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Slidell Memorial Hospital and Medical Center

December 31, 1997

Schedule of Board of Commissioners Fees (Unaudited)

Audited Consolidated Financial Statements

Report on Compliance and on Internal Control Over Financial Reporting

Report of Independent Auditors on Compliance with Trust Indenture

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

Slidell Memorial Hospital and Medical Center

Board of Commissioners' Fees (Unaudited)

Year ended December 31, 1997

Commissioner	Meetings Attended	Amount
Emily Cote	27	$ 2,025
Mary Ann Dutton	28	2,100
David Fargo	25	1,875
Gus Fritchie	13	975
Thomas Hall	13	975
Albert Hamauei	31	2,325
Mark Hines	18	1,350
Janie McKenzie	14	1,050
John Pasqua	17	1,275
Steve Stefancik	17	1,275
Clinton Thomas, Jr.	11	825
Total		$16,050

Consolidated Financial Statements

Slidell Memorial Hospital and Medical Center

Year ended December 31, 1997
with Report of Independent Auditors

Slidell Memorial Hospital and Medical Center

Consolidated Financial Statements

Year ended December 31, 1997

Contents

ERNST & YOUNG LLP

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Report of Independent Auditors

The Board of Commissioners
St. Tammany Parish Hospital Service District No. 2

We have audited the accompanying consolidated balance sheet of St. Tammany Parish Hospital Service District No. 2 (d/b/a Slidell Memorial Hospital and Medical Center) as of December 31, 1997, and the related consolidated statements of revenue, expenses and 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.

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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of St. Tammany Parish Hospital Service District No. 2 at December 31, 1997, and the consolidated results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have issued our report dated February 27, 1998 on our consideration of St. Tammany Parish Hospital Service District No. 2's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

Ernst & Young LLP

February 27, 1998

Slidell Memorial Hospital and Medical Center

Consolidated Balance Sheet

December 31, 1997

Assets	
Current assets:	
Cash and cash equivalents	$ 3,501,369
Patient accounts receivable, less allowance for uncollectible accounts of $3,374,000	15,318,004
Assets whose use is limited and required for current debt service	885,257
Inventories	1,549,480
Prepaid expenses and other receivables	988,907
Total current assets	22,243,017
Assets whose use is limited or restricted, less current portion:	
By board or under indenture agreement for capital improvements and debt service	31,185,778
Other assets:	
Investment in affiliated organizations	1,275,599
Bond issuance costs, net of accumulated amortization of $333,399	1,502,490
Intangible assets, net of accumulated amortization of $171,003	69,777
	2,847,866
Land, buildings and equipment:	
Land and land improvements	4,466,386
Buildings	45,409,237
Equipment	32,420,813
Less accumulated depreciation and amortization	(38,017,583)
Construction in progress	1,873,903
	46,152,756
	$ 102,429,417

Liabilities and fund balance	
Current liabilities:	
Trade accounts payable	$ 2,459,156
Salaries, wages and benefits payable	2,469,585
Accrued vacation payable	1,134,164
Accrued interest and other expenses	3,354,952
Amounts due to third-party payors	1,419,961
Amounts due within one year on capital lease obligations and long-term debt	2,680,212
Total current liabilities	13,518,030
Capital lease obligations, less amounts due within one year	1,214,126
Long-term debt, less amounts due within one year	37,348,469
Fund balance	50,348,792
	$ 102,429,417

See accompanying notes.

Slidell Memorial Hospital and Medical Center

Consolidated Statement of Revenue, Expenses and Fund Balance

Year ended December 31, 1997

Net patient service revenue	$ 82,898,844
Other revenue	4,568,034
Total revenue	87,466,878
Expenses:	
Salaries and wages	33,594,298
Employee benefits	8,795,829
Supplies and materials	11,541,767
Other direct expenses	7,411,134
Professional fees	4,134,190
Purchased services	3,458,257
Provision for bad debts	5,582,171
Depreciation and amortization	5,653,318
Interest	2,499,657
Total expenses	82,670,621
Revenue in excess of expenses	4,796,257
Transfer of Hospice Foundation assets to SMH Foundation	220,048
Fund balance at beginning of year	45,332,487
Fund balance at end of year	$ 50,348,792

See accompanying notes.

Slidell Memorial Hospital and Medical Center

Consolidated Statement of Cash Flows

Year ended December 31, 1997

Operating activities	
Revenue in excess of expenses	$ 4,796,257
Adjustments to reconcile revenue in excess of expenses to net cash provided by operating activities:	
Depreciation and amortization	5,653,318
Changes in operating assets and liabilities:	
Patient accounts receivable, net	(3,811,502)
Inventories and other operating assets	(160,358)
Accounts payable and other accrued expenses	3,787,167
Items whose cash flows are capital and related financing activities:	
Interest expense	2,499,656
Loss on sale of capital assets	85,957
Items whose cash flows are investing activities:	
Interest income	(1,901,065)
Net cash provided by operating activities	10,949,430
Capital and related financing activities	
Receipts from sale of capital assets	16,108
Payments for acquisitions of land, buildings and equipment	(8,104,538)
Principal paid on capital leases and long-term debt	(3,119,461)
Interest paid on capital leases and long-term debt	(2,675,130)
Net cash used in capital and related financing activities	(13,883,021)
Investing activities	
Decrease in assets whose use is limited or restricted	1,334,675
Receipts of interest earned	1,937,913
Investments in affiliated organizations	(267,019)
Net cash provided by investing activities	3,005,569
Net increase in cash and cash equivalents	71,978
Cash and cash equivalents at beginning of year	3,429,391
Cash and cash equivalents at end of year	$ 3,501,369

See accompanying notes.

