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Bossier Medical Center

December 31, 1997

Audited Financial Statements

Report on Compliance and on Internal
Control Over Financial Reporting

Report on Schedule of Depreciation and Related Calculations
of the Special Depreciation Fund Requirements

Audit Results document

Under provisions of state law, this report is a public document. A copy of the report has been submitted to the audited, or reviewed, entity and other appropriate public officials. The report is available for public inspection at the Baton Rouge office of the Legislative Auditor and, where appropriate, at the office of the parish clerk of court.

Release Date MAY 13 1998

Financial Statements

Bossier Medical Center

Years ended December 31, 1997 and 1996
with Report of Independent Auditors

Bossier Medical Center

Financial Statements

Years ended December 31, 1997 and 1996

Contents

Report of Independent Auditors..1

Audited Financial Statements

Balance Sheets..2
Statements of Revenues, Expenses and Changes in Fund Balance..4
Statements of Cash Flows..5
Notes to Financial Statements..6

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Report of Independent Auditors

The Board of Directors
Bossier Medical Center

We have audited the balance sheet of Bossier Medical Center as of December 31, 1997, and the related statements of revenues, expenses and changes in fund balance and cash flows for the year 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 audit. The financial statements of Bossier Medical Center for the year ended December 31, 1996, were audited by other auditors whose report dated March 19, 1997, expressed an unqualified opinion on those statements prior to restatement.

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. 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 audit provides a reasonable basis for our opinion.

In our opinion, the 1997 financial statements referred to above present fairly, in all material respects, the financial position of Bossier Medical Center at December 31, 1997, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

We also audited the adjustments described in Note 11 that were applied to restate the 1996 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

In accordance with *Government Auditing Standards*, we have issued our report dated March 13, 1998 on our consideration of Bossier Medical Center's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Ernst & Young LLP

March 13, 1998

Bossier Medical Center

Balance Sheets

	December 31 1997	1996 As adjusted (Note 11)
Assets		
Current assets:		
Cash and cash equivalents	**$ 3,229,880**	$ 8,338,985
Patient accounts receivable, less allowances for uncollectible accounts of $3,037,000 in 1997 and $3,119,000 in 1996	**10,582,226**	9,869,034
Amounts due from third-party payors	**516,048**	-
Assets whose use is limited and required for current liabilities	**713,032**	700,010
Inventories	**993,204**	702,853
Prepaid expenses and other receivables	**616,513**	426,579
Total current assets	**16,650,903**	20,037,461
Assets whose use is limited, less current portion:		
By board for plant and equipment additions and replacements—interest-bearing deposits and investment securities	**5,008,636**	1,689,539
Under revenue bond ordinance—held by trustee	**890,405**	1,035,203
Pursuant to Louisiana Workers' Compensation Act	**100,000**	100,000
	5,999,041	2,824,742
Property, plant and equipment:		
Land and land improvements	**1,884,635**	1,882,986
Buildings	**12,938,167**	12,454,542
Fixed equipment	**13,062,466**	12,577,166
Major movable equipment	**21,869,854**	21,873,823
Minor equipment	**1,021,855**	1,042,900
Construction in progress	**-**	5,501
	50,776,977	49,836,918
Less accumulated depreciation	**30,627,843**	29,419,078
	20,149,134	20,417,840
Other assets:		
Cost in excess of acquired net assets, less accumulated amortization of $452,974 in 1997 and $356,446 in 1996	**312,271**	525,275
Unamortized bond issuance costs	**137,665**	172,758
Other	**12,388**	18,655
	462,324	716,688
	$ 43,261,402	$ 43,996,731

	December 31	
	1997	1996
		As adjusted (Note 11)
Liabilities and fund balance		
Current liabilities:		
Accounts payable and accrued expenses	$ 2,103,277	$ 2,036,090
Pension plan contribution payable	–	132,000
Accrued salaries and payroll-related costs	689,567	734,918
Accrued vacation	868,239	822,348
Amounts due to third-party payors	–	424,000
Interest payable on revenue bonds	198,032	215,007
Current portion of revenue bonds payable	515,000	485,000
Total current liabilities	4,374,115	4,849,363
Revenue bonds payable, less current portion	4,710,000	5,225,000
Fund balance	34,177,287	33,922,368
	$ 43,261,402	$ 43,996,731

See accompanying notes.

Bossier Medical Center

Statements of Revenues, Expenses and Changes in Fund Balance

	Year ended December 31	
	1997	1996 As adjusted (Note 11)
Net patient service revenue	**$ 47,898,609**	$ 50,593,534
Other revenue	**421,122**	434,876
Total revenue	**48,319,731**	51,028,410
Expenses:		
Salaries and wages	**19,855,370**	19,336,645
Employee benefits and payroll taxes	**3,957,503**	4,372,531
Supplies and materials	**6,878,054**	7,775,165
Purchased services	**3,910,748**	3,710,650
Provision for doubtful accounts	**4,461,587**	5,276,129
Other operating expenses	**5,917,114**	5,590,672
Depreciation and amortization	**2,650,258**	3,023,713
Interest expense	**434,477**	488,079
Total expenses	**48,065,111**	49,573,584
Income from operations	**254,620**	1,454,826
Nonoperating investment income	**530,381**	322,161
Revenue in excess of expenses	**785,001**	1,776,987
Operating transfer to City of Bossier City	**(550,000)**	(550,000)
Restricted donation	**19,918**	-
Fund balance at beginning of year, as previously reported	**34,897,322**	33,493,381
Less prior period adjustments (Note 11)	**(974,954)**	(798,000)
Fund balance at beginning of year, as adjusted	**33,922,368**	32,695,381
Fund balance at end of year	**$ 34,177,287**	$ 33,922,368

See accompanying notes.

