KPMG

LAKEWOOD MEDICAL CENTER

Financial Statements

December 31, 1999 and 1998

With Independent Auditors' Report Thereon

KPMG

Suite 3500 One Shell Square
New Orleans, LA 70139-3599

Independent Auditors' Report

The Board of Commissioners
Hospital Service District No. 2 of
St. Mary Parish, Louisiana
(Lakewood Medical Center):

We have audited the accompanying balance sheets – restricted and unrestricted funds of Hospital Service District No. 2 of St. Mary Parish, Louisiana (Lakewood Medical Center) as of December 31, 1999 and 1998, and the related statements of revenues and expenses - unrestricted funds, changes in fund equity – restricted and unrestricted funds, and cash flows – restricted and unrestricted funds for the years then ended. These financial statements are the responsibility of Lakewood Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards 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 Lakewood Medical Center as of December 31, 1999 and 1998, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 14, 2000, on our consideration of Lakewood Medical Center's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

KPMG LLP

March 14, 2000, except as to
the fourth paragraph of
note 6, which is as of
June 29, 2000

LAKEWOOD MEDICAL CENTER

Balance Sheets - Restricted and Unrestricted Funds

December 31, 1999 and 1998

Assets		1999	1998
Current assets:			
Cash and cash equivalents (notes 2 and 3)	$	85,370	183,077
Assets limited as to use required for current liabilities (note 4)		522,383	520,983
Patient accounts receivable, net allowance for uncollectible accounts of $1,511,237 and $2,437,000 in 1999 and 1998, respectively		3,527,101	3,688,327
Ad valorem tax receivable		566,163	459,738
Other receivables		232,242	258,851
Inventories		490,809	604,974
Prepaid expenses and other current assets		147,663	129,831
Total current assets		5,571,731	5,845,781
Assets limited as to use (notes 3 and 4):			
For plant and equipment additions and replacement by Board of Commissioners		448,023	814,587
For plant and equipment additions and replacement by donors		100,542	-
For maintenance and purchase of capital and technology relating to maintenance taxes received		1,538,417	2,328,079
For debt service:			
Revenue bond		1,348	1,428
General obligation bonds		1,046,908	1,491,449
Total assets limited as to use		3,135,238	4,635,543
Less assets limited as to use required for current liabilities		(522,383)	(520,983)
Noncurrent assets limited as to use		2,612,855	4,114,560
Property and equipment, net (note 5)		10,741,948	10,624,585
Debt issuance costs, net of accumulated amortization of $12,718 and $8,479 in 1999 and 1998, respectively		37,493	41,720
	$	18,964,027	20,626,646

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LAKEWOOD MEDICAL CENTER

Balance Sheets - Restricted and Unrestricted Funds

December 31, 1999 and 1998

Liabilities and Fund Equity		**1999**	**1998**
Current liabilities:			
Current portion of:			
Long-term debt (note 6)	$	965,000	915,000
Capital lease obligations (note 7)		476,018	444,147
Accounts payable		2,854,741	2,501,345
Accrued salaries, wages and benefits		795,572	896,678
Due to third-party payors		81,111	683,533
Accrued interest (note 6)		466,090	64,830
Total current liabilities		5,638,532	5,505,533
Capital lease obligations, less current portion (note 7)		413,079	889,096
Long-term debt, less current portion (note 6)		6,621,000	7,586,000
Total liabilities		12,672,611	13,980,629
Fund equity:			
Contributed capital		207,169	128,456
Fund balances:			
Restricted for debt service on general obligation bonds		958,382	1,393,254
Restricted for plant replacement and other		122,158	9,000
Unrestricted		5,003,707	5,115,307
Total fund equity		6,291,416	6,646,017
Commitments and contingencies (notes 5, 6, 7, 11, 12, 13 and 14)			
Total liabilities and fund equity	$	18,964,027	20,626,646

See accompanying notes to financial statements.

LAKEWOOD MEDICAL CENTER

Statements of Revenues and Expenses - Unrestricted Funds

Years ended December 31, 1999 and 1998

		1999	1998
Net patient service revenue (note 8)	$	20,850,661	23,964,929
Other revenue		151,903	191,532
Total operating revenues		21,002,564	24,156,461
Expenses:			
Salaries, wages and benefits		11,310,378	12,443,192
Professional fees		1,737,881	1,533,732
Supplies and other		5,545,212	6,401,002
Provision for uncollectible accounts		2,547,503	3,369,015
Depreciation and amortization		1,952,227	1,952,805
Interest		490,851	642,535
Total operating expenses		23,584,052	26,342,281
Loss from operations		(2,581,488)	(2,185,820)
Nonoperating gains (losses):			
Ad valorem taxes		868,315	775,450
Disproportionate share proceeds		989,653	-
Donations		40,772	83,003
Interest income		132,268	156,929
Rental income, net		(6,120)	12,491
Nonoperating gains, net		2,024,888	1,027,873
Excess of expenses and losses over revenues and gains	$	(556,600)	(1,157,947)

See accompanying notes to financial statements.