1. Organization and Significant Accounting Policies

Organization

St. Tammany Parish Hospital Service District No. 2 (the District), d/b/a Slidell Memorial Hospital and Medical Center (the Hospital), is a nonprofit corporation organized as a political subdivision of the State of Louisiana. The governing authority of the District is the St. Tammany Parish Police Jury, which is the governing authority of St. Tammany Parish, Louisiana. The governing authority appoints members of the St. Tammany Parish Hospital Service District No. 2 Board of Commissioners (the Board) to oversee and govern the operations of the Hospital.

Principles of Consolidation

The consolidated financial statements include the accounts and transactions of the Hospital and its member organizations, Camellia Leasing Corporation (Camellia), Slidell Memorial Health Foundation, Inc. (SMH Foundation) and SMH Physician Practice Services, Inc. (Physician Practice Services). All material intercompany accounts and transactions have been eliminated in consolidation.

Basis of Accounting

The Hospital utilizes the accrual basis of accounting for proprietary funds. Under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Activities That Use Proprietary Fund Accounting*, the Hospital has elected not to apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989.

Income Tax Status

The Hospital is exempt from federal income tax under both Section 115 of the Internal Revenue Code as a governmental entity and Section 501(a) as a hospital organization as described in Section 501(c)(3). The exemption from federal income taxes also extends to state income taxes. SMH Foundation has been designated as a not-for-profit organization described in Internal Revenue Code Section 501(c)(3) and is exempt from federal income taxation under Internal Revenue Code Section 501(a). Camellia and Physician Practice Services are taxable not-for-profit corporations.

1. Organization and Significant Accounting Policies (continued)

Net Patient Service Revenue and Related Receivables

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

Medicare and Medicaid Reimbursement Programs

The Hospital is reimbursed under the Medicare Prospective Payment System (PPS) for acute care inpatient services provided to Medicare beneficiaries and is paid a predetermined amount for these services based, for the most part, on the Diagnosis Related Group (DRG) assigned to the patient. In addition, the Hospital is paid prospectively for Medicare inpatient capital costs based on the federal specific rate. The Hospital qualifies as a disproportionate share provider under the Medicare regulations. As such, the Hospital receives an additional payment for Medicare inpatients served. Except for Medicare disproportionate share reimbursement and Medicare bad debts, there is no retroactive settlement for inpatient costs under the Medicare inpatient prospective payment methodology.

The Hospital is paid a prospective per diem rate for Medicaid inpatients. The per diem rate is based on a peer grouping methodology which assigns a per diem rate to each hospital in the peer group.

Medicare rehabilitation, skilled nursing, and home health services are reimbursed on a cost basis, subject to certain limitations imposed by governmental authorities. Medicare outpatient services (excluding ambulatory surgery, clinical lab and radiology diagnostic procedures), Medicaid outpatient services (excluding ambulatory surgery and clinical lab), and Medicare bad debts are reimbursed on a cost basis. Outpatient ambulatory surgery, radiology and other diagnostic services rendered to Medicare beneficiaries are reimbursed based on a blend of costs, published facility fees and prevailing charges. Medicare and Medicaid outpatient clinical lab and Medicaid ambulatory surgery are reimbursed based upon the respective fee schedules.

1. Organization and Significant Accounting Policies (continued)

Retroactive cost settlements based upon annual cost reports are estimated for those programs subject to retroactive settlement and recorded in the financial statements. Final determination of retroactive cost settlements to be received under the Medicare and Medicaid regulations is subject to review by program representatives. The difference between a final settlement and an estimated settlement in any year is reported as an adjustment of net patient service revenue in the year the final settlement is made.

Cash Equivalents and Investments

Cash equivalents and investments are recorded at cost which approximates market value. The Hospital reports short-term, highly liquid investments (that are both readily convertible to known amounts of cash and mature within three months or less from date of purchase) as cash equivalents, excluding amounts classified as assets whose use is limited or restricted on the balance sheet. As of December 31, 1997, the Hospital's cash, cash equivalents and certificates of deposit were entirely insured or collateralized with securities held by its agent in the Hospital's name.

Inventories

Inventories are valued at the lower of cost (first-in, first-out method) or market.

Land, Buildings and Equipment

Land, buildings and equipment acquisitions are recorded at cost except for assets donated to the Hospital. Donated assets are recorded at the fair value of the assets at the date of donation. Depreciation of buildings and equipment is computed using the straight-line method in amounts sufficient to amortize the cost of these assets over their estimated useful lives.