Bossier Medical Center

Statements of Cash Flows

	Year ended December 31 1997	1996 As adjusted (Note 11)
Operating activities		
Income from operations	$ 254,620	$ 1,454,826
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization	2,650,258	3,023,713
Provision for doubtful accounts	4,461,587	5,276,129
Interest expense	434,477	488,079
Investment income on revenue bond funds	(56,177)	(70,347)
Write-off of cost in excess of acquired net assets and abandoned construction project	77,651	176,954
Changes in operating assets and liabilities:		
Increase in patient accounts receivable	(5,174,779)	(3,801,537)
(Increase) decrease in inventories, prepaid expenses and other receivables	(480,285)	1,097
Increase in amounts due from third-party payors	(516,048)	–
Decrease in other assets	6,267	68,155
Increase (decrease) in accounts payable and accrued expenses	67,187	(20,410)
Increase (decrease) in pension plan contribution payable	(132,000)	132,000
Increase (decrease) in accrued salaries and payroll-related costs	(45,351)	152,156
Increase in accrued vacation	45,891	–
Increase (decrease) in amounts due to third-party payors	(424,000)	266,000
Net cash provided by operating activities	1,169,298	7,146,815
Noncapital financing activities		
Operating transfer to the City of Bossier City	(550,000)	(680,953)
Net cash used in noncapital financing activities	(550,000)	(680,953)
Capital and related financing activities		
Purchases of property, plant and equipment	(2,226,280)	(677,860)
Principal payments on debt incurred for capital purposes	(485,000)	(585,000)
Payments of note payable	–	(440,331)
Interest paid on revenue bonds and note payable	(416,360)	(470,159)
Net cash used in capital and related financing activities	(3,127,640)	(2,173,350)
Investing activities		
Interest received on investments and cash equivalents	586,558	392,508
Purchases of investments	(1,097,630)	–
Net cash (used in) provided by investing activities	(511,072)	392,508
Net increase (decrease) in cash and cash equivalents	(3,019,414)	4,685,020
Cash and cash equivalents at beginning of year	11,763,737	7,078,717
Cash and cash equivalents at end of year	$ 8,744,323	$ 11,763,737

See accompanying notes.

1. Accounting Policies

Description of Business

Bossier Medical Center (the Hospital) is a municipal health care center owned and operated by the City of Bossier City, Louisiana. The Hospital is a component unit of the City of Bossier City (the City) as defined by Statement of Governmental Accounting Standards No. 14, *The Financial Reporting Entity*. The Hospital's component unit relationship to the City is principally due to the Hospital's financial accountability to the City as defined in Statement No. 14. The financial statements include only those accounts and transactions which relate to Bossier Medical Center.

Income Taxes

The Hospital qualifies as tax-exempt under existing provisions of the Internal Revenue Code, and accordingly its income is generally not subject to federal or state income taxes.

Proprietary Fund Accounting

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

Accounting Standards

Pursuant to Statement of Governmental Accounting Standards 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 the provisions of all relevant pronouncements of the Financial Accounting Standards Board issued after November 30, 1989.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

1. Accounting Policies (continued)

Statements of Revenues, Expenses and Changes in Fund Balance

For purposes of presentation, 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 nonoperating income and expenses.

Net Patient Service Revenue and Related Receivables

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows.

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. Inpatient nonacute services and certain outpatient services related to Medicare beneficiaries are paid based on cost reimbursement methodologies. The Hospital is paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.

Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined per diem rates. Outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. The Hospital is paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicaid fiscal intermediary.

The Hospital also has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. Payment methods under these agreements include prospectively determined rates per discharge, discounts from established charges and prospectively determined per diem rates.

Net patient service revenue is reported at the estimated net realizable amounts due from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

1. Accounting Policies (continued)

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

Charity Care

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

Cash Equivalents

The Hospital considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Investments

Investments are recorded at cost, which approximates fair value.

Investment Income

Investment income from revenue bond funds that are held by trustee is reported as other revenue. Such investment income totaled $56,177 and $70,347 in 1997 and 1996, respectively. Investment income from all other unrestricted or board-designated investments is reported as nonoperating income.

Inventories

Inventories primarily consist of drugs and medical supplies and are valued at the most recent invoice price which approximates the lower of cost (first-in, first-out method) or market.

1. Accounting Policies (continued)

In 1997, the Hospital changed its method of accounting for inventories in several departments from the direct expense method to the inventory method. This change in accounting method resulted in a reduction in supplies and materials expense totaling approximately $338,000 in 1997.

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 in amounts sufficient to amortize the cost of its assets over their estimated useful lives. The range of estimated useful lives is 15 to 40 years for the building and its components and 3 to 20 years for equipment.

Assets Whose Use Is Limited

Assets whose use is limited include funds set aside by the board of directors for future property, plant and equipment additions or replacements, over which the board retains control and may at its discretion subsequently use for other purposes, assets held under a bond indenture agreement, and a certificate of deposit held by trustee under workers' compensation funding arrangements. As of December 31, 1997 and 1996, these funds consisted principally of cash, certificates of deposit, United States treasury bills, mutual funds with underlying investments in United States government securities, and money market funds.

Cost in Excess of Acquired Net Assets

Cost in excess of the fair market value of the net assets of physician practices acquired is amortized on a straight-line basis over the lives of the physicians' contracts with the Hospital, not exceeding five years. Amortization expense totaled $135,353 and $194,112 in 1997 and 1996, respectively, and is included in depreciation and amortization expense in the statements of revenues, expenses and changes in fund balance.

In 1997, the Hospital wrote off the net unamortized balance of cost in excess of acquired net assets totaling $77,651 related to a physician who had terminated employment at the Hospital.

1. Accounting Policies (continued)

Unamortized Bond Issuance Costs

The costs incurred to issue the 1987 Hospital Revenue Refunding Bonds are being amortized over the scheduled maturities of the bonds using the interest method. Amortization expense totaled $35,093 and $38,102 in 1997 and 1996, respectively, and is included in interest expense in the statements of revenues, expenses and changes in fund balance.

Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years. The Hospital is self-insured for certain risks as discussed in Note 10.

Reclassifications

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

2. Third-Party Payor Arrangements

The Hospital participates in the Medicare and Medicaid programs as a provider of medical services to program beneficiaries. During the years ended December 31, 1997 and 1996, approximately 55% and 53%, respectively, of the Hospital's patient service charges were related to services provided 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 programs.

2. Third-Party Payor Arrangements (continued)

Revenues derived from the Medicare program are subject to audit and adjustment by the fiscal intermediary and must be accepted by the United States Department of Health and Human Services before settlement amounts become final. Revenues derived from the Medicaid program are subject to audit and adjustment and must be accepted by the Department of Health and Hospitals of the State of Louisiana before settlement amounts become final. Estimated settlements for the years ended through December 31, 1994 for the Medicare and Medicaid programs have been reviewed by program representatives and adjustments have been recorded to correct for the changes required.