LAKEWOOD MEDICAL CENTER

Statements of Changes in Fund Equity - Restricted and Unrestricted Funds

Years ended December 31, 1999 and 1998

	Contributed capital	Fund Balances: Restricted for debt service on general obligation bonds	Fund Balances: Restricted for plant replacement and other	Fund Balances: Unrestricted
Balance at January 1, 1998	$ -	1,812,866	15,000	5,858,254
Additions (deductions):				
Capital grants received	128,456	-	-	-
Investment earnings	-	87,888	-	-
Excess of expenses and losses over revenues and gains	-	-	-	(1,157,947)
Debt service on general obligation bonds:				
Principal payments	-	(415,000)	-	415,000
Interest paid or accrued	-	(92,500)	-	-
Donations received	-	-	77,003	-
Transfers to finance property, equipment and other	-	-	(83,003)	-
Balance at December 31, 1998	128,456	1,393,254	9,000	5,115,307
Additions (deductions):				
Capital grants received	78,713	-	-	-
Investment earnings	-	75,483	-	-
Excess of expenses and losses over revenues and gains	-	-	-	(556,600)
Debt service on general obligation bonds:				
Principal payments	-	(445,000)	-	445,000
Interest paid or accrued	-	(65,355)	-	-
Donations received	-	-	122,158	-
Transfers to finance property, equipment and other	-	-	(9,000)	-
Balance at December 31, 1999	$ 207,169	958,382	122,158	5,003,707

See accompanying notes to financial statements.

LAKEWOOD MEDICAL CENTER

Statements of Cash Flows -
Restricted and Unrestricted Funds

Years ended December 31, 1999 and 1998

	1999	1998
Cash flows from operating activities:		
Loss from operations	$ (2,581,488)	(2,185,820)
Adjustments to reconcile loss from operations to net cash provided by operating activities:		
Depreciation and amortization	1,952,227	1,952,805
Provision for uncollectible accounts	2,547,503	3,369,015
Interest expense considered capital financing activity	490,851	642,535
Nonoperating gains	983,533	-
Changes in operating assets and liabilities:		
Increase in patient accounts receivables	(2,386,277)	(2,634,373)
Decrease in other receivables	26,609	15,357
(Increase) decrease in prepaid expenses and other current assets	(17,832)	23,269
Decrease (increase) in inventories	114,165	(7,438)
Increase in accounts payable	426,561	781,044
(Decrease) increase in accrued salaries	(101,106)	282,238
Decrease in due to third-party payors	(602,422)	(92,446)
Net cash provided by operating activities	852,324	2,146,186
Cash flows from investing activities:		
Net rental receipts	-	78,993
Investment in assets limited as to use	1,802,909	(211,874)
Investment earnings	207,751	244,817
Net cash provided by investing activities	2,010,660	111,936
Cash flows from noncapital financing activities:		
Ad valorem taxes	761,890	716,272
Net proceeds from restricted donations	122,158	77,003
Net cash provided by noncapital financing activities	884,048	793,275
Cash flows from capital and related financing activities:		
Acquisitions of property and equipment	(2,138,529)	(1,012,497)
Capital grants received	78,713	128,456
Principal paid on long-term debt and capital leases	(1,359,146)	(1,498,025)
Interest paid on long-term debt and capital leases	(154,946)	(654,634)
Unrestricted donations received	31,773	-
Net cash used in capital and related financing activities	(3,542,135)	(3,036,700)
Net increase in cash and cash equivalents	204,897	14,697
Cash and cash equivalents at beginning of year	804,163	789,466
Cash and cash equivalents at end of year	$ 1,009,060	804,163

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LAKEWOOD MEDICAL CENTER

Statements of Cash Flows -
Restricted and Unrestricted Funds

Years ended December 31, 1999 and 1998

		1999	1998
Reconciliation of cash and cash equivalents to the balance sheets:			
Cash and cash equivalents in current assets	$	85,370	183,077
Cash and cash equivalents in assets limited as to use:			
For plant and equipment additions and replacement by Board		448,023	170,540
For plant and equipment additions and replacement by donors		100,542	-
For maintenance and purchase of capital and technology relating to maintenance taxes received		352,445	432,137
For debt service on revenue bond		1,348	1,428
For debt service on general obligation bonds		21,332	16,981
	$	1,009,060	804,163
Noncash capital financing and investing activities - capital lease obligation for property and equipment	$	-	455,115

See accompanying notes to financial statements.