Equipment held under capital lease obligations has been recorded at the present value of the minimum lease payments. Amortization of leased assets is included in depreciation and amortization expense.

Unamortized Bond Issuance Costs

The costs incurred in connection with the issuance of the Hospital's revenue bonds have been deferred and are being amortized over the life of the bond issues. Amortization is included in depreciation and amortization expense.

1. Organization and Significant Accounting Policies (continued)

Employee Health and Workers' Compensation Insurance

The Hospital is self-insured for hospitalization and workers' compensation claims. Estimated amounts for claims incurred but not reported are calculated based on claims experience and, together with unpaid claims, are included in accrued interest and other expenses on the consolidated balance sheet.

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.

2. Assets Whose Use Is Limited

The terms of the Hospital's revenue bond issues require certain funds to be maintained on deposit with the trustee. The funds on deposit with the trustee and funds designated by the Board for capital improvements as of December 31, 1997 were as follows:

Current assets:	
Under bond indenture:	
Bond debt service account	$ 885,257
Noncurrent assets:	
Under bond indenture:	
Capital improvement account	$ 7,530,998
Debt service reserve account	4,389,787
	11,920,785
By board:	
Designated for capital improvements	18,959,582
Other	305,411
	$ 31,185,778

2. Assets Whose Use Is Limited (continued)

Statutes authorize the Hospital to invest in direct obligations of the U. S. Government, certificates of deposit of state banks and 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 fund institutions registered with the Securities and Exchange Commission (provided the underlying investments of these funds meet certain restrictions). The Hospital's funds were invested in certificates of deposit and U. S. Government obligations carried at cost which approximated market value at December 31, 1997.

3. Third-Party Payor Arrangements

The Hospital participates in the Medicare and Medicaid programs as a provider of medical services to program beneficiaries. During the year ended December 31, 1997, approximately 45% of the Hospital's gross patient service charges were derived from 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.

Revenue derived from the Medicare program is 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. Revenue derived from the Medicaid program is subject to audit and adjustment and must be accepted by the State of Louisiana, Department of Health and Hospitals before the settlement amounts become final. The fiscal intermediary has completed its review of estimated settlements for fiscal years ended through September 30, 1995. Annually, management evaluates the recorded estimated settlements and adjusts these balances based upon the results of the intermediary's audit of filed cost reports and additional information becoming available. Although the fiscal intermediary has not completed its audits of the estimated settlements for the fiscal year ended September 30, 1996, the three-month period ended December 31, 1996, and the year ended December 31, 1997, the Hospital does not anticipate significant adverse adjustments to the recorded settlements for those years.

3. Third-Party Payor Arrangements (continued)

The Hospital has also entered into payment agreements with certain commercial insurance carriers and managed care organizations The basis for payment to the Hospital under these agreements includes prospectively determined daily rates and discounts from established charges.

During fiscal years 1992 and 1993, the Hospital recorded (based upon published regulations) approximately $650,000 of revenue related to services provided to Medicaid beneficiaries under the age of one year old. During fiscal year 1995, the Hospital received notice that the Health Care Financing Administration (HCFA) is challenging the Louisiana Department of Health and Hospitals' (DHH) method for reimbursing hospitals in the State of Louisiana for the cost of services provided to Medicaid beneficiaries under the age of one year old. The Hospital has been informed by officials of DHH that DHH is trying to resolve the issues raised by HCFA and maintain the proposed reimbursement methodology for the period July 1, 1992 through June 30, 1994. The outcome of this matter and the impact on the Hospital's financial statements cannot be determined at this time.

4. Community Benefits

As a community health care provider, the Hospital's stated mission is "to meet the needs of our customers by providing excellence in health maintenance and education services in a compassionate and cost-effective manner." As such, total revenue includes that generated from direct patient care, rentals from various medical office buildings, interest income, and sundry revenue related to the operation of the Hospital and its member organizations.

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care provided during the year ended December 31, 1997, measured at established rates, totaled $4,667,957.

In addition, the Hospital sponsors or participates in numerous activities to benefit the community. Many of these activities are sponsored with the knowledge that they will not be self-supporting or financially viable. The Hospital has conducted a Community Health Assessment to identify health risks in the community. Through this research, the Hospital has developed wellness and prevention programs that target these high-risk areas for a healthier community.

4. Community Benefits (continued)

Annually, the Hospital sponsors several health fairs and programs regarding such issues as diabetes, breast cancer, prostate cancer, smoke stoppers, nutrition, exercise, cardiology, women's health, parenting skills, developmental topics, etc., to provide access to the community on health-related information. Also, the Hospital provides health screening at no cost or a reduced cost to the community. Some health screenings include prostate cancer, cholesterol, colorectal, skin cancer, glucose, and thyroid screenings.

The Hospital also donates employees' time and encourages its employees to volunteer for charitable organizations and to participate in fund-raising activities. In addition, the Hospital aided various community service organizations through donations and sponsorships.

