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LAKEWOOD MEDICAL CENTER

Financial Statements

December 31, 1997 and 1996

With Independent Auditors' Report Thereon

KPMG Peat Marwick LLP

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) (the Medical Center) as of December 31, 1997 and 1996, and the related statements of revenues and expenses - unrestricted funds, changes in fund balances - restricted and unrestricted funds, and cash flows - restricted and unrestricted funds for the years then ended. These financial statements are the responsibility of the 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 *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, 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.

In accordance with *Government Auditing Standards*, we have also issued a report dated March 5, 1998, on our consideration of the Medical Center's internal control structure and a report dated March 5, 1998, on its compliance with laws and regulations.

KPMG Peat Marwick LLP

March 5, 1998

LAKEWOOD MEDICAL CENTER

Balance Sheets -
Restricted and Unrestricted Funds

December 31, 1997 and 1996

Assets	1997	1996
Current assets:		
Cash and cash equivalents (notes 2 and 3)	$ 288,025	36,141
Assets limited as to use required for current liabilities (note 4)	517,292	516,467
Patient accounts receivable, less allowances for doubtful accounts of $1,503,000 and $1,220,000 in 1997 and 1996, respectively	4,422,969	3,622,771
Ad valorum tax receivable	493,059	550,000
Other receivables	274,208	187,002
Inventories	597,536	571,264
Prepaid expenses and other current assets	153,100	147,307
Total current assets	6,746,189	5,630,952
Assets limited as to use (notes 3 and 4):		
For plant and equipment additions and replacement by board of commissioners	793,901	743,661
For maintenance and purchase of capital and technology relating to maintenance taxes received	1,514,702	766,159
For debt service:		
Revenue bond	1,492	1,517
General obligation bonds	1,993,929	2,333,787
Total assets limited as to use	4,304,024	3,845,124
Less assets limited as to use required for current liabilities	517,292	516,467
Noncurrent assets limited as to use	3,786,732	3,328,657
Property and equipment, net (note 5)	11,178,717	12,401,049
Debt issuance costs, net of accumulated amortization of $65,923 in 1997 and $61,683 in 1996	45,947	50,187
Total assets	$ 21,757,585	21,410,845

(Continued)

LAKEWOOD MEDICAL CENTER

Balance Sheets -
Restricted and Unrestricted Funds, Continued

Liabilities and Fund Balances	1997	1996
Current liabilities:		
Current portion of:		
Long-term debt (note 6)	$ 871,663	815,911
Capital lease obligations (note 7)	561,803	525,009
Accounts payable	1,720,301	1,214,742
Accrued salaries, wages and benefits	614,440	581,532
Due to third-party payors	775,979	819,558
Accrued interest	76,929	88,213
Total current liabilities	4,621,115	4,044,965
Capital lease obligations, less current portion (note 7)	949,350	1,511,153
Long-term debt, less current portion (note 6)	8,501,000	9,372,664
Total liabilities	14,071,465	14,928,782
Fund balances:		
Restricted for debt service on general obligation bonds	1,812,866	2,218,430
Restricted for plant replacement and other	15,000	15,000
Unrestricted	5,858,254	4,248,633
	7,686,120	6,482,063
Commitments and contingencies (notes 6, 7, 12, 13 and 14)		
Total liabilities and fund balances	$ 21,757,585	21,410,845

See accompanying independent auditors' report.

LAKEWOOD MEDICAL CENTER

Statements of Revenues and Expenses - Unrestricted Funds

Years ended December 31, 1997 and 1996

	1997	1996
Net patient service revenue (note 8)	$ 24,726,026	22,681,695
Other revenue	219,307	184,115
Total operating revenues	24,945,333	22,865,810
Expenses:		
Salaries, wages and benefits	11,375,940	10,961,412
Professional fees	1,150,793	1,256,439
Supplies and other	7,051,626	6,438,683
Provision for uncollectible accounts	2,438,583	2,255,036
Depreciation and amortization	1,893,007	1,626,074
Interest	697,351	704,512
Total operating expenses	24,607,300	23,242,156
Gain (loss) from operations	338,033	(376,346)
Nonoperating gains (losses):		
Ad valorem taxes	746,947	841,589
Donations	29,798	86,959
Interest income	114,444	86,804
Rental income, net	2,927	14,034
Loss on equipment disposal	(12,528)	(224,400)
Total nonoperating gains, net	881,588	804,986
Revenues and gains in excess of expenses and losses	$ 1,219,621	428,640

See accompanying notes to financial statements.

