Financial Statements

Morehouse General Hospital

Years ended May 31, 1999 and 1998

Morehouse General Hospital

Financial Statements

Years ended May 31, 1999 and 1998

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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, 1999 and 1998, 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, 1999 and 1998, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The year 2000 supplementary information on page 17 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board (GASB), and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because disclosure criteria specified by GASB Technical Bulletin No. 98-1 as amended are not sufficiently specific to permit us to perform procedures that would provide meaningful results. In addition, we do not provide assurance that the Hospital has become year 2000 compliant, the Hospital's year 2000 remediation efforts were successful in whole or in part, or that parties with which the Hospital does business have become year 2000 compliant.

In accordance with *Government Auditing Standards*, we have issued our report dated January 31, 2000 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. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Ernst + Young LLP

January 31, 2000

Morehouse General Hospital

Balance Sheets

	May 31 1999	1998
Assets		
Current assets:		
Cash and cash equivalents	**$ 1,549,483**	$ 1,762,660
Patient accounts receivable, less allowances for uncollectible accounts of $3,067,000 in 1999 and $2,921,000 in 1998	**6,168,514**	5,634,576
Settlements due from third-party payors	**–**	1,966,273
Inventories	**675,664**	807,480
Current assets whose use is limited	**434,254**	495,019
Prepaid and other assets	**231,233**	280,375
Total current assets	**9,059,148**	10,946,383
Noncurrent assets whose use is limited	**2,880,077**	4,664,169
Other assets:		
Amounts due from physicians, net	**106,842**	287,081
Property, plant, and equipment:		
Land	**272,384**	272,384
Buildings	**9,931,681**	10,069,469
Equipment	**20,459,519**	19,866,011
Construction in progress	**5,041,283**	2,038,089
	35,704,867	32,245,953
Less accumulated depreciation	**21,030,322**	19,296,195
	14,674,545	12,949,758
Total assets	**$ 26,720,612**	$28,847,391

	May 31	
	1999	**1998**
Liabilities and fund balance		
Current liabilities:		
Trade accounts payable	**$ 1,181,490**	$ 1,985,868
Retainage payable	**214,479**	99,493
Employee compensation and payroll taxes	**1,076,160**	1,017,878
Settlements due to third-party payors	**291,200**	–
Other accrued liabilities	**297,264**	404,983
Current portion of capital lease obligations	**987,017**	851,129
Current portion of long-term debt	**231,572**	219,775
Total current liabilities	**4,279,182**	4,579,126
Capital lease obligations, less current portion	**2,187,838**	2,118,926
Long-term debt, less current portion	**4,193,236**	4,424,648
Total liabilities	**10,660,256**	11,122,700
Fund balance	**16,060,356**	17,724,691
Total liabilities and fund balance	**$ 26,720,612**	$ 28,847,391

See accompanying notes.

Morehouse General Hospital

Statements of Revenue, Expenses, and Fund Balance

	Year ended May 31	
	1999	**1998**
Net patient service revenue	**$ 28,284,213**	$30,911,967
Other revenue	**1,182,675**	1,093,943
Total revenue	**29,466,888**	32,005,910
Expenses:		
Routine services	**4,819,287**	5,100,517
Ancillary services	**12,819,711**	13,306,937
General services	**2,585,442**	2,878,627
Fiscal and administrative services	**5,939,574**	5,964,430
Depreciation and amortization	**2,113,738**	1,941,269
Provision for bad debts	**2,589,793**	2,025,071
Interest	**263,678**	289,341
Total expenses	**31,131,223**	31,506,192
Revenue in excess of (less than) expenses	**(1,664,335)**	499,718
Fund balance at beginning of period	**17,724,691**	17,174,974
Other changes *(Note 1)*	**–**	49,999
Fund balance at end of period	**$ 16,060,356**	$17,724,691

See accompanying notes.

