ARTHUR ANDERSEN LLP

LOUISIANA STATE UNIVERSITY SCHOOL OF MEDICINE IN NEW ORLEANS FACULTY GROUP PRACTICE (D/B/A) LSU HEALTHCARE NETWORK

FINANCIAL STATEMENTS AS OF JUNE 30, 1998 AND 1997 TOGETHER WITH AUDITORS' REPORT

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors of Louisiana
State University School of Medicine in
New Orleans Faculty Group Practice:

We have audited the accompanying statements of financial position of the Louisiana State University School of Medicine in New Orleans Faculty Group Practice d.b.a. LSU Healthcare Network (a Louisiana nonprofit organization) ("LSUHN") as of June 30, 1998 and 1997, and the related statements of activities and changes in net assets and cash flows for the year ended June 30, 1998 and for the period from inception to June 30, 1997. These financial statements are the responsibility of LSUHN's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of LSUHN as of June 30, 1998 and 1997 and the results of its operations and its cash flows for the year ended June 30, 1998 and for the period from inception through June 30, 1997 in conformity with generally accepted accounting principles.

In accordance with Governmental Auditing Standards, we have also issued a report on our consideration of LSUHN's compliance and internal controls over financial reporting dated August 21, 1998.

Arthur Andersen LLP

New Orleans, Louisiana,
August 21, 1998

LSU HEALTHCARE NETWORK

STATEMENTS OF FINANCIAL POSITION

AS OF JUNE 30, 1998 AND 1997

	1998	1997
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents (Note 2)	$ 493,674	$ 771,805
Accounts receivable (net of contractual allowances and adjustments and doubtful accounts of $29,508,122 in 1998 and $6,745,238 in 1997)	16,437,857	3,005,143
Prepaid expenses	26,299	-
Total current assets	6,957,830	3,776,748
ORGANIZATIONAL COSTS (net of accumulated amortization of $275,402 in 1998 and $18,360 in 1997) (Note 2)	-	257,042
PROPERTY, PLANT AND EQUIPMENT, net	267,920	-
OTHER ASSETS:		
Investment in Crescent Benefits, LLC (Note 5)	5,681	20,000
Total assets	$17,231,431	$ 4,053,990
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable	$ 832,283	$ 51,887
Due to LSUMC Foundation (Note 3)	336,512	336,612
Due to LSU Medical Center (Note 3)	14,637,374	2,749,014
Total current liabilities	15,806,169	3,137,513
NET ASSETS (Unrestricted) (Note 2)	1,425,262	916,477
Total liabilities and net assets	$17,231,431	$ 4,053,990

The accompanying notes are an integral part of these financial statements.

LSU HEALTHCARE NETWORK

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS

FOR THE YEAR ENDED JUNE 30, 1998 AND FOR THE PERIOD

FROM INCEPTION OF OPERATIONS AT MARCH 1, 1997 THROUGH JUNE 30, 1997

	1998	1997
NET PATIENT SERVICE REVENUE	$ 46,257,548	$ 4,954,179
OPERATING EXPENSES:		
Leased employees - faculty	18,380,893	2,196,946
Leased employees - non faculty	6,424,740	423,211
Bad debt expense	9,350,886	867,176
Medical supplies	1,739,541	-
Depreciation	29,770	18,360
General and administrative	3,828,455	91,249
Personnel	2,138,231	37,590
Total operating expenses	41,892,516	3,634,532
Income from operations	4,365,032	1,319,647
OTHER REVENUES (EXPENSES):		
Medical school enhancement fund (Note 3)	(3,702,420)	(408,700)
Interest income and other income	117,534	5,530
Loss on joint venture	(14,319)	-
Total other revenues (expenses)	(3,599,205)	(403,170)
INCREASE IN UNRESTRICTED NET ASSETS BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	765,827	916,477
CUMULATIVE EFFECT OF A CHANGE IN AN ACCOUNTING PRINCIPLE (Note 2)	(257,042)	-
INCREASES IN UNRESTRICTED NET ASSETS	508,785	916,477
UNRESTRICTED NET ASSETS, beginning of period	916,477	-
UNRESTRICTED NET ASSETS, end of period	$ 1,425,262	$ 916,477

The accompanying notes are an integral part of these financial statements.

