Hospital Service District No. 1 of Tangipahoa Parish, Louisiana

June 30, 1997

Materials Presented to Board of Commissioners on November 5, 1997

North Oaks Health System

Results

1997

Results

Report to

the

Board of Commissioners

Audit Results

Results

Results

ERNST & YOUNG LLP

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November 5, 1997

Management of
North Oaks Health System

Ernst & Young LLP congratulates the Hospital on another year of favorable operating results. I would like to thank the Hospital's management and accounting department for their efforts in helping us to timely meet your reporting deadlines. As a result of our audit, I am pleased to present this 1997 Audit Results Binder for North Oaks Health System.

The 1997 Audit Results Binder includes, among other items, audited financial statements, compliance reports, selected operating statistics and graphs, and *The Board Report*, an Ernst & Young LLP publication on current trends and developments in the health care industry.

I hope you find the 1997 Audit Results Binder an effective tool for reviewing operations for 1997 and useful as a stepping stone into 1998. If you would like additional information or have questions, please contact me. I wish you continued success in 1998 and look forward to continuing to serve you.

Very truly yours,

L. Greg Swan

L. Greg Swan
Partner

North Oaks Health System

June 30, 1997
Audit Results Binder

I. Audited Consolidated Financial Statements

II. Other Reports

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Tab I

Financial Statements

Hospital Service District No. 1
of Tangipahoa Parish, Louisiana

Years ended June 30, 1997 and 1996
with Report of Independent Auditors

Hospital Service District No. 1 of Tangipahoa Parish, Louisiana

Financial Statements

Years ended June 30, 1997 and 1996

Contents

ERNST & YOUNG LLP

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Report of Independent Auditors

The Board of Commissioners
Hospital Service District No. 1 of
Tangipahoa Parish, Louisiana

We have audited the accompanying balance sheets of Hospital Service District No. 1 of Tangipahoa Parish, Louisiana (the Hospital or the District) as of June 30, 1997 and 1996, and the related statements of revenue, expenses and fund balance and cash flows for the years then ended. These financial statements are the responsibility of the Hospital'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. 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 Hospital at June 30, 1997 and 1996, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Ernst & Young LLP

September 17, 1997

Hospital Service District No. 1 of Tangipahoa Parish, Louisiana

Balance Sheets

	June 30 1997	1996
Assets		
Current assets:		
Cash	**$ 3,713,780**	$ 2,257,524
Patient accounts receivable, net of estimated uncollectibles of $3,978,000 in 1997 and $4,286,000 in 1996	**18,493,650**	19,006,544
Assets whose use is limited required for current liabilities—self-insurance claims and debt service	**2,794,914**	2,960,485
Inventories	**230,217**	226,146
Prepaid expenses and other current assets	**1,256,532**	1,286,442
Total current assets	**26,489,093**	25,737,141
Assets whose use is limited:		
Under bond indenture agreement—held by trustee: Revenue Bonds, Series 1994 and 1990	**25,217,348**	40,248,729
By board for plant and equipment additions and replacements	**28,788,989**	23,990,130
By board for self-insurance claims	**663,830**	657,175
	54,670,167	64,896,034
Less assets whose use is limited required for current liabilities	**2,794,914**	2,960,485
Noncurrent assets whose use is limited	**51,875,253**	61,935,549
Notes receivable	**561,837**	578,696
Unamortized debt issuance costs	**2,040,755**	2,157,957
Other assets	**267,688**	352,922
Property, plant and equipment:		
Land	**4,009,784**	3,829,784
Buildings and equipment	**74,399,222**	66,531,521
Construction in progress	**27,934,363**	7,640,887
	106,343,369	78,002,192
Less accumulated depreciation	**40,282,740**	35,782,456
	66,060,629	42,219,736
	$147,295,255	$132,982,001

	June 30	
	1997	1996
Liabilities		
Current liabilities:		
Accounts payable	**$ 6,554,097**	$ 4,639,768
Accrued salaries and payroll-related costs	**2,873,756**	2,475,534
Accrued interest payable	**1,553,146**	1,568,480
Accrued self-insurance claims	**1,836,323**	1,195,055
Estimated third-party payor settlements — Medicare and Medicaid	**6,245,023**	4,882,616
Current portion of capital lease obligations	**251,115**	240,824
Current portion of long-term debt	**1,015,000**	585,000
Total current liabilities	**20,328,460**	15,587,277
Capital lease obligations, excluding current portion	**429,185**	680,299
Long-term debt, net of unamortized bond discount of $879,086 in 1997 and $929,571 in 1996, excluding current portion	**59,905,914**	60,870,429
Fund balance	**66,631,696**	55,843,996
	$147,295,255	$132,982,001

See accompanying notes.

Hospital Service District No. 1 of Tangipahoa Parish, Louisiana

Statements of Revenue, Expenses and Fund Balance

	Year ended June 30	
	1997	1996
Net patient service revenue	**$ 95,953,997**	$ 88,756,907
Other revenue	**3,119,636**	3,373,595
Total revenue	**99,073,633**	92,130,502
Expenses:		
Routine services	**15,559,034**	14,374,868
Ancillary services	**37,471,918**	35,240,637
Household and property	**3,836,021**	3,710,696
Dietary and cafeteria	**2,142,049**	1,969,919
Administration and general	**21,513,962**	18,460,769
Provision for bad debts	**1,918,797**	2,060,922
Depreciation	**4,731,274**	4,422,739
Interest	**1,112,878**	1,392,663
Total expenses	**88,285,933**	81,633,213
Revenue in excess of expenses	**10,787,700**	10,497,289
Fund balance at beginning of year	**55,843,996**	45,327,836
Contributions for equipment additions	**–**	18,871
Fund balance at end of year	**$ 66,631,696**	$ 55,843,996

See accompanying notes.

Hospital Service District No. 1 of Tangipahoa Parish, Louisiana

Statements of Cash Flows

	Year ended June 30 1997	1996
Operating activities		
Revenue in excess of expenses	**$ 10,787,700**	$ 10,497,289
Adjustments to reconcile revenue in excess of expenses to net cash provided by operating activities:		
Depreciation	**4,731,274**	4,422,739
Net loss (gain) on disposals of assets	**15,179**	(1,100)
Interest income	**(1,660,097)**	(1,804,233)
Interest expense	**1,112,878**	1,392,663
Changes in operating assets and liabilities:		
Patient accounts receivable	**512,894**	(3,392,358)
Inventories, prepaid expenses and other current assets	**25,839**	(367,872)
Estimated third-party payors settlements—Medicare and Medicaid	**1,362,407**	(1,256,698)
Accounts payable, accrued salaries and payroll-related costs, and other accrued expenses	**2,953,819**	1,790,166
Net cash provided by operating activities	**19,841,893**	11,280,596
Capital and related financing activities		
Purchases of property, plant and equipment	**(27,654,483)**	(11,386,062)
Proceeds from disposals of assets	**16,815**	1,100
Principal payments on long-term debt	**(585,000)**	(555,000)
Principal payments on capital lease obligations	**(240,822)**	(349,982)
Interest payments on bonds and capital leases	**(3,807,988)**	(3,493,273)
Change in other assets, net	**85,234**	18,871
Net cash used in capital and related financing activities	**(32,186,244)**	(15,764,346)
Investing activities		
Interest earned	**3,557,881**	4,042,695
(Increase) decrease in assets whose use is limited:		
Under bond indenture agreement	**15,031,381**	3,325,179
By board for plant and equipment	**(4,798,859)**	(3,733,274)
By board for self-insurance claims	**(6,655)**	(45,066)
Other	**16,859**	43,426
Net cash provided by investing activities	**13,800,607**	3,632,960
Net increase (decrease) in cash	**1,456,256**	(850,790)
Cash at beginning of year	**2,257,524**	3,108,314
Cash at end of year	**$ 3,713,780**	$ 2,257,524

See accompanying notes.

1. Organization and Significant Accounting Policies

Organization

Hospital Service District No. 1 of Tangipahoa Parish, Louisiana (the Hospital or the District) is a nonprofit public corporation organized under powers granted to parish police juries by Chapter 10, Title 45 of the Louisiana Revised Statutes of 1950. All corporate powers are vested in the board of commissioners appointed by the Tangipahoa Parish Police Jury. The District owns and operates North Oaks Medical Center, a 268-bed acute care hospital, and North Oaks Rehabilitation Hospital, a 35-bed hospital which provides rehabilitation and skilled nursing services. The Hospitals are located on two campuses in the city of Hammond, Louisiana. As a political subdivision, the Hospital is exempt from federal income taxes under Section 115 of the Internal Revenue Code. This exemption also applies to state income taxes.