LAKEWOOD MEDICAL CENTER

Statements of Changes in Fund Balances -
Restricted and Unrestricted Funds

Years ended December 31, 1997 and 1996

	Fund Balances		
	Restricted for debt service on general obligation bonds	Restricted for plant replacement and other	Unrestricted
Balance at January 1, 1996	$ 2,606,303	15,000	3,454,993
Additions (deductions):			
Investment earnings	117,427	-	-
Revenues and gains in excess of expenses and losses	-	-	428,640
Debt service on general obligation bonds:			
Principal payments	(365,000)	-	365,000
Interest paid or accrued	(140,300)	-	-
Donations received	-	86,959	-
Transfers to finance property, equipment and other	-	(86,959)	-
Balance at December 31, 1996	2,218,430	15,000	4,248,633
Additions (deductions):			
Investment earnings	101,586	-	-
Revenues and gains in excess of expenses and losses	-	-	1,219,621
Debt service on general obligation bonds:			
Principal payments	(390,000)	-	390,000
Interest paid or accrued	(117,150)	-	-
Donations received	-	29,798	-
Transfers to finance property, equipment and other	-	(29,798)	-
Balance at December 31, 1997	$ 1,812,866	15,000	5,858,254

See accompanying notes to financial statements.

LAKEWOOD MEDICAL CENTER

Statements of Cash Flows - Restricted and Unrestricted Funds

Years ended December 31, 1997 and 1996

		1997	1996
Cash flows from operating activities:			
Gain (loss) from operations	$	338,033	(376,346)
Interest expense considered capital financing activity		697,351	704,512
Adjustments to reconcile operating gain (loss) to net cash provided by operating activities:			
Depreciation and amortization		1,893,007	1,626,074
Provision for uncollectible accounts		(2,438,583)	(2,255,036)
Changes in operating assets and liabilities:			
Decrease in patient receivables		1,638,385	1,840,091
Increase in other receivables		(87,206)	(11,973)
(Increase) decrease in prepaid expenses and other assets		(5,793)	68,227
(Increase) decrease in inventories		(26,272)	174,082
Increase in accounts payable		505,559	351,089
Increase (decrease) in accrued salaries		32,908	(106,488)
Decrease in due to third-party payors		(43,579)	(154,552)
Net cash provided by operating activities		2,503,810	1,859,680
Cash flows from investing activities:			
Net rental receipts		60,182	71,289
Ad valorem taxes received		686,738	591,289
(Investment in) utilization of assets limited as to use		(290,009)	107,882
Investment earnings		216,030	204,232
Net cash provided by investing activities		672,941	974,692
Cash flows from capital and related financing activities:			
Acquisitions of property, plant and equipment		(752,129)	(1,394,369)
Principal paid on long-term debt and capital leases		(1,325,010)	(920,311)
Interest paid on long-term debt and capital leases		(708,635)	(708,829)
Donations received		29,798	86,959
Net cash used in capital and related financing activities		(2,755,976)	(2,936,550)
Net increase (decrease) in cash and cash equivalents		420,775	(102,178)
Cash and cash equivalents at beginning of year		368,691	470,869
Cash and cash equivalents at end of year	$	789,466	368,691

(Continued)

Statements of Cash Flows -
Restricted and Unrestricted Funds, Continued

		1997	1996
Reconciliation of cash and cash equivalents to the balance sheet:			
Cash and cash equivalents in current assets	$	288,025	36,141
Cash and cash equivalents in assets limited as to use:			
For plant and equipment additions and replacement by board of commissioners		159,739	152,241
For maintenance and purchase of capital and technology		326,894	170,327
For debt service on revenue bonds		1,492	1,517
For debt service on general obligation bonds		13,316	8,465
	$	789,466	368,691

The Medical Center entered into capital lease obligations of $1,702,330 for new equipment in 1996.

See accompanying notes to financial statements.

(1) Organization and Significant Accounting Policies

Lakewood Medical Center (the Medical Center) is a nonprofit public corporation, exempt from federal income taxes under Internal Revenue Code Section 115 (as a governmental entity) and Section 501(a) (as a hospital organization described in Section 501(c)(3)), owned by Hospital Service District No. 2 of St. Mary Parish, Louisiana (the District). The Medical Center 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) 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.

(b) Use of Estimates

Management of the Medical Center has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with generally accepted accounting principles. Actual results could differ from those estimates.

(c) Proprietary Fund Accounting

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

(d) 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.

(e) Cash and Cash Equivalents

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

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(f) Assets Limited as to Use

Assets limited as to use include:

- Assets set aside by the Board of Commissioners for future capital improvements over which the Board retains control and may at its discretion subsequently use for other purposes, 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.