(1) Organization and Significant Accounting Policies

Lakewood Medical Center (the Medical Center) operates as a hospital service district whose income is exempt from federal and state income taxes because the Medical Center is considered an integral part of a governmental unit. The Medical Center is owned by Hospital Service District No. 2 of St. Mary Parish, Louisiana (the District) and is organized under powers granted to Parish Police Juries by the State Legislature under Act 420 of 1950. All corporate powers are vested in a Board of Commissioners (the Board) appointed by the Parish Police Jury of St. Mary Parish, Louisiana. The significant accounting policies used by the Medical Center in preparing and presenting its financial statements are summarized as follows:

(a) Proprietary Fund Accounting

The Medical Center utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

(b) Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Medical Center has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

(c) Use of Estimates

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

(d) Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less.

(e) Assets Limited as to Use

Assets limited as to use include:

- Assets set aside by the Board for future capital improvements over which the Board retains control and may at its discretion subsequently use for other purposes,
- Assets set aside by donor restriction for future capital improvements, and
- Assets set aside under indenture agreements.

Assets limited as to use that will be used for current liabilities are reflected as current assets in the accompanying balance sheets.

(f) *Investments*

Investments in equity securities with readily determinable fair values and all investments in debt securities, including these held in assets limited as to use, are reported at fair values based on quoted market values with gains and losses included in the statements of revenues and expenses – unrestricted funds. Donated investments are recorded at fair value at the date of donation.

Investment income includes interest and dividend income, realized gains and losses, and unrealized gains and losses. Realized gains and losses are determined using the specific identification method. Investment income is recorded as nonoperating gains unless its use is restricted by donor.

(g) *Inventories*

Inventories consisting primarily of medical supplies and drugs, are stated at the latest invoice price which approximates the lower of cost (first-in, first-out), or market.

(h) *Property and Equipment*

Property and equipment are stated at cost less accumulated depreciation and amortization. Donated equipment is recorded at fair value at date of donation, which is then treated as cost. Equipment under capital lease is stated at the lower of the present value of minimum lease payments or fair value at the inception of the lease.

Depreciation and amortization on plant and equipment is calculated on the straight-line method over the estimated useful lives of the assets. Equipment held under capital leases is amortized on the straight-line method over the shorter of the lease term or estimated useful life of the asset.

(i) *Fund Balance Restricted for Debt Service on General Obligation Bonds*

Upon receipt of tax revenues which were levied through December 31, 1994, the Medical Center records the proceeds from ad valorem taxes levied on property within the District as additions to the restricted fund balance for debt service on general obligation bonds. These monies are available only for payment of the debt service on the general obligation bonds. As principal payments are made on the general obligation bonds, a transfer to unrestricted funds is recorded. Interest payments result in a transfer to other revenue in the statements of revenue and expenses - unrestricted funds to offset the interest on the general obligation bonds included in expenses.

Beginning in the year ended December 31, 1995, the proceeds from ad valorem taxes levied on December 31 of each year on property within the District for the same tax year ended December 31, are recorded as additions to assets limited as to use for plant and equipment additions and replacement by Board. These funds are only available for the maintenance and purchase of capital and technology. Current taxes are received beginning in December of each year and become delinquent after February 28 of the following year.

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(j) ***Statements of Revenues and Expenses***

Transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as revenues and expenses. Peripheral or incidental transactions are reported as nonoperating gains and losses.

(k) ***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.

Retroactively calculated contractual adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

(l) ***Charity Care and Provision for Uncollectible Accounts***

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

Uncollectible amounts from patients who do not meet the criteria under the Medical Center's charity care policy are classified as an operating expense in the provision for uncollectible accounts.

(m) ***Debt Issuance Costs***

Expenses related to issuance of bonds are deferred and amortized over the period the bonds remain outstanding.

(n) ***Income Taxes***

The Medical Center's income is exempt from federal and state income tax because it is considered an integral part of a governmental unit.