Basis of Accounting

The Hospital uses the accrual basis of accounting for proprietary funds. Under 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 Hospital has elected not to apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989.

Inventories

Inventories are valued at the latest invoice price which approximates lower of cost (first-in, first-out method) or market.

Property, Plant and Equipment

The Hospital records all property, plant and equipment acquisitions at cost except for assets donated to the Hospital. Donated assets are recorded at appraised value at the date of donation. The Hospital provides for depreciation of its plant and equipment using the straight-line method based on the estimated useful lives of the assets as suggested by the American Hospital Association. Equipment recorded under capital lease obligations is included in buildings and equipment and the associated amortization of these assets is included in depreciation expense.

1. Organization and Significant Accounting Policies (continued)

Debt Issuance Expense

The Hospital recorded as an asset the costs incurred in connection with the issuance of the 1994 Revenue Bonds. These costs are being amortized using the interest method over the life of the bond issue. The amortization is included in interest expense in the statement of revenue, expenses and fund balance.

Self-Insurance Claims

Accrued self-insurance claims represent the Hospital's accrual for self-insured professional liability and workers' compensation claims and employee health.

Net Patient Service Revenue and Related Receivables

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. The Hospital provides care to patients even though they are covered by contractual payment arrangements that do not pay full charges or may lack adequate insurance. As a result, the Hospital is exposed to certain credit risks. The Hospital manages such risks by regularly reviewing its accounts and contracts and by providing appropriate allowances.

Medicare and Medicaid Reimbursement

The Hospital is paid under the Medicare Prospective Payment System (PPS) which pays the Hospital a predetermined amount for Medicare inpatient services rendered based, for the most part, on the Diagnosis Related Group (DRG) assigned to the patient. Medicaid inpatient services are paid on a prospective per diem system.

Medicare outpatient services, psychiatric care, home health services, bad debts, skilled nursing services, rehabilitation services, and Medicaid outpatient services are reimbursed a tentative amount during the year which is subject to a retroactive payment adjustment determined in accordance with appropriate Medicare or Medicaid program regulations. Retroactive cost settlements are accrued on an estimated basis in the period the related services are rendered and adjusted as necessary in future periods as final settlements are determined.

1. Organization and Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

Changes in Presentation of Comparative Statements

Certain amounts in the 1996 financial statements have been reclassified to conform to the 1997 presentation.

2. Cash and Investments

Statutes authorize the Hospital to invest in United States Government obligations and agencies, certificates of deposit of national banks located in Louisiana or banks organized under the laws of Louisiana, any federally insured investment, guaranteed investment contracts issued by a financial institution having one of the two highest rating categories of Standard & Poor's Corporation or Moody's Investors Services, or in mutual or trust institutions which are registered with the Securities Exchange Commission under the Securities Act of 1933 and the Investment Act of 1940 and which have underlying investments consisting solely of securities of the United States Government or its agencies.

The Hospital's bank balances of deposits at June 30, 1997 and 1996, which are included in cash and assets whose use is limited on the balance sheet, were entirely insured or collateralized with securities held by an agent for the pledging bank in the Hospital's name.

At June 30, 1997 and 1996, the Hospital had invested $35,705,311 and $51,404,862, respectively, in U. S. Government obligations and money market accounts whose underlying investments consist solely of securities of the U. S. Government or its agencies, which are held by a trustee or an agent of the Hospital in the Hospital's name. The cost of such investments approximates market at June 30, 1997 and 1996. These funds are recorded in assets whose use is limited on the balance sheet.

3. Health Insurance Program Reimbursement

The Hospital participates in the Medicare and Medicaid programs as a provider of medical services to program beneficiaries. During the years ended June 30, 1997 and 1996, approximately 67% and 69%, respectively, of the Hospital's patient service charges were furnished to Medicare and Medicaid program beneficiaries.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Hospital believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, 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 program.

Medicare and Medicaid settlements have been determined following the principles of reimbursement applicable to each program and have been recorded in the accounts of the Hospital. Estimated settlements for the years through June 30, 1994 have been audited or reviewed by program representatives and adjustments of $677,000 and $382,000 for fiscal years 1997 and 1996, respectively, have been recorded to increase net patient service revenue in each of the years to reflect the effect of changes made by program representatives. No significant differences are anticipated between the settlements recorded and the final settlements to be determined by program representatives.

4. Charity Care

The Hospital 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 Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue.

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The following information measures the level of charity care provided during the years ended June 30, 1997 and 1996.

	1997	1996
Charges foregone, based on established rates	**$ 5,905,626**	$ 4,395,212

5. Assets Whose Use Is Limited

The terms of the Hospital's 1994 and 1990 Revenue Bonds require funds to be maintained on deposit in certain accounts with the trustee. The funds on deposit in the accounts are required to be invested by the trustee in accordance with the terms of the Bond Resolution. As of June 30, 1997 and 1996, the funds were deposited as follows:

	1997	1996
Bond debt service accounts	$ 431,378	$ 269,974
Sinking fund accounts	1,705,413	853,397
Construction account	18,144,250	32,274,185
Capitalized interest	–	1,865,238
Reserve accounts	4,936,307	4,985,935
	$ 25,217,348	$ 40,248,729

The Hospital board of commissioners has designated Hospital funds to be used for future plant and equipment additions, separate and apart from the expansion program, and to fund self-insurance claims.

The funds, included in assets whose use is limited, were invested in certificates of deposit, U. S. Government obligations and money market funds which are carried at cost which approximates the market value at June 30, 1997 and 1996.

6. Note Receivable

The Hospital entered into an agreement with the Cancer, Radiation and Research Foundation (the Foundation) for the purpose of constructing a facility that provides radiation oncology treatments on an outpatient basis. Under the terms of the agreement, the Hospital loaned $680,331 to the Foundation to construct the facility on the Hospital's campus. The note receivable from the Foundation is payable over 30 years and bears an annual interest rate of 5.5%. The Hospital holds a mortgage on the facility (excluding equipment, furniture and fixtures) to collateralize the note receivable. In addition, the Hospital agreed to lease the land upon which the facility is located to the Foundation for a nominal annual rental fee. The initial lease term is for 30 years with 3 successive 10-year renewal options.

7. Employee Retirement Plan

The Hospital has a defined contribution plan which covers all full-time employees who elect to participate after they have met certain eligibility requirements. Under the plan, the Hospital is required to contribute 2% of the salaries of eligible employees while participants may contribute up to the maximum level allowed by the Internal Revenue Code or 25% of gross salary, whichever is less. The participants vest immediately in the Hospital's and their contributions. The retirement benefits received by the participants will depend upon the accumulated value of their accounts upon termination, attaining age 59 1/2, severe financial hardship, or death.

Retirement expense included in administration and general expense on the statement of revenue, expenses and fund balance was $393,343 in fiscal year 1997 and $385,110 in fiscal year 1996, representing the required contributions in both years. Employee contributions were $871,410 in 1997, representing 4.43% of total covered payroll. Total payroll and covered payroll were $46,454,558 and $19,667,166, respectively, for the year ended June 30, 1997.

8. Risk Management

Prior to July 1, 1993, the Hospital was self-insured for medical malpractice on a claims-made basis for individual claims up to $100,000. Effective July 1, 1993, the Hospital subscribed to the Louisiana Hospital Association Insurance Trust Fund for medical malpractice coverage up to $100,000. For individual malpractice claims in excess of $100,000, the Hospital participates in the State of Louisiana Patient Compensation Fund (the Fund). The Fund provides malpractice coverage to the Hospital for claims in excess of $100,000 up to $500,000. According to current state law, medical malpractice liability (exclusive of future medical care awards) is limited to $500,000 per occurrence. Hospital management has no reason to believe that the Hospital will be prevented from continuing its participation in the Fund.

The Hospital is involved in litigation arising in the ordinary course of business. Claims alleging malpractice have been asserted against the Hospital and are currently in various stages of litigation. As of June 30, 1997, the Hospital has accrued $649,400 for the estimated loss and litigation expenses related to professional liability claims for which the Hospital is self-insured. Claims have been filed alleging damages in excess of the amount accrued for estimated malpractice costs. It is the opinion of management that estimated malpractice costs accrued at June 30, 1997 are adequate to provide for potential losses resulting from pending or threatened litigation. Additional claims may be asserted against

8. Risk Management (continued)

the Hospital arising from services provided to patients through June 30, 1997. The Hospital is unable to determine the ultimate cost of the resolution of such potential claims and, accordingly, no accrual has been made for them.

