accounting Policies (continued)

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 cost (determined on first-in, first-out method) or net realizable value.

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 nonoperating in the statement of revenues, expenses, and changes in net assets.

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 loss of $189 in 2002 and gain of $426 in 2001 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.

1. Summary of Significant Accounting Policies (continued)

Capital Assets

Capital assets are stated at cost. Expenditures which substantially increase the useful lives of existing assets are capitalized. Routine maintenance and repairs are expensed as incurred. Depreciation and amortization (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. 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 asset or liability.

1. Summary of Significant Accounting Policies (continued)

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 $116 in 2002 and $43 in 2001. Amortization expense related to bond discounts was $134 in 2002 and $139 in 2001. These amounts are included in interest expense on 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 Bonds was $2,073 and $2,223 in 2002, respectively; $2,496 and $2,464 in 2001, respectively. Amortization of capitalized interest is included in depreciation expense.

In 2001, the System adopted the provisions of Financial Accounting Standards Board Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which requires companies to recognize all of its derivative instruments as either assets or liabilities in the financial statements. The implementation of Statement No. 133, recorded as a cumulative effect, increased the January 1, 2001 fund balance by an aggregate total of $1,232.

The System entered into an interest-rate swap agreement in 1999 to effectively convert a portion of its fixed rate debt to a variable rate basis. This derivative instrument is not designated as a hedging instrument and 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 5).

1. Summary of Significant Accounting Policies (continued)

Concentrations of Credit Risk

Financial instruments which 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 percent 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 System adopted the provisions of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* as amended by GASB Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus* and GASB Statement No. 38, *Certain Financial Statement Note Disclosures* effective January 1, 2001 and restated its financial statements for 2001. 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, Expenditures and Changes in Net Assets, and Statement of Cash Flows, for the System as a whole
- ❖ Notes to the Financial Statements

2. Changes in Accounting Principles (continued)

Statement No. 38 requires additional disclosures to be made in the notes to the financial statements in conjunction with the adoption of Statement No. 34 related to debt and lease obligations.

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. Application of this standard is required for fiscal 2004. The impact of GASB Statement No. 39 on financial reporting and the results of financial position has not been determined.

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.

At December 31, 2002, the financial statement carrying amount of the System's deposits was $623. The actual bank balances including accrued interest totaled $570, the difference represents outstanding checks payable and normal reconciling items. Of the bank balances, approximately $100 was covered by federal depository insurance and is thus a category (1) deposit risk in accordance with the provisions of GASB Statement No. 3. The remainder was secured by collateral pools of U.S. government and municipal securities.

(Dollars in Thousands)

3. Deposits and Investments (continued)

Investments

The System's investment policies are governed by state statutes which authorize the System to invest in U.S. government obligations. Investments are categorized to give an indication of the level of risk assumed by the System at year end. The categorized investments include those which are classified as cash and cash equivalents in accordance with the provisions of GASB Statement No. 9.

At December 31, 2002, cash and investments include:

	(1) Insured or Registered, or Securities Held By the System or its Agent in the System's Name	(3) Uninsured and Unregistered, with Securities Held by the Counterparty, or its Trust Department or Agent but Not in the System's Name	Cost	Fair Value
U. S. Treasury notes	$ 20,107	$ -	$ 20,107	$ 20,839
U. S. Agency obligations	103,636	-	103,636	108,690
Repurchase agreements	-	8,791	8,791	8,791
	$ 123,743	$ 8,791		
Money market funds			156,180	156,180
Total cash and investments			$ 288,714	$ 294,500

The amounts invested in money market funds are not classified by risk categories because they are not evidenced by securities that exist in physical or book entry form as defined by GASB Statement No. 3.

(Dollars in Thousands)

4. Capital Assets

The following schedules summarize the capital assets of the System as of December 31, 2002 and 2001:

2002	Beginning Balance	Additions	Reductions/ Transfers	Ending Balance
Capital assets not being depreciated:				
Land	$ 8,954	$ -	$ -	$ 8,954
Construction in progress	6,270	18,041	(5,644)	18,667
Total non-depreciated capital assets	15,224	18,041	(5,644)	27,621
Depreciable capital assets:				
Land improvements	8,177	6	(484)	7,699
Buildings and fixed equipment	369,451	2,892	(311)	372,032
Equipment	185,431	9,833	(525)	194,739
Total depreciable capital assets	563,059	12,731	(1,320)	574,470
Less accumulated depreciation:				
Land improvements	(6,337)	(526)	479	(6,384)
Buildings and fixed equipment	(212,452)	(18,281)	311	(230,422)
Equipment	(142,446)	(11,893)	541	(153,798)
Total accumulated depreciation	(361,235)	(30,700)	1,331	(390,604)
Total depreciable capital assets, net	201,824	(17,969)	11	183,866
Total capital assets, net	$ 217,048	$ 72	$ (5,633)	$ 211,487