(2) Cash and Cash Equivalents

Cash and cash equivalents include cash on deposit with financial institutions, excluding amounts whose use is limited by Board designation. At December 31, 1999 and 1998, the Medical Center had cash as follows:

		1999	1998
Demand deposits	$	83,770	181,877
Petty cash		1,600	1,200
	$	85,370	183,077

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(3) Bank Deposits

Under state law, the bank balances of bank deposits and cash balances included in assets limited as to use, as discussed in note 4, must be secured by Federal deposit insurance or the pledge of securities owned by the fiscal agent. At December 31, 1999 and 1998, the market value of pledged securities plus the federal deposit insurance exceeded the amount on deposit with the fiscal agent banks. At December 31, 1999 and 1998, the Medical Center had bank deposits as follows:

		1999	1998
Secured by Federal deposit insurance	$	318,175	327,746
Collateralized by securities held by the pledging financial institution's trust department in the Medical Center's name		1,864,485	2,066,009
	$	2,182,660	2,393,755
Carrying value of bank deposits in the balance sheets	$	1,934,017	1,803,832

Reconciliation of carrying value of bank deposits to the balance sheets is as follows:

		1999	1998
Demand deposits	$	83,770	181,877
Cash and cash equivalents in assets limited as to use:			
For plant and equipment additions and replacement by Board		448,023	170,540
For plant and equipment additions by donors		100,542	-
For maintenance and purchase of capital and technology relating to maintenance taxes received		352,445	432,137
For debt service on revenue bond		1,348	1,428
For debt service on general bonds		21,332	16,981
Certificates of deposit in assets limited as to use:			
For debt service on general obligation bonds		926,557	1,000,869
	$	1,934,017	1,803,832

(Continued)

(4) Assets Limited as to Use

Governmental accounting standards require that the carrying amounts of investments as of the balance sheet date be categorized according to the level of credit risk associated with the Medical Center's investments at the time. The level of credit risk is defined as follows:

Category 1 - Insured (including government securities) or registered, or collateralized with securities held by the Medical Center or its agent in the Medical Center's name.

Category 2 - Uninsured and unregistered, collateralized with securities held by the counterparty's trust department or agent in the Medical Center's name.

Category 3 - Uninsured and unregistered, or uncollateralized, including balances collateralized with securities held by the pledging financial institution, but not in the Medical Center's name.

The detail of assets limited as to use at December 31, 1999 and 1998 are as follows:

		1999	1998
For plant and equipment additions and replacement by Board:			
Cash and cash equivalents	$	448,023	170,540
U.S. Treasury securities		-	643,007
Accrued interest receivable		-	1,040
		448,023	814,587
For plant and equipment additions and replacement by donors - cash and cash equivalents		100,542	-
For maintenance and purchase of capital and technology relating to maintenance taxes received:			
Cash and cash equivalents		352,445	432,137
U.S. Treasury securities		1,185,972	1,871,184
Accrued interest receivable		-	24,758
		1,538,417	2,328,079
For debt service on Series 1978 revenue bond - cash and cash equivalents		1,348	1,428

		1999	1998
For debt service on Series 1976 general obligation bonds:			
Cash and cash equivalents	$	21,332	16,981
Certificates of deposit		926,557	1,000,869
U.S. Treasury securities		99,019	98,920
Accrued interest receivable		-	374,679
		1,046,908	1,491,449
Total assets limited as to use		3,135,238	4,635,543
Less amounts classified as current		(522,383)	(520,983)
Noncurrent assets limited as to use	$	2,612,855	4,114,560

At December 31, 1999 and 1998, all assets limited as to use are Category 1 type investments.

In connection with the Series 1978 revenue bond, the Medical Center established a sinking fund and reserve fund. The reserve fund is used for the purpose of making payments of principal and interest on the bond if funds available for payment of principal and interest in the sinking fund are insufficient. At December 31, 1999 and 1998, there were no funds on deposit in the reserve fund. The amounts on deposit in the sinking fund were $1,348 and $1,428 at December 31, 1999 and 1998, respectively. The Medical Center has not funded the sinking fund since September 1993 (see note 6).

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(5) Property and Equipment

Property and equipment, by major category, at December 31, 1999 and 1998 are as follows:

	1999	1998
Land and improvements	$ 118,210	118,210
Building and improvements	23,102,581	22,677,458
Fixed equipment	3,907,076	3,833,137
Major moveable equipment	10,224,354	9,899,643
Construction in progress	1,898,012	583,257
	39,250,233	37,111,705
Less accumulated depreciation and amortization	(29,724,161)	(28,011,203)
	9,526,072	9,100,502
Equipment under capital lease obligations	2,157,445	2,157,445
Less accumulated amortization	(941,569)	(633,362)
	1,215,876	1,524,083
Property and equipment, net	$ 10,741,948	10,624,585

At December 31, 1999, the Medical Center was obligated under purchase commitments of approximately $296,000 related to the completion of various plant and equipment improvement projects.