The Hospital is self-insured for workers' compensation up to $225,000 per claim, and employee health up to $80,000 per claim. A liability is recorded when it is probable that a loss has been incurred and the amount of that loss can be reasonably estimated. Liabilities for claims incurred are reevaluated periodically to take into consideration recently settled claims, frequency of claims and other economic and social factors. The Hospital purchased commercial insurance which provides coverages for workers' compensation and employee health claims in excess of the self-insured limits.

Changes in the Hospital's aggregate claims liability in fiscal years 1997 and 1996 were as follows:

Year Ended June 30	Beginning of Fiscal Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year End
1997	**$ 1,195,055**	**$ 5,224,547**	**$ (4,583,279)**	**$1,836,323**
1996	$ 1,517,345	$ 4,121,783	$ (4,444,073)	$1,195,055

9. Capital Lease Obligations

The Hospital has entered into capital lease obligations for radiology, cat scan and telephone equipment. Future minimum lease payments, by year and in the aggregate, under these capital lease obligations consisted of the following at June 30, 1997:

1998	$ 281,250
1999	245,928
2000	208,309
2001	–
2002	–
Total minimum lease payments	735,487
Less amount representing imputed interest	55,187
Present value of net minimum lease payments (including $251,115 classified as current)	$ 680,300

10. Long-Term Debt (continued)

On July 5, 1994, the District issued $61,535,000 of Hospital Revenue Bonds, Series 1994 (the Series 1994 Bonds). The proceeds of the Series 1994 bonds, along with other available funds were used to advance refund $10,015,000 of the Series 1990 bonds, fund certain additions, renovation and improvements to the Hospital and reimburse the Hospital for the cost of previous property, plant and equipment acquisitions. The Series 1994 Bonds consist of $16,190,000 of serial bonds and $45,345,000 of term bonds. The serial bonds mature annually in amounts ranging from $50,000 at February 1, 1995 to $1,815,000 at February 1, 2009 and bear interest rates ranging from 3.80% to 5.95%. The term bonds consist of $10,855,000 due February 1, 2014 bearing interest at 6.125% and $34,490,000 due February 1, 2024 bearing interest at 6.250%. The term bonds are subject to mandatory sinking fund redemption prior to maturity at par in amounts ranging from $1,920,000 at February 1, 2010 to $4,465,000 at February 1, 2024. Payments of the scheduled principal and interest on the 1994 Revenue Bonds are insured by AMBAC Indemnity Corporation. Under the terms of the Bond Indenture, the Hospital is required to maintain, among other provisions, a certain debt service coverage ratio and minimum level of days cash on hand.

In connection with the advance refunding of a portion of the outstanding Series 1990 Bonds, $10,150,000 in proceeds from the Series 1994 bonds were deposited in an irrevocable trust with a trustee and used to purchase U. S. Government securities. The U. S. Government securities held by the trust, together with interest to be earned, are sufficient to provide for the payment of principal and interest on the portion of the Series 1990 Bonds advance refunded. As a result, $10,015,000 of the Series 1990 Bonds are considered to be defeased effective July 5, 1994.

During fiscal years 1997 and 1996, the Hospital capitalized interest cost of $2,617,646 and $2,620,239, respectively, as part of the expansion project. In addition, interest earned on unexpended bond proceeds in the amount of $1,667,965 and $2,225,841 in fiscal years 1997 and 1996, respectively, were capitalized as a reduction to the expansion project.

The scheduled maturities of the Series 1990 Bonds (portion not advance refunded) and the Series 1994 Bonds for the next five fiscal years ending June 30 are as follows: 1998—$1,015,000; 1999—$1,070,000; 2000—$1,125,000; 2001—$1,180,000; 2002—$1,240,000; and $56,170,000 thereafter.

11. Commitments

The Hospital had incurred $25,929,829 related to the expansion project in connection with the 1994 Bond Issue. The Signature Building and the Medical Office Building are expected to be completed in March 1998 at an estimated additional cost of approximately $22,110,095. Deposits of $1,831,888 have been placed on equipment whose total purchase price is $6,466,728 which will be placed in service in the new hospital building.

Tab II

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Report of Independent Auditors on the Internal Control Structure

The Board of Commissioners
Hospital Service District No. 1
of Tangipahoa Parish, Louisiana

We have audited the financial statements of Hospital Service District No. 1 of Tangipahoa Parish, Louisiana (the District) as of and for the year ended June 30, 1997, and have issued our report thereon dated September 17, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *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.

The management of the District is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of the District for the year ended June 30, 1997, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation and we assessed control risk 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 structure. Accordingly, we do not express such an opinion.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities 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 structure and its operation that we consider to be material weaknesses as defined above.

This report is intended for the information of the board of commissioners, management, and the Office of Legislative Auditor, State of Louisiana. However this report is a matter of public record and its distribution is not limited.

Ernst & Young LLP

September 17, 1997

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Report of Independent Auditors on Compliance With Laws and Regulations

The Board of Commissioners
Hospital Service District No. 1 of
Tangipahoa Parish, Louisiana

We have audited the financial statements of Hospital Service District No. 1 of Tangipahoa Parish, Louisiana (the District) as of and for the year ended June 30, 1997, and have issued our report thereon dated September 17, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *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.

Compliance with laws, regulations, contracts, and grants applicable to the District is the responsibility of the District's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the District's compliance with certain provisions of laws, regulations, and contracts. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion. The District has advised us that it has not received any grants; accordingly, no procedures were applied by us with respect to grants.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*.

This report is intended for the information of the board of commissioners, management, and the Office of Legislative Auditor, State of Louisiana. However this report is a matter of public record and its distribution is not limited.

Ernst + Young LLP

September 17, 1997

ERNST & YOUNG LLP

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Report of Independent Auditors on Compliance With Revenue Bond Resolution

The Board of Commissioners
Hospital Service District No. 1 of
Tangipahoa Parish, Louisiana

We have audited, in accordance with generally accepted auditing standards, the balance sheet of Hospital Service District No. 1 of Tangipahoa Parish, Louisiana (the District) as of June 30, 1997, and the related statements of revenue, expenses and fund balance and cash flows for the year then ended, and have issued our report thereon dated September 17, 1997.

In connection with our audit, nothing came to our attention that caused us to believe that the District failed to comply with the terms, covenants, provisions, or conditions of Sections 208, 401, 402, 501, 504 through 507, 512, 601, 602, 711, 718, 802(a), 802(b), and 1301 of the Composite Bond Resolution relating to $13,000,000 Hospital Revenue Bonds (Series 1990) and $61,535,000 Hospital Revenue Bonds (Series 1994) reflecting the provisions of Resolutions adopted by Hospital Service District No. 1 of the Parish of Tangipahoa, State of Louisiana on July 17, 1990, November 28, 1990, May 18, 1994, and June 22, 1994 insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance.

This report is intended solely for the information of the board of commissioners, management, the bond trustee, and the Office of Legislative Auditor, State of Louisiana. However this report is a matter of public record and its distribution is not limited.

Ernst & Young LLP

September 17, 1997

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Independent Accountants' Report on Schedule of Depreciation and Principal Requirements

The Board of Commissioners
Hospital Service District No. 1 of
Tangipahoa Parish, Louisiana

We have reviewed the accompanying Schedule of Depreciation and Principal Requirements as of June 30, 1997, in accordance with standards established by the American Institute of Certified Public Accountants. All information in this schedule is the representation of the management of Hospital Service District No. 1 of Tangipahoa Parish, Louisiana (the Hospital).

A review consists principally of inquiries of Hospital personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the accompanying Schedule of Depreciation and Principal Requirements taken as a whole. Accordingly, we do not express such an opinion.

As described in Note 1, the schedule referred to above has been prepared in accordance with Section 512 of the Composite Bond Resolution relating to $13,000,000 Hospital Revenue Bonds (Series 1990) and $61,535,000 Hospital Revenue Bonds (Series 1994) reflecting the provisions of Resolutions adopted by Hospital Service District No. 1 of the Parish of Tangipahoa, State of Louisiana, on July 17, 1990, November 28, 1990, May 18, 1994, and June 22, 1994.

Based on our review, we are not aware of any material modifications that should be made to the accompanying Schedule of Depreciation and Principal Requirements as of June 30, 1997 in order for it to be in conformity with the basis of accounting described in Note 1.

This report is intended solely for the information of the board of commissioners, management, and the bond trustee and should not be used for any other purpose.