3. Cash and Investments

As of December 31, 1997 and 1996, the bank balances of the Hospital's deposits were entirely insured or collateralized with securities held in the Hospital's name by the trust department of a bank other than the pledging bank.

The Hospital has investments in mutual funds which have underlying investments consisting solely of securities of the United States government. These mutual fund investments had a balance of $1,603,437 and $1,735,213 at December 31, 1997 and 1996, respectively, and are included in cash and cash equivalents in the statements of cash flows. The Hospital also has an investment in a U.S Treasury bill with a balance of $1,097,630 at December 31, 1997. All of these investments were classified as Category 1, which indicates that the securities are insured or registered, or are held by the Hospital or its agent in the Hospital's name.

Cash and cash equivalents included in the statements of cash flows as of December 31, 1997 and 1996, follow:

	1997	1996
Cash and cash equivalents	**$ 3,229,880**	$ 8,338,985
Assets whose use is limited:		
By board for plant and equipment additions and replacements	**3,911,006**	1,689,539
Under revenue bond ordinance	**1,603,437**	1,735,213
	$ 8,744,323	$ 11,763,737

3. Cash and Investments (continued)

Statutes authorize the Hospital to invest in direct obligations of the U.S. Government or its agencies, certificates of deposit of state banks or national banks having their principal office in the State of Louisiana, and any other federally insured investments, guaranteed investment contracts issued by a financial institution having one of the two highest rating categories published by Standard & Poor's or Moody's, and mutual or trust funds registered under the Securities and Exchange Commission (provided the underlying investments of these funds meet certain restrictions).

4. Revenue Bond Funds

Assets whose use is limited under the 1987 Revenue Bond Ordinance (all of which are cash or cash equivalents) were as follows:

	1997	1996
Current assets—revenue bond debt retirement funds:		
Interest account	$ 198,032	$ 215,010
Principal account	515,000	485,000
	713,032	700,010
Noncurrent assets—revenue bond debt retirement funds - reserve account	890,405	1,035,203
	$ 1,603,437	$ 1,735,213

5. Net Patient Service Revenue

Net patient service revenue for the years ended December 31, 1997 and 1996 was as follows:

	1997	1996
Gross patient service revenue, net of charity care charges foregone of $444,745 and $315,488 in 1997 and 1996, respectively	$ 85,490,886	$ 87,152,567
Less provision for contractual and other adjustments	37,592,277	36,559,033
Net patient service revenue	$ 47,898,609	$ 50,593,534

6. Revenue Bonds Payable

Revenue bonds payable consist of Hospital Revenue Refunding Bonds, Series 1987, dated September 1, 1987. These bonds consist entirely of fixed rate serial bonds bearing interest ranging from 7.15% to 7.85%, and requiring principal payments ranging from $515,000 to $840,000 through January 1, 2005. Principal and interest are secured by a pledge of, and payable only from, the future revenues of the Hospital.

The revenue bonds maturing on January 1, 1998, and thereafter, are callable at the option of the City on or after July 1, 1997, at a premium of up to 2% of the principal amount retired or redeemed prior to July 1, 2001.

The future principal payments for the next five years for the 1987 Hospital Revenue Refunding Bonds are as follows: 1998 - $515,000; 1999 - $545,000; 2000 - $580,000; 2001 - $615,000; and 2002 - $665,000.

In 1987, the Hospital created an irrevocable trust in an amount sufficient to pay principal and interest on its outstanding 1985 Revenue Bonds. The recording of the in-substance defeasance resulted in the removal of the outstanding bonds and the trust assets from the Hospital's balance sheet in 1987. The 1985 revenue bonds were called on January 1, 1996, at a redemption price of 102% of the principal amount plus accrued interest. The principal amount of the called bonds was $5,225,000.

The Hospital is required to comply with covenants contained in the 1987 Revenue Bond Ordinance, including, among other requirements, the maintenance of certain funds on deposit with the Trustee, annual certification to the Trustee of adequate insurance coverage, limitations on the issuance of additional indebtedness by the Hospital, and the maintenance of a debt service coverage ratio of 1.20. The Hospital was in compliance with revenue bond covenants for the years ended December 31, 1997 and 1996.

7. Transactions With the City of Bossier City

After the Hospital pays operating expenses and makes deposits as described in the 1987 Revenue Bond Ordinance, the City of Bossier City may transfer amounts, on an annual basis, from the Hospital's operating fund to the City's general fund (or any other fund the City designates). Transfers to the City may not exceed 5% of the Hospital's net property, plant, and equipment balance as shown on the most recently audited financial statements.

8. Leases

The Hospital leases medical and administrative equipment and physicians' office space under operating leases with terms that vary from month-to-month to five years. Total rental expense for 1997 and 1996 for all operating leases was $1,283,726 and $1,293,842, respectively.

Under the terms of one of its operating lease agreements, the Hospital has an obligation to purchase the leased property, consisting of physicians' office space, for a purchase price of $306,000, on or before May 31, 1999.

Future minimum lease payments under operating leases that have initial or remaining lease terms in excess of one year as of December 31, 1997 are as follows:

Year ending December 31:	
1998	$ 390,834
1999	343,098
2000	186,836
2001	14,280
2002	1,190
Total minimum lease payments	$ 936,238

9. Retirement Plan

Plan Description

Bossier Medical Center Employees' Pension Plan (the Plan) is a single-employer noncontributory defined benefit public employee retirement system (PERS) administered by the City of Bossier City. The Plan covers all employees who meet Plan specified length of service requirements. The Plan provides retirement, death and disability benefits to plan members and beneficiaries. The Hospital's board of directors has the authority to establish and amend benefit provisions. The City of Bossier City issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to Mr. Charles E. Glover, Director of Finance, City of Bossier City, P. O. Box 5337, Bossier City, Louisiana 71171-5337.

9. Retirement Plan (continued)

Funding Policy

The contribution requirements of the Hospital are established and may be amended by the Hospital's board of directors. The Hospital is required to contribute at an actuarially determined rate; the current rate is 6.5% of annual covered payroll.