Morehouse General Hospital

Statements of Cash Flows

	Year ended May 31 1999	1998
Operating activities and gains and losses		
Revenue in excess of (less than) expenses	**$ (1,664,335)**	$ 499,718
Adjustments to reconcile revenue in excess of (less than) expenses to net cash provided by operating activities:		
Depreciation and amortization	**2,113,738**	1,941,269
Interest expense	**263,678**	289,341
Interest income	**(231,196)**	(246,721)
Provision for bad debts	**2,589,793**	2,025,071
Provision for uncollectible physician receivables	**137,539**	–
(Gain) loss on sale of building and equipment	**4,585**	2,968
Changes in operating assets and liabilities:		
Patient accounts receivable	**(3,123,731)**	(1,839,465)
Inventories, prepaid, and other assets	**180,958**	13,140
Trade accounts payable and retainage payable	**(689,392)**	1,482,130
Employee compensation, payroll taxes, and other accrued liabilities	**(49,437)**	(105,143)
Settlements due to/from third-party payors	**2,257,473**	(3,255,649)
Net cash provided by operating activities	**1,789,673**	806,659
Capital and related financing activities		
Purchases of land, buildings, and equipment	**(2,056,594)**	(3,198,255)
Payments of capital lease obligations	**(1,581,556)**	(980,800)
Payments of long-term debt	**(219,775)**	(105,577)
Interest expense	**(263,678)**	(289,341)
Proceeds from the issuance of long-term debt	–	4,750,000
Net cash provided by (used in) capital and related financing activities	**(4,121,603)**	176,027
Investing activities		
Interest income	**231,196**	246,721
Increase in assets whose use is limited	**1,844,857**	(2,834,945)
Loan payments from physician	**42,700**	33,578
Net cash provided by (used in) investing activities	**2,118,753**	(2,554,646)
Net change in cash and cash equivalents	**(213,177)**	(1,571,960)
Cash and cash equivalents at beginning of period	**1,762,660**	3,334,620
Cash and cash equivalents at end of period	**$ 1,549,483**	$ 1,762,660

During the years ended May 31, 1999 and 1998, the Hospital entered into capital leases totaling $1,786,356 and $1,159,020, respectively.

See accompanying notes.

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 approximates 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. During the years ended May 31, 1999 and 1998, the Hospital capitalized approximately $175,000 and $48,000 of interest, respectively.

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 1998. 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 amounts in the 1998 financial statements have been reclassified to conform to their 1999 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

2. Cash and Investments (continued)

institutions which are registered with the Securities Exchange Commission under the Securities Act of 1933 and the Investment Act of 1940 and which have underlying investments consisting solely of securities of the United States government or its agencies.

The Hospital's bank 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, 1999 and 1998, 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 $1,432,317 and $1,386,536 at May 31, 1999 and 1998, 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.

3. Assets Whose Use Is Limited (continued)

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, 1999 and 1998 were as follows:

	May 31	
	1999	**1998**
Board-designated assets:		
Certificates of deposit	**$ 1,081,972**	$ 1,039,389
Mutual fund investment	**1,432,317**	1,386,536
	2,514,289	2,425,925
Trusteed funds (principally United States government obligations):		
Construction Fund	**292,429**	2,267,239
Debt Service Fund	**587**	272
Debt Service Reserve Fund	**472,391**	454,829
Capital Additions and Contingencies Fund	**34,635**	10,923
	800,042	2,733,263
Total assets whose use is limited	**3,314,331**	5,159,188
Less current portion	**434,254**	495,019
Noncurrent assets whose use is limited	**$ 2,880,077**	$ 4,664,169

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, 1999 and 1998, approximately 75% 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.

4. Third-Party Reimbursement (continued)

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, 1999 and 1998, net patient service revenue was decreased by approximately $396,000 and was increased by approximately $170,000, respectively, to reflect changes in the estimated settlements for certain prior years.

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 employment before becoming fully vested is used to reduce the Hospital's current year contribution requirement. For the years ended May 31, 1999 and 1998, the contribution requirements were $956,580 and $939,136, 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, 1999 and 1998, the contribution requirements were $80,095 and $111,034, respectively.