Ernst & Young LLP

September 17, 1997

Hospital Service District No. 1 of
Tangipahoa Parish, Louisiana

Schedule of Depreciation and Principal Requirements

June 30, 1997

Fiscal Year Ending June 30	Principal Payments	Depreciation Amounts	Excess Depreciation Over Principal Payments	Excess Principal Payments Over Depreciation (Depreciation Shortfall)	Present Value of Depreciation Shortfall (Section 512(e))
1998	$ 1,015,000	$ 5,347,157	$ 4,332,157	$ –	$ –
1999	1,070,000	7,101,634	6,031,634	–	–
2000	1,125,000	7,101,634	5,976,634	–	–
2001	1,180,000	7,101,634	5,921,634	–	–
2002	1,240,000	7,101,634	5,861,634	–	–
2003	1,310,000	6,967,266	5,657,266	–	–
2004	1,375,000	6,967,266	5,592,266	–	–
2005	1,455,000	5,830,186	4,375,186	–	–
2006	1,535,000	4,505,454	2,970,454	–	–
2007	1,620,000	4,430,604	2,810,604	–	–
2008	1,715,000	4,272,909	2,557,909	–	–
2009	1,815,000	4,185,636	2,370,636	–	–
2010	1,920,000	4,185,475	2,265,475	–	–
2011	2,040,000	4,185,314	2,145,314	–	–
2012	2,165,000	4,162,216	1,997,216	–	–
2013	2,295,000	3,564,084	1,269,084	–	–
2014	2,435,000	1,638,773	–	796,227	758,312
2015	2,585,000	42,997	–	2,542,003	2,305,674
2016	2,750,000	42,997	–	2,707,003	2,338,414
2017	2,920,000	42,997	–	2,877,003	2,366,921
2018	3,100,000	42,997	–	3,057,003	2,395,246
2019	3,295,000	42,997	–	3,252,003	2,426,700
2020	3,500,000	–	–	3,500,000	2,487,390
2021	3,720,000	–	–	3,720,000	2,517,849
2022	3,955,000	–	–	3,955,000	2,549,435
2023	4,200,000	–	–	4,200,000	2,578,443
2024	4,465,000	–	–	4,465,000	2,610,601
	$ 61,800,000	$ 88,863,861	$ 62,135,103	$ 35,071,242	$ 25,334,985

See accompanying note.

Hospital Service District No. 1 of
Tangipahoa Parish, Louisiana

Note to Schedule of Depreciation and Principal Requirements

June 30, 1997

1. Basis of Presentation

The computation in the Schedule of Depreciation and Principal Requirements is prescribed by Section 512 of the Composite Bond Resolution relating to $13,000,000 Hospital Revenue Bonds (Series 1990) and $61,535,000 Hospital Revenue Bonds (Series 1994) reflecting the provisions of Resolutions adopted by Hospital Service District No. 1 of the Parish of Tangipahoa, State of Louisiana, on July 17, 1990, November 28, 1990, May 18, 1994, and June 22, 1994.

The amount on deposit in the Accumulated Capital Reserve Account as of June 30, 1997 was $0.

The assumed annual discount rate and the annual rate of return is 5% per Section 512(e) and (f) of the Bond Resolution.

The Accumulated Capital Reserve Requirement is calculated to be $25,334,985 (Section 512(g)).

The Hospital expended $6,553,474 during the year ended June 30, 1997 for the acquisition of depreciable property. Therefore, the net requirement is $18,249,241, requiring equal annual deposits of $706,230 each year through 2013.

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Independent Accountants' Report on Schedule of Debt Service Coverage Ratio, Cash on Hand, and Average Daily Expense

The Board of Commissioners
Hospital Service District No. 1 of
Tangipahoa Parish, Louisiana

We have reviewed the accompanying Schedule of Debt Service Coverage Ratio, Cash on Hand, and Average Daily Expense for the year ended June 30, 1997 of Hospital Service District No. 1 of Tangipahoa Parish, Louisiana (the District). Our review was conducted in accordance with standards established by the American Institute of Certified Public Accountants.

A review is substantially less in scope than an audit, the objective of which is the expression of an opinion on the accompanying Schedule of Debt Service Coverage Ratio, Cash on Hand, and Average Daily Expense. Accordingly, we do not express such an opinion.

The Schedule of Debt Service Coverage Ratio, Cash on Hand, and Average Daily Expense is prescribed by Section 711(e) of the Composite Bond Resolution relating to $13,000,000 Hospital Revenue Bonds (Series 1990) and $61,535,000 Hospital Revenue Bonds (Series 1994) reflecting the provisions of Resolutions adopted by Hospital Service District No. 1 of the Parish of Tangipahoa, State of Louisiana, on July 17, 1990, November 28, 1990, May 18, 1994, and June 22, 1994.

Based on our review, nothing came to our attention that caused us to believe that the accompanying Schedule of Debt Service Coverage Ratio, Cash on Hand, and Average Daily Expense is not presented in conformity with the basis set forth in Note 1.

This report is intended solely for the information of the board of commissioners, management, and the bond trustee. However this report is a matter of public record and its distribution is not limited.

Ernst & Young LLP

September 17, 1997

Hospital Service District No. 1 of
Tangipahoa Parish, Louisiana

Schedule of Debt Service Coverage Ratio,
Cash on Hand, and Average Daily Expense

Year ended June 30, 1997

Debt service coverage ratio:	
Net income available for debt service:	
Excess of revenue over expenses	$ 10,787,700
Add:	
Depreciation	4,731,274
Interest expense	1,112,878
Net income available for debt service	$ 16,631,852
Maximum annual debt service	$ 5,023,799
Debt service coverage ratio	3.31
Minimum required debt service coverage ratio per Section 501	1.20
Cash on hand:	
Cash on hand	$ 33,166,599
Average daily expense:	
Operating expenses	$ 88,285,933
Less:	
Depreciation	4,731,274
Provision for bad debts	1,918,797
	$ 81,635,862
Average daily expense (based on 365 days)	$ 223,660
Days cash on hand	148
Minimum required days cash on hand per Section 718	45

See accompanying note.

Hospital Service District No. 1 of
Tangipahoa Parish, Louisiana

Note to Schedule of Debt Service Coverage Ratio,
Cash on Hand, and Average Daily Expense

June 30, 1997

1. Basis of Presentation

The computation in the Schedule of Debt Service Coverage Ratio, Cash on Hand, and Average Daily Expense is prescribed by Sections 711(e) and 718 of the Composite Bond Resolution relating to $13,000,000 Hospital Revenue Bonds (Series 1990) and $61,535,000 Hospital Revenue Bonds (Series 1994) reflecting the provisions of Resolutions adopted by Hospital Service District No. 1 of the Parish of Tangipahoa, State of Louisiana, on July 17, 1990, November 28, 1990, May 18, 1994, and June 22, 1994.

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The Board of Commissioners
Hospital Service District No. 1
of Tangipahoa Parish, Louisiana

We have audited, in accordance with generally accepted auditing standards, the financial statements of Hospital Service District No. 1 of Tangipahoa Parish, Louisiana for the year ended June 30, 1997, and have issued our report thereon dated September 17, 1997.

Statement on Auditing Standards No. 61, *Communication With Audit Committees*, requires the independent auditor to communicate to the audit committee certain information regarding the scope and results of the audit to assist the committee in overseeing the financial reporting and disclosure process for which management is responsible. This letter summarizes the reporting requirements of this statement for our 1997 audit.

Auditors' Responsibility Under Generally Accepted Auditing Standards

Our audit, conducted in accordance with generally accepted auditing standards, is designed to provide reasonable, rather than absolute, assurance that the Hospital Service District No. 1 of Tangipahoa Parish, Louisiana financial statements are free of material misstatement. These financial statements are the responsibility of management and it is our responsibility to express an opinion on these financial statements based on our audit results.

Significant Accounting Policies

The accounting principles followed by Hospital Service District No. 1 of Tangipahoa Parish, Louisiana and the methods of applying these principles conform, in all material respects, with generally accepted accounting principles generally used by governmental health care entities. The annual audited financial statements include a summary of these significant accounting policies. During the course of our audit, we noted no changes in significant accounting policies or their application.

Accounting Estimates and Management Judgments

The preparation of financial statements requires the use of accounting estimates and management judgments. These estimates and judgments are generally based on knowledge and experience about past and current events and assumptions about future events. Certain estimates are particularly sensitive because of their significance to the financial statements and the possibility that actual future events affecting them may differ significantly from management's current expectations. Examples of these areas at the Hospital Service District include estimated Medicare and Medicaid settlements and, to a lesser degree, allowances for uncollectible accounts and self-insured reserves.

Estimated Medicare and Medicaid Settlements

The Hospital Service District files Medicare and Medicaid cost reports with appropriate intermediaries based on an aggressive interpretation of cost reimbursement rules and regulations in effect. Amounts recorded as due to or from these third-party contractual agencies are based on the results of analyses using a more conservative interpretation of rules and regulations. Final determination of ultimate amounts earned under contractual reimbursement programs is subject to review and audit by the appropriate intermediaries. Differences between estimates and actual results are recorded as adjustments to net reserves in the period final determination is made. During fiscal 1997, adjustments recorded were $677,000 related to prior year's cost report settlements.