(g) Investments

Investments are stated at cost, adjusted for amortization of premiums, accretion of discounts and impairments in value that are deemed other than temporary. Premiums and discounts are amortized using the straight-line method which is not materially different from the interest method.

(h) Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. 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 at the beginning of the lease term or fair value at the inception of the lease.

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

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

Upon receipt of tax revenues levied through December 31, 1994, the Medical Center records the proceeds from ad valorem taxes levied on property within Hospital Service District No. 2 of St. Mary Parish, Louisiana as additions to the temporarily 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 statement of revenue and expenses of 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 Hospital Service District No. 2 of St. Mary Parish, Louisiana for the same tax year ended December 31, are recorded as additions to

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assets limited as to use for plant and equipment additions and replacement by Board of Commissioners. 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.

(j) Statement of Revenues and Expenses

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as revenue and expenses. Peripheral or incidental transactions are reported as 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 as final settlements are determined.

(l) 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. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue.

(m) Income Taxes

The Medical Center qualifies as tax-exempt under existing provisions of the Internal Revenue Code, and its income, generally, is not subject to Federal or State income taxes.

(n) Debt Issuance Costs

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

(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, 1997 and 1996, the Medical Center had cash as follows:

	1997	1996
Demand deposits	$ 286,825	34,441
Petty cash	1,200	1,700
	$ 288,025	36,141

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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 by board designation, 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, 1997 and 1996, the market value of pledged securities plus the federal deposit insurance exceeded the amount on deposit with the fiscal agent banks. At December 31, 1997 and 1996, the Medical Center had bank deposits as follows:

	1997	1996
Secured by Federal deposit insurance	$ 336,451	444,840
Collateralized by securities held by the pledging financial institution's trust department in the Medical Center's name	2,391,303	2,468,247
Total	$ 2,727,754	2,913,087
Carrying value of bank deposits in the balance sheets	$ 2,173,830	2,163,915

Reconciliation of carrying value of bank deposits to the balance sheets:

	1997	1996
Demand deposits	$ 286,825	34,441
Cash and cash equivalents in assets limited as to use:		
For plant and equipment additions and replacement	159,739	152,241
For maintenance and purchase of capital and technology relating to maintenance taxes	326,894	170,327
For debt service on revenue bonds	1,492	1,517
For debt service on general bonds	13,316	8,465
Certificates of deposit in assets limited as to use:		
For debt service on general obligation bonds	1,385,564	1,796,924
	$ 2,173,830	2,163,915

(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 Hospital or its agent in the Hospital's name.

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

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

The details of assets limited as to use at December 31, 1997 and 1996 are as follows:

	1997	1996
For plant and equipment additions and replacement by board of commissioners:		
Cash and cash equivalents	$ 159,739	152,241
U.S. Treasury notes	622,804	585,221
Accrued interest receivable	11,358	6,199
	793,901	743,661
For maintenance and purchase of capital and technology relating to maintenance taxes received:		
Cash and cash equivalents	326,894	170,327
U.S. Treasury notes	1,170,086	584,853
Accrued interest receivable	17,722	10,979
	1,514,702	766,159
For debt service on Series 1978 revenue bond - cash and cash equivalents	1,492	1,517
For debt service on Series 1976 general obligation bonds:		
Cash and cash equivalents	13,316	8,465
Certificates of deposit	1,385,564	1,796,924
U.S. Treasury notes	172,507	97,595
Accrued interest receivable	422,542	430,803
	1,993,929	2,333,787
Total assets limited as to use	4,304,024	3,845,124
Less amounts classified as current	517,292	516,467
Noncurrent assets limited as to use	$ 3,786,732	3,328,657

On December 31, 1997 and 1996, all assets whose use is limited are a Category 1 type investment.

In connection with the 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

(Continued)

fund are insufficient. At December 31, 1997 and 1996, there were no funds on deposit in the reserve fund. The amounts on deposit in the sinking fund were $1,492 and $1,517 at December 31, 1997 and 1996, respectively. The Medical Center has not funded the sinking fund since September 1993 (see Note 6).

(5) Property and Equipment

Property and equipment, by major category, at December 31, 1997 and 1996 are as follows:

	1997	1996
Land and improvements	$ 118,210	118,210
Building and improvements	22,655,371	22,625,729
Fixed equipment	3,798,588	3,792,436
Major moveable equipment	8,129,774	6,804,534
Construction in progress	66,244	-
	34,768,187	33,340,909
Less accumulated depreciation	25,339,706	23,517,844
	9,428,481	9,823,065
Equipment under capital lease obligations	3,033,351	3,878,520
Less accumulated amortization	1,283,115	1,300,536
	1,750,236	2,577,984
	$ 11,178,717	12,401,049

At December 31, 1997, the Medical Center was obligated under purchase commitments of approximately $300,000 related to the completion of various plant and equipment improvements relating to an energy conservation project. Fifty percent of the cost incurred relating to the energy conservation project will be reimbursed by a federal program if certain requirements are met once the project has been completed.