(6) Long-term Debt

Long-term debt at December 31, 1999 and 1998 is as follows:

		1999	1998
Revenue bond, Series 1978, 6%, due serially to 2011, with remaining annual installments ranging from $490,000 to $716,000	$	6,606,000	7,076,000
General obligation bonds, Series 1976, interest ranging from 6% to 6.2%, in varying installments through 2001 with remaining annual installments ranging from $475,000 to $505,000		980,000	1,425,000
		7,586,000	8,501,000
Less current installments of long-term debt		(965,000)	(915,000)
	$	6,621,000	7,586,000

Revenue Bond, Series 1978 - In 1978, the Medical Center issued to the National Oceanic and Atmospheric Administration (NOAA), Office of Coastal Zone Management, its revenue bond in the amount of $10,636,000, secured by a pledge of the Medical Center's future revenue. The bond can be paid prior to maturity without penalty. In connection with the issuance of the 1978 revenue bond, the Medical Center is required to maintain funds in a revenue bond sinking fund, reserve fund, and depreciation fund. The reserve fund and the sinking and depreciation funds are to be funded up to certain amounts with excess revenue as defined in the Bond Resolution. During 1994, the reserve fund was exhausted to pay the debt service payments on the revenue bond (see note 4).

At December 31, 1999 and 1998, the Medical Center is not in compliance with the Bond Resolution in that it does not have the required funds on deposit in the sinking fund, reserve fund and the depreciation fund. However, the revenue bond payment schedule cannot be changed as a result of the lack of required funds on deposit. The bondholder, after giving proper notice, has the right to appoint a receiver for the Medical Center; however, the bondholder has indicated that it currently has no intention to exercise this right.

Also, at December 31, 1999, the Medical Center is in default of the Bond Resolution covenants in that it had not made scheduled interest payments of $410,460. This amount is included in current liabilities at December 31, 1999. The Medical Center has received a commitment from NOAA to restructure the Revenue Bond repayment terms by reducing the required payments and extending the term of the debt. The terms of the Revenue Bond restructuring were finalized on June 29, 2000. This restructuring will cure the default of the Revenue Bond covenants in that unpaid interest will be included in the restructured amount of the debt.

General Obligation Bonds, Series 1976 - During 1976, the District issued $6,250,000 of general obligation bonds to acquire hospital buildings, machinery and equipment. The bonds are payable from

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the proceeds of a special ad valorem tax levied by the St. Mary Parish Police Jury over the period the bonds are outstanding. The tax receipts and related interest earned on invested unexpended tax receipts are restricted for the payment of principal and interest on the general obligation bonds (see note 4). The bonds are callable at the option of the District in inverse order of maturities on any interest payment date at the principal amount, plus a premium of up to 1.5%.

The Medical Center paid interest relating to long-term debt of $74,555 and $528,000 during the years ended December 31, 1999 and 1998, respectively.

Aggregate maturities of the Medical Center's long-term debt at December 31, 1999 are as follows:

Year ended December 31:	
2000	$ 965,000
2001	1,015,000
2002	530,000
2003	550,000
2004	570,000
Thereafter	3,956,000
	$ 7,586,000

(7) Leases

The Medical Center has entered into equipment lease agreements that have been classified as capital leases. Under the terms of the leasing agreements, the Medical Center is obligated to pay a monthly rental payment over the primary term of the lease, which generally is for five years. The leased equipment collateralizes the capital lease obligations. Future minimum lease payments at December 31, 1999 under capital lease obligations are as follows:

Year ending December 31:	
2000	$ 523,358
2001	345,147
2002	83,414
2003	7,055
	958,974
Less imputed interest	(69,877)
Present value of future lease obligations	889,097
Less amounts due within one year	(476,018)
Long-term portion of capital lease obligations	$ 413,079

The Medical Center is obligated under non-cancelable operating leases for equipment. Future lease payments for one of the leases is based upon patient usage. Amounts paid under this lease totaled

$36,829 and $77,539 during 1999 and 1998, respectively. Other future minimum lease payments for operating leases having initial or remaining noncancelable lease terms in excess of one year as of December 31, 1999 are as follows:

Year ended December 31:		
2000	$	41,700
2001		41,700
2002		41,700
2003		38,225

Total rental expense incurred for all operating leases was $108,900 and $82,674 for the years ended December 31, 1999 and 1998, respectively.