5. Employee Retirement Plan (continued)

Contributions made during the periods for both plans discussed above were $929,953 and $979,897 in 1999 and 1998, respectively. The Hospital's unfunded contribution requirement related to both plans of $47,103 and $220,995 at May 31, 1999 and 1998, respectively, is included in other accrued liabilities on the balance sheet. Total payroll for all employees was $11,389,651 and $11,938,722 for the years ended May 31, 1999 and 1998, respectively. Substantially 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, 1999 and 1998.

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 $929,543 and $979,897 for the years ended May 31, 1999 and 1998, 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, 1999:

Fiscal year ending May 31:	
2000	$1,232,096
2001	939,263
2002	745,020
2003	566,696
2004	291,740
Thereafter	–
Total minimum lease payments	3,774,815
Amount representing interest (ranging from 0% to 10.4%)	(599,960)
Present value of net minimum lease payments (including $987,017 classified as current)	$3,174,855

The cost of leased assets included in equipment totaled $6,220,236 and $5,019,728 and accumulated amortization was $2,642,895 and $2,217,048 at May 31, 1999 and 1998, respectively. The equipment collateralizes the capital lease obligations.

7. Long-Term Debt

The Hospital's long-term debt as of May 31, 1999 and 1998 consisted of bonds payable as follows:

	1999	**1998**
Hospital Revenue Bonds, Series 1997	**$ 4,424,808**	$ 4,644,423
Less current portion	**231,572**	219,775
	$ 4,193,236	$ 4,424,648

7. Long-Term Debt (continued)

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 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. Certain of these other provisions were not met but the violations were cured.

The scheduled maturities of the Series 1997 Bonds for the next five fiscal years ending May 31 are as follows: 2000—$231,572; 2001—$244,003; 2002—$257,099; 2003—$270,898; 2004—$285,441; and $3,135,795 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 May 31, 2000.

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 $4,750,000 related to the renovation in connection with the 1997 Bond Issue. The renovations are expected to be completed in June 1999 at an estimated additional cost of approximately $42,000.

10. Net Patient Service Revenue

Net patient service revenue is comprised of the following:

	1999	1998
Total patient service charges (excluding charity care of $130,503 in 1999 and $149,260 in 1998)	**$ 59,692,669**	$ 58,983,545
Contractual and other allowances:		
Medicaid	**5,720,208**	4,929,358
Medicare	**19,846,430**	18,562,831
Managed care organizations	**3,021,882**	2,502,005
Other	**2,819,936**	2,077,384
Total contractual and other allowances	**31,408,456**	28,071,578
Net patient service revenue	**$ 28,284,213**	$ 30,911,967

Morehouse General Hospital

Required Year 2000 Supplementary Information (Unaudited)

May 31, 1999

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 substantially completed all planned work to address the Year 2000 issue prior to January 1, 2000. The planned work covered three primary areas: principal information technology hardware and software operating systems; embedded systems within clinical equipment and the like; and the ability of vendors and third-party payors to themselves effectively manage the Year 2000 issue with their own organizations.

Management is not aware of any significant adverse effects of the Year 2000 issue on the Hospital's systems or operations. However, there is no guarantee that all systems, equipment, or other entities with the ability to significantly impact the Hospital's operations are Year 2000 compliant.

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Board of Commissioners at May 31, 1999

	01-Jun-98 31-Dec-98	01-Jan-99 31-May-99	Total @ 5/31/99
Dr Carter Cox	$240	$280	$520
Nancy Sawyer	$80	$0	$80
John M Yeldell	$200	$0	$200
Gary Stevenson	$160	$200	$360
Mattie Washington	$200	$240	$440
VE Vetsch	$0	$280	$280
Alfred Twymon		$240	$240
Total	$880	$1,240	$2,120

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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, 1999 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 accompanying Note.

This report is intended solely for the information and use of the board of commissioners, management, and the bond trustee and is not intended to be and should not be used by anyone other than these specified parties. However this report is a matter of public record and its distribution is not limited.