LSU HEALTHCARE NETWORK

STATEMENTS OF CASH FLOWS

FOR THE YEAR ENDED JUNE 30, 1998 AND FOR THE PERIOD

FROM INCEPTION OF OPERATIONS AT MARCH 1, 1997 THROUGH JUNE 30, 1997

	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES:		
Increase in net assets	$ 508,785	$ 916,477
Adjustments to reconcile increase in net assets to net cash provided by operating activities-		
Depreciation and amortization	29,770	18,360
Increase in accounts receivable	(13,432,714)	(3,005,143)
Increase in prepaid expense	(26,299)	-
Increase in accounts payable	780,396	51,887
Increase (decrease) in due to LSUMC Foundation	(100)	336,612
Increase in due to LSU Medical Center	11,888,360	2,749,014
Net cash provided by operating activities	(251,802)	1,067,207
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of fixed assets	(297,690)	-
Organizational costs (write-off) (Note 2)	257,042	(275,402)
(Investment in) loss on Crescent Benefits, LLC	14,319	(20,000)
Net cash used by investing activities	(26,329)	(295,402)
Net increase (decrease) in cash and cash equivalents	(278,131)	771,805
CASH AND CASH EQUIVALENTS, beginning of period	771,805	-
CASH AND CASH EQUIVALENTS, end of period	$ 493,674	$ 771,805

The accompanying notes are an integral part of this financial statement.

LSU HEALTHCARE NETWORK

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1998 AND 1997

1. NATURE OF ACTIVITIES:

Louisiana State University School of Medicine in New Orleans Faculty Group Practice d.b.a. LSU Healthcare Network ("LSUHN"), a Louisiana non-profit organization, assists the LSU Medical Center ("LSUMC") in carrying out its medical, educational, and research functions. LSUHN provides heath care to the general public including, but not limited to, the delivery of physician medical services and other health care services to individuals. LSUHN receives compensation for these services from the Medicare and Medicaid programs, from certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations and directly from the patients themselves.

From inception of operations at March 1, 1997 through September 30, 1997, all services provided by LSUHN were rendered in the public hospitals serviced by LSUMC. These hospitals include Earl K. Long in Baton Rouge, University Medical Center in Lafayette, the Medical Center of Louisiana in New Orleans and University Hospital in New Orleans. Beginning October 1, 1997, LSUHN's activities include services provided in both the public hospitals and the private clinics serviced by LSUMC. LSUHN and LSUMC (through the Board of Supervisors of Louisiana State University and Agricultural and Mechanical College) have entered into Cooperative Endeavor and Operating Agreements that allow for the two entities to work together in a mutually beneficial manner. The agreements delineate the obligations and responsibilities of both LSUHN and LSUMC. Both parties have the right to terminate the Operating Agreement with or without cause upon 60 days written notice.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Accounting

The financial statements of LSUHN have been prepared on the accrual basis of accounting and, accordingly, reflect all significant receivables, payables and other liabilities.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents

LSUHN considers all highly liquid investments in money market funds and investments available for current use with an initial maturity of three months or less to be cash equivalents.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line basis over estimated useful lives of 5 years.

Net Assets

LSUHN has received no contributions with donor-imposed restrictions and therefore total net assets are classified as unrestricted in accordance with Statement of Financial Accounting Standards No. 117. However, the Board of Directors of LSUHN has designated $3,904,355 as of June 30, 1998 and $452,651 as of June 30, 1997 of unrestricted net assets to be used to support LSUMC and its various clinical departments. The remaining unrestricted net asset balance of $(2,479,093) as of June 30, 1998 and $463,826 as of June 30, 1997 is dedicated to support of clinic operations and other administrative services provided by LSUHN.

Net Patient Service Revenue

LSUHN has agreements with third parties that provide for payments at amounts different from its established rates. Net patient service revenue is reported at the estimated net amounts realizable from patients, third party payors, and others for services rendered. Major third party payor arrangements are summarized below.

Medicare - Payment for professional fees is generally based on the Resource Based Relative Value Scale.

Medicaid - Payment for professional services is generally based on either predetermined fee schedules or fee for service.

LSUHN has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to LSUHN under these agreements includes prospectively determined rates per office visit and discounts from established charges.

Charity Care

LSUHN provides care to patients in the public hospital system without regard to their ability to pay for those services. Because LSUHN does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue.