(Dollars in Thousands)

4. Capital Assets (continued)

2001	Beginning Balance	Additions	Reductions/ Transfers	Ending Balance
Capital assets not being depreciated:				
Land	$ 8,877	$ 77	$ -	$ 8,954
Construction in progress	22,962	16,389	(33,081)	6,270
Total capital assets not being depreciated	31,839	16,466	(33,081)	15,224
Capital assets being depreciated:				
Land improvements	8,113	69	(5)	8,177
Buildings and fixed equipment	346,958	23,191	(698)	369,451
Equipment	173,882	12,818	(1,269)	185,431
Total capital assets being depreciated	528,953	36,078	(1,972)	563,059
Less accumulated depreciation for:				
Land improvements	(5,859)	(480)	2	(6,337)
Buildings and fixed equipment	(194,675)	(17,983)	206	(212,452)
Equipment	(130,894)	(13,837)	2,285	(142,446)
Total accumulated depreciation	(331,428)	(32,300)	2,493	(361,235)
Total capital assets being depreciated, net	197,525	3,778	521	201,824
Total capital assets, net	$ 229,364	$ 20,244	$ (32,560)	$ 217,048

Total depreciation and amortization expense related to capital assets for 2002 and 2001 was $30,700 and $32,300, respectively.

(Dollars in Thousands)

5. Long-Term Debt

Changes in long-term debt for 2002 and 2001 are as follows:

	2002				
	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 3.90% to 5.80% and mature in varying amounts through 2027	$ 60,290	$ -	$ (4,010)	$ 56,280	$ 4,195
Hospital Refunding Revenue Bonds, Series 1997A, bear interest at rates ranging from 4.1% to 5.5% and mature in varying amounts through 2019	76,885	-	(230)	76,655	240
Hospital Improvement Revenue Bonds, Series 1999, bear interest at rates ranging from 6.125% to 6.150% and mature in varying amounts through 2029	56,995	-	-	56,995	-
Equipment obligation, GE Leasing, as defined in the respective lease agreement at an interest rate of 4.96% and matures through 2007	6,347	-	(1,325)	5,022	1,391
Equipment obligation, Banc One Leasing, as defined in the respective lease agreement at an interest rate of 4.958% and matures through 2004	3,449	-	(1,283)	2,166	1,348
Equipment obligation, IBM Credit Corporation, as defined in the respective lease agreement at interest rates ranging from 4.0% to 4.92% and matures through 2004	758	-	(327)	431	342
	204,724	-	(7,175)	197,549	7,516
Unamortized discount and loss	(10,343)	-	514	(9,829)	-
	194,381	-	(6,661)	187,720	7,516
Current installments	(7,175)	(7,516)	7,175	(7,516)	-
Long-term debt	$ 187,206	$ (7,516)	$ 514	$ 180,204	$ 7,516

(Dollars in Thousands)

5. Long-Term Debt (continued)

	2001				
	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 3.90% to 5.80% and mature in varying amounts through 2027	$ 64,105	$ -	$ (3,815)	$ 60,290	$ 4,010
Hospital Refunding Revenue Bonds, Series 1997A, bear interest at rates ranging from 4.1% to 5.5% and mature in varying amounts through 2019	77,105	-	(220)	76,885	230
Hospital Improvement Revenue Bonds, Series 1999, bear interest at rates ranging from 6.125% to 6.150% and mature in varying amounts through 2029	56,995	-	-	56,995	-
Equipment obligation, GE Leasing, as defined in the respective lease agreement at an interest rate of 4.96% and matures through 2007	7,607	-	(1,260)	6,347	1,325
Equipment obligation, Banc One Leasing, as defined in the respective lease agreement at an interest rate of 4.958% and matures through 2004	4,671	-	(1,222)	3,449	1,283
Equipment obligation, IBM Credit Corporation, as defined in the respective lease agreement at interest rates ranging from 4.0% to 4.92% and matures through 2004	994	-	(236)	758	327
	211,477	-	(6,753)	204,724	7,175
Unamortized discount and loss	(12,098)	-	1,755	(10,343)	-
	199,379	-	(4,998)	194,381	7,175
Current installments	(6,517)	(7,175)	6,517	(7,175)	-
Long-term obligations	$ 192,862	$ (7,175)	$ 1,519	$ 187,206	$ 7,175

5. Long-Term Debt (continued)

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. This unamortized difference ($7,848 at December 31, 2002), reported in the accompanying financial statements, as a reduction from long-term debt, is included as a reduction 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.