The Medical Center leases office space to members of its medical staff under operating leases whose terms are generally for 5 years. Assets held for lease at December 31, 1999 consist of buildings and improvements with an original cost of $1,092,895. Accumulated depreciation of the leased assets totaled $648,529 at December 31, 1999. The future minimum lease rentals at December 31, 1999 to be received from these leases are as follows:

Year ended December 31:		
2000	$	104,742
2001		66,157
2002		62,980
2003		52,313
2004		30,980

(8) Net Patient Service Revenue

The Medical Center has agreements with governmental and other third-party payors that provide for reimbursement to the Medical Center at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Medical Center's billings at established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with major third-party payors follows:

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

  Certain types of exempt inpatient and outpatient services related to Medicare beneficiaries are paid based upon a cost reimbursement methodology. The Medical Center is paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Medical Center and audits by the Medicare fiscal intermediary.

- Medicaid - Inpatient services rendered to Medicaid program beneficiaries are generally paid at an all-inclusive per diem rate. Outpatient services rendered to Medicaid program beneficiaries are reimbursed based upon a cost reimbursement methodology. The Medical Center is paid at a tentative rate with final settlement determined after submission of annual cost reports by the Medical Center and audits by the Medicaid fiscal intermediary.

A summary of net patient service revenue for the years ended December 31, 1999 and 1998 is as follows:

		1999	1998
Gross patient service revenue	$	36,460,496	40,211,055
Less provision for contractual adjustments		15,609,835	16,246,126
	$	20,850,661	23,964,929

(9) Charity Care

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. The Medical Center provided charity care of $22,135 and $229,386 in 1999 and 1998, respectively, based upon foregone charges using established rates.

(10) Accrued Employee Leave Benefits

At December 31, 1999 and 1998, employees of the Medical Center have accumulated and vested $325,158 and $453,705, respectively, of employee leave benefits. This is recorded as an obligation of the Medical Center.

(11) Pension Plan

Effective January 1, 1996, the Medical Center adopted a defined contribution plan. Employees who have completed one year of service and are age 21 or older, are eligible to participate in the Plan. Plan participants are fully vested after 5 years of service or upon participant death or disability.

The amount contributed to the plan by the Medical Center is determined by the management of the Medical Center. Compensation is defined as base pay up to a maximum of 80 hours for each pay period including regular hours worked, vacation and holidays. Total salaries were $9,277,089 and $10,248,237 for the years ended December 31, 1999 and 1998, respectively. Total covered compensation for eligible plan participants was $6,426,967 and $6,152,233 for the years ended December 31, 1999 and 1998, respectively. Plan contributions by the Medical Center for the same periods were $192,809 and $184,567, respectively. Plan participants are allowed to direct the investment of their plan assets to those investment options designated by the plan administrator. The plan does not permit loans to participants, or investment in insurance policies, qualifying employer securities or employer real property.

(12) Business and Credit Concentration

The Medical Center grants credit to patients, substantially all of whom are local residents. The Medical Center generally does not require collateral or other security extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under health insurance programs, plans or policies (e.g., Medicare, Medicaid, Blue Cross and commercial insurance policies).

(Continued)

At December 31, 1999, the Medical Center had a net receivable from the Federal government (Medicare and Medicaid) of approximately $1,071,000 and $146,000, respectively. Amounts included in due to third-party payors represent estimated settlements to be paid to Medicare and Medicaid for all cost reports for which final settlements have not been made. Final settlement has been made by the intermediary for all years through December 31, 1997 and 1996 for Medicare and Medicaid, respectively.

(13) Contingencies

Medical Malpractice
The Medical Center participates in the Louisiana Hospital Association Trust Fund (the Trust Fund) and the Louisiana Patients' Compensation Fund for medical malpractice claims. As a participant, the Medical Center has a statutory limitation of liability which provides that no award can be rendered against it in excess of $500,000, plus interest and costs. The Trust Fund provides malpractice coverage for claims up to $100,000 and the Compensation Fund provides additional coverage on a claims-made basis for claims over $100,000 and up to $500,000.

Health Benefits
The Medical Center provides health insurance benefits to its employees under a self-insured plan. The plan requires that the Medical Center pay the first $50,000 of covered benefits per employee. The Medical Center has recorded its estimate of the ultimate liability for known and incurred but not reported claims in the accompanying financial statements.

(14) Operations of the Medical Center

The Medical Center had an excess of expenses and losses over revenues and gains of $556,600 and $1,157,947 for the years ended December 31, 1999 and 1998, respectively, and continues to experience losses during 2000. At December 31, 1999, current liabilities exceeded current assets by $66,801. At December 31, 1999, the Medical Center was in arrears on scheduled interest payments of $410,460 on its Series 1978 Revenue Bond. The Medical Center has a commitment from the bondholder to restructure the terms of the Revenue Bond debt (see note 6).

Management projects a loss for 2000, but believes the Medical Center will be able to meet the expected restructured debt service requirements. Management is executing plans to increase net patient service revenues and reduce operating expenses in 2000 in an effort to increase cash flows and improve operating results.