Annual Pension Cost and Net Pension Obligation

For 1997, the Hospital's annual pension cost of $660,000 was equal to 100% of the Hospital's actual contributions. The required contribution for 1997 was determined as part of the January 1, 1997 actuarial valuation using the aggregate actuarial cost method. This method does not identify or separately amortize unfunded liabilities. Significant actuarial assumptions included: (a) 7.5% investment rate of return, compounded annually, (b) projected salary increases of 3% per year compounded annually, attributable to inflation, (c) additional projected salary increases of 1% per year, attributable to seniority/merit, (d) no postretirement benefit increases, and (e) postretirement benefit values based on 7.5% interest and sex specific 1983 Group Annuity mortality. The Plan's net pension obligation was zero at December 31, 1997.

The Hospital's pension liability at transition was determined in accordance with Statement No. 27 of the Governmental Accounting Standards Board and equaled zero before and after transition.

10. Professional Liability, Employee Medical, and Workers' Compensation Insurance

The Hospital is qualified under the State of Louisiana medical malpractice program and has obtained coverage for the first $100,000 of professional liability per occurrence through the Louisiana Hospital Association Trust Fund (Trust Fund), effective through October 31, 1997, and through a commercial insurance carrier effective November 1, 1997. Additional coverage is provided by the Louisiana Patients' Compensation Fund (LPCF) for the next $400,000 of professional liability up to the present statutory maximum of $500,000 per claim (exclusive of additional amounts for future medical expense provided by law). The Trust Fund and the LPCF provide coverage on an occurrence basis, and the commercial coverage is provided on a claims made basis.

10. Professional Liability, Employee Medical, and Workers' Compensation Insurance (continued)

The Hospital has certain pending and threatened litigation and claims incurred in the ordinary course of business; however, management believes that the probable resolution of such contingencies will not exceed the Hospital's insurance coverages, and will not materially affect the financial position of the Hospital or the results of its operations.

Prior to January 1, 1997, the Hospital was self-insured for employee health care claims up to an annual individual stop-loss limitation of $75,000. Commercial insurance is in force for those claims which exceed the annual individual stop-loss limitation and do not exceed the individual lifetime reinsurance limitation of $1,000,000. Effective January 1, 1997, the Hospital purchased insurance covering employee health claims through a preferred provider organization and is no longer self-insured for this risk.

The Hospital provides coverage for payment of compensation and benefits required of employers pursuant to the Louisiana Workers' Compensation Act through a partially self-insured plan. A commercial carrier covers claims exceeding the $200,000 per incident stop-loss limitation up to an annual aggregate limit of $1,000,000. The Hospital is responsible for all workers' compensation claims incurred below the per incident limitation and in excess of the annual aggregate limitation. The Hospital has pledged a certificate of deposit in the amount of $100,000 with the Office of Workers' Compensation for the State of Louisiana as collateral to secure the prompt payment of workers' compensation claims.

The Hospital records a liability for workers' compensation 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.

11. Prior Period Adjustments

The 1996 financial statements of the Hospital have been restated to correct for the effects of certain errors related to an overstatement of net patient accounts receivable and the write-off of an abandoned construction project. The effect of the adjustments was to decrease previously reported fund balance as of January 1, 1996 by $798,000, decrease previously reported 1996 income from operations and revenue in excess of expenses by $176,954 and decrease previously reported fund balance as of December 31, 1996 by $974,954.

12. Year 2000 Computer Issues (Unaudited)

The Year 2000 issue is the result of computer programs being written using two digits rather than four to define the applicable year. The Hospital's computer programs and certain computer aided medical equipment that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in system failures or miscalculations causing disruption of operations or medical equipment malfunctions that could affect patient diagnosis and treatment. The Hospital believes that with modifications to existing software and conversions to new software, the Year 2000 issue will not pose significant operational problems for its computer systems. However, if such modifications and conversions are not made, or are not completed timely, the Year 2000 issue could have a material impact on the operations of the Hospital.

The Hospital has initiated the process of preparing its computer systems and applications for the year 2000. The Hospital expects to incur internal staff costs as well as external consulting and other expenses to prepare the systems for the year 2000. However, there can be no assurance that the systems of other companies, on which the Hospital's systems rely, will be timely converted or that any such failure to convert by another company (such as third-party payors) would not have an adverse effect on the Hospital's systems.

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Report on Compliance and on Internal Control Over Financial Reporting

The Board of Directors
Bossier Medical Center

We have audited the financial statements of Bossier Medical Center as of and for the year ended December 31, 1997, and have issued our report thereon dated March 13, 1998. We also audited the adjustments described in Note 11 to the financial statements that were applied to restate the 1996 financial statements. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Bossier Medical Center's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*, except as follows:

> Bossier Medical Center did not comply with public bid laws in the award of contracts related to a construction project with a total cost of approximately $500,000.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Bossier Medical Center's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may

occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted matters involving the internal control over financial reporting that we have reported to management in a separate letter dated November 27, 1997, prior to our engagement as auditors of Bossier Medical Center as of and for the year ended December 31, 1997.

* * * * *

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

Ernst + Young LLP

March 13, 1998

ERNST & YOUNG LLP

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Report of Independent Auditors

The Board of Directors
Bossier Medical Center

We have audited, in accordance with generally accepted auditing standards, the financial statements of Bossier Medical Center for the year ended December 31, 1997, and have issued our report thereon dated March 13, 1998. We also have audited the accompanying schedule of depreciation and related calculations of the special depreciation fund requirement of the Hospital for the year ended December 31, 1997, based on the financial statements referred to above. This information is the responsibility of the Hospital's management. Our responsibility is to express an opinion on this information based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the schedule of depreciation and related calculations of the special depreciation fund requirements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the schedule of depreciation and related calculations of the special depreciation fund requirements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the method of preparing the schedule of depreciation and the method of calculating the special depreciation fund requirement is prescribed by Sections 101 and 509 of the Ordinance No. 54 of 1987 authorizing the issuance of and securing Hospital Revenue Bonds of the City of Bossier City, State of Louisiana, adopted July 22, 1987.