Allowances for Uncollectible Accounts

The Hospital Service District records an estimate for uncollectible patient accounts based on past experience and other factors that could currently impact collectibility. Procedures used in fiscal 1997 were consistent with prior periods.

Self-Insurance Reserves

Prior to July 1, 1995, the Hospital Service District was self-insured for professional liability up to $100,000 on a claims made basis. The Hospital Service District remains self-insured for individual workers' compensation claims and employee health claims up to $225,000 and $80,000, respectively. Estimated amounts are recorded as liabilities for self-insured risks based on individual circumstances and historical experience. The total self-insured liability at June 30, 1997 was approximately $1,800,000.

Significant Audit Adjustments

During our review of the client's calculation of the allowance for contractuals, we noted an audit adjustment for the current year that had a positive impact on the operating statement of $964,000. This entry was posted to the financial statements.

There were no other significant audit adjustments.

Other Matters

Statement on Auditing Standards No. 61 also requires communications to the board of commissioners in the following areas:

- Other information in documents containing audited financial statements.

- Disagreements with management.

- Consultations with other accountants.
- Major issues discussed with management prior to retention.
- Difficulties encountered in dealing with management when performing the audit.
- Methods of accounting for significant unusual transactions and for controversial or emerging areas.

During the course of our audit, we did not encounter any circumstances and we are unaware of any items in any of these areas which require discussion with the board of commissioners.

This report is intended solely for the information and use of the board of commissioners.

Ernst & Young LLP

September 17, 1997

Tab III

Presentation of Audit Results

North Oaks Health System

June 30, 1997

ERNST & YOUNG LLP

Summary of What We Agreed To Do

Ernst & Young Reports

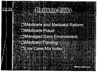
- Audited Financial Statements and Other Financial Information
- Report on Internal Control Structure
- Report on Compliance with Laws and Regulations
- Report on Compliance with Revenue Bond Resolution
- Report on Schedule of Debt Service Coverage Ratio, Cash on Hand, and Average Daily Expense
- Report on Schedule of Depreciation and Principal Requirements
- Report on Communication with Audit Committee

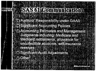
ERNST & YOUNG LLP

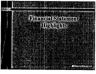
Areas of Audit Emphasis

- Accounts receivable, revenue and allowance for uncollectibles
- Reimbursement settlement estimates and related reserves
- Capital expenditures
- Legal Compliance Program
- Debt compliance
- Self-insurance reserves

ERNST & YOUNG LLP

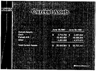

Business Risks
Medicare and Medicaid Reform
Medicare Fraud
Managed Care Environment
Medicaid Funding
Low Case Mix Index


SAS 61 Communications
Auditors' Responsibility under GAAS
Significant Accounting Policies
Accounting Estimates and Management Judgments including: Medicare and Medicaid settlements, allowance for uncollectible accounts, self-insurance reserves
Significant Audit Adjustments
Other


Financial Statement Highlights

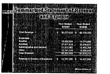

Summarized Balance Sheets
June 30,1997
June 30,1996
Total Assets
Current liabilities
Debt
Fund balance

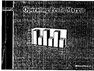

Current Ratio

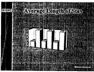

Current Assets
June 30,1997
Current Assets:
Cash
Patient A/R
Other
Total Current Assets


Days Cash on Hand

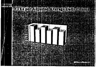

Days Revenue in A/R

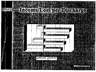

Summarized Statement of Revenue and Expense
Year Ended
Year Ended
Total Revenue
Expenses:
Routine
Ancillary
Administrative and General
Other
Total Expense
Revenue in Excess of Expenses

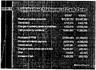

Operating Profit Margin


Average Length of Stay


Debt Service Coverage







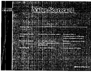
	6/30/97	6/30/98
Revenue in excess of expenses	$10,787,700	$10,467,280
Depreciation	4,721,274	4,422,739
Changes in operating assets and liabilities	4,332,919	(3,608,432)
Cash provided by operations	19,841,893	11,280,586
Purchases of PP&E	(27,054,493)	(11,369,082)
Principal and interest payments	(4,223,618)	(4,392,238)
Interest earned	2,327,881	4,042,896
Changes in assets whose use is limited	10,225,607	(453,101)
Other	118,938	(83,387)
Increase in Cash	1,495,268	(560,792)

Notes to Financial Statements

- Includes all disclosures required by Governmental Healthcare entities
- Similar in organization and content as prior year

Operating and Financial Indicators

Value Results


Value Scorecard


Value Scorecard (cont'd)


Value Scorecard (cont'd)

Looking Ahead to Next Year

Ernst & Young LLP

Continuity and Commitment of Your Team

[illegible]	Engagement Audit Partner	[illegible]	[illegible]
[illegible]	Independent Review Partner	[illegible]	[illegible]
[illegible]	Audit Senior	[illegible]	[illegible]

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Accounting Developments

Emerging GASB Issues and Pronouncements

Emerging issues that could have a significant impact on health care providers include:

- GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*
- Exposure draft, *Accounting and Financial Reporting for Nonexchange Transactions*
- Exposure draft, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*

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Identified Business Risks - 1998 New Developments

- Health Care Fraud and Abuse
- Balanced Budget Act of 1997
- Managed Care Environment
- Year 2000 Information Systems Issues
- Increased Outpatient Volumes

Performance Ratios

- The following performance ratios were obtained from information provided by HCIA for 1995. The amounts were derived from cost report data and do not necessary agree to the Hospital's audited financial statements.

Performance Ratios

	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

Performance Ratios (cont'd)

Performance Ratios (cont'd)

Performance Ratios (cont'd)

Tab IV

North Oaks Health System

Results

Report to

the Board of

Commissioners

Results

Audit Results

Results

Results

ERNST & YOUNG LLP

November 5, 1997

Board of Commissioners
North Oaks Health System

Dear Members of the Board of Commissioners:

We are pleased to present the results of our audit of the financial statements of North Oaks Health System.

Our approach for the System was designed to combine a historical perspective with a focus on the Health Care industry as well as the System's current and emerging business issues.

This Report to the Board of Commissioners summarizes our audit process, the scope of our engagement, the reports issued and various analyses and observations related to the System's financial position and results of operations. The document also contains a review of the Board of Commissioners communications required by our professional standards, as well as current accounting developments that will affect the System.

The completion of this year's audit was accomplished through the effective support and the assistance of the System's finance, medical, and administrative personnel. As always, we strive to continually improve the quality of our audit services. This meeting is a forum for you to provide feedback on ways we can continue to meet and exceed your expectations.

We appreciate this opportunity to meet with you. If you have any questions or comments before-hand, please call Greg Swan at (504) 596-4206.

Very truly yours,

Ernst & Young LLP

Contents

North Oaks Health System

Focus 1997

Audit Results

ERNST & YOUNG LLP

Our Approach

As discussed with Management during the planning meeting, our audit plan represented an approach responsive to the assessment of risk for the System. Specifically, we designed our audit to:

- Issue an opinion on the financial statements of the System.
- Express negative assurance on the System's compliance with Revenue Bond Resolution.
- Issue an Independent Auditors' Report on Schedule of Debt Service Coverage Ratio, Cash on Hand, and Average Daily Expense.
- Issue an Independent Auditors' Report on Schedule of Depreciation and Principal Requirements.
- Express negative assurance on the System's compliance with laws and regulations.

Areas of Audit Emphasis

The principal areas of audit emphasis were as follows:

- Accounts receivable, revenue and allowances for uncollectibles.
- Reimbursement settlement estimates and related reserves.
- Capital expenditures.
- The System's Medicare and Medicaid fraud and abuse compliance program.
- Debt Compliance.
- Various reserves, in particular the reserves related to the self-insurance program.

There were no changes to our planned approach or areas of audit emphasis.

Update of Identified Business Risks

Key issues discussed in our planning session, including their business and audit implications, are outlined below. Relevant comments relating to each item are summarized on the accompanying page.