5. Leases

The Hospital leases medical and administrative equipment under operating leases with terms that vary from month-to-month to five years. Total rental expense included in other direct expenses on the consolidated statement of revenue, expenses and fund balance was $801,117 for the year ended December 31, 1997.

The Hospital also leases medical equipment under lease agreements accounted for as capital lease obligations in accordance with Financial Accounting Standards Board Statement No. 13. These capital lease obligations expire at various dates through 2001. The land, buildings and equipment balances on the consolidated balance sheet include equipment under capital lease obligations of $5,253,091 less accumulated amortization of $2,613,296 at December 31, 1997.

5. Leases (continued)

The future minimum lease payments at December 31, 1997 for noncancelable leases are as follows:

	Operating Leases	Capital Leases
1998	$ 243,318	$ 826,336
1999	225,584	771,792
2000	163,541	413,614
2001	38,874	111,103
2002 and thereafter	–	–
	$ 671,317	2,122,845
Amounts representing imputed interest		190,746
Present value of capital lease obligations (including $717,973 classified as amounts due within one year)		$ 1,932,099

The Hospital and its subsidiary, Camellia, lease space to physicians through a combination of cancelable and noncancelable lease agreements. Rental income earned under these agreements was $858,323 for the year ended December 31, 1997.

The future minimum lease payments to be received from noncancelable lease agreements at December 31, 1997 are as follows:

	Operating Leases
1998	$ 448,324
1999	243,722
2000	129,295
2001	58,307
2002	58,904
	$ 938,552

6. Long-Term Debt

The details and balances of long-term debt are presented below:

Hospital Revenue Bonds, Series 1994, described in detail below ($1,130,000 due in 1998)	$ 31,180,000
Hospital Revenue Bonds, Series 1996, described in detail below ($652,501 due in 1998)	7,276,630
Certificates of Indebtedness, Series 1995, described in detail below ($164,468 due in 1998)	825,120
Note payable to physician, 8%, due October 1, 1999, with monthly principal and interest payments of $1,420 ($15,270 due in 1998), collateralized by land and building with a net book value of $126,444	28,958
	39,310,708
Less amounts due within one year	1,962,239
	$ 37,348,469

Hospital Revenue Bonds

On May 5, 1994, the Hospital issued $35 million of Hospital Revenue Bonds, Series 1994 (the 1994 Revenue Bonds) to finance the cost of constructing improvements to the Hospital and to defease or liquidate outstanding debt. The bonds are collateralized by a pledge of the Hospital's revenue. Proceeds from the 1994 Revenue Bonds were deposited with a trustee and restricted for the purpose described in the Trust Indenture.

At December 31, 1997, the 1994 Revenue Bonds consisted of: (1) $12,750,000 of serial bonds with interest rates ranging from 5% to 6%, payable in annual installments of $1,130,000 to $1,750,000 from October 1, 1998 to 2006; (2) $5,905,000 of 6.125% term bonds due October 1, 2009, with mandatory sinking fund requirements of $1,855,000 to $2,085,000 from October 1, 2007 to 2009; (3) $4,565,000 of 6.125% term bonds due October 1, 2011, with mandatory sinking fund requirements of $2,215,000 and $2,350,000 on October 1, 2010 and 2011; and (4) $7,960,000 of 6.25% term bonds due October 1, 2014, with mandatory sinking fund requirements ranging from $2,495,000 to

6. Long-Term Debt (continued)

$2,815,000 from October 1, 2012 to 2014. The bonds are subject to redemption prior to maturity, at the option of the Hospital, on or after October 1, 2004, in whole or in part with premiums of up to 2% of the principal balance.

In connection with the 1994 Revenue Bonds, the Hospital purchased a bond insurance policy issued by Connie Lee Insurance Company which guarantees the scheduled payment of principal and interest on the 1994 Revenue Bonds. Also, the Hospital entered into a Trust Indenture with First National Bank of Commerce which stipulates certain terms and covenants with which the Hospital must comply. The Hospital was in compliance with these covenants as of December 31, 1997.

On October 7, 1996, the Hospital issued $8 million of Hospital Revenue Bonds, Series 1996 (the 1996 Revenue Bonds) to finance the cost of constructing improvements to the Hospital. The 1996 Revenue Bonds bear interest at 5.7% and are payable monthly in equal installments of principal and interest totaling $87,533. The 1996 Revenue Bonds are subject to the 1994 Trust Indenture and have been issued on a parity with the outstanding 1994 Revenue Bonds. The 1996 Revenue Bonds are subject to redemption prior to maturity, at the option of the Hospital, at any time, in whole or in part with a defined prepayment penalty. Essentially, the prepayment penalty is equal to the economic difference, if any, to the original purchaser of the bonds, of obtaining an equivalent loan at the time of the redemption.