In our opinion, the schedule referred to above presents fairly, in all material respects, the depreciation and related calculations of the special depreciation fund requirement for the year ended December 31, 1997, on the basis of the requirement referred to in the preceding paragraph, except that the schedule of depreciation has been prepared based on calendar years rather than on years ending March 31 as specified in the Ordinance.

This report is intended solely for the use of the board of directors and management of Bossier Medical Center, the City Council of the City of Bossier City, and the bond trustee and should not be used for any other purpose.

Ernst & Young LLP

March 13, 1998

Bossier Medical Center

Schedule of Depreciation and Related Calculations of the Special Depreciation Fund Requirement

December 31, 1997

Year Ending December 31	Depreciation Allowance	Sinking Fund/ Principal Requirements	Annual Depreciation Shortfall
1997	$ 2,514,904	$ 515,000	$ –
1998	2,530,547	545,000	–
1999	2,261,032	580,000	–
2000	1,970,239	615,000	–
2001	1,723,576	665,000	–
2002	1,534,278	710,000	–
2003	1,320,868	755,000	–
2004	1,118,950	840,000	–
			–
	$ 14,974,394	$ 5,225,000	$ –

Crossover Date — N/A
Special Depreciation Fund Requirement for the year ended December 31, 1997 — $0

See accompanying notes.

Bossier Medical Center

Notes to Schedule of Depreciation and Related Calculations of the Special Depreciation Fund Requirement

December 31, 1997

1. Basis of Presentation

The method of preparing the schedule of depreciation and the method of calculating the special depreciation fund requirement is prescribed by Sections 101 and 509 of the Ordinance No. 54 of 1987 authorizing the issuance of and securing Hospital Revenue Bonds of the City of Bossier City, State of Louisiana, adopted July 22, 1987.

2. Accounting Policy

The Hospital provides for depreciation of its plant and equipment using the straight-line method in amounts sufficient to amortize the cost of its assets over their estimated useful lives. The range of estimated useful lives is 15 to 40 years for the building and its components and 3 to 20 years for equipment.

Bossier Medical Center

Results

Report to the Board of Directors

1997

Results

Audit Results

Results

Results

ERNST & YOUNG LLP

■ 4200 One Shell Square
New Orleans, LA 70139

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April 24, 1998

The Board of Directors
and Management
Bossier Medical Center

We are pleased to present the results of our audit of the financial statements of Bossier Medical Center for the year ended December 31, 1997.

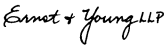
As this was our first audit of the Hospital in a number of years, our audit approach was designed to combine a fresh look at the Hospital's current and emerging business issues with a focus on the Health Care industry issues of today.

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

The completion of this year's audit was accomplished through the effective support and the assistance of the Hospital's accounting and administrative personnel. Because we hope to develop a long-term working relationship with you and the Hospital, one of our goals is 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, please call Greg Swan at (504) 596-4206.

Very truly yours,



Contents

Focus 1997 **Audit Results** 1
Summary of What We Agreed To Do 2
Update of Identified Business Risks 3
Financial Statement Highlights 4
Required Communications 12
Focus 1997 **Value Results** 14
Value Scorecard 15
Looking Ahead to **Next Year** 16
Continuity and Commitment of Your Team 17
Health Care, Hospitals — Accounting Developments 18
Identified Business Risks — 1998 New Developments 19
Trends — Performance Ratios 21
Value Ideas 22
1998 Audit Planning 23
Appendix **Audit Process** 24
Our Audit Process 25

Bossier Medical Center

Focus 1997

Audit Results

Summary of What We Agreed To Do

Our Approach

As discussed with Management during the auditor selection process as well as during our audit planning process, our audit plan represented an approach responsive to the assessment of risk for the Hospital. Specifically, we designed our audit to:

- Issue an opinion on the financial statements of the Hospital.
- Issue a report on the Hospital's compliance and internal control over financial reporting.
- Issue a report on the Hospital's Schedule of Depreciation and Related Calculations of the Special Depreciation Fund Requirements.
- Follow up on the status of the Hospital's implementation of the recommendations included in our November 1997 report on our review of internal controls, and communicate any additional significant recommendations noted.
- Provide financial information to the City of Bossier City's auditors necessary for consolidation purposes.

Areas of Audit Emphasis

The principal areas of audit emphasis were as follows:

- Accounts receivable, and allowances for uncollectible accounts, contractual adjustments and managed care discounts.
- Reimbursement settlement estimates and related reserves.
- Capital expenditures.
- Workers compensation self-insurance reserves.
- Physician compensation.
- Compliance with debt covenants.

There were no changes to our planned approach or areas of audit emphasis, except that we also audited the adjustments that were applied to restate the Hospital's 1996 financial statements, to correct for the effects of certain errors noted by the Hospital's current management, in order to determine the propriety and proper application of those adjustments.

Update of Identified Business Risks

Key issues discussed during our audit process, including their business and audit implications, are outlined below along with relevant comments relating to each item.

Internal/External Factors	Business Implication	1997 Audit Implication	Audit Results and Comments
Industry Issue **Medicare and Medicaid Reform** Balanced Budget Act of 1997 freezes payments and reduces future updates and encourages the movement to managed care.	High dependency on third party reimbursement and continued erosion of payments presents the Hospital with operating margin challenges.	Identify and focus on the following audit issues: • Economic performance • Medicare/Medicaid regulatory environment	Management has begun to estimate the effects of the Balanced Budget Act. Except for routine cost report audits, the Hospital has not undergone any third party regulatory audits.
Industry Issue **Fraud and Abuse** Expansion of Operation Restore Trust and anticipated additional federal and state funding of fraud enforcement initiatives.	Expanded and heightened government enforcement initiatives increase the need for an effective Corporate Compliance Program.	Obtain an understanding of management's monitoring activities over internal controls and status of development of Corporate Compliance Program.	We gained an understanding of management's monitoring activities over internal controls. We noted the Hospital has not yet developed or implemented a Hospital-wide Corporate Compliance Program.
Industry Issue **Managed Care Environment** The percentage of patients covered by managed care contracts continues to rise and complexity of risk sharing arrangements is increasing.	Hospital assumption of additional risk to maintain patient volumes.	Review significant contracts for proper recording of revenues and for related liabilities and disclosure of risks.	We reviewed significant contracts for proper recording of revenues and the related contractual discounts. Adjustments were recorded to correct for errors noted.
Industry Issue **Managed Care Capitation** Capitation arrangements continue to grow in volume and higher risk profile of insured population.	Increased litigation due to increasing pressure to care for patients efficiently.	Focus on risk management system.	The Hospital does not yet have significant capitation arrangements. We reviewed the risk management system.
Industry Issue **Growth in Physician Groups** Nationally, the growth in physicians' groups continues.	Management should evaluate the need for an MSO and other changes in physician contracts.	Consider availability, cost and continuity of physician services to staff Hospital operations.	We reviewed significant physician contracts and evaluated accounting policies in this area.

