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Financial Statements

Morehouse General Hospital

Years ended May 31, 1998 and 1997

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 MAR 10 1999

Morehouse General Hospital

Financial Statements

Years ended May 31, 1998 and 1997

Contents

ERNST & YOUNG LLP

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Report of Independent Auditors

The Board of Commissioners
Morehouse Parish Hospital Service District

We have audited the accompanying balance sheets of Morehouse Parish Hospital Service District (Morehouse General Hospital) as of May 31, 1998 and 1997, and the related statements of revenue, expenses, and fund balance and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Morehouse General Hospital at May 31, 1998 and 1997, the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have issued our report dated August 7, 1998 on our consideration of Morehouse General Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts.

Ernst & Young LLP

August 7, 1998

Morehouse General Hospital

Balance Sheets

	May 31	
	1998	**1997**
Assets		
Current assets:		
Cash and cash equivalents	**$ 1,762,660**	$ 3,334,620
Patient accounts receivable, less allowances for uncollectible accounts of $2,921,173 in 1998 and $2,008,224 in 1997	**5,634,576**	5,820,182
Settlements due from third-party payors	**1,966,273**	–
Inventories	**807,480**	861,990
Current assets whose use is limited	**495,019**	–
Prepaid and other assets	**280,375**	239,005
Total current assets	**10,946,383**	10,255,797
Noncurrent assets whose use is limited	**4,664,169**	2,324,243
Other assets:		
Unamortized bond issuance costs	**–**	13,249
Amounts due from physicians, net	**287,081**	320,659
Property, plant, and equipment:		
Land	**272,384**	241,678
Buildings	**10,069,469**	9,504,779
Equipment	**19,866,011**	18,140,025
Construction in progress	**2,038,089**	–
	32,245,953	27,886,482
Less accumulated depreciation	**19,296,195**	17,413,010
	12,949,758	10,473,472
Total assets	**$28,847,391**	$23,387,420

	May 31	
	1998	**1997**
Liabilities and fund balance		
Current liabilities:		
Trade accounts payable	**$ 1,985,868**	$ 603,231
Retainage payable	**99,493**	–
Employee compensation and payroll taxes	**1,017,878**	1,158,892
Settlements due to third-party payors	**–**	1,289,376
Other accrued liabilities	**404,983**	369,112
Current portion of capital lease obligations	**851,129**	864,538
Current portion of long-term debt	**219,775**	–
Total current liabilities	**4,579,126**	4,285,149
Capital lease obligations, less current portion	**2,118,926**	1,927,297
Long-term debt, less current portion	**4,424,648**	–
Total liabilities	**11,122,700**	6,212,446
Fund balance	**17,724,691**	17,174,974
Total liabilities and fund balance	**$ 28,847,391**	$23,387,420

See accompanying notes.

Morehouse General Hospital

Statements of Revenue, Expenses, and Fund Balance

	Year ended May 31	
	1998	**1997**
Net patient service revenue	**$30,911,967**	$29,082,378
Other revenue	**1,093,943**	1,104,963
Total revenue	**32,005,910**	30,187,341
Expenses:		
Routine services	**5,100,517**	4,998,079
Ancillary services	**13,306,937**	11,607,102
General services	**2,878,627**	2,679,016
Fiscal and administrative services	**5,964,430**	5,848,932
Depreciation and amortization	**1,941,269**	1,902,220
Provision for bad debts	**2,025,071**	1,792,307
Interest	**289,341**	208,241
Total expenses	**31,506,192**	29,035,897
Revenue in excess of expenses	**499,718**	1,151,444
Fund balance at beginning of period	**17,174,974**	16,022,767
Other changes *(Note 1)*	**49,999**	763
Fund balance at end of period	**$17,724,691**	$17,174,974

See accompanying notes.