On May 5, 1994, the Hospital defeased the 1988 Revenue Bonds outstanding with a portion of the proceeds from the 1994 Revenue Bonds. The Hospital created an irrevocable trust to provide for the payment and retirement of the outstanding 1988 Revenue Bonds. The Hospital deposited U. S. Government Securities with a net carrying value of $10,259,635 into the trust from the proceeds of the 1994 Revenue Bonds together with other funds provided by the Hospital. Securities deposited in the trust fund, together with interest earned, are sufficient to provide for the payment of principal and interest on the defeased 1988 Revenue Bonds on the respective maturity dates. The unpaid principal balance of the 1988 Revenue Bonds was $7,915,000 at December 31, 1997.

During 1966 and 1975, the Hospital issued Revenue Bonds of $625,000 and $2,500,000, respectively, to expand and improve Hospital facilities. On October 11, 1988, these bonds were defeased with the proceeds of the 1988 Revenue Bonds. The Hospital created an irrevocable trust to provide for the payment and retirement of its outstanding 1966 and

6. Long-Term Debt (continued)

1975 Revenue Bonds. Proceeds from the 1988 Revenue Bonds were used to purchase U. S. Government securities that were deposited in the irrevocable trust. The U. S. Government securities, together with interest earned, are sufficient to provide for the payment of principal and interest on the defeased Revenue Bonds on the respective maturity dates. These bonds had unpaid principal balances of $125,000 and $600,000, respectively, at December 31, 1997.

Certificates of Indebtedness

On April 20, 1995, the Hospital issued $1,203,000 in Certificates of Indebtedness, Series 1995 (the Certificates) to refinance two promissory notes due in April 1995. Principal is payable in monthly installments commencing on May 20, 1995 and maturing in 2002. The unpaid principal balances of the Certificates bear interest at a rate of 8.5% which is payable monthly. The Certificates are secured by and payable solely from the Hospital's excess annual revenues. The Hospital was in compliance with all covenants associated with the Certificates as of December 31, 1997.

The combined aggregate amount of maturities and sinking fund requirements of long-term debt for the next five years are: $1,962,239 in 1998; $2,073,375 in 1999; $2,175,923 in 2000; $2,310,922 in 2001; and $2,298,924 in 2002.

7. Employee Benefits

The Hospital has a qualified noncontributory defined contribution pension plan which provides pension benefits for eligible employees. Employees are eligible to participate in the plan when they have a minimum of one year of continuous service. The plan agreement requires the Hospital to contribute a percentage of the first $17,500 of compensation, plus an additional percentage for the portion of compensation in excess of $17,500. The percentages to be applied are based on years of continuous service and range from .8% to 8%. Participating employees become fully vested immediately in Hospital contributions and the interest allocated to their accounts.

The Hospital's total payroll for the year ended December 31, 1997 was $33,594,298, and its contributions were determined based on covered salaries of $21,662,559. During the year ended December 31, 1997, the Hospital made required contributions to the plan of $901,119 (approximately 4% of covered payroll).

8. Risk Management

The Hospital is involved in litigation arising in the ordinary course of business. Claims alleging malpractice have been asserted against the Hospital and are currently in various stages of litigation. The Hospital participates in the Louisiana Hospital Association Trust Fund and the Louisiana Patients' Compensation Fund for insurance coverage on medical malpractice claims. As a participant, the Hospital 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 an additional $400,000 of coverage. These funds provide the Hospital with malpractice coverage on an occurrence basis up to the $500,000 statutory limitation. Hospital management has no reason to believe that the Hospital will be prevented from continuing its participation in the Fund. Additional claims may be asserted against the Hospital arising from services provided to patients through December 31, 1997. The Hospital is unable to determine the ultimate cost of the resolution of such potential claims and, accordingly, no accrual has been made for them.

The Hospital is self-insured for workers' compensation up to $300,000 per claim, and employee health up to $120,000 per claim. A liability is recorded when it is probable that a loss has been incurred and the amount of that loss can be reasonably estimated. Liabilities for claims incurred are reevaluated periodically to take into consideration recently settled claims, frequency of claims and other economic and social factors. The Hospital purchased commercial insurance which provides coverages for workers' compensation and employee health claims in excess of the self-insured limits.

Changes in the Hospital's aggregate claims liability for the year ended December 31, 1997 were as follows:

Year Ended December 31	Beginning of Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	Balance at Year End
1997	$849,451	$ 5,616,073	$ 5,021,759	$1,443,765

9. Commitments

The Hospital has several major construction projects planned or in process, funded by the issuance of its revenue bonds. The remaining estimated costs to be incurred related to these projects is approximately $3,267,000. The amount of interest capitalized related to these projects during the year ended December 31, 1997 is immaterial to the consolidated financial statements.

At December 31, 1997, the Hospital had commitments to acquire $1,201,000 of equipment which it plans to purchase with working capital in fiscal year 1997.

As of December 31, 1997, the Hospital had invested $1,126,000 to acquire part ownership in a health maintenance organization (HMO) joint venture. The HMO began operations in January 1995. At December 31, 1997, the Hospital had outstanding commitments of $874,000 to provide additional working capital funds to the HMO. The amount is to be paid by December 31, 1998.