Ernst + Young LLP

January 31, 2000

Morehouse Parish Hospital Service District

Schedule of Debt Service Coverage Ratio

Year ended May 31, 1999
(Unaudited)

Revenue in excess of (less than) expenses	$ (1,664,335)
Depreciation and amortization	2,113,738
Interest	263,678
Income available for debt service	$ 713,081
Maximum annual debt service requirements	$ 457,911
Debt service coverage ratio	1.56
Requirement	1.25

See accountants' review report and accompanying note.

Morehouse Parish Hospital Service District

Note to Schedule of Debt Service Coverage Ratio

May 31, 1999
(Unaudited)

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 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, 1999, and have issued our report thereon dated January 31, 2000. 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, except as noted below, that are required to be reported herein under *Government Auditing Standards*.

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 turnover in the Chief Financial Officer position and certain other issues related to the Hospital cost report. As the cost report is a significant component of the Hospital's financial statements, the audit could not be completed without these issues being resolved.

In the future, management will develop other estimates related to the information used to complete the cost report and thus issue the audited financial statements as required by the Office of Legislative Auditor, State of Louisiana.

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.

However, we noted other matters involving the internal control over financial reporting that we have reported to management of Morehouse General Hospital in a separate letter dated January 31, 2000.

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

Ernst & Young LLP

January 31, 2000

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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, 1999, and have issued our report thereon dated January 31, 2000. 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 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 6.9 requires that the Hospital submit audited financial statements to the trustee within 150 days after the close of the fiscal year. The audited financial statements were not completed within 150 days of May 31, 1999.

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

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January 31, 2000

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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 or the Hospital) for the year ended May 31, 1999, 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. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the specific internal control components does not reduce to a relatively low level the risk that errors or fraud 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. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

The following are areas for which a significant audit adjustment was recorded or for which a repeat adjustment or management letter comment was noted.

Adequacy of the Allowance for Doubtful Accounts

Currently, the Hospital has a policy in which the accounts receivable and the related allowances are reviewed and analyzed monthly utilizing a consistent approach. However, this policy is not reviewed on a periodic basis to ensure that the policy results in an estimate of the allowance that appropriately considers the collectibility of the accounts receivable. This has resulted in significant audit adjustments for the years ended May 31, 1999 and 1998.

Management should establish a bad debt policy to monitor specific accounts receivable balances and to identify potential collection problems on a more timely basis. Also, evaluating the adequacy of the allowance utilizing a more formal and objective approach would help ensure that the various factors (i.e., aging, payor type, historical results, write-offs, etc.) affecting collectibility are analyzed and that the allowance is reasonable and supportable. These policies should also consider any physician clinic receivables.

Management's Response

Management concurs with the above finding and will ensure that receivables are monitored on a more timely basis to ensure that the allowance for doubtful accounts is adequate on an interim basis and at year end.

Third-Party Accounting

The Hospital currently accounts for differences between standard charges and expected interim payments at the time of billing. Differences between interim payments and final reimbursement on cost-based programs are generally accounted for annually, concurrent with the preparation of the Hospital's Medicare and Medicaid cost reports. In addition, the Hospital's analysis of the allowance for contractual discounts on third-party accounts warrants improvement. Both of these areas have resulted in significant adjustments to the Hospital's year-end results for several years.

In order to improve the accuracy of interim financial reporting and reduce the possibility of surprises at year end, we recommend the Hospital enhance its procedures for third-party accounting through a combination of interim cost report preparation and additional settlement analysis performed on a quarterly basis, as well as a refinement of the model used to estimate the allowance for contractual discounts.

Management's Response

Management concurs with the above finding and will ensure that the accounting for third-party accounts is enhanced to ensure the accuracy of these accounts on an interim basis and at year end.

Interim Financial Reporting

The Hospital's interim financial statements are used extensively by management and the board of commissioners to make management and operating decisions. Accordingly, it is important that the interim financial statements reflect a fair presentation of interim results and incorporate all necessary adjustments. Historically, significant adjustments have been recorded to the year-end financial statements as a result of the audit process. This has resulted in inaccurate interim financial information being used throughout the year to make business decisions.