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(6) Long-term Debt

Long-term debt at December 31, 1997 and 1996 is as follows:

	1997	1996
Revenue bond, Series 1978, 6%, due serially to 2011, with remaining installments ranging from \$370,000 to \$716,000	\$ 7,526,000	7,936,000
General obligation bonds, Series 1976, interest ranging from 6% to 6.2%, due in varying installments through 2001, with remaining annual installments ranging from \$390,000 to \$505,000	1,840,000	2,230,000
Note payable to St. Mary Parish, noninterest-bearing	6,663	22,575
	9,372,663	10,188,575
Less current installments of long-term debt	871,663	815,911
	\$ 8,501,000	9,372,664

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 depreciation fund are to be funded up to certain amounts with excess revenue as defined in the Resolution. During 1994, the reserve fund was exhausted to pay the debt service payments on the revenue bond (see note 4).

The Medical Center is currently not in compliance with the Resolution as 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 bondholders, after giving proper notice, have the right to appoint a receiver of the Medical Center, however the bondholders have indicated that they currently have no intention to exercise this right.

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 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

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(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%.

Note Payable to St. Mary Parish - In 1979, the Medical Center entered into a loan with the Parish of St. Mary, Louisiana, for $200,000. In 1986, the Hospital leased space to the Sheriff of St. Mary Parish for 15 years in satisfaction of the remaining unpaid principal amount of $166,667. During 1991 and 1993, the lease was amended to include additional office space for use by St. Mary Parish.

The Medical Center paid interest relating to long-term debt of approximately $589,000 and $624,000 during the years ended December 31, 1997 and 1996, respectively.

Aggregate maturities of the Medical Center's long-term debt at December 31, 1997 are as follows:

Year ended December 31	
1998	$ 871,663
1999	915,000
2000	965,000
2001	1,015,000
2002	530,000
Thereafter	5,076,000

(7) Leases

The Medical Center has entered into lease agreements that have been capitalized in accordance with Financial Accounting Standards Board Statement No. 13, *Accounting for 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. Depending on the lease agreement, the Medical Center has the option to purchase the leased equipment at the fair market price, renew the lease for an additional lease term at the fair market rental rate, or return the equipment to the lessor. Future minimum lease payments at December 31, 1997 under capital lease obligations are as follows:

Year ending December 31:	
1998	$ 644,833
1999	394,067
2000	394,067
2001	242,126
	1,675,093
Less imputed interest	(163,940)
Present value of future lease obligations	1,511,153
Less amounts due within one year	(561,803)
Long-term portion of capitalized lease obligations	$ 949,350

(Continued)

Leased assets included in equipment totaled $3,033,351 and $3,878,520 at December 31, 1997 and 1996, respectively. Related accumulated amortization was $1,283,115 and $1,300,536, respectively. The leased equipment collateralizes the capital lease obligations.

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 leases totaled $74,216 and $69,751 during 1997 and 1996, 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, 1997 are summarized as follows:

Year ending December 31:	
1998	$ 77,539
1999	40,177
2000	40,177
2001	6,696

Total rental expense incurred for all operating leases was $90,355 and $124,368 for the years ended December 31, 1997 and 1996, 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, 1997 consist of buildings and improvements with an original cost of $1,092,895. Accumulated depreciation of the leased assets totaled $502,197 at December 31, 1997. The future minimum lease rentals at December 31, 1997 to be received from these leases are as follows:

Year ending December 31	
1998	$ 108,298
1999	108,298
2000	56,706
2001	56,417
2002	44,560
Thereafter	18,133

(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.

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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.

Presented below is a summary of net patient service revenue for the years ended December 31, 1997 and 1996:

	1997	1996
Gross patient service revenue	$ 40,120,024	36,261,259
Less provision for contractual adjustments	15,393,998	13,579,564
	$ 24,726,026	22,681,695

(9) Major Sources of Revenue

The Medical Center participates in the Medicare and Medicaid programs as a provider of medical services to program beneficiaries. The Medical Center derived 62% and 65% of its gross patient revenue in 1997 and 1996, respectively, from patients covered by the Medicare and Medicaid programs.

(10) 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 approximately $101,000 and $105,000 in 1997 and 1996, respectively, based upon foregone charges using established rates.