5. Long-Term Debt (continued)

The Series 1997, 1997A, and 1999 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, and 1999 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. Accordingly, the bond proceeds and indebtedness have been recorded as assets and liabilities of the System.

In 1999, the System entered into a 15-year interest rate swap agreement for a notional amount of $56 million of its fixed-rate general obligation bonds. Based on the swap agreement, the System makes payments calculated at a variable rate equal to the BMA Swap Index to the counterparty to the swap. In return the counterparty makes payments to the County based on the fixed rate of 5.41%. Only the net difference in payments is exchanged with the counterparty, the $56 million in bond principal is not exchanged; it is only the basis on which the interest payments are calculated. Net interest savings for 2002 and 2001 was $2,254 and $1,544, respectively and is included as a reduction to interest expense. At December 31, 2002, the fair value of the swap agreement based on current settlement price is $4,335 due from the counterparty and is included in other assets. The increase of $2,338 in the fair value of the swap is recorded as unrealized gains on investments in the statement of revenues, expenses, and changes in net assets.

(Dollars in Thousands)

5. Long-Term Debt (continued)

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, 2002 are as follows:

	Total Lease Obligation			Total Hospital Revenue Bonds		
	Principal	**Interest**	**Total**	**Principal**	**Interest**	**Total**
2003	$ 3,081	$ 307	$ 3,388	$ 4,435	$ 10,335	$ 14,770
2004	2,368	161	2,529	4,655	10,114	14,769
2005	688	92	780	4,880	9,888	14,768
2006	723	57	780	5,100	9,646	14,746
2007	759	21	780	5,360	9,386	14,746
2008-2012	-	-	-	31,200	42,371	73,571
2013-2017	-	-	-	40,430	32,921	73,351
2018-2022	-	-	-	37,335	22,185	59,520
2023-2027	-	-	-	37,975	12,413	50,388
2028-2029	-	-	-	18,560	1,729	20,289
	$ 7,619	$ 638	$ 8,257	189,930	$160,988	$350,918
Unamortized discount				(1,981)		
Unamortized difference between reacquisition price and the net carrying amount of old debt				(7,848)		
Present value of net minimum payments on hospital revenue bonds				$180,101		

The Bond Reserve Fund required under the Trust Indenture has been established with the Trustee. The balance as of December 31, 2002 and 2001 was $18,530 and $18,581, respectively. The cost value of Hospital Revenue Bonds was $187,949 at December 31, 2002. The fair value of Hospital Revenue Bonds ($200,647 at December 31, 2002) is estimated using discounted cash flow analyses based on current borrowing rates for similar types of borrowing arrangements.

(Dollars in Thousands)

6. Other Long Term Liabilities

2002	Beginning Balance	Additions	Payments	Ending Balance	Due Within One Year
Worker's compensation	**$ 4,050**	**$ 4,498**	**$ (2,597)**	**$ 5,951**	**$ 2,700**
Self-insurance	**25,421**	**16,328**	**(11,033)**	**30,716**	**12,389**
Amounts due third-party payors	**45,404**	**815**	**(631)**	**45,588**	**9,441**
Accrued vacation and sick leave	**18,366**	**3,955**	**(1,805)**	**20,516**	**1,895**
	$ 93,241	**$ 25,596**	**$ (16,066)**	**$ 102,771**	**$ 26,425**

2001	Beginning Balance	Additions	Payments	Ending Balance	Due Within One Year
Worker's compensation	$ 3,941	$ 1,758	$ (1,649)	$ 4,050	$ 2,200
Self-insurance	25,745	16,410	(16,734)	25,421	12,500
Amounts due third-party payors	33,524	12,777	(897)	45,404	11,122
Accrued vacation and sick leave	15,963	3,979	(1,576)	18,366	1,805
	$ 79,173	$ 34,924	$ (20,856)	$ 93,241	$ 27,627

Accrued Sick and Vacation

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% of eligible hours at their current rate of pay. The maximum pay out is 800 hours. As of December 31, 2002 and 2001, the liability for accrued sick and vacation was $20,516 and $18,366, respectively.

(Dollars in Thousands)

6. Other Long Term Liabilities (continued)

Self-Insurance Liabilities

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 discounted at a rate of six percent for 2001 and undiscounted for 2002.