10. 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 Commissioners
St. Tammany Parish Hospital Service District No. 2

We have audited the financial statements of St. Tammany Parish Hospital Service District No. 2 (d/b/a Slidell Memorial Hospital and Medical Center) as of and for the year ended December 31, 1997, and have issued our report thereon dated February 27, 1998. 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 Slidell Memorial Hospital and 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*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Slidell Memorial Hospital and 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.

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

Ernst & Young LLP

February 27, 1998

Ernst & Young LLP

4200 One Shell Square
701 Poydras Street
New Orleans
Louisiana 70139-9869

Phone: 504 581 4200

Report of Independent Auditors on Compliance With Trust Indenture

The Board of Commissioners
St. Tammany Parish Hospital Service District No. 2

We have audited, in accordance with generally accepted auditing standards, the consolidated balance sheet of St. Tammany Parish Hospital Service District No. 2 (d/b/a Slidell Memorial Hospital and Medical Center) as of December 31, 1997, and the related consolidated statements of revenue, expenses and fund balance and cash flows for the year then ended, and have issued our report thereon dated February 27, 1998.

In connection with our audit, nothing came to our attention that caused us to believe that Slidell Memorial Hospital and Medical Center failed to comply with the terms, covenants, provisions, or conditions of Sections 2.12, 2.13, 4.20, 6.11, 7.1, 7.2, 7.3, and 7.4 of the Trust Indenture dated March 1, 1995 between First National Bank of Commerce and St. Tammany Parish Hospital Service District No. 2, insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance.

This report is intended solely for the board of commissioners, management and First National Bank of Commerce and should not be used for any other purpose.

Ernst & Young LLP

February 27, 1998

Slidell Memorial Hospital and Medical Center

Results

Report to

the Board

of Commissioners

Results

Audit Results

Results

Results

ERNST & YOUNG LLP

ERNST & YOUNG LLP

701 Poydras Street
New Orleans, LA 70139

Phone (504) 581-4200

April 14, 1998

The Board of Commissioners
and Management
Slidell Memorial Hospital and Medical Center

We are pleased to present the results of our audit of the consolidated financial statements of Slidell Memorial Hospital and Medical Center (the Hospital) for the year ended December 31, 1997.

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

This Report to the Board of Commissioners summarizes our audit process, the scope of our engagement, the reports issued and various analyses and observations related to the Hospital's financial position and results of operations. The document also includes the Board communications 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 finance and administrative personnel. As always, we strive to continually improve the quality of our audit services. This meeting is a forum for you to provide feedback on ways we can continue to meet and exceed your expectations.

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

Very truly yours,

Ernst & Young LLP

Contents

Slidell Memorial Hospital and Medical Center

Focus 1997

Audit Results

ERNST & YOUNG LLP

Our Approach

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

- Issue an opinion on the consolidated financial statements of the Hospital.
- Express negative assurance on the Hospital's compliance with the Revenue Bond Trust Indenture.
- Issue a report on compliance and on the internal control over financial reporting.

Areas of Audit Emphasis

The principal areas of audit emphasis were as follows:

- Accounts receivable and allowances for uncollectibles, contractual adjustments, and managed care discounts.
- Reimbursement settlement estimates and related reserves.
- Investments in affiliated organizations.
- Capital expenditures.
- Self-insurance reserves.
- Debt compliance.

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

Update of Identified Business Risks

Key issues discussed in our planning session, including their business and audit implications, are outlined below 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 included the estimated effects of the Balanced Budget Act in the 1998 Hospital budget. Results of regulatory audits to date have not been significant.
Industry Issue **Fraud and Abuse** Expansion of Operation Restore Trust and anticipated additional federal and state funding of fraud enforcement initiatives.	Management should evaluate the effectiveness of its compliance program.	Obtain an understanding of management's monitoring activities over internal controls and status of development of corporate compliance program.	Through discussions with management, we obtained an understanding of monitoring activities over internal controls and status of development of corporate compliance program, noting the recent appointment of a compliance officer and approval of a formal code of conduct. However, a formal, overall corporate compliance program has not yet been developed.
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, noting no material errors. Managed care business has grown, particularly in the Medicare area, resulting in a slowdown in the collection of receivables.

The Hospital's 1997 consolidated financial statements reflect solid financial and operational performance. Slidell Memorial Hospital appears to be well positioned relative to its competition with respect to profitability, liquidity and creditworthiness.

Condensed Statements of Revenues and Expenses

	Year ended December 31 1997	Year ended September 30 1996
Net patient service revenue	$ 82,898,844	$ 73,965,247
Other revenue	4,568,034	3,698,840
Total revenue	87,466,878	77,664,087
Total expenses	82,670,621	74,149,990
Revenue in excess of expenses	$ 4,796,257	$ 3,514,097

Detail of Expenses

	Year ended December 31 1997	Year ended September 30 1996
Salaries and wages	$ 33,594,298	$ 30,037,412
Employee benefits	8,795,829	7,111,084
Supplies and materials	11,541,767	10,651,939
Other direct expenses	7,411,134	7,055,543
Professional fees	4,134,190	3,726,767
Purchased services	3,458,257	3,734,102
Provision for bad debts	5,582,171	4,719,480
Depreciation and amortization	5,653,318	4,981,797
Interest	2,499,657	2,131,866
Total Expenses	$ 82,670,621	$ 74,149,990