Organizational Costs

LSUHN elected to adopt American Institute of Certified Public Accountants Statement of Position 98-5, "Reporting on the Cost of Start-up Activities" in the fiscal year ending June 30, 1998. This Statement requires the cost of start-up activities and organizational costs to be expensed as incurred. The impact of adopting this statement is a reduction in unrestricted Net Assets of $257,042 which is reflected as the cumulative effect of a change in accounting principle in the Statement of Activities and Changes in Net Assets for the Year ended June 30, 1998.

Income Taxes

LSUHN is a nonprofit corporation organized under the laws of the State of Louisiana. It is exempt from Federal income tax under Section 501(c)(3) of the Internal Revenue Code of 1986, and qualifies as a support organization, as defined in Section 501(a) of the Code. It is exempt from Louisiana income tax under the authority of RS 47:121(5).

Prior Year Reclassifications

Certain prior year amounts have been reclassified to conform to current year presentation.

3. RELATED PARTY TRANSACTIONS:

Physician and non-physician employees of LSUMC provide certain clinical and administrative services to LSUHN. Approximately $17,901,795 and $294,770 was paid for services provided under this arrangement during fiscal years ended June 30, 1998 and 1997, respectively. Approximately $12,128,493 and $2,340,314 was owed to LSUMC for physician and non-physician services, including amounts accrued relating to accounts receivable, as of June 30, 1998 and 1997, respectively.

LSUHN's affiliation agreement with LSUMC requires LSUHN to pay ten percent (10%) of its annual gross cash receipts to LSUMC, through the Medical School Enhancement Fund ("MSEF") to support the clinical, academic and research missions of the Medical Center. Cash payments totaling $1,602,239 were made to the MSEF during the fiscal year ended of June 30, 1998. As of June 30, 1998 and 1997, approximately $2,508,881 and $408,700, respectively, was due to LSUMC for MSEF payments, including amounts accrued relating to accounts receivable.

Prior to June 30, 1997, the LSUMC Foundation advanced LSUHN $336,612 to fund organizational costs and certain operating expenses. The unpaid portion of this is reflected as a liability in the accompanying balance sheet.

4. PROPERTY, PLANT AND EQUIPMENT:

Property, plant and equipment at June 30, 1998 consists of:

	1998
Furniture, fixtures and equipment	$ 297,690
Less: Accumulated depreciation	29,770
Property, plant and equipment, net	$267,920

5. OTHER ASSETS:

Crescent Benefits, LLC

LSUHN has a 20% interest in a Limited Liability Company called Crescent Benefits, LLC ("Crescent"). Crescent will provide third party administration health claim services to municipality related customers, if the entity is successful in bidding on those services. LSUHN has committed to contribute up to an additional $80,000 to Crescent should Crescent be successful in obtaining contracts in which case the other owners would contribute up to $320,000, keeping LSUHN's total interest at 20%. LSUHN accounts for its interest in Crescent under the equity method. Should Crescent be unsuccessful in obtaining the desired municipality contracts, plans are to liquidate the company and return any remaining capital to the members. LSUHN has reduced its initial investment in Crescent by $14,319 to reflect LSUHN's share of operating losses through June 30, 1998.

Children's Healthcare Network

LSUHN is a member of the Children's Healthcare Network ("CHN"), a non-profit organization. CHN will negotiate managed care contracts relating to pediatric patient populations on behalf of LSUHN and the other two members of CHN, the Pediatric Physician's Network, Inc. and Children's Hospital. LSUHN originally contributed $47,700 to CHN to fund its portion of start-up costs for that organization. The CHN Board subsequently voted to return this contribution to LSUHN in order to be consistent with capital requirements from other CHN owners. CHN is currently financing start-up cash flow needs through a line of credit with Children's Hospital. LSUHN owns a 33-1/3% interest in CHN and accounts for its interest in CHN under the equity method.

6. COMMITMENTS:

LSUHN leases office space and equipment under operating leases that expire at various dates through April 2003. Certain of the lease agreements provide for escalations based on cost of operations. Total rent expense for the year ended June 30, 1998 and 1997 was $872,295 and $0, respectively.