It is imperative that the Hospital improve its interim accounting processes. Specifically, two of the more significant areas that should be focused on include the allowance for bad debts and the third-party accounts as discussed above. Improvements in these two areas should greatly enhance the accuracy of the interim financial reporting.

Management's Response

Management concurs with the above finding and will develop policies to ensure that the allowance for bad debts and third-party accounts are appropriately estimated on a monthly basis so that interim financial results are accurately reflected.

Monitoring Debt Compliance

The Hospital had two instances of noncompliance for the year ended May 31, 1999, as reported in our separate Report on Compliance with Bond Resolution dated January 31, 2000. Based on our discussions with management, it was noted that the Hospital does not have any processes in place to monitor debt compliance on a monthly basis to ensure the Hospital remains in compliance with all requirements of the 1997 Bond Resolution. Failure to meet these requirements could create serious financial consequences for the Hospital.

We recommend management implement a policy whereby the Hospital's compliance with its debt agreement is monitored on a monthly basis.

Management's Response

Management concurs with the above finding and will develop policies to monitor debt compliance on a monthly basis.

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The following are other significant items which we would like to bring to the attention of management.

Bad Debt Write-Off Policy

During 1999, the Hospital experienced a significant increase in bad debt write-offs. Based on discussions with management, it was noted that the fluctuation in write-offs was partially due to management not following their formal bad debt write-off policy in 1999 or other recent years, resulting in a build up of accounts that needed to be written off.

Management should review its current bad debt write-off policy and develop a process to ensure the policy is followed and that receivables are monitored consistently and written off appropriately.

Management's Response

Management concurs with the above finding and will develop a policy to monitor bad debt write-offs so that receivables are appropriately accounted for.

Information Systems Recommendations

To design appropriate procedures in the conduct of our financial audit, we conducted a review to evaluate the controls surrounding the Hospital's financial systems environment. Our procedures consisted primarily of discussions with personnel in the Information Systems department.

The environmental controls (i.e., controls not specific to any one application) reviewed included:

- The overall organization of the Data Processing department and its relationship to user areas.

- Procedures relating to the backup and recovery of critical programs and data, and the ability to restore processing ability in the event of a short-term or long-term processing interruption.

- Control over access to information in general and to production data files in particular.

- The procedures and controls surrounding the development of new information systems and the maintenance of existing application systems.

Our evaluation of the internal controls within the information processing environment affects the nature, timing, and extent of our audit procedures. Also, we believe that strong information systems controls are important because of management's increasing reliance on computer-generated data to make key decisions in many aspects of their business.

Areas where we believe opportunities exist for improvement include the following:

- Development of password access controls
- Use of formal system access forms
- Use of access violation reports that permit the identification and monitoring of both valid and invalid access attempts
- Development of a formal personnel termination notification process
- A periodic review of user access privileges
- Development of a business continuity plan

A detailed letter of recommendations related to the above topics has been provided to management and is available for review by the board of commissioners, if desired.

Management's Response

Management will review the above suggestions and consider implementation during fiscal year 2000.

Environmental Matters

The health care industry continues to face many new and evolving challenges. Below are some environmental issues that will affect the Hospital in the near-term future.

Information Security Issues

The Health Insurance Portability and Accountability Act (HIPAA) is one of the most far-reaching pieces of health care legislation ever to be enacted. This legislation, when fully implemented, will require all providers, health plans and clearinghouses that electronically store or transmit individually identifiable health information to maintain reasonable administrative, technical, and physical mechanisms to keep information private, confidential and secure. Many experts believe the scope and breadth of the security provisions of HIPAA legislation will challenge the time and resource commitments of certain organizations on a magnitude akin to the Year 2000 redemption efforts.