Internal/External Factors		Business Implication
Industry Issue Medicare and Medicaid Reform	Continued pressures on reducing payments and on movement to managed care	High dependency on third party reimbursement and continued erosion of payments presents the System with operating margin challenges
Industry Issue Medicare Fraud	There is a major HHS initiative to conduct detailed reviews of Medicare payments for fraud and abuse. Similar reviews can be expected by the state	Management should evaluate the effectiveness of its compliance program
Industry Issue Managed Care Environment	The percentage of patients covered by managed care contracts is increasing. Current Louisiana Managed Care growth is below the nation averages	System assumption of additional risk to maintain patient volumes
Business Issue Medicaid Funding	Financial instability of state program and resulting pressures to reduce payments	High dependency on reimbursement and continued erosion of payments presents the System with operating margin challenges
Business Issue Low Case Mix Index	Low Case Mix Index relative to peers	Possible loss of revenues

	1997 Audit Implication	Audit Results and Comments
Industry Issue Medicare and Medicaid Reform	Identify and focus on the following audit issues: • Economic performance • Medicare/Medicaid fraud and abuse reviews	Review the Medicare/Medicaid Net Income/Loss Per Discharge Inquired of management as to the result of Medicare/Medicaid fraud and abuse reviews The System has undergone several audits by third party payor auditors. The findings to date have not been significant.
Industry Issue Medicare Fraud	Obtain an understanding of management's monitoring activities over internal controls	Through discussions with management we have obtained an understanding of management's monitoring activities over internal controls
Industry Issue Managed Care Environment	Review significant contracts for proper recording of revenues and for related liabilities and risks	During our substantive testing we reviewed significant contracts for proper recording of revenues and the related contractual allowance discount.
Business Issue Medicaid Funding	Long-term viability	We noted that management takes a conservative approach to recording income related to payments expected from Medicaid in response to their funding uncertainties.
Business Issue Low Case Mix Index	Long-term viability	Management should review its current DRG coding and ensure that accounts are properly coded

Financial Statement Highlights

Summarized Balance Sheets

	June 30 1997	June 30 1996
Assets		
Total current assets	**26,489,093**	25,737,141
Noncurrent assets whose use is limited	**51,875,253**	61,935,549
Property, plant and equipment:	**66,060,629**	42,219,736
Other	**2,870,280**	3,089,575
Total assets	**$ 147,295,255**	$ 132,982,001
Liabilities		
Total current liabilities	**20,328,460**	15,587,277
Long-term debt	**60,335,099**	61,550,728
Fund balance	**66,631,696**	55,843,996
	$ 147,295,255	$ 132,982,001

Summarized Statements of Revenue, Expenses and Fund Balance

	Year ended June 30 1997	Year ended June 30 1996
Total revenue	**99,073,633**	92,130,502
Expenses:		
Routine services	**15,559,034**	14,374,868
Ancillary services	**37,471,918**	35,240,637
Administration and general	**21,513,962**	18,460,769
Other	**13,741,019**	13,556,939
Total expenses	**88,285,933**	81,633,213
Revenue in excess of expenses	**10,787,700**	10,497,289

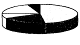
Summarized Statements of Cash Flows

	Year ended June 30 1997	Year ended June 30 1996
Revenue in excess of expenses	**$ 10,787,700**	$ 10,497,289
Depreciation	**4,731,274**	4,422,739
Changes in operating assets and liabilities:	**4,322,919**	(3,639,432)
Net cash provided by operating activities	**19,841,893**	11,280,596
Purchases of property, plant and equipment	**(27,654,483)**	(11,386,062)
Principal and interest payments	**(4,633,810)**	(4,398,255)
Interest earned	**3,557,881**	4,042,695
Change in assets whose use is limited	**10,225,867**	(453,161)
Other	**118,908**	(63,397)
Net increase (decrease) in cash	**1,456,256**	(850,790)

Significant Metrics

Gross Patient Revenue by Payor Source

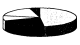
1997



- The slight growth in managed care from 1996 to 1997 is consistent with industry trends. It is anticipated that the payor class will continue to increase into 1998.

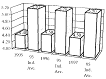
Gross Patient Revenue by Payor Source

1996



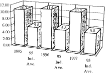
- In 1996 1 in 2 Americans was enrolled in health maintenance organizations, preferred provider organizations, point-of-service plans, or some form of "managed care." For the non elderly insured population, this figure is even higher: nearly 2 in 3 non elderly insured Americans were enrolled in one form of managed care. Medicare reforms are likely to include reductions in physician and hospital reimbursement and increased incentives for more senior citizens to move into managed care plans.

Average Length of Stay (Unadjusted)



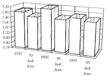
- Management should continue to monitor length of stay as an area to control costs.

Operating Profit Margin (%)



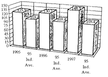
- The System continues to have a strong operating profit margin.

Current Ratio



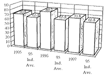
- The working capital ratio continues to be stable and above the majority of the System's competitors.

Days Cash on Hand



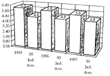
- The days cash on hand remains strong, despite continued investments in plant and equipment.

Days in Net Accounts Receivable



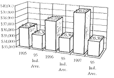
- Patient accounts receivable is net of the allowance for bad debts of $4,286,000 in 1996 and $3,978,000 in 1997.
- Allowance for bad debts decreased due to the improvement in the managed care, commercial, and self-pay aging. The allowance was computed consistently with prior periods.

FTEs per Adjusted Daily Census



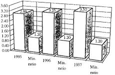
- FTES and related costs are two variables which directly effect profitability.
- These calculations include a slight increase in the number of FTEs from 1304 in 1996 to 1357 in 1997.

Salary & Benefits per FTE Personnel



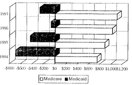
- Benefits in relation to salary costs approximated 16.21% of salary expense for 1996 and 16.78% of salary expense for 1997.

Debt Service Coverage Ratio



- The System continues to exceed its minimum debt service coverage ratio of 1.2.

Net Income/Loss Per Discharge



- The System has seen improvement in its Net Income/Loss per Discharge for Medicare and Medicaid patients.

Required Communications

Statement of Auditing Standards No. 61 and other professional standards require the auditor to provide the Board of Commissioners with additional information regarding the scope and results of the audit that may assist the Committee in overseeing management's financial reporting and disclosure process. Below we summarize these required communications.

Area	Comments
Auditors' Responsibilities under Generally Accepted Auditing Standards (GAAS)	
The financial statements are the responsibility of management. Our audit was designed in accordance with GAAS which provides for reasonable, rather than absolute, assurance whether the financial statements are free of material misstatement. We have a responsibility to opine on whether the financial statements are fairly stated in accordance with Generally Accepted Accounting Principles.	It is our opinion that scope of our audit was adequate and that the financial statements of North Oaks Health System as of June 30, 1997 are presented fairly in conformity with generally accepted accounting principles applied on a consistent basis.
Significant Accounting Policies	
Initial selection of and changes in significant accounting policies or their application and new accounting and reporting standards during the year must be reported.	The accounting principles followed by North Oaks Health System and the methods of applying these principles conform, in all material respects, with generally accepted accounting principles generally used by governmental healthcare entities.
Management Judgments and Accounting Estimates	
The preparation of financial statements requires the use of accounting estimates. Certain estimates are particularly sensitive due to their significance to the financial statements and the possibility that future events may differ significantly from management's expectations.	Significant estimates included in the 1997 financial statements are: *Estimated Medicare and Medicaid Settlements* for which the difference between estimated and actual results are recorded as adjustment to net revenue in the period the final determination is made. *Allowance for Uncollectible Accounts* which is based on past experience and other factors. Procedures used in fiscal 1997 were consistent with prior periods. *Self-Insurance Reserves* for professional liability, worker's compensation and employee health claims. The total self-insured liability at June 30, 1997, was approximately $1,800,000.

Area	Comments
Significant Audit Adjustments	There was one audit adjustment for the current year for $964,000 that had a positive impact on the profit and loss statement. The audit adjustment resulted from management's estimate of the allowance for contractuals accounts made prior to closing the books. Proposed audit adjustments are evaluated in the aggregate giving consideration to the offsetting effect of comparable differences in the prior year. For the past two years, there have been no proposed audit adjustments that have not been recorded.
Disagreements with Management on Financial Accounting and Reporting Matters	There were no disagreements with Management.
Consultation with Other Accountants	To the best of our knowledge there were no consultations with other accounting firms or independent accountants about auditing or accounting matters as they relate to the 1997 audited financial statements.
Serious Difficulties Encountered in Performing the Audit	There were no difficulties encountered in performing the audit.
Material Errors, Irregularities and Illegal Acts	Our audit did not identify any reportable conditions including material weaknesses in internal accounting controls or material errors, material irregularities or possible illegal acts.

North Oaks Health System

Focus 1997

Value Results

ERNST & YOUNG LLP

Value Scorecard

In addition to providing you with the results of our audit, this meeting provides a forum to refine your expectations regarding our services going forward. We include below some recent examples of value-added assistance provided to the System, and seek your input as to additional value we can bring to the System and the Board.