Minimum annual lease payments for each of the next five years ending June 30, are as follows:

Year	Payments
1999	$806,089
2000	773,742
2001	259,490
2002	48,086
2003	10,351
Total	$1,897,758

7. CREDIT FACILITIES:

On January 1, 1998, LSUHN entered into a $1,250,000 secured revolving credit facility with the LSU Medical Center Foundation ("Lender"), a private, non-profit organization which supports the activities of LSU Medical Center. The revolving credit facility has a term of two years with an option for the Lender to call the balance of the loan outstanding at December 31, 1998 with prior written notice on or before November 30, 1998. Any outstanding balance bears interest at the per annum rate published by the Wall Street Journal as the prime rate. The revolving credit facility requires the Lender's approval for LSUHN to incur additional borrowings and grants the Lender a security interest in 90% of LSUHN's accounts receivable. As of June 30, 1998, no amounts were outstanding under the revolving credit facility.

8. 401(k) PLAN

In December 1997, LSUHN established a 401(k) plan for the benefit of its employees. The plan permits an employee to contribute up to 15% of their compensation to the plan, subject to certain limitations. At its discretion, LSUHN may make contributions to the 401(k) plan for the benefit of participating employees. For the year ended June 30, 1998 401(k) plan expense was $80,964.

9. CONCENTRATIONS OF CREDIT RISK:

LSUHN provides services in New Orleans, Baton Rouge and Lafayette. LSUHN grants credit to its patients, some of whom are insured under third-party payor agreements. LSUHN routinely obtains assignment of or is otherwise entitled to receive patients' benefits from Medicare, Medicaid and other third-party payors. The mix of receivables from patients and third party payors at June 30, 1998 and 1997, was as follows:

	1998	1997
Medicaid	34.7%	65.0%
Medicare	20.0%	15.7%
Commercial	19.5%	9.6%
HMO/PPO	12.3%	3.7%
Self Pay	13.5%	6.0%
	100%	100%

LSUHN routinely invests its surplus operating funds in money market mutual funds that generally invest in highly liquid U.S. Government and agency obligations. Investments in money market funds are not insured or guaranteed by the U.S. Government; however, management believes the credit risk related to these investments is minimal.

10. GOVERNMENT REGULATIONS:

The healthcare industry is subject to numerous laws and regulations of Federal, state and local governments. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Recently, government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. The office of the Inspector General of the Department of Health and Human Services has undertaken a project to audit Medicare billings of certain academic medical institutions. The government has stated that it believes that a significant amount of Medicare claims filed by teaching physicians are not properly documented as required by current interpretations of Medicare standards. If a provider is found to be in violation of these documentation standards, the government may require repayment of any overcharges and may impose a penalty of treble damages plus up to $10,000 per false claim. Management believes that LSUHN is in compliance with fraud and abuse as well as other applicable government laws and regulations, and with the Medicare documentation standards. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

Legislation and regulation at all levels of government have affected and are likely to continue to affect the operation of LSUHN. Federal healthcare reform legislation proposals debated in Congress in recent years have included proposals for the imposition of price controls and/or healthcare spending budgets or targets, significant reductions in Medicare and Medicaid program reimbursement to healthcare providers and the promotion of a restructured delivery and payment system focusing on competition among providers based on price and quality, managed care, and steep discounting or capitated payment arrangements with many, if not all, of LSUHN's principal payors. *It is not possible at this time to determine the impact on the LSUHN of government plans* to reduce Medicare and Medicaid spending, government implementation of national and state healthcare reform or market-initiated delivery system and/or payment methodology changes. However, such changes could have an adverse impact on operating results and cash flows of LSUHN in future years.

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMEND IN ACCORDANCE WITH GOVERNMENTAL AUDITING STANDARDS

To the Board of Directors of
Louisiana State University School of Medicine
in New Orleans Faculty Group Practice:

We have audited the financial statements of the Louisiana State University School of Medicine in New Orleans Faculty Group Practice, d.b.a. LSU Healthcare Network (a Louisiana nonprofit organization) ("LSUHN") as of and for the year ended June 30, 1998, and have issued our report thereon dated August 21, 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 LSUHN's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement accounts. 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 disclose no instances of noncompliance that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered LSUHN'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 weakness. 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 Directors and management, however, this report is a matter of public record and its distribution is not limited.

Arthur Andersen LLP

New Orleans, Louisiana
August 21, 1998

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August 31, 1998

Arthur Andersen LLP

Suite 4500
201 St Charles Avenue
New Orleans LA 70170 4500
504 581 5454

To the Board of Directors
Louisiana State University School of Medicine
in New Orleans
Faculty Group Practice
d.b.a. LSU Healthcare Network:

As part of our audit of the financial statements for the Louisiana State University School of Medicine in New Orleans Faculty Group Practice (LSUHN) for the year ended June 30, 1998, we considered the LSUHN's internal control structure in determining the scope of our audit procedures for the purpose of rendering an opinion on the financial statements. Our primary purpose in this engagement was not to provide assurances on the internal control structure. We noted the following matters that we want to bring to your attention.