KPMG

Suite 3500 One Shell Square
New Orleans, LA 70139-3599

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

The Board of Commissioners
Hospital Service District No. 2 of
St. Mary Parish, Louisiana
(Lakewood Medical Center):

We have audited the financial statements of Hospital Service District No. 2 of St. Mary Parish, Louisiana (Lakewood Medical Center) as of and for the year ended December 31, 1999, and have issued our report thereon dated March 14, 2000. We conducted our audit in accordance with generally accepted auditing standards 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 Lakewood Medical Center'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 the 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 Lakewood Medical Center'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, which we have reported to the management of Lakewood Medical Center in a separate letter dated March 14, 2000.

This report is intended solely for the information and use of the Board of Commissioners, management, and the State of Louisiana Legislative Auditor, and is not intended to be, and should not be used by anyone other than these specified parties.

KPMG LLP

March 14, 2000

KPMG

Suite 3500 One Shell Square
New Orleans, LA 70139-3599

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The Board of Commissioners
Hospital Service District No. 2 of
St. Mary Parish, Louisiana
(Lakewood Medical Center)

Members of the Board:

We have audited the financial statements of Hospital Service District No. 2 of St. Mary Parish, Louisiana (Lakewood Medical Center) for the year ended December 31, 1999, and have issued our report thereon dated March 14, 2000. In planning and performing our audit of the financial statements of Lakewood Medical Center, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. The maintenance of adequate control designed to fulfill control objectives is the responsibility of management. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, controls found to be functioning at a point in time may later be found deficient because of the performance of those responsible for applying them, and there can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the organization. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants.

Furthermore, our audit was not designed to, and does not, provide any assurance that a Year 2000 issue which may exist will be identified, on the adequacy of Lakewood Medical Center's remediation plans related to Year 2000 financial or operational issues, or on whether Lakewood Medical Center is or will become Year 2000-compliant on a timely basis. Year 2000 compliance is the responsibility of management.

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. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

Operating Challenges

During the years ended December 31, 1999 and 1998, Lakewood Medical Center had an excess of expenses and losses over revenues and gains of $557,000 and $1,158,000, respectively. (In 1997, there was an excess of revenues over expenses of $1,220,000). At December 31, 1999, current liabilities exceeded current assets by $67,000 and fund equity was $6,291,000, including $5,004,000 of unrestricted fund balance.

Cash and cash equivalents at December 31, 1999 were $3,221,000; however, $1,047,000 is held for repayment of the general obligation bonds ($980,000 principal outstanding), $101,000 is restricted by donors for plant replacement, and $1,538,000 represents cumulative unspent maintenance taxes received for capital and technology items. This leaves approximately $535,000 available to meet current liabilities. Approximately $450,000 is included in long-term assets limited as to use. Since this has been designated by the Board for equipment additions and replacements, it could be "undesignated" and moved to current assets.

At December 31, 1999, cumulative unspent maintenance taxes received were $1,538,000. Management is currently evaluating whether future costs for items such as maintenance and repair expense and equipment capital and operating lease payments can be made with maintenance taxes. Management should also evaluate whether such costs incurred during the past three years could be covered with maintenance taxes. Any transfers from unspent maintenance taxes could provide funds to meet operating needs.

During 1999, scheduled interest payments of $410,460 were not paid when due and this amount is reported in current liabilities at December 31, 1999. The Revenue Bond holder has committed to restructure the terms of the Revenue Bond debt. The interest rate will be reduced by 1%, payments will be reduced and the final maturity date of the debt will be extended. Management should finalize this debt modification as soon as possible.

Net patient service revenue decreased 13% to $20,851,000 during the year ended December 31, 1999. While some of this decline related to reduced reimbursements from the Medicare and Medicaid programs, there was a decrease in inpatient admissions and outpatient visits. Management is working to increase utilization of the facilities. Through March 2000, three primary care physicians have agreed to relocate to Morgan City. Efforts to promote Lakewood Medical Center have been increased and remodeling of the facility has occurred, including the recently completed expansion and remodeling of the emergency room. Management should continue its physician recruitment efforts.

Results in 1999 included a Medicaid Disproportionate Share payment of $990,000. (There was no such revenue in 1998). Currently, it is not expected that such a payment will be made in 2000 to hospitals that provide a disproportionately high level of charity and uncompensated care. Management should pursue any possible strategies in this area with the Louisiana Hospital Association.

Management implemented efforts to control expenses in the last quarter of 1999. The impact of these changes on the bottom line has been significant, however, monthly losses continue to occur in 2000. Management should continue to evaluate costs and opportunities to streamline operations.