Morehouse General Hospital

Statements of Cash Flows

	Year ended May 31 1998	1997
Operating activities and gains and losses		
Revenue in excess of expenses	**$ 499,718**	$ 1,151,444
Adjustments to reconcile revenue in excess of expenses to net cash provided by operating activities:		
Depreciation and amortization	**1,941,269**	1,902,220
Interest expense	**289,341**	208,241
Interest income	**(246,721)**	(251,498)
Provision for bad debts	**2,025,071**	1,792,307
Provision for uncollectible physician receivables	**–**	178,918
(Gain) loss on sale of building and equipment	**2,968**	(17,923)
Changes in operating assets and liabilities:		
Patient accounts receivable	**(1,839,465)**	(2,307,039)
Inventories, prepaid, and other assets	**13,140**	1,019
Trade accounts payable and retainage payable	**1,482,130**	122,187
Employee compensation, payroll taxes, and other accrued liabilities	**(105,143)**	276,161
Settlements due to/from third-party payors	**(3,255,649)**	760,085
Net cash provided by operating activities	**806,659**	3,816,122
Capital and related financing activities		
Purchases of land, buildings, and equipment	**(3,198,255)**	(1,527,954)
Payments of capital lease obligations	**(980,800)**	(810,592)
Payments of long-term debt	**(105,577)**	(214,285)
Interest expense	**(289,341)**	(208,241)
Proceeds from the issuance of long-term debt	**4,750,000**	–
Net cash provided by (used in) capital and related financing activities	**176,027**	(2,761,072)
Investing activities		
Interest income	**246,721**	251,498
Increase in assets whose use is limited	**(2,834,945)**	(103,386)
Loan payments from physician	**33,578**	6,105
Net cash provided by (used in) investing activities	**(2,554,646)**	154,217
Net increase in cash and cash equivalents	**1,571,960**	1,209,267
Cash and cash equivalents at beginning of period	**3,334,620**	2,125,353
Cash and cash equivalents at end of period	**$ 1,762,660**	$ 3,334,620

During the years ended May 31, 1998 and 1997, the Hospital entered into capital leases totaling $1,159,020 and $1,190,346, respectively.

See accompanying notes.

Morehouse General Hospital

Notes to Financial Statements

May 31, 1998

1. Accounting Policies

Description of Business

Morehouse Parish Hospital Service District (District), doing business as Morehouse General Hospital (Hospital), was organized on December 17, 1982 under powers granted to parish police juries by the State of Louisiana. The geographical boundaries of the District coincide with those of Morehouse Parish. All corporate powers are vested in a board of commissioners appointed by the Morehouse Parish Police Jury. The District is exempt from income taxes as a political subdivision of the State of Louisiana under Section 115 of the Internal Revenue Code. The District is also exempt from federal income tax under Section 501(a) as a hospital organization described in Section 501(c)(3). The federal income tax exemptions also extend to state income taxes.

Basis of Accounting

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

Net Patient Service Revenue and Related Receivables

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. The Hospital provides services to patients who reside primarily in the local geographic region. Patient accounts receivable for which the Hospital receives payment under contractual arrangements are stated at the estimated net amounts from such payors, which are generally less than established billing rates. As a result, the Hospital is exposed to certain credit risks. The Hospital manages such risks by regularly reviewing its accounts and contracts and by providing appropriate allowances.

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.

1. Accounting Policies (continued)

Contractual Third-Party Payors

The Hospital provides acute care inpatient services 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. Medicare inpatient acute care capital-related costs are paid on a prospectively determined amount per discharge, subject to a minimum level based on a percentage of capital-related costs.

Medicaid inpatient services are paid on a prospective per diem basis. Medicare, bad debts and outpatient psychiatric and home health services to Medicare beneficiaries are reimbursed, subject to certain limitations imposed by governmental authorities, on a cost basis. Retroactive cost settlements based upon annual cost reports are estimated and recorded in the financial statements. Final determination of amounts to be received under cost reimbursement regulations is subject to review by program representatives. The difference between a final settlement and estimated settlement in any year is reported as an adjustment of net patient service revenue in the year the final settlement is made.

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.

Inventories

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

Property, Plant, and Equipment

The Hospital records all property, plant, and equipment acquisitions at cost, except for assets donated to the Hospital. Donated assets are recorded at appraised value at the date of donation. The Hospital provides for depreciation of its plant and equipment using the straight-line method in amounts sufficient to amortize the cost of its assets over their estimated useful lives.