Accounts Receivable Detailed Trial Balance

As part of our audit, we requested a June 30, 1998 detailed trial balance by patient that reconciles to the general ledger. LSUHN was unable to produce the year-end accounts receivable trial balance for the purpose of our testing. This detailed listing should be generated and reviewed on a monthly basis to determine if any individual balances are unreasonable and if there are any unusual items that would indicate systemic problems with the billing and collection process. The details should be reviewed for accounts on the IDX system and those billed by the outside service provider, HMS. In addition to the internal control provided by this detailed review, LSUHN has a contractual responsibility to maintain this detail in accordance with the line of credit security agreement with the LSU Medical Center Foundation (Article 4 section 4.5) in which LSUHN has pledged its accounts receivable balance to secure the line of credit. LSU Medical Center Foundation as the creditor maintains the right to review, at any time, a detailed list of the patient balances that comprise the accounts receivable. We recommend that LSUHN develop formal procedures with respect to the monitoring of accounts receivable on a monthly basis which includes the review and maintenance of the detailed trial balance.

Reconciliation of the Accounts Receivable Trial Balance to the General Ledger

LSUHN does not reconcile the IDX accounts receivable trial balance and the HMS trial balance to the general ledger on a monthly basis. Reconciliation of the receivables subsidiary ledger to the general ledger is a control technique that should be performed on a monthly basis to ensure that billing and collections activity is properly recorded in the general ledger and to ensure that accounts receivable and revenue are not misstated.

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Billing Lag
AA noted that the LSUHN has approximately a month and a half lag between the date of service and when the bill is posted to the IDX system. One of the reasons noted for the billing lag is the delay caused by a doctor not completing the required documentation in the patient medical record in a timely manner. We recommend that the Network develop a monitoring control that allows management to identify the doctors that consistently sign-off on the patient charts late. Management is currently reviewing other reasons for the billing lag and taking steps to reduce it. We encourage management in their efforts to investigate these delays and to implement solutions as soon as possible.

HMS
LSUHN utilizes HMS to process the billing for the New Orleans public hospital activities. In our discussions with Network personnel, we noted there are no controls to ensure that all charges performed in a certain department are posted by HMS. The original charge documentation is sent directly to HMS for processing. The Network does not know the amount of charges generated by a department until HMS sends the monthly statement. Therefore, the Network should perform a test to ensure all department charges are processed. The Network should select a sample of charges generated by a department and trace these charges to a detail of the charges by patient supplied by HMS. The sample should be selected from the daily patient logs that detail the activity in a department. LSUHN should monitor all HMS activity for propriety.

Annual Leave
LSUHN properly accrued annual (vacation) leave for state employees; however, LSUHN did not accrue for LSUHN employees. Per review of the LSUHN summary of benefits, all employees, including Network employees, qualify for annual leave benefits. Employees earn annual leave benefits as services are rendered. Accordingly, these benefits should be accrued over the period when the services are performed in accordance with the Network's formal policies. Accrual of these benefits is appropriate even when the rights do not legally vest or otherwise accumulate, providing the entity's policies indicate payment will be made. However, in such cases, the accrual should be reduced for estimated amounts, if any, that will not be paid due to nonuse, termination or other reasons. Annual leave pay should be accrued using current salary rates and the accrual should be adjusted when the rates change.

Property Depreciation
During 1998, LSUHN did not have a formalized property depreciation policy or calculation. The depreciable amount of an item of property, plant and equipment should be allocated on a systematic basis over its useful life. The depreciation method used should reflect the pattern in which the Network consumes the asset's

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economic benefits. Because the amount of fixed assets held by LSUHN is growing, we recommend that the Network implement a formal property ledger and depreciation calculation in order to maintain adequate property records.

Conflict of Interest Statements
AA noted that LSUHN does have a conflict of interest policy (Disclosure policy); however, this policy does not require directors, officers or employees to sign an annual conflict of interest statement. The policy requires the directors, officers, and employees to notify LSUHN as a conflict arises. Conflict-of-interests statements are intended to provide the board of directors with information about the existence or nonexistence of relationships between the reporting persons and parties with whom the company transacts business. We recommend that LSUHN obtain written conflict of interest forms from directors, officers, and employees on an annual basis.