Issue	Description of Assistance	Value
Knowledge Transfer		
Information Security Review	General review of computer controls	Issuance of letter of recommendations to Ted Bruning, Director of Information Systems.
Peer Group Analysis	Key performance indicators compared to competitors selected at planning event	Information on industry trends and competitors
Board Report	Current events in healthcare	Current strategic information
Increasing Shareholder Value		
Taxes	Research on tuition reimbursement program	Employees were allowed to receive tax benefits for tuition reimbursement provided by North Oaks
Taxes	Performed research and provided appropriate forms for the Hospital to request refund of backup withholding taxes	Hospital was able to request refunds of backup withholding taxes that had been mistakenly withheld
Cost Reports	Assistance in determining the appropriate method of calculating physical therapy salary equivalents limits	Hospital obtained assurance that they had correctly prepared the current year cost report
Cost Reports	Review of audit adjustment for unnecessary borrowing received from Medicare intermediary	Project is currently in process

North Oaks Health System

Looking Ahead to
Next Year

ERNST & YOUNG LLP

Continuity and Commitment of Your Team

Ernst & Young continues to serve you with a multi-disciplinary team of professionals who offer both health care expertise and a long history of involvement with the System. Their enthusiasm and commitment to the System results in responsive, innovative and forward looking service focused on its business issues.

Engagement Member	Responsibility	Years of Health Care Experience	Years of Service to the System
L. Greg Swan	Engagement Audit Partner	20	3
Bruce Linklater	Independent Review Partner	28	3
Melanie M. Housey	Audit Senior	4	4

Emerging GASB Issues and Pronouncements

Emerging issues that could have a significant impact on health care providers include:

- GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*
- Exposure draft, *Accounting and Financial Reporting for Nonexchange Transactions*
- Exposure draft, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*

Identified Business Risks — 1998 New Developments

The following issues are on the horizon for the 1998 audit, and will be pursued in our planning activities for next year. We encourage your discussion of these and any other emerging matters.

Understanding Internal/External Factors		Business Implication	1998 Audit Implication
Industry Issue **Health Care Fraud and Abuse**	The Federal government continues to aggressively pursue strategies to eliminate fraud and abuse in the health care system.	These government antifraud and abuse initiatives highlight the need for effective corporate compliance programs.	We will continue to communicate the importance of testing the effectiveness of existing programs or other compensating controls.
Industry Issue **Balanced Budget Act of 1997**	The Balanced Budget Act will result in reductions in FFS payments and major structural changes to the Medicare program.	The Balanced Budget Act presents challenges for the Hospital to reduce costs to maintain profitability.	We will continue to review the effect the Balanced Budget Act will have on the System's reimbursement.
Industry Issue **Managed Care Environment**	The percentage of patients covered by managed care contracts is increasing. Capitation arrangements continue to grow in volume.	The Hospital will assume additional risk to maintain patient volumes and faces increased pressure to care for patients efficiently.	We will continue to review managed care contracts and assess the impact they have on the Hospital's revenue.
Business Issue **Year 2000 Information Systems Issues**	Most mainframe systems and applications support only two-digit years. Year 2000 requires these systems to recognize four-digit years to avoid calculation errors.	Management has begun to evaluate the Year 2000 impact. Vendor packages presumably will be altered through vendor solutions.	We will continue to review and discuss with management its approach and progress relative to Year 2000 issues and will share industry practices with management as they become available.
Industry Issue **Increased Outpatient Volume** **Operation of Satellite Sites**	The industry trend continues to move toward the treatment of patients on an outpatient basis and the establishment of satellite locations to provide these services.	The revenue recognized by the Hospital will be driven more by the reimbursement agreements in place for outpatient services. Accounts receivable issues associated with outpatient services will require greater emphasis.	We will reevaluate our approach to the Hospital's revenue cycle to ensure that we have a sufficient understanding of outpatient cycles including registration, insurance verification and the accumulation of satellite charges.

These topics are explained in greater detail because of their current relevance to the Hospital currently.

Balanced Budget Act of 1997

In planning for the changes the Budget Act will create for your organization, consider the following steps:

Step 1, Financial Impact — Consider how the Budget Act payment reduction and managed care growth provisions will affect the Hospital's bottom line.

Step 2, Environment — Discuss the attributes of the environment in which the Hospital does business. What will the forces in the Budget Act mean for your market environment? Your key stakeholders?

Step 3, Enterprise Vision — After you assess the overall effects of the Act on your environment, consider how it affects your organization's mission and your stakeholder's wants.

Step 4, Strategic Implications — What are the strategic implications for your enterprise as a whole? On selected departments? On your strategic partners? What are the strategic implications for your key stakeholders? Consider the interrelationships between implications for your key stakeholders and for your enterprise.

Step 5, Infrastructure — What kinds of people, processes, and technologies will be needed for your enterprise and your key stakeholders to succeed?

Step 6, New Competencies — What new skills will you need to bring to your organization? How will you bring them there? What new skills will your stakeholders need?

Step 7, Change Assessment: The Proactive Approach — Using this method to assess the overall changes in your environment, your mission, your strategy, your infrastructure, and your competencies, assess the degree of change you will need to go through to meet your priorities. Then develop specific action steps from your answers to each questions above.

Corporate Compliance Program

The federal government is aggressively pursuing strategies to eliminate fraud and abuse in the health care system. Unfortunately, the laws and regulations in this area are not always clear and are continually evolving. In some cases, what was generally accepted practice in the past has subsequently been deemed to be fraudulent or abusive.

In addition to the obvious business reasons for establishing an effective corporate compliance program, organizations have another incentive as well—the requirements of the Federal Sentencing Guidelines for Organizations ("Guidelines"), issued by the Federal government in 1991. In implementing a corporate compliance program, the Hospital should consider the requirements of the Guidelines. The negative ramifications of violations of laws and regulations may be mitigated if management has exercised due care in establishing a corporate compliance program that meets the minimum aspects of an effective program under the Guidelines. For example, the range of the fine for an organization with a corporate compliance program that meets the requirements of the Guidelines is substantially less than the range of the fine for an organization without such a program.

It is not enough to simply establish a corporate compliance program. As noted above, fines under the Guidelines may be mitigated only if the organization maintains an effective program. Therefore, after the Hospital establishes a corporate compliance program, it is important that the program's effectiveness be evaluated and documented on a periodic basis.

To strengthen controls we encourage management and the boards to implement procedures to evaluate the effectiveness of its Corporate Compliance Program on a periodic basis.

The following is a list of areas specifically identified by the Office of the Inspector General as potential problem areas in the industry:

- Capital Cost Prospective Payment System.
- Outlier Payments.
- Multiple Providers Within the 72-Hour Payment Window.
- Diagnosis-Related Group Miscoding.
- Outlier Adjustment Follow-up.
- Cost at Non-Prospective Payment System Providers.
- Hospital Discharge Planning.
- Ownership of Home Health Agencies – impact on discharge planning.
- Medicare Paying for Items Included in Medicaid Rates.
- Bad Debt Claims by Medicare Providers Yet HMO Liable

Chargemaster Review

We recommend that management review its charge structure to identify certain benefits such as:

- a greater percentage of every dollar of rate increase being realized in net revenue;
- a more competitive rate structure;
- identification of opportunities for additional reimbursement;
- minimization of the possibility of fraud and abuse violations by verifying CPT coding;
- identification of services provided to patients which are not being charged for or alternative charge structuring which better reflects actual resource consumption and changes in technology; and
- ensuring all individual charges of the hospital are at least equal to "usual, customary, and reasonable" industry fee screens.

Intermediate Sanctions Legislation

The new Intermediate Sanctions legislation imposes substantial penalties on certain individuals that receive or approve unreasonable compensation or engage in non-fair-market-value transactions with certain tax-exempt organizations. The penalties apply retroactively to compensation arrangements or transactions occurring after September 13, 1995, except for payments made pursuant to any written contract that was binding on that date.

The new penalties will generally not apply to compensation arrangements and transactions approved by an independent board or committee. The board or committee must use appropriate comparability data and adequately document its determination. The board or committee generally must conduct this review process before the organization pays the compensation or any consideration. If these steps are not taken, the IRS may view the transaction as unreasonable, resulting in excise taxes being imposed

Therefore, we highly recommend you review your organization's exposure to the "sanctions" excise tax. An organization should review such areas as compensation levels and the process to determine same, as well as other transactions between your exempt organization and a "disqualified person." Your organization should proactively address this legislation.