1. Accounting Policies (continued)

Assets held under capital lease obligations are included in equipment. These assets have been recorded at the present value of the minimum lease payments which approximated the fair market value of the leased assets (see Note 6). Amortization of leased assets is provided for using the straight-line method over the term of the related lease and is included in depreciation and amortization expense.

Investments and Investment Income

During the year ended May 31, 1998, the Hospital elected to adopt the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and For General Investment Pools*; accordingly, all investments are stated at fair market value. Differences between the cost and the fair market value of the investments are included in investment income. The cumulative effect of the difference between the cost and the fair market value of the investments was previously reported as a separate component of fund balance. A reclassification of $49,999 from fund balance to interest income was recorded in the current year. The accounting change was applied retroactively; however, prior period financial statements were not restated as the effect is not material.

Cash Equivalents

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

Reclassifications

Certain reclassifications have been made to the 1997 financial statements to conform to their 1998 presentation.

2. Cash and Investments

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

2. Cash and Investments (continued)

The Hospital's bank deposits consist of demand deposit accounts and certificates of deposit. These bank deposits are included in cash and cash equivalents and assets whose use is limited. At May 31, 1998 and 1997, the Hospital's deposits were fully insured or collateralized with securities held by the agent of the pledging banks in the Hospital's name.

In addition to the bank deposits held, the Hospital had invested $1,386,536 and $1,326,534 at May 31, 1998 and 1997, respectively, in a mutual fund whose underlying investments consist solely of securities of the United States government or its agencies (see Note 3). These funds are recorded in assets whose use is limited on the balance sheet.

3. Assets Whose Use Is Limited

The terms of the Hospital's 1997 Revenue Bonds require funds to be maintained on deposit in certain accounts with the trustee. The funds on deposit in the accounts are required to be invested by the trustee in accordance with the terms of the Bond Resolution.

In addition, the Hospital's board of commissioners has designated certain assets to be used for future plant and equipment additions. The composition of assets whose use is limited as of May 31, 1998 and 1997 were as follows:

	May 31	
	1998	**1997**
Board-designated assets:		
Certificates of deposit	**$ 1,039,389**	$ 997,709
Mutual fund investment	**1,386,536**	1,326,534
	2,425,925	2,324,243
Trusteed funds (principally United States government obligations):		
Construction Fund	**2,267,239**	–
Debt Service Fund	**272**	–
Debt Service Reserve Fund	**454,829**	–
Capital Additions and Contingencies Fund	**10,923**	–
	2,733,263	–
Total assets whose use is limited	**5,159,188**	2,324,243
Less current portion	**495,019**	–
Noncurrent assets whose use is limited	**$ 4,664,169**	$ 2,324,243

4. Third-Party Reimbursement

The Hospital participates in the Medicare and Medicaid programs as a provider of medical services to program beneficiaries. During the years ended May 31, 1998 and 1997, approximately 75% and 77%, respectively, of gross patient service charges were derived from Medicare and Medicaid program beneficiaries. Certain Medicare and Medicaid services are reimbursed on a cost basis. Regulations in effect require annual retroactive settlements for these costs based upon cost reports filed by the Hospital. Although final settlements are not made until a subsequent period, the Hospital estimates and records these retroactive settlements in its financial statements in the period in which services are rendered.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Hospital believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid program.

Differences between original estimates and subsequent revisions (including final settlements) are included in the statement of revenue, expenses, and fund balance in the period in which the revisions are made. During the years ended May 31, 1998 and 1997, net patient service revenue was increased by approximately $170,000 and $700,000, respectively, to reflect changes in the estimated settlements for certain prior years. Management does not anticipate significant unfavorable adjustments by program representatives to unaudited Medicare or Medicaid settlements for the years ended May 31, 1996 through 1998.