7. Operating Leases

The System has entered into operating lease agreements for a parking facility, medical space, and office space, which expire through 2011. The contracts are generally for five years and contain rent escalation clauses and renewal options for additional periods ranging from two to five years.

Minimum rental commitments under operating leases extending beyond one year at December 31, 2002 are as follows:

2003	$ 1,484
2004	1,400
2005	11,707
2006	272
2007	265
2008–2011	599
Total	$ 15,727

Rent expense totaled $1,484 in 2002 and $1,190 in 2001.

8. Benefit Plans

Pension

Employee retirement benefits are available for substantially all employees under contributory retirement plans administered by the Public Employees Retirement System (PERS). This retirement program is a statewide, cost-sharing, multiple-employer defined benefit plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits for plan members and beneficiaries.

The Public Employees Retirement System's Comprehensive Annual Financial Report for the multi-employee defined benefit plan may be obtained by writing to Public Employees Retirement System of Ohio, 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 percent of covered payroll and the System is required to contribute 13.55 percent of covered payroll. The System's contributions to PERS for the years ending December 31, 2002, 2001 and 2000 were $34,584, $32,505 and $24,291, respectively, equal to the required contributions for each year.

Postretirement Benefits

PERS 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 a Postemployment Benefit Other Than Pension Benefit as described in GASB Statement No. 12. A portion of each employer's contribution to PERS 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 2002 and 2001 used to fund postretirement health care benefits was $12,761 and $10,463, respectively, which is included in the System's pension contribution of $34,584 and $32,505 for the years ending December 31, 2002 and 2001, respectively.

Benefits are advance-funded using the entry age normal actuarial cost method. Significant actuarial assumptions include a rate of return on investments of 8.00 percent; active employee payroll increases of 4.00 percent compounded annually and between 0.50 to 6.30 percent based on additional pay increases; and health care cost increases of 4.00 percent annually.

8. Benefit Plans (continued)

As of December 31, 2001, (the most recent information available), PERS had $11,600 million in net assets available for payment of postemployment benefits. The actuarial accrued liability for postemployment benefits and the unfunded actuarial accrued liability were $16,400 million and $4,800 million, respectively. The number of active contributing participants was 402,041.

9. Net Asset Transfer

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 for its stated purposes. During 2002, a review of these funds determined that funds related to completed clinical trials and certain donated money should be transferred to The MetroHealth Foundation. The total amount transferred in 2002 was $2,229.

10. Commitments

As of December 31, 2002, the System has contractual commitments for the construction of the critical care pavilion totaling approximately $54.5 million. These projects are being funded with bond proceeds and gifts.

11. Subsequent Event

In February 2003, the Board of Trustees adopted a resolution authorizing issuance and sale of approximately $31 million of Ohio Hospital Improvement Variable Rate Demand Revenue Bonds. The proceeds from the bonds will be used to pay commitments on the new Critical Care Pavilion and build a new business administration facility.

The MetroHealth System

Schedule of Expenditures of Federal Awards

Year ended December 31, 2002

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
Research and Development Cluster			
U.S. Department of Health and Human Services			
Direct Programs:			
Transcriptional Interference & Tumorigenicity	93.396		$ 49,145
Hispanic/White Differences	93.226		57,560
Regulation of AP-2 and HER-2/NEU Gene Promoters	93.396		296,886
Race in Opioid Analgesia	93.226		29,374
Neuronal Migration	93.853		322,792
Total Research and Development Cluster			755,757
U.S. Department of Agriculture			
Pass-Through Programs From:			
State of Ohio:			
Special Supplemental Food Program for Women, Infants and Children	10.557	18-3-001-1-CL	4,051,800
U.S. Department of Health and Human Services			
Direct Programs:			
Residency Training in Primary Care	93.884		161,083
Pass-Through Programs From:			
HIV Emergency Aid-Cluster:			
Cuyahoga County Board of Commissioners:			
Ryan White Title I—Medical/Dental Services	93.914	CE12706-01; CE13368-01	686,066
Federation for Community Planning:			
Title X/Family Planning	93.217	5FPHPA050520	305,761
Cuyahoga Health and Nutrition:			
Health Start Outreach and Enrollment	93.558	CD12390-01	113,575

The MetroHealth System

Schedule of Expenditures of Federal Awards (continued)