Financial Statement Highlights

The Hospital's 1997 financial statements reflect a solid financial position and declining but still profitable operational performance. Bossier Medical Center appears to be adequately positioned relative to its competition with respect to liquidity and creditworthiness.

Condensed Statements of Revenue and Expenses

	Year ended December 31 1997	1996 (As adjusted)
Net patient service revenue	$ 47,898,609	$ 50,593,534
Other revenue	421,122	434,876
Total revenue	48,319,731	51,028,410
Total expenses	48,065,111	49,573,584
Income from operations	254,620	1,454,826
Nonoperating investment income	530,381	322,161
Revenue in excess of expenses	$ 785,001	$ 1,776,987

Detail of Expenses

	Year ended December 31 1997	1996 (As adjusted)
Salaries and wages	$ 19,855,370	$ 19,336,645
Employee benefits and payroll taxes	3,957,503	4,372,531
Supplies and materials	6,878,054	7,775,165
Purchased services	3,910,748	3,710,650
Provision for doubtful accounts	4,461,587	5,276,129
Other operating expenses	5,917,114	5,590,672
Depreciation and amortization	2,650,258	3,023,713
Interest expense	434,477	488,079
Total Expenses	$ 48,065,111	$ 49,573,584

Restatement of 1996 Financial Statements

	Effect on 1/1/96 Fund Balance	Effect on 1996 Income
Increase allowance for contractual adjustments on managed care and physician accounts receivable	$ (991,000)	$ –
Reduce allowance for doubtful accounts for the effects of additional discounts recorded above	193,000	–
Write off architect fees related to construction project abandoned in 1996	–	(176,954)
	$ (798,000)	$ (176,954)
Fund balance at 1/1/96, as previously reported	33,493,381	
Fund balance at 1/1/96, as adjusted	$ 32,695,381	
Revenue in excess of expenses for 1996, as previously reported		1,953,941
Revenue in excess of expenses for 1996, as adjusted		$ 1,776,987

Condensed Balance Sheets

	December 31 1997	1996 (As adjusted)
Current assets	$ 16,650,903	$ 20,037,461
Assets whose use is limited	5,999,041	2,824,742
Property, plant and equipment, net	20,149,134	20,417,840
Other assets	462,324	716,688
Total Assets	$ 43,261,402	$ 43,996,731
Current liabilities	$ 4,374,115	$ 4,849,363
Revenue bonds payable	4,710,000	5,225,000
Fund balance	34,177,287	33,922,368
Total Liabilities and Fund Balance	$ 43,261,402	$ 43,996,731

Condensed Statements of Cash Flows

	Year ended December 31 1997	1996 (As adjusted)
Income from operations	$ 254,620	$ 1,454,826
Depreciation and amortization	2,650,258	3,023,713
Interest expense, interest income on bond funds and asset write-offs	455,951	594,686
Changes in operating assets and liabilities	(2,191,531)	2,073,590
Net Cash Provided by Operating Activities	1,169,298	7,146,815
Operating transfer to City of Bossier City	(550,000)	(680,953)
Net cash used in noncapital financing activities	(550,000)	(680,953)
Purchases of property, plant and equipment	(2,226,280)	(677,860)
Principal and interest paid on revenue bonds and notes payable	(901,360)	(1,495,490)
Net cash used in capital and related financing activities	(3,127,640)	(2,173,350)
Interest received	586,558	392,508
Purchases of investments	(1,097,630)	-
Net cash (used in) provided by investing activities	(511,072)	392,508
Net increase/(decrease) in cash and cash equivalents	(3,019,414)	4,685,020
Cash and cash equivalents at beginning of year	11,763,737	7,078,717
Cash and cash equivalents at end of year	$ 8,744,323	$ 11,763,737

Significant Metrics

Gross Patient Revenue by Payor Source

1997

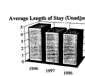
■ Medicare=52.0%	■ Medicaid=3.0%	□ Blue Cross/Blue Shield=8.0%
□ Commercial Insurance=30.0%	■ Self-Pay=5.0%	■ Other=2.0%

- Due to system limitations, the Hospital's managed care revenues are included in the commercial insurance category.
- Consistent with industry trends, the Hospital has experienced a shift from commercial payors and traditional Medicare to managed care. This shift is expected to continue in 1998.

Gross Patient Revenue by Payor Source

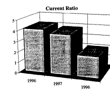
1996

- In 1996, 1 in 2 Americans was enrolled in HMOs, PPOs, 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.

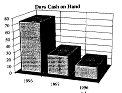


- The Hospital's acute care average length of stay declined in 1997 but remains slightly above the 1996 industry average.

- 1996 results have been restated to reflect the write-off of an abandoned construction project.
- Operating profit margin declined considerably in 1997 due partly to declining admissions and continued shift toward managed care.

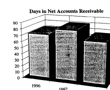


- The Hospital's current ratio significantly exceeds the industry average.



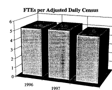
- Days' cash on hand exceeds the industry average but declined significantly in 1997.
- The decline was primarily due to additional funded depreciation which is excluded from cash. Funded depreciation totaled $5,009,000 at 12/31/97 and $1,690,000 at 12/31/96.

Days in Net Accounts Receivable

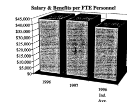


- The Hospital's days revenue in net accounts receivable increased 13% in 1997 and remains significantly higher than the industry average.

FTEs per Adjusted Daily Census



- FTEs per adjusted daily census remained constant from 1996 to 1997, and are slightly over the industry average.



- Salary and benefits per FTE exceed the industry average.
- These amounts include physicians salaries and bonuses.