Information Systems
During our discussions regarding the EDP systems used by LSUHN, we noted several areas in which additional internal controls would improve the security and integrity of the systems. A separate detailed memo has been provided to management that discusses control procedures that should be considered in managing and operating the systems during the prior year audit. A similar detailed memo has been given to management for the current year (Exhibit A), which includes the prior year comments that have not been implemented along with any new issues noted in the current year. The memos list controls to be considered in the areas of logical access, continuity of operations (backup and disaster recovery), physical and environmental controls, and organization and management of EDP activities. We recommend that management conduct a thorough review of its system needs and current controls to develop system objectives and a systems plan. This review should include both the systems owned by LSUHN and the systems leased from LSUMC. The plan should include implementation of controls to ensure the security and integrity of the issue.

Tax Issue
LSUHN has not applied for tax-exempt status for sales and use tax on certain medical equipment and devices. As the volume of purchases continue to increase at the Network, the cash flow impact of this exemption could be material. We recommend that LSUHN file for exempt status with the applicable taxing authorities as soon as possible. If necessary, Arthur Andersen personnel are available to assist the Network with filing these applications.

Inventory
Inventory used at LSUHN clinic locations is currently expensed when purchased. Technically, the inventory should be recorded as an asset when purchased and expensed when used. Management is currently investigating cost-beneficial

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alternatives to capturing information to appropriately record inventory, we encourage this effort to maintain adequate records.

This letter and the accompanying memorandum are intended solely for the use of management and the Board of Directors and are not intended for any other purpose.

We appreciate the courtesies and cooperation extended to our representatives during the course of their work. We would be pleased to discuss the recommendations in greater detail or otherwise assist in their implementation at your convenience.

Very truly yours,

Arthur Andersen LLP

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LSU HEALTHCARE NETWORK
IMPLEMENTATION OF PRIOR YEAR RECOMMENDATIONS
AS OF JUNE 30, 1998

	Implemented	Partially Implemented	Not Implemented
Billing Procedures		X(1)	
Charity Care		X(2)	
Charge Master Database	X		
Charge Code Override	X		
Receipt of Funds for Patient Charges		X(3)	
Bad Debt Reserve			X
Bad Debt Write-offs	X		
Investment Policy	X		
Policy and Procedures Manual	X		
Maintenance of Check Register	X		
Travel and Entertainment Documentation		X(4)	
Electronic Data Processing		X(5)	

(1) We noted that LSUHN has made an improvement in regards to keeping patient logs and reconciling the logs to charge forms turned in to the billing department. However, we noted that not all of the departments are currently using a patient log. We recommend that the each department in the Network keep patient logs that are reconciled to the charge forms on a regular basis.

(2) Consistent with prior year, LSUHN did not record free care on the IDX system during fiscal year 1998. As of July 1998, HMS handles the billing and collections for the public activity at New Orleans. LSUHN plans to expand the operations of HMS to include Lafayette. HMS records all charges, including charges that previously would have been considered charity and therefore not recorded at all. Although the public activity at Charity and University Hospital represents a large portion of the free care provided by the Network, we recommend that the Network record all charges in order to ensure that all charges that may be partially collectable are recorded.

(3) In the prior year, we noted that LSUHN should direct payments to its lockbox as often as possible. As of October 1, 1997, the Network took over the private clinic operations of the LSUMC. These clinics receive payments from the patients at the point of service; therefore, the prior year recommendation that LSUHN direct all payments to the lockbox does not apply to the clinics. In the course of our work, we were informed of two instances that involved the theft of immaterial amounts of LSUHN funds. We reviewed the controls in place and noted that LSUHN had adequate controls in place; however, the individuals responsible for the control activities were lax about their duties. Although as a result of the thefts, the LSUHN staff responsible for the control activity was made aware of their duties, AA recommends that the LSUHN draft a formal procedure that documents each employees responsibility regarding cash receipts.

(4) We noted that the Network has formalized a Travel and Entertainment policy in the past year. However, in our testing of Travel and Entertainment expense, we noted one instance in which there was no receipt present for the reimbursement and a second instance in which there was no approval noted for the reimbursement.