5. Employee Retirement Plan

The Hospital sponsors a noncontributory, defined-contribution retirement plan, which covers substantially all full-time employees after they have met certain eligibility requirements. Under the provisions of the plan document, the Hospital is required to contribute 10% of the eligible employee's salary. The plan provides for the contributions (and interest allocated to the employee's account) to become partially vested after three years of continuous employment and fully vested after seven years of continuous employment. The unvested portion of an account of an employee who terminates

5. Employee Retirement Plan (continued)

employment before becoming fully vested is used to reduce the Hospital's current year contribution requirement. For the years ended May 31, 1998 and 1997, the contribution requirements were $939,136 and $943,675, respectively.

The Hospital has an additional retirement plan which covers all employees not covered under the above plan. Under the provisions of the plan, the Hospital is required to contribute 6.05% of the participating employee's salary. The employee becomes partially vested after three years of continuous employment and fully vested after seven years of continuous employment. For the years ended May 31, 1998 and 1997, the contribution requirements were $111,034 and $63,721, respectively.

Contributions made during the periods for both plans discussed above were $979,897 and $909,294 in 1998 and 1997, respectively. The Hospital's unfunded contribution requirement related to both plans of $220,995 and $180,127 at May 31, 1998 and 1997, respectively, is included in other accrued liabilities on the balance sheet. Total payroll for all employees was $11,938,722 and $10,919,291 for the years ended May 31, 1998 and 1997, respectively. All employees of the Hospital are covered by one of the two plans discussed above.

The Hospital established the Morehouse General Hospital Tax Deferred Savings Plan. This plan, which qualifies as a tax-sheltered annuity plan under Section 403(b) of the Internal Revenue Code, covers all employees who elect to participate. The plan allows participants to defer a portion of their annual compensation. The amount of annual contributions to the plan by participants is subject to certain limitations as defined in the plan agreement. The participants vest 100% immediately in their contributions and investment earnings of the plan. The plan agreement allows discretionary employer contributions to be made to the plan. No employer contributions were made during the years ended May 31, 1998 and 1997.

Retirement expense net of forfeitures related to the above plans included in fiscal and administrative services on the statements of revenue, expenses, and fund balance was $979,897 and $960,596 for the years ended May 31, 1998 and 1997, respectively.

6. Leases

The Hospital has entered into several capital leases for various types of equipment. Under the terms of the leasing arrangements, the Hospital is obligated to pay a monthly rental payment over the primary term of the leases, which range from five to seven years.

6. Leases (continued)

Future minimum lease payments, by year and in the aggregate, under capital leases consisted of the following at May 31, 1998:

Fiscal year ending May 31	
1999	$1,041,645
2000	1,015,214
2001	701,757
2002	439,205
2003	183,559
Thereafter	8,322
Total minimum lease payments	3,389,702
Amount representing interest (ranging from 0% to 10.4%)	419,647
Present value of net minimum lease payments (including $851,129 classified as current)	$2,970,055

The cost of leased assets included in equipment totaled $5,019,728 and $5,602,902 and accumulated amortization was $2,217,048 and $3,106,073 at May 31, 1998 and 1997, respectively. The equipment collateralizes the capital lease obligations.

During the years ended May 31, 1998 and 1997, the Hospital entered into capital leases totaling $1,159,020 and $1,190,346, respectively.

7. Long-Term Debt

The Hospital's long-term debt as of May 31, 1998 and 1997 consisted of bonds payable as follows:

	1998	**1997**
Hospital Revenue Bonds, Series 1997	**$ 4,644,423**	$ –
Less current portion	**219,775**	–
	$ 4,424,648	$ –

On November 3, 1997, the Hospital issued $4,750,000 of Hospital Revenue Bonds (Series 1997) which are term bonds with an annual interest rate of 5.24%. Payment of the scheduled principal and interest on the 1997 Revenue Bonds is due in monthly installments

7. Long-Term Debt (continued)

of $38,159. The 1997 Revenue Bonds are obligations of the Hospital secured by a pledge of the Hospital's revenue.

Under the terms of the Bond Indenture, the Hospital is required to maintain, among other provisions, a specified minimum debt service coverage ratio.