Required Communications

Statement on Auditing Standards No. 61 and other professional standards require the auditor to provide the Board of Directors with additional information regarding the scope and results of the audit that may assist the Board 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 the scope of our audit was adequate and that the financial statements of Bossier Medical Center as of December 31, 1997 and for the year then ended are presented fairly in conformity with generally accepted accounting principles applied on a consistent basis. It is also our opinion that the adjustments applied to restate the 1996 financial statements are appropriate and have been properly applied.
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 the Hospital and the methods of applying these principles conform, in all material respects, with generally accepted accounting principles generally used by governmental healthcare entities. We noted no changes in significant accounting policies or their application, except for the change in method of accounting for certain inventories as described in Note 1 to the financial statements.
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.	Areas requiring significant accounting estimates are: *Estimated Medicare and Medicaid Settlements* for which differences between original estimates and subsequent revisions (including final settlements) are recorded as adjustments to revenue in the period in which the revisions are made. During 1997, such adjustments, on a net basis, were not significant to the Hospital's operating results. *Allowance for Uncollectible Accounts* which is based on estimated uncollectible percentages based on past experience and other factors applied to various aging categories of accounts receivable. Estimation process used in 1997 was consistent with prior periods, except that allowance was calculated for HMO/PPO accounts as well as commercial payors, and the effects of contractual allowances recorded for these payors were considered in the estimation process. *Allowances for Contractual Adjustments and Discounts* which are based on estimated DRG amounts for Medicare inpatient claims and on interim payment rates, per diem rates, and other payment factors for discounted payors. Estimation process used in 1997 was generally consistent with prior periods.

<table>
<tr><th>Area</th><th>Comments</th></tr>
<tr><td>Management Judgments and Accounting Estimates
(continued)</td><td>Self-Insurance Reserve for worker's compensation claims which is estimated based on specific claims as well as historical experience. In the prior year, the Hospital used an actuary to assist in estimating the worker's compensation claims reserve; however, an actuary was not used as of December 31, 1997.</td></tr>
<tr><td>Significant Audit Adjustments</td><td>There were several audit adjustments recorded in the 1997 financial statements. The net effect of the adjustments was an approximate $10,000 increase in excess revenues over expenses as follows:
<table>
<tr><td>Net increase in A/R allowances</td><td>$(115,000)</td></tr>
<tr><td>Decrease in Medicare settlement</td><td>(135,000)</td></tr>
<tr><td>Record construction w/o in 1996</td><td>177,000</td></tr>
<tr><td>Increase inventory to physical count</td><td>79,000</td></tr>
<tr><td>Other</td><td>4,000</td></tr>
<tr><td>Total</td><td>$ 10,000</td></tr>
</table>
In addition, as described earlier, several adjustments were made to the 1996 financial statements to correct for certain errors noted therein.

Certain other audit differences were identified and discussed with Management; these differences were considered immaterial and, therefore, were not recorded in the Hospital's 1997 financial statements.</td></tr>
<tr><td>Disagreements with Management on Financial Accounting and Reporting Matters</td><td>There were no disagreements with Management.</td></tr>
<tr><td>Major Issues Discussed with Management Prior to Retention</td><td>Prior to our retention as the Hospital's auditors, we discussed with Management the potential for restatement of the 1996 financial statements to correct certain errors noted therein.</td></tr>
<tr><td>Consultation with Other Accountants</td><td>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. Management did discuss the adjustments made to the 1996 financial statements with the Hospital's prior auditors.</td></tr>
<tr><td>Serious Difficulties Encountered in Performing the Audit</td><td>There were no serious difficulties encountered in performing the audit.</td></tr>
<tr><td>Material Errors, Irregularities and Illegal Acts</td><td>Our audit did not identify any material weaknesses in internal accounting controls or material errors, material irregularities or possible illegal acts, except for audit adjustments which were recorded by the Hospital and except for noncompliance with public bid laws in connection with the rehab unit renovation project.</td></tr>
</table>

Bossier Medical Center

Focus 1997

Value Results

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 Hospital, and seek your input as to additional value we can bring to the Hospital and the Board.

Issue	Description of Assistance	Value
Knowledge Transfer		
Technical Update	Summary of emerging accounting issues and pronouncements.	Current information on accounting topics which may affect the Hospital's financial statements in the future.
Information Security Review	General review of computer controls.	Written recommendations to management to enhance internal controls over the information system environment.
Peer Group Analysis	Key performance indicators compared to selected competitors.	Information on performance of key competitors.
Board Report	Discusses current topics in the health care industry.	Current strategic information.
Increasing Shareholder Value		
Taxes	Timely assistance with Foundation and payroll tax issues.	Finalization of tax-exempt status of Foundation and compliance with payroll tax reporting requirements.
Project Assistance		
Internal Control Review	Performed extensive review of Hospital's internal accounting controls and provided written recommendations for improvements.	Provided new management with information to assist in prioritizing areas for improvement, implementing improvements in internal accounting controls, and enhancing certain accounting processes.
Restatement of 1996 Financial Statements	Assisted management in determining the propriety of certain adjustments made to the 1996 financial statements as well as the proper application of the adjustments.	Provided for more accurate 1997 financial statements.
Adoption of GASB Statements 25 and 26	Assisted management in adopting new accounting standards affecting the Hospital's pension plan.	Accounting and financial statement disclosures are in conformity with the new standards and are consistent with the City of Bossier City.

Bossier Medical Center

Looking Ahead to

Next Year

ERNST & YOUNG LLP

Continuity and Commitment of Your Team

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

Engagement Member	Responsibility	Years of Health Care Experience
Greg Swan	Engagement Audit Partner	20
Bruce Linklater	Independent Review Partner	25
Sally Seyler	Audit Senior Manager	19
Arthur Parham	Tax Senior Manager	20
Jennifer Callahan	Audit Senior	5

Greg, Sally and Jennifer also performed the review of internal controls for the Hospital in late 1997, through which valuable knowledge and insight regarding the Hospital's accounting policies and practices were gained. This also helped to facilitate a smooth transition from the prior auditors and helped us to deliver all reports on time.