Collection of patient accounts receivable was very strong in 1999 due to effective implementation of the Cash Retriever program and other management efforts, including collection of deposits before inpatient stays and collection at time of service for outpatient services. At December 31, 1999, patient accounts receivable greater than 180 days were reduced 42% to $869,000 and self-pay accounts receivable were reduced 38% to $1,920,000 compared to amounts at December 31, 1998. Continued emphasis in this area might further increase cash flow and reduce bad debt write offs.

Lakewood Medical Center has significant operating challenges for 2000. Effective execution by management of the initiatives already identified and noted above can have a significant impact on operating results.

* * * * * *

This report is intended solely for the information and use of the Board of Commissioners, management and others within Lakewood Medical Center, and is not intended to be, and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP

LAKEWOOD
• MEDICAL • CENTER •
P.O. DRAWER 2308 • MORGAN CITY, LA 70381 • (504) 384-2200

August 24, 2000

Ms. Cheryl A. Payne, Manager
KPMG LLP
451 Florida Blvd., Suite 1700
Baton Rouge, LA 70801

Dear Ms. Payne:

As per our telephone conversation, the following are our answers to the Operating Challenges brought up in your Management Letter of March 14, 2000.

The Board of Commissioners of Hospital Service District No. 2 of St. Mary Parish, d/b/a/ Lakewood Medical Center, voted to remove Quorum as the management firm for Lakewood and contracted with Our Lady of the Lake Hospital, Inc., to provide management services beginning May 1, 2000. The Board approved Mr. Clifford M. Broussard to act as Chief Executive Officer and Mr. Richard M. W. Sorensen to act as Chief Financial Officer. Their responsibilities became effective May 1, 2000.

The Operating Challenges that must be addressed to enable the revenues to cover and exceed the expenses are twofold. Control expenses and increase revenue. Such factors as the reduction of Medicare outpatient reimbursements due to the new APC/OPPS system just serve to complicate the solutions and add to the challenges. Steps taken in the last quarter of 1999 to control costs had a significant effect on the expenses, but in some instances also had an adverse affect on the ability to generate revenue. These effected areas are being restructured to again be able to attract patients and begin generating additional revenues. The recruiting of physicians is a major area that must be accomplished to create the needed revenue for the long run. However, this must be accomplished at a manageable cost due to very limited funds with which to work. By the middle of September, an additional general surgeon should begin his practice. By late November, two additional Internists should begin their practices. These three physicians should have a significant impact on revenue. Other physicians are being recruited for the future. This requires an investment by the hospital that is hard to come by given the current cash flow situation, however, must be accomplished.

The Maintenance Tax Fund was evaluated and found to be able to pay for some of the medical equipment purchased in the past and for maintenance of the building and equipment. By recouping some monies paid in the past for maintenance and shifting some current equipment payments to this Fund, some funds were moved to meet current operational needs. Some of the balance of the Fund has been dedicated to the replacement of a 450-ton chiller and other building and equipment repairs that must be done to meet codes and remain in operation. A complete evaluation of building repair needs is being accomplished to plan a long-term solution to bring the building and equipment back to the proper condition. This plan should be completed soon.

The restructuring of the Revenue Bond is moving forward. The restructure is scheduled to be completed by December 1, 2000. The missed interest payment of $410,460 is included in the restructure as is the payment of principle and interest due in June of 2000. The interest rate has been reduced from 6% to 5%. The payment due for December 5, 2000 will be $75,000 and the 2001 payment will be $100,000. Then the payment will be $400,000 per year through 2018. All payments will apply to principle and interest charged each year will be added to the end of the loan. There will be no interest charged on the interest. Beginning in 2019, the payments will be $450,000 per year until paid off in 2026. The reduction in payments for 2000 and 2001 will assist with the cash flow now. Also, there will be a transition period for the funding of the reserves to assist the Medical Center with the cash needed for physicians and building/equipment repairs.

A continuing emphasis is being placed on the collection of patient accounts both through the Cash Retriever program and the filing of insurance. When cost reduction efforts were implemented in the last quarter of 1999, some personnel left in this area and were not replaced. Also, the hours were cut for those remaining. The full hours of work time have been restored and assistance with collections is being obtained through cross training and replacement of some personnel. The complete charge and coding system for patient accounts is being reviewed and updated as necessary to produce the best reimbursement given the documented medical situation being billed.

Lakewood Medical Center is addressing its operating challenges for 2000 and beyond, through the administration of the facility from the Board down and through its Medical Staff.

If you need additional information or have questions, please contact me.

Sincerely,

Richard M. W. Sorensen
Chief Financial Officer

gmp