The scheduled maturities of the Series 1997 Bonds for the next five fiscal years ending May 31 are as follows: 1999—$219,775; 2000—$231,572; 2001—$244,003; 2002—$257,099; 2003—$270,898; and $3,421,076 thereafter.

8. Malpractice, Employee Medical and Workers' Compensation Insurance

During the ordinary course of operations, the Hospital has been named a defendant in lawsuits alleging medical malpractice. The Hospital is insured for malpractice insurance coverage on a claims-made basis for individual claims up to $100,000. For individual malpractice claims in excess of $100,000, the Hospital participates in the State of Louisiana Patient Compensation Fund. This fund provides malpractice insurance coverage on a claims-made basis for claims up to the statutory maximum exposure of $500,000, which currently exists under Louisiana law, plus interest and future medical costs. The Hospital has purchased additional malpractice insurance providing coverage up to $900,000 in the aggregate. The Hospital has renewed its existing malpractice insurance through October 31, 1998.

The Hospital is self-insured for workers' compensation up to $200,000 per claim, and employee health up to $45,000 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.

9. Commitments

The Hospital has incurred approximately $2,000,000 related to the renovation in connection with the 1997 Bond Issue. The renovations are expected to be completed in April 1999 at an estimated additional cost of approximately $2,750,000.

10. Impact of 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. Any of the Hospital's computer programs that have time-sensitive software may recognize a date using "00" as the year 1900 rather than the year 2000. This could result in system failure or miscalculations causing disruptions of operations and patient care, including, among other things, a failure of certain patient care applications and equipment, a failure of control systems, a temporary inability to process transactions, send invoices, or engage in similar normal business activities.

Based on a recent assessment, the Hospital determined that it will be required to modify or replace significant portions of its software, hardware and patient care equipment so that its systems will function properly with respect to dates in the year 2000 and thereafter. Affected systems may include clinical and biomedical instrumentation and equipment used within the Hospital for purposes of direct or indirect patient care such as imaging, laboratory, pharmacy, and respiratory devices; cardiology measurement and support devices; emergency care devices (including monitors, defibrillators, dialysis equipment, and ventilators); operating room equipment (including lasers, transfusion equipment, anesthesia equipment, and pumps); automated implants and/or the devices used to program them; and general patient care devices (including telemetry and endoscopy equipment and IV pumps). The Hospital presently believes that with modifications to existing software and conversions to new clinical and biomedical instrumentation and equipment, the Year 2000 Issue will not pose significant operations problems. 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 plans to initiate formal communications with all of its significant suppliers and large customers to determine the extent to which the Hospital's interface systems are vulnerable to those third parties' failure to remediate their own Year 2000 Issues. The Hospital's total Year 2000 project cost and estimates to complete include the estimated costs and time associated with the impact of third-party Year 2000 Issues based on presently available information. However, there can be no guarantee that the systems of other companies on which the Hospital's systems rely will be timely converted and would not have an adverse effect on the Hospital's systems.

The Hospital will utilize both internal and external resources to reprogram, or replace, and test the software and patient care equipment for Year 2000 modifications. The Hospital anticipates completing the Year 2000 project prior to any anticipated impact on its operating systems.

10. Impact of Year 2000 Computer Issues (Unaudited) (continued)

The date on which the Hospital believes it will complete the Year 2000 modifications is based on management's best estimates, which were derived utilizing numerous assumptions of future events, including the continued availability of certain resources, third-party modification plans and other factors. However, there can be no guarantee that these estimates will be achieved and actual results could differ materially from those anticipated. Specific factors that might cause such material differences include, but are not limited to, the availability and cost of replacement equipment and personnel trained in this area, the ability to locate and correct all relevant computer codes, and similar uncertainties.