Implementing regulations were published by the Department of Health and Human Services in November 1999 and were originally scheduled to be effective in February of 2000. However, the public comment period for the proposed health care privacy regulation, originally set to end on January 3, 2000, has been extended 45 days until February 17, 2000 in response to numerous requests from health industry trade associations and organizations for more time to respond. Following the effective date, large providers will be given 24 months to become fully compliant with these provisions. It is anticipated that penalties and enforcement will be strict and could result in both civil and criminal sanctions.

The security requirements of HIPAA are many, but are essentially broken into three categories:

- **Administrative Procedures** - including certification reviews, chain of trust partnership agreements, policies and procedures, access authorization, audits of MIS security, personnel authorization and security processes, MIS security configuration management procedures, incident reporting, risk analysis, security training and termination processes.

- **Physical Safeguards** - including assigned security responsibilities, controls over receipt and removal of hardware and software, physical access controls and disaster backup and recovery.

- **Technical Security** - including logical access controls, audit trails of systems access/activity, authorization control over disclosure and use of information, data authentication to prove data has not been altered, individual authentication to verify identity and establish accountability, and nonrepudiation. As achieving compliance with these standards will require significant systems and organizational re-engineering, we recommend that the Hospital begin to develop a plan to achieve compliance. Such a plan should include as a minimum:

- Establishment of procedures for monitoring legislative and regulatory activity regarding health information privacy.

- Performance of a current state risk/gap analysis to identify current vulnerabilities. This may include an evaluation to determine how secure your current IT environment is from internal and external security attacks, and an assessment of security vulnerabilities and control weaknesses compared to anticipated confidentiality and minimum security baseline standards. Inventory all health information obtained by your organization, determine how it is being used and to whom the information is being distributed.

- Review of current security measures over health information and compare these measures to current best practices regarding the securing of confidential information.

- Evaluation of the length of time required to implement the best practices identified above, including the education of employees and others who receive health information from you.

- Identification of individual(s) responsible and steps required to achieve compliance by February 2002.

Management's Response

Management agrees that the HIPPA legislation will be important to the Hospital and will begin reviewing current policies.

Corporate Compliance

The federal government is continuing 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. In response to this environment, the Hospital recently implemented a formal corporate compliance program.

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. 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, it is important that the effectiveness of the Hospital's program be evaluated and documented on a periodic basis in light of the Guidelines.

We encourage management and the board of commissioners to consider implementing procedures to evaluate the effectiveness of the Hospital's corporate compliance program on a periodic basis.

Management's Response

Management agrees that auditing and monitoring of a corporate compliance plan is important and will work to implement some auditing and monitoring of the current plan in the upcoming year.

Balanced Budget Act—Outpatient PPS

Traditional government entitlement programs are the primary target for spending reductions in the Balanced Budget Act of 1997 (the BBA). The BBA's impact is not linear; only about 20% of the BBA's impact on the health care industry has been experienced through fiscal year 1999. Already, there are signs of the negative impact the BBA is having on the industry, including consolidation, declining financial health, reduced bond ratings, reduced access to capital, reduced access to care, staff layoffs, and divestiture of services.

One of the changes required by the BBA is the implementation of a prospective payment system (PPS) for outpatient services. Implementation of an outpatient PPS system was originally required by January 1, 1999, but has now been delayed until after January 1, 2000. The outpatient PPS impact is expected to result in a 3.8% reduction in outpatient payments, and a 0.4% reduction in total Medicare payments. As a result of outpatient PPS, hospitals will have to ensure that they have coding staff who are properly trained to accurately code outpatient claims so that the hospital will be reimbursed properly. Accurate coding will not only have payment implications, but implications for compliance and fraud as well. In addition, hospitals may have to make programmatic changes as well as upgrades to information systems in order to implement the new payment system. Hospitals should review their outpatient cost structures to ensure they are prepared for outpatient PPS.

Management's Response

Management concurs with the above finding and will work to estimate the effects of the new provisions of the Balanced Budget Act regarding outpatient PPS in fiscal year 2000.

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to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

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

Ernst & Young LLP

January 31, 2000