Emerging Accounting Issues and Pronouncements

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

- Investments—In March 1997, the GASB issued GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, that requires governmental entities to report most investments at fair value in their annual financial statements for periods beginning after June 15, 1997. All investment income, including changes in the fair value of investments, should be reported as revenue in the operating statements. For entities other than external investment pools, cost-based measures are permitted to report certain money market investments provided that the investment has a remaining maturity when purchased of one year or less.

- Financial Reporting—During the first quarter of 1997, the GASB also issued an exposure draft of a proposed Statement, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. Under the proposed Statement, the basis financial statements would include both entity-wide perspective and fund perspective financial statements with a single set of notes. Management's discussion and analysis, to be presented as required supplementary information, would analyze a government's financial performance for the year and its financial position at year end. The proposed effective date of a final Statement is for periods beginning after June 15, 2000.

- Year 2000 Costs—In Issue No. 96-14, the EITF addresses how to account for the external and internal costs specifically associated with modifying internal-use computer software for the year 2000 issue. The EITF reached a consensus that these costs should be charged to expense as incurred.

- Accounting for Certain Managed Care Arrangements—The AICPA Health Care Committee and the AICPA Insurance Companies Committee are working jointly on a proposed SOP (Statement of Position) which would address the differences in accounting for similar transactions entered into by health care organizations and insurance companies. The SOP would amend the Audit and Accounting Guide for Health Care Organizations. An exposure draft is expected in the near future.

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.

Year 2000 Computer Issues

The Year 2000 issue is the result of computer programs being written using two digits rather than four to define the applicable year. The Hospital's computer programs and certain computer aided medical equipment that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in system failures or miscalculations causing disruption of operations or medical equipment malfunctions that could affect patient diagnosis and treatment. The Hospital believes that with modifications to existing software and conversions to new software, the Year 2000 issue will not pose significant operational problems for its computer systems. However, if such modifications and conversions are not made, or are not completed timely, the Year 2000 issue could have a material impact on the operations of the Hospital.

The Hospital has initiated the process of preparing its computer systems and applications for the year 2000. The Hospital expects to incur internal staff costs as well as external consulting and other expenses to prepare the systems for the year 2000. However, there can be no assurance that the systems of other companies, on which the Hospital's systems rely, will be timely converted or that any such failure to convert by another company (such as third-party payors) would not have an adverse effect on the Hospital's systems.

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 stakeholders' 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 question 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 board 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

Trends — Performance Ratios (1996)

	Bossier Medical Center	Doctors' Hospital of Shreveport	Glenwood Regional Medical Center	Schumpert Medical Center	Willis-Knighton Medical Center
Utilization Profile					
Occupancy Rate (%)	65.67	31.20	50.71	50.38	50.73
FTEs per Adjusted Daily Census	5.54	7.27	4.26	6.34	6.06
Salary & Benefits per FTE Personnel	48,313	37,224	37,292	37,065	45,883
Average Length of Stay (Unadjusted)	4.52	5.30	4.57	4.53	4.20
O/P Revenue as % of Total Pt. Revenue	38.44	38.66	40.75	29.14	28.90
Payor Mix Profile					
Medicare Case Mix Index	1.36	1.23	1.33	1.56	1.60
Medicare Days %	63.82	72.34	53.42	56.37	55.44
Medicaid Days %	3.65	4.06	6.00	7.43	10.82
Liquidity Profile					
Operating Profit Margin (%)	3.19	(4.81)	6.85	4.67	11.15
Total Profit Margin (%)	3.80	(4.81)	10.38	4.72	13.49
Cash Flow Margin (%)	9.68	0.95	24.52	14.76	14.93
Uncollectible Ratio (%)	41.95	56.39	39.70	44.05	48.04
Debt Service Coverage Ratio	25.20	11.30	5.57	5.21	11.55
Creditworthiness Profile					
Cash Flow to Total Liabilities	0.49	0.04	0.34	0.40	0.22
Current Ratio	4.31	0.07	4.13	1.87	8.33
Days Cash on Hand	65.24	(7.27)	152.73	13.09	106.74
Days in Net Accounts Receivable	77.04	7.00	52.45	75.38	63.34
Average Payment Period (Days)	37.94	28.60	55.90	61.55	22.62
Long-term Liabilities to Capitalization	0.13	2.06	0.39	0.15	0.44
Capital Costs as % of Operating Exp.	8.08	10.27	13.75	12.10	1.92
Average Age of Plant (Years)	10.40	2.46	7.67	7.76	31.95

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 (1996). 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.

Suggestions for Improvement in the Business

During the latter part of 1997, we assisted the Hospital by performing a review of internal controls and providing written recommendations for improvement, most of which management had begun to address as of our audit date. We have not repeated those recommendations below. Following are other observations for your review.

Topic	Development	Recommended Action
Managed Care Accounts Receivable	The Hospital does not maintain managed care logs to assist in evaluation of the performance of its managed care contracts, the determination of whether the proper amount has been paid, and the estimation of discounts on unpaid claims.	We recommend the Hospital consider implementing a managed care log system. Such a system can help with the areas mentioned as well as with negotiating new or renewed contracts.
Medicare and Medicaid Settlements	The Hospital's Medicare and Medicaid settlement accounts have been adjusted to approximately equal the amounts due to or from the Medicare and Medicaid programs based on filed or to be filed cost reports. Reserves for potential intermediary adjustments have not been recorded.	It is our understanding that management is not aware of any items which are probable of disallowance or adjustment by the intermediary. However, we recommend management review past intermediary audit results and monitor future results to identify any potential significant adjustments for which reserves should be established. This should help prevent any significant negative "surprises" as a result of intermediary audits.

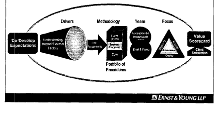
1998 Audit Planning

Planning for the 1998 audit will be developed in cooperation with management. As a balanced effort, it will give full recognition to the newly implemented 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 have discussions with management throughout the year regarding current developments and we will challenge the continuing adequacy of the 1998 audit plan. Any significant changes to the plan will be promptly communicated to you.

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 Hospital.

Co-Develop Expectations

In setting mutual expectations, we agree on: 1) understanding the Hospital's needs; 2) providing useful deliverables; and, 3) measuring the value of our relationship. This meeting with the Audit Committee 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 Hospital'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 Hospital'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 Hospital'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 Hospital'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 Hospital'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 Hospital'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 Hospital succeed.