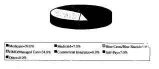
Condensed Balance Sheets

	December 31 1997	September 30 1996
Current assets	$ 22,243,017	$ 18,612,025
Assets whose use is limited	31,185,778	24,083,284
Other assets	2,847,866	2,751,176
Property plant and equipment, net	46,152,756	44,095,942
Total Assets	$ 102,429,417	$ 89,542,427
Current liabilities	$ 13,518,030	$ 9,888 594
Debt and capital leases	38,562,595	35,316 704
Fund balance	50,348,792	44,337,129
Total Liabilities and Fund Balance	$ 102,429,417	$ 89,542,427

Condensed Statements of Cash Flows

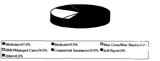
	Year ended December 31 1997	Year ended September 30 1996
Revenue in excess of expenses	$ 4,796,257	$ 3,514,097
Depreciation and amortization	5,653,318	4,981,797
Interest expense, interest income and loss on sale of assets	684,548	604,884
Changes in operating assets and liabilities	(184,693)	868,157
Net Cash Provided by Operating Activities	10,949,430	9,968,935
Acquisitions of land, buildings, and equipment	(8,104,538)	(4,618,914)
Principal and interest paid on capital leases and debt	(5,794,591)	(4,888,274)
Other, net	16,108	(234,036)
Net cash used in financing activities	(13,883,021)	(9,741,224)
Decrease in restricted investments	3,741,806	1,980,419
Receipts of interest earned	1,937,913	1,293,590
Investments in affiliated organizations	(267,019)	(3,662)
Net cash provided by investing activities	5,412,700	3,270,347
Net increase in cash, cash equiv. and unrestricted investments	2,479,109	3,498,058
Cash, cash equiv. and unrestricted investments at beginning of year	19,612,184	15,560,620
Cash, cash equiv. and unrestricted investments at end of year	$ 22,091,293	$ 19,058,678

Gross Patient Revenue by Payor Source
1997



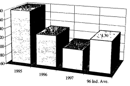
- Consistent with industry trends, the Hospital has experienced a shift from commercial payors and traditional Medicare to managed care. This shift is expected to continue in 1998.

Gross Patient Revenue by Payor Source
1996



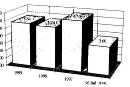
- In 1996, one in two Americans was enrolled in health maintenance organizations, preferred provider organizations, point-of-service plans, or some form of "managed care." For the non-elderly insured population, this figure is even higher: nearly two in three non-elderly insured Americans were enrolled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

Average Length of Stay (Unadjusted)



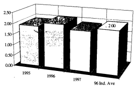
- Average length of stay (acute) decreased in 1996 to equal the industry average, and continued to decrease in 1997.

Operating Profit Margin (%)



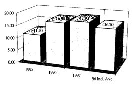
- The Hospital continues to have a strong operating profit margin.

Current Ratio



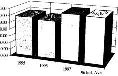
- The Hospital's current ratio was slightly over the industry average in 1996, and decreased slightly in 1997.
- Excluded from current assets in the above ratio is $19 million in funded depreciation.

Days Cash on Hand



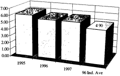
- Days cash on hand approximates the industry average.
- Excluded from cash is $19 million in funded depreciation.

Days in Net Accounts Receivable



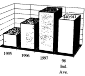
- Historically, the Hospital's days revenue in accounts receivable has been below the industry average.
- Days revenue in accounts receivable increased significantly in 1997, due primarily to an increase in Medicare managed care business, which is slower paying than traditional Medicare.

FTEs per Adjusted Daily Census



- The Hospital's FTEs per adjusted daily census are slightly over the industry average.

Salary & Benefits per FTE Personnel



- The Hospital's salaries and benefits per FTE were slightly lower than the industry average in 1996.
- The 6% increase in 1997 is due to salary increases as well as increased expenses for health insurance benefits.

Required Communications

Statement on Auditing Standards No. 61 and other professional standards require the auditor to provide the Board of Commissioners with additional information regarding the scope and results of the audit that may assist the 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 consolidated financial statements of Slidell Memorial Hospital and 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.
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 used by governmental healthcare entities. During the course of the audit, we noted no changes in significant accounting policies or their application.
Management Judgments and Accounting Estimates The preparation of financial statements requires the use of accounting estimates. Certain estimates are particularly sensitive due to their significance to the financial statements and the possibility that future events may differ significantly from management's expectations.	Significant estimates included in the 1997 consolidated financial statements are: *Estimated Medicare and Medicaid Settlements* for which the difference between estimated and actual results are recorded as adjustments to net revenue in the period the final determination is made by the fiscal intermediary. During 1997, such adjustments were not significant to the Hospital's operating results. *Allowances for Uncollectible Accounts* which is based on past experience and other factors that could impact collectibility. Estimation process used in 1997 was consistent with prior periods. *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 consistent with prior periods.