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

The Board of Commissioners
Morehouse Parish Hospital Service District

We have audited the financial statements of Morehouse Parish Hospital Service District (Morehouse General Hospital) (the Hospital) as of and for the year ended May 31, 1998, and have issued our report thereon dated August 7, 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 the financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts. 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 herein under *Government Auditing Standards.*

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Morehouse General Hospital'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

August 7, 1998

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Independent Accountants' Report on Schedule of Debt Service Coverage Ratio

The Board of Commissioners
Morehouse Parish Hospital Service District

We have reviewed the accompanying Schedule of Debt Service Coverage Ratio for the year ended May 31, 1998 of Morehouse Parish Hospital Service District. Our review was conducted in accordance with standards established by the American Institute of Certified Public Accountants.

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

The Schedule of Debt Service Coverage Ratio is prescribed by Section 5.1 of the Bond Resolution relating to $4,750,000 Hospital Revenue Bonds (Series 1997) reflecting the provisions of Resolutions adopted by Morehouse Parish Hospital Service District on November 3, 1997.

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

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

Ernst + Young LLP

August 7, 1998

Morehouse Parish Hospital Service District

Note to Schedule of Debt Service Coverage Ratio

May 31, 1998

1. Basis of Presentation

The computation in the Schedule of Debt Service Coverage Ratio is prescribed by Section 5.1 of the Bond Resolution relating to $4,750,000 Hospital Revenue Bonds (Series 1997) reflecting the provisions of Resolutions adopted by Morehouse Parish Hospital Service on November 3, 1997.

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Report of Independent Auditors on Compliance With Bond Resolution

The Board of Commissioners
Morehouse Parish Hospital Service District

We have audited the financial statements of Morehouse Parish Hospital Service District (the Hospital) as of and for the year ended May 31, 1998, and have issued our report thereon dated August 7, 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.

In connection with our audit, nothing came to our attention that caused us to believe that the Hospital failed to comply with the terms, covenants, provisions, or conditions of Sections 2.7, 4.1, 4.2, 5.1 through 5.6, 6.1, 6.9, and 10.1 of the Bond Resolution relating to $4,750,000 Hospital Revenue Bonds (Series 1997) reflecting the provisions of Resolutions adopted by the Morehouse Parish Hospital Service District on November 3, 1997, except as noted below, insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance.

Section 5.3 - Debt Service and Other Funds requires that the Hospital transfer from the General Fund, monthly in advance on or before the 20th day of each month of each year, a sum equal to the amount of principal and interest due on the Bonds on the first day of the next month. During our review of the transfers, we noted not all transfers were made prior to the 20th of the month; however, all transfers were made prior to the due date of the payment.

Section 5.3 - Debt Service and Other Funds also requires that a Reserve Fund be established and an amount equal to the reserve fund requirements be maintained in the account at all times. The reserve fund requirements are equal to the Hospital's debt service for one year. As of May 31, 1998, the balance in the reserve fund reflected a deficit of the 1999 debt service amount by $3,078.

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

Ernst & Young LLP

August 7, 1998

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The Board of Commissioners
Morehouse Parish Hospital Service District

In planning and performing our audit of the financial statements of Morehouse Parish Hospital Service District (Morehouse General Hospital) as of and for the year ended May 31, 1998, we considered its internal control to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. The following suggestion is submitted to assist in improving procedures and controls.

Audit Report

We noted an instance of noncompliance regarding failure to submit the audited financial statements to the Office of Legislative Auditor within six months of the close of the entity's fiscal year, as required by Louisiana Revised Statue 24:513. We suggest that management submit the audited financial statements as required by the Statue.

Management Response

The delay in the issuance of the audited financial statements was due to receiving the "Provider Statistical and Summary Report" (PS&R) later than anticipated from the fiscal intermediary. This report is a significant source of information that is used in the preparation of the Hospital's cost report. As the cost report is a significant component of the Hospital's financial statements, the audit could not be completed without the final cost report.

In the future, if the PS&R is not available we will work to obtain other information to be used to complete the cost report and thus issue the audited financial statements as required by the Office of Legislative Auditor, State of Louisiana.

Other

The health care industry continues to face many new and evolving challenges. Consistent with the prior year, we have included below our observations surrounding certain environmental issues that can be expected to affect the Hospital. We believe management and the board of commissioners should continue to focus on the following issues.