Federal Grantor/Pass-Through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Expenditures
U.S. Department of Health and Human Services (continued)			
Pass-Through Programs From:			
Medicaid Assistance Programs:			
Cuyahoga County Community Mental Health Board:			
Community Mental Health	93.778	129000	292,591
Alcohol & Drug Addiction Service Board:			
Miracle Village	93.778	18408-01	236,634
Chemical Dependency	93.778	18311-01	45,344
Total Medicaid Assistance			574,569
Alcohol & Drug Addiction Service Board:			
Federal SAPT Block Grant-Women's Set Aside	93.959	18-06817-00-WOMEN-T-02-9704	111,137
State of Ohio:			
TB Prevention and Control/Outreach	93.118	18-3-001-2-CK	247,425
Federal HIV Care	93.917	18-3-001-1-AT	53,835
Subtotal Pass-Through Programs			2,092,368
Total U.S. Department of Health and Human Services			2,253,451
U.S. Department of Housing and Urban Development			
Pass-Through Programs From:			
Cuyahoga Metropolitan Housing Authority:			
Drug Elimination—Substance Abuse Outreach Program/Crisis Intervention	14.193	42-703-01	99,069
Drug Elimination—Miracle Village	14.854	43-703-01	90,979
City of Cleveland, Extended Hours HIV/AIDS Education and Testing	14.218	58496	21,056
Subtotal Pass-Through Programs			211,104
U.S. Department of Education			
Pass-Through Programs From:			
State of Ohio:			
Early Intervention—Hospital Based	84.181	18-3-001-1-DD	76,685
Total Expenditures of Federal Awards			$ 7,348,797

The MetroHealth System

Notes to the Schedule of Expenditures of Federal Awards

Year ended December 31, 2002

Note A. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of The MetroHealth 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 financial statements.

Medicaid Assistance Programs

The amount received from Medicaid in 2002 represents only a portion of the total amount billed by The MetroHealth System. Therefore, the federal expenditure amount reported represents the actual receipts at the Federal Financial Participation reimbursement rate.

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

The Board of Trustees
The MetroHealth System

We have audited the financial statements of The MetroHealth System as of and for the year ended December 31, 2002, and have issued our report thereon dated February 26, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether The MetroHealth 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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered The MetroHealth 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 the Board of Trustees in a separate letter dated February 26, 2003.

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

Ernst + Young LLP

February 26, 2003

ERNST & YOUNG

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Report of Independent Auditors on Compliance with Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

The Board of Trustees
The MetroHealth System

Compliance

We have audited the compliance of The MetroHealth 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, 2002. The MetroHealth 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 MetroHealth System's management. Our responsibility is to express an opinion on The MetroHealth System's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States; 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 MetroHealth 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 MetroHealth System's compliance with those requirements.

In our opinion, The MetroHealth 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, 2002.

Internal Control Over Compliance

The management of The MetroHealth System is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered The MetroHealth 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 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.

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

Ernst + Young LLP

February 26, 2003

The MetroHealth System

Schedule of Findings and Questioned Costs

Year ended December 31, 2002

Part I—Summary of Auditor's Results

Financial Statement Section

Type of auditor's report issued:	Unqualified Opinion			
Internal Control over financial reporting:				
Material weakness(es) identified?	____	yes	✓	no
Reportable condition(s) identified not considered to be material weaknesses?	____	yes	✓	none reported
Noncompliance material to financial statement noted?	____	yes	✓	no

Federal Awards Section

Dollar threshold used to determine Type A programs:	$300,000			
Auditee qualified as low-risk auditee?	✓	yes	____	no
Type of auditor's report issued on compliance for major programs:	Unqualified Opinion			
Internal Control over major programs:				
Material weakness(es) identified?	____	yes	✓	no
Reportable condition(s) identified not considered to be material weakness(es)?	____	yes	✓	none reported
Any audit findings disclosed that are required to be reported in accordance with Circular A-133 (section .510(a))?	____	yes	✓	no

Part I—Summary of Auditor's Results (continued)

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
93.914	Ryan White Title I-Medical/Dental Services
93.217	Title X/Family Planning
93.778	Medicaid Assistance Program
93.959	Federal SAPT Block Grant-Women's Set Aside
93.118	TB Prevention and Control/Outreach

Part II—Schedule of Financial Statement Findings

This section identifies the reportable conditions, material weaknesses, and instances of noncompliance related to the financial statements that are required to be reported in accordance with Chapter 5.18 of *Government Auditing Standards*.

None.

Part III—Schedule of Federal Award Findings and Questioned Costs

This section identifies the reportable conditions, material weaknesses, and instances of noncompliance, including questioned costs, related to the audit of major federal programs, as required to be reported by Circular A-133 section __.510.

None.

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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
SEPTEMBER 16, 2003