Area	Comments
Management Judgments and Accounting Estimates (continued)	*Self-Insurance Reserves* for worker's compensation and employee health claims up to $300,000 and $120,000, respectively. Estimated reserve amounts are recorded based on specific claims as well as historical experience. The total self-insured liability at December 31, 1997 was approximately$1,444,000.
Significant Audit Adjustments	There were no recorded audit differences affecting the Hospital's 1997 consolidated financial statements. Certain audit differences were identified and discussed with management; these differences were considered immaterial and, therefore, not recorded in the Hospital's 1997 consolidated financial statements.
Disagreements with Management on Financial Accounting and Reporting Matters	There were no disagreements with Management.
Consultation with Other Accountants	To the best of our knowledge, there were no consultations with other accounting firms or independent accountants about auditing or accounting matters as they relate to the 1997 consolidated financial statements.
Serious Difficulties Encountered in Performing the Audit	There were no serious difficulties encountered in performing the audit.
Material Errors, Irregularities and Illegal Acts	Our audit did not identify any material weaknesses in internal accounting controls or material errors, material irregularities or possible illegal acts

Slidell Memorial Hospital and Medical Center

Focus 1997

Value Results

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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		
Information Security Review	General review of computer controls	Communicated findings to Information System Director to assist in enhancing internal controls over the information system environment.
Peer Group Analysis	Key performance indicators compared to selected competitors	Information on performance by key competitors.
Board Report	Current topics in healthcare	Current strategic information
Increasing Shareholder Value		
Taxes	Reviewed proposed liquidation of Physician Practice Services for tax consequences.	Identified opportunity for approximately $300,000 in tax savings through alternative structuring of the liquidation
Project Assistance		
Due Diligence Assistance	Assisted in due diligence process with respect to the New Orleans Alliance hospitals	Helped management identify questions and concerns for follow-up

Slidell Memorial Hospital and Medical Center

Looking Ahead to

Next Year

ERNST & YOUNG LLP

Continuity and Commitment of Your Team

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

Engagement Member	Responsibility	Years of Health Care Experience	Years of Service to the Hospital
Greg Swan	Engagement Audit Partner	20	3
Arthur Parham	Tax Senior Manager	20	10
Sally Seyler	Audit Senior Manager	19	1
Jeffray Teague	Audit Senior	2	2

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 statement. 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 basic 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)

	Slidell Memorial Hospital	Columbia Lakeview Regional Med Ctr	East Jefferson General Hospital	Northshore Regional Medical Center	Pendleton Memorial Methodist Hospital	St. Tammany Parish Hospital
Utilization Profile						
Occupancy Rate (%)	52.66	39.12	64.18	54.24	44.78	50.33
FTEs per Adjusted Daily Census	6.52	6.39	6.63	4.61	6.41	2.29
Salary & Benefits per FTE Personnel	43,550	41,703	46,123	38,416	40,329	49,398
Average Length of Stay (Unadjusted)	4.30	2.90	5.13	4.63	3.42	3.77
O/P Revenue as % of Total Pt Revenue	37.04	35.59	29.52	21.72	34.02	77.70
Payor Mix Profile						
Medicare Case Mix Index	1.44	1.66	1.63	1.58	1.65	1.40
Medicare Days %	50.86	38.22	56.13	48.57	47.12	50.05
Medicaid Days %	8.35	20.08	4.61	11.40	14.08	16.65
Liquidity Profile						
Operating Profit Margin (%)	2.60	(8.60)	4.75	18.97	8.91	3.93
Total Profit Margin (%)	4.52	(8.60)	11.66	18.98	9.79	5.97
Cash Flow Margin (%)	11.83	(0.38)	18.37	21.99	15.04	11.66
Uncollectible Ratio (%)	51.04	47.59	46.31	59.65	50.78	46.65
Debt Service Coverage Ratio	7.69	(0.09)	40.02	0.00	4.03	3.33
Creditworthiness Profile						
Cash Flow to Total Liabilities	0.20	0.00	0.23	3.26	0.28	0.25
Current Ratio	1.88	1.87	3.51	4.09	2.38	3.17
Days Cash on Hand	15.65	(2.58)	188.96	(20.23)	50.41	68.14
Days in Net Accounts Receivable	55.08	63.91	62.73	127.68	91.20	69.95
Average Payment Period (Days)	51.93	34.40	77.35	31.59	73.74	75.01
Long term Liabilities to Capitalization	0.44	0.88	0.34	0.00	0.47	0.27
Capital Costs as % of Operating Exp	8.74	7.57	7.59	7.16	7.91	6.94
Average Age of Plant (Years)	7.10	2.69	8.29	7.99	10.08	9.07

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.

1998 Audit Planning

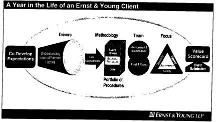
Planning for the 1998 audit will be developed in cooperation with management. As a balanced effort, it will give full recognition to the existing internal controls, as well as an assessment of inherent and control risks. Being responsive to these risk assessments, the 1998 audit will address both your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

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

Slidell Memorial Hospital and Medical Center

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.