Trends

Performance Ratios

	North Oaks Health System	Baton Rouge General	East Jefferson	Lakeview Regional	Our Lady of the Lake	St. Tammany Parish
Occupancy Rate (%)	51.08	63.74	76.16	35.01	56.97	58.20
Medicare Case Mix Index	1.24	1.48	1.59	1.61	1.56	1.37
Medicare Days %	51.28	60.70	58.87	46.13	57.68	49.91
Medicaid Days %	18.51	11.63	5.27	24.14	6.82	18.66
Operating Profit Margin (%)	7.03	15.99	2.03	(3.47)	6.77	5.52
Total Profit Margin (%)	10.44	16.29	8.42	(3.47)	12.19	5.96
Debt Service Coverage Ratio	7.04	0.00	55.28	15.27	27.81	7.26
Cash Flow to Total Liabilities	0.20	0.44	0.19	0.01	0.18	0.30
Current Ratio	3.91	2.20	4.71	0.68	2.06	2.10
Days Cash on Hand	115.48	0.02	197.81	(11.51)	11.53	37.68
Days in Net Accounts Receivable	41.12	88.49	64.28	114.97	73.88	71.49
Average Payment Period (Days)	43.95	37.71	59.03	132.34	53.08	58.06
Long-term Liabilities to Capitalization	0.58	0.68	0.36	0.83	0.48	0.29
Capital Costs as a % of Operating Expenses	6.96	5.40	7.27	6.69	7.30	6.88
Average Age of Plant (Years)	8.04	13.00	7.70	1.13	8.00	6.76
FTEs per Adjusted Daily Census	5.76	5.91	5.97	7.32	5.74	6.60
Salary & Benefits per FTE Personnel	$42,703	$33,300	$44,833	$39,885	$39,359	$40,540
Outpatient Revenue as a % of Total Patient Revenue	36.73	25.19	27.50	34.24	23.04	37.32
Uncollectible Ratio (%)	46.89	40.21	44.62	40.88	37.71	44.26

Source: HCIA

Key performance indicators provide a diagnostic tool to evaluate the Hospital's performance relative to its peers/direct competitors. We are also compiling historical comparisons to assist management in analyzing performance trends. The comparisons are based upon the latest year in which all competitors have data reported in the HCIA database (1995). The HCIA calculations utilize the information reported on the Medicare reporting forms and may not result in the same ratios/data as would be determined by using audited financial statements.

1998 Audit Planning

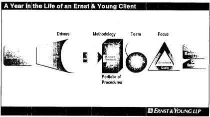
Planning for the 1998 audit will be developed in cooperation with management. As a balanced effort, it will give full recognition to the existing internal controls, as well as an assessment of inherent and control risks. Being responsive to these risk assessments, the 1998 audit will address both your and management's expectations and provide for the best utilization of audit resources.

We will continue to meet with management throughout the year to review current developments and challenge the continuing adequacy of the 1998 audit plan. Any significant changes to the plan will be promptly communicated to you.

North Oaks Health System

Appendix

Audit Process



A process focused on continuous improvement and exceeding client expectations.

ERNST & YOUNG LLP

Our Audit Process

The accompanying graphic illustrates our evolving audit process for the System.

Co-Develop Expectations

In setting mutual expectations, we agree on: 1) understanding the System's needs; 2) providing useful deliverables; and, 3) measuring the value of our relationship. This meeting with the Board of Commissioners allows us to validate and extend this agreement.

Drivers

Audit risk is influenced by business risk. Our audit begins with understanding factors that could affect the System's business condition and risk, including stakeholder needs, industry trends, evolving standards, competitive strategy and market developments.

Business Risks

We monitor key issues and changes in the business environment to understand the System's business risks. Through this understanding, we consider the affects of any identified business risks on our combined (inherent and control) risk assessments and on the nature, extent and timing of our audit procedures.

Methodology

With an understanding of current and emerging business risks, we establish a "portfolio" of audit procedures. These include: core compliance procedures; analysis of processes that manage and control business risk; and procedures necessitated by events that occur throughout the year. The mix and emphasis evolves as the business evolves.

Team

We work to leverage the resources that exist within the System's Internal Audit and Financial Departments. This teaming enables us to eliminate unnecessary duplication, increase audit quality and increase the cost-effectiveness of our relationship.

Focus

Our primary deliverable is assurance as described in our opinion of the System's financial statements. Respecting the talents of management, and the processes and controls they employ, we have the right team looking at the right things. Our results are to be objective, efficient and provide a real-time view of the business.

Client Satisfaction

We monitor our success in meeting the System's needs and expectations through our client satisfaction improvement process.

Value Scorecard

The goal of a traditional audit is to render an opinion on the System's financial statements. Our goal is to deliver on all of your expectations and to be measured against these expectations. In addition to the attest objective, we expect to be evaluated on: 1) providing "early warning alerts," i.e., timely communications regarding financial information and controls; and 2) providing meaningful business insight that helps the System succeed.

Operating and Financial Indicators
Hospital Size: 250-399 beds

	6/30/97	6/30/96	Industry Averages (1) 12/31/95
FTEs per adjusted average daily census	5.6	5.9	4.8
Salary and benefits per net patient service revenue	56.0	55.7	N/A
Salary and benefits per FTE	$ 39,629	$37,936	$ 35,366
Salary and benefits as a % of operating expense	60.9%	60.6%	N/A
Capital costs as a % of operating expenses	6.6%	7.1%	8.2%
Occupancy rate (hospital only) on 170 beds	61.8%	62.2%	53.0%
Average length of stay (days) (hospital only)	4.5	4.5	5.2
O/P revenue as a % of total patient revenue	33.9%	36.3%	31.2%
Operating profit margin	11.2%	11.4%	5.8%
Total liabilities per bed	$266,216	$254,580	N/A
Current ratio	2.7	3.2	2.5
Days revenue in accounts receivable	71.8	80.2	65.8
Return on equity	16.2%	18.8%	N/A
Days expenses of cash on hand	148.3	130.7	103.4

(1) Data Source: Health Care Investment Analysts, Inc.
Values represent sample medians for the calendar year

Medicare Analysis

	1997	1996
Medicare inpatient charges	$47,657,474	$44,300,000
Medicare inpatient costs	$16,973,681	$16,815,886
Medicare inpatient operating payments	$18,298,547	$17,818,995
Medicare disproportionate share payments	730,313	710,423
Medicare inpatient capital payments	2,058,448	2,130,243
	21,087,308	20,659,661
Payments in excess of cost	$ 4,113,627	$ 3,502,887
Medicare cases	3,748	3,788
Costs per case	$ 4,529	$ 4,439
Payments per case	$ 5,077	$ 4,892
Capital payments per case	549	562
Total payments	$ 5,626	$ 5,454
Income per case	$ 1,096	$ 1,015
Case mix index	1.26	1.28
Average length of stay (days)	5.0	5.1

Medicaid Analysis

	1997	1996
Medicaid inpatient charges	$25,878,912	$23,291,115
Medicaid inpatient costs	$10,191,491	$ 9,565,097
Per day	$ 926	$ 838
Per discharge	$ 3,986	$ 3,586
Reimbursement	$ 9,477,173	$ 9,359,483
Per day	$ 862	$ 819
Per discharge	$ 3,706	$ 3,509
Excess cost over reimbursement	$ 714,318	$ 205,614
Per day	$ 65	$ 19
Per discharge	$ 279	$ 77
Patient days (excluding newborn)	10,996	11,417
Discharges	2,557	2,667
Average length of stay (days):		
Adult	3.3	3.4
NICU	8.3	8.4

Contractual Adjustments as a Percentage of Program Charges

	1997	1996
Medicare gross revenue	$81,443,542	$75,018,605
Medicare contractual adjustments	$45,921,527	$43,475,920
Contractuals as a percent of gross medicare revenue	56%	58%
Medicaid gross revenue	$32,930,732	$33,144,158
Medicaid contractual adjustments	$22,112,090	$21,407,969
Contractual as a percent of gross medicaid revenue	67%	65%

Revenue Indicators
(excludes Nursery days)

	1997	1996	Percentage Increase/ (Decrease)
Patient days	56,303	53,825	5%
Adjusted patient days	85,130	85,582	(1)%
Total revenue	$ 99,073,633	$ 92,130,502	8%
Total revenue per adjusted patient day	$ 1,164	$ 1,077	8%

Operating Results Per Adjusted Patient Day

	Operating Revenue	Revenue Percentage Increase/ (Decrease)	Operating Expense	Expense Percentage Increase	Income Per Day
1993	$ 950	–	$ 842	2%	$ 108
1994	$ 919	(3)%	$ 845	–	$ 74
1995	$ 1,051	14%	$ 938	11%	$ 113
1996	$ 1,077	2%	$ 954	2%	$ 123
1997	$ 1,164	8%	$ 1,037	8%	$ 127