Corporate Compliance

The federal government continues to aggressively pursue strategies to eliminate fraud and abuse in the health care system. 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. During our audit, we noted that the Hospital had not yet established a corporate compliance program designed to prevent errors or acts that may be deemed fraudulent or abusive.

In an effort to promote voluntary development of corporate compliance programs, in February 1998, the Office of Inspector General (OIG) released its long-awaited *Compliance Program Guidance for Hospitals* (Model Program). Within the Model Program, the OIG provides its views on the value and fundamental principles of compliance programs and specific elements that each hospital should consider when developing and implementing an effective program. The Model Program is based, in part, on the U.S. Sentencing Commission Guidelines for Organizations (Guidelines) which set forth the minimum expectations of an effective compliance program. Failure to implement an effective program increases the risk of errors, omissions, and improper actions which increase the risk of significant liabilities to the Hospital. An effective corporate compliance program not only reduces the risk of legal or regulatory infractions, but also mitigates the penalties resulting from such infractions.

The development of an effective corporate compliance program requires a substantial commitment of time, energy, and resources by senior management and the Hospital's board of directors. However, the OIG believes that the costs of implementing a program are far outweighed by the long-term benefits, including:

- Demonstrating to the community and employees the Hospital's strong commitment to honest and responsible provider and corporate conduct.

- Providing a more accurate view of employee and contractor behavior relating to fraud and abuse.

- Creating a centralized source for distributing information on health care statutes, regulations, and other program directives related to fraud and abuse.

- Reaffirming the Hospital's commitment to its mission, vision, and principles.

Furthermore, while developing a compliance program is voluntary (i.e., the Hospital is not required by law to follow the new guidelines), when a hospital has an *effective* compliance program in place that *predates* any governmental investigation, the OIG indicates that it "may be a factor toward reducing a provider's risk of criminal, civil, or administrative liability" in an investigation. Also, the OIG notes that recent case law suggests that the

failure of a corporate director to attempt in good faith to institute a compliance program in certain situations may be a breach of a director's fiduciary obligation.

The absence of an effective corporate compliance program subjects the Hospital's management and board of directors to significant exposure. Therefore, we suggest that the implementation of a corporate compliance program be given the highest priority.

As noted above, the Hospital's compliance program must be *effective* to afford it the protection under the Guidelines. In the Model Program, the OIG notes that the "existence of benchmarks that demonstrate implementation and achievements are essential to any effective program." As part of implementing its program, for example, the Hospital should consider surveying its employees to benchmark its compliance culture. Future surveys should be used to measure the change in the Hospital's compliance culture. In addition, ongoing monitoring activities, examples of which are discussed below, are required to document the program's effectiveness.

In connection with implementing an enterprise wide corporate compliance infrastructure, we recommend that the Hospital take steps to help ensure that control, compliance, and monitoring procedures are operating effectively to minimize the risk from fraud and abuse throughout the organization and to demonstrate the compliance program's effectiveness. As part of this process, the Hospital should consider:

- Performing a formal risk assessment for each function or department of the Hospital to identify risks and challenge the adequacy of controls.

- Using automated tools to prevent or detect potential billing irregularities (e.g., lab unbundling).

- Conducting special compliance audits to evaluate the effectiveness of the Hospital's compliance program.

- Implementing procedures to prevent employing or retaining sanctioned individuals or engaging in transactions with sanctioned entities.

In its published guidance, the OIG strongly encourages organizations to implement the above as well as certain other internal control/monitoring processes.

Management Response

We are complying with the suggestion made by Ernst & Young and have begun to develop a corporate compliance plan which will meet the minimum requirements as suggested by the OIG's model program.

Year 2000 Information Systems Issues

The Hospital's information systems and other embedded systems (e.g., medical devices and automated facility equipment) are dependent on the processing of certain date-specific patient care, billing and other pertinent business information. With the imminent arrival of the Year 2000, a significant business issue has been created that directly impacts the above technologies employed by the Hospital. The problem relates to the manner in which these technologies handle date processing. Most technologies do not incorporate specific logic for properly handling dates after December 31, 1999 due to assumptions made by software and magnetic chips that a two-digit year is in the twentieth century (i.e., 1900s). Most technologies have been developed with the two-digit year assumptions due to the lack of computer memory and this being a way to save on previously expensive memory.