(11) Accrued Vacation

At December 31, 1997 and 1996, employees of the Medical Center have accumulated and vested $217,005 and $197,470, respectively, of employee leave benefits. This is recorded as an obligation of the Medical Center.

(12) 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.

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The amount contributed to the plan by the Medical Center is determined by the management of the Medical Center. Management approved a funding level of 3% of each eligible participant's compensation as of July 7, 1996. No contributions were made prior to July 7, 1996. 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 for all employees were $9,546,665 for the year ended December 31, 1997 and $4,707,253 for the period July 7, 1996 to December 31, 1996. Total covered compensation for eligible plan participants was $5,666,933 for the year ended December 31, 1997 and $2,680,133 for the period July 7, 1996 to December 31, 1996. Plan contributions for the same periods were $170,008 and $80,404, respectively. Loans to participants are not allowed and 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 allow for investment in insurance policies or qualifying employer securities or employer real property.

(13) 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).

Receivables from the Medicare and Medicaid programs represent a concentrated credit risk for the Medical Center. Management does not believe that there is a significant risk of loss associated with these programs. Various other payors, subject to differing economic conditions, do not represent significant concentrated credit risks to the Medical Center. Management continually monitors and adjusts its reserves and allowances associated with these receivables.

At December 31, 1997, the Medical Center had a net receivable from the Federal government (Medicare) of approximately $756,000 and a net payable to the State of Louisiana (Medicaid) of approximately $96,000. 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, 1994 and 1993 for Medicare and Medicaid, respectively.

(14) Contingencies

The Medical Center participates in the Louisiana Hospital Association 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.

(Continued)

LAKEWOOD MEDICAL CENTER

Notes to Financial Statements

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 reflected its estimate of the ultimate liability for known and incurred but not reported claims in the accompanying financial statements.

KPMG Peat Marwick LLP

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 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, 1997, and have issued our report thereon dated March 5, 1998.

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 general purpose financial statements are free of material misstatement.

The management of Lakewood Medical Center 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 Lakewood Medical Center for the year ended December 31, 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 an opinion 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 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 general purpose 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.

However, we noted certain matters involving the internal control structure and its operation that we have provided to the management of Lakewood Medical Center, in a separate letter dated March 5, 1998.

This report is intended for the information of the Board of Commissioners, management, and the Legislative Auditor. However, this report is a matter of public record and its distribution is not limited.

KPMG Peat Marwick LLP

March 5, 1998

KPMG Peat Marwick LLP

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 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, 1997, and have issued our report thereon dated March 5, 1998.

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 general purpose financial statements are free of material misstatement.

Compliance with laws, regulations, contracts, and grants applicable to Lakewood Medical Center is the responsibility of Lakewood Medical Center's management. As part of obtaining reasonable assurance about whether the general purpose financial statements are free of material misstatement, we performed tests of Lakewood Medical Center's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of the audit of financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

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 Legislative Auditor. However, this report is a matter of public record and its distribution is not limited.

KPMG Peat Marwick LLP

March 5, 1998

KPMG Peat Marwick LLP

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

March 5, 1998

CONFIDENTIAL

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

Dear Members:

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, 1997, and have issued our report thereon dated March 5, 1998. In planning and performing our audit of the consolidated 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 and not to provide assurance on internal control. We have not considered the internal control structure since the date of our report.

During our audit we noted certain matters involving the internal control structure and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve the internal control structure or result in other operating efficiencies and are summarized below.

Year 2000

The Year 2000 has the potential to significantly impact the business and operations of the Medical Center. The Year 2000 problem is the result of computer programs being written using two digits rather than four to define the applicable year. Any of the Medical Center's programs that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in a major system failure or miscalculations. Even though the Medical Center has recently purchased software which should be Year 2000 compliant, it is unknown what impact the Year 2000 will have on pre-existing software or relationships with vendors and other third parties that may not be Year 2000 compliant. It is recommended that the Medical Center begin to investigate and discuss the impact of the Year 2000 issues to determine the Medical Center's exposure.

Our audit procedures are designed primarily to enable us to form an opinion on the financial statements and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the Medical Center's organization gained during our work to make comments and suggestions that we hope will be useful to you.

This report is intended solely for the information and use of the Board of Commissioners, management and others within Lakewood Medical Center.

We wish to acknowledge the cooperation and courtesy extended to us by the management and others of Lakewood Medical Center throughout the audit. Should you have any questions concerning the matters presented in this letter, we will be pleased to discuss them with you at your convenience.

Very truly yours,

KPMG Peat Marwick LLP