The Year 2000 problem is a very serious and complex issue, and it threatens virtually all areas of a company's operations to some degree. System failures or miscalculations due to Year 2000 impact may cause disruptions in operations and patient care, including, among other things, a failure of certain patient care applications and equipment, a failure of control systems, a temporary inability to process transactions, send invoices, or engage in normal business activities. Your operations could be significantly affected if you, your customers or your suppliers do not deal effectively with the Year 2000 issue.

Specific to a health care organization, particular attention should be directed to clinical and biomedical instrumentation and equipment which may be affected by the use of embedded chips. Affected systems may include, but are not limited to, those used within the System for purposes of direct or indirect patient care such as imaging, laboratory, pharmacy, and respiratory devices; cardiology measurement and support devices; emergency care devices (including monitors, defibrillators, dialysis equipment, and ventilators); and general patient care devices (including telemetry and endoscopy equipment and IV pumps).

Our responsibility as your auditors is to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. As such, our audit of the Hospital's financial statements is not designed to determine the Hospital's readiness for the Year 2000. Further, we have no responsibility with regard to the Hospital's efforts to make its systems, or any other systems, such as those of vendors, service providers, or any other third parties Year 2000 ready, or to provide assurance on whether the Hospital has addressed or will be able to address all affected systems on a timely basis.

In conjunction with our audit planning, we made limited inquiries of selected personnel regarding the Hospital's Year 2000 readiness plan. Based on our limited inquiries, management informed us that they believe the Hospital is progressing in the plan for Year 2000 readiness. The Hospital should follow through with the planned testing and examination of all areas that may be affected.

We recommend that you continue to monitor the plan's progress, as well as continuously reassess your systems and operations to identify areas of risk not previously identified. It is critical that the Hospital implement its plan on schedule.

While performing our limited inquiries described above, we also became aware of other areas that we believe require additional attention as part of the Hospital's Year 2000 efforts. Our comments should not be considered as all-inclusive of the issues and risks of the Year 2000. As the Year 2000 group continues with this project, we recommend they consider the following matters:

- Address this project from a business perspective to ensure all equipment and non-IT systems are ready for the Year 2000.

- Assess exposures to external agents. Because the Hospital cannot be assured that its vendors, bankers, and other business partners will be properly prepared for the changeover, the Hospital should consider implementing additional verification procedures to test the accuracy of information received from the external agents that is date-dependent.

- Additionally, we recommend that management develop an appropriate risk management program reporting directly to Hospital executives to ensure the projects are on target for solving the problem and meeting the deadline.

Management Response

We are complying with the suggestions made by Ernst & Young and are proceeding with the Year 2000 plan we have implemented.

Balanced Budget Act

Traditional government entitlement programs are the primary target for spending reductions in the Balanced Budget Act of 1997 (the Act). The Act reduces overall spending by $140 billion over five years, $115 billion of which is in the Medicare program. Every provider's revenue and financial bottom line will be impacted with hospitals, physicians and post-acute providers such as SNFs and HHAs absorbing most of the cuts. Hospitals remain a target because of the impending bankruptcy of the Part A Trust Fund and reports of high hospital margins on Medicare. A short-term analysis of the Act does not yield an accurate view of its impact. The Act's impact is not linear; less than 10% of its financial impact will be experienced in the first year. Only 25% of the impact will be felt in the first two years. To understand the full impact on its revenue, an organization should perform, at a minimum, a five-year analysis.

Management Response

We are generally following the steps that Ernst & Young asked us to consider. We are giving the most consideration to analyzing the impact of payment changes that are effective on June 1, 1998 at the beginning of our new fiscal year.

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

We would be pleased to discuss the above matters or to respond to any questions, at your convenience.

Ernst & Young LLP

August 7, 1998