(5) In 1998, LSUHN upgraded the IDX billing system to version 8.4. LSUHN has obtained from the vendor, in writing, assurances that this version of the software is year 2000 compliant. However, a formal Year 2000 assessment of other system has not been completed. In addition, the internal control recommendations in the 1997 management letter have not been implemented.

EXHIBIT A

ARTHUR ANDERSEN

To: The Files, New Orleans

From: Mignon Kohnke, New Orleans

Date: August 20, 1998

Subject: LSU Healthcare Network

This memo documents the findings of the general controls review of the LSU Healthcare Network's ("the Company") Electronic Data Processing (EDP) function and was performed as part of the annual financial audit. The observations contained in this memo were obtained from interviews with John Caire (Chief Financial Officer) and George Gilmore (Manager of Information Systems) on Wednesday, August 12, 1998.

The focus of the interview was the EDP function at the Company and the general controls over computer systems. Documented below are the exposure points that were identified during the interview process. It should be noted that the information contained in this memorandum is based solely on discussions and observations with the Company's personnel. No testing or verification work was performed to determine if existing procedures and controls are functioning as intended.

<u>Summary Findings:</u>

- *Year 2000* - The primary issue surrounding the year 2000 pertains to computer systems that store dates in the format of Month-Day-Year ("MM-DD-YY") with only two characters allocated for the century identifier. For example, November 13, 2000 would be stored in the format 11-13-00. Computer hardware and software applications that use dates in this fashion will potentially interpret the date as November 13, <u>19</u>00. All computer hardware and software is potentially at risk of producing unpredictable results or complete failure. It is important to note that resources are expected to become scarce and more expensive as the year approaches.

    - The Company utilizes a number of computer systems that are provided and supported by the LSU Medical Center (e.g., network and building infrastructure). As such, the Company should ascertain the status of the LSU Medical Center's Year 2000 initiatives and evaluate the level of threat that these exposure points could pose to the business.

    - *A formal analysis should be conducted to determine if hardware (computers, security systems, telecommunication systems, etc.) and other software (application software, system software, etc.) are at risk. Vendors should be contacted in writing to determine whether their products are Year 2000 compliant, and if they are not compliant, vendors should be requested to provide their plans for becoming compliant.

      The Company is currently aware of one software application, the lab system, which is considered "mission critical" to business processing on which a formal assessment has not been performed to determine if it is Year 2000 compliant.

    - A formal Year 2000 compliance plan should be drafted for the Company that includes, at a minimum, the following:
      - a comprehensive list of all exposure points prioritized by risk,
      - a defined criteria for determining the repair vs. replace decision for hardware and software,
      - a cost analysis of the repair vs. replace decision,

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- a determination from where the knowledge and experience needed to implement the compliance plan will be obtained,
- a date by which all activities must be completed,
- a defined process for measuring the status of the plan.

- A committee should be established including personnel from all areas of the business (e.g., senior management, information systems, operations, finance, legal/regulatory, etc.) that has overall responsibility for the Year 2000 compliance program.

- *Since the Year 2000 represents an immovable deadline, the Company should consider its impact in the budgeting process. Additional resources will be required to manage and perform the process of replacing or upgrading non-compliant systems in order to ensure the deadline will be met. External resources should be contacted to determine availability and to obtain required commitments.

• *Logical Access Controls* - Logical exposures can result in the disclosure of confidential information, legal repercussions, sabotage, industrial espionage, destruction of data and direct financial loss. The greatest exposure is often from the accidental ignorant where there is no intent to perpetrate a violation.

- *Currently, the vendor and consultants responsible for supporting the IDX billing system have system access. However, the number and security access of logins that they utilize is unknown.

  Special system logins (e.g. vendors) should be disabled and only temporarily enabled when necessary. Furthermore, vendor access should be restricted to the test environment. If vendor access to the production environment is required, all changes should be reviewed to ensure they were necessary and appropriate and access should be disabled when no longer necessary.

- *It is advisable to assign security administration responsibilities, including documenting a security policy, to ensure controls are adequate to prevent unauthorized access to the Company's assets. Required training should be identified and scheduled to facilitate the design and implementation of application security.

- *A written data security policy has not been prepared. A data security policy is typically used to establish management's position on the importance of data use, disclosure, and accuracy, as well as software licensing guidelines and confidentiality of passwords. Assignment of data ownership responsibility, computer system access and use, and possible actions the Company can take for non-compliance should be included in the policy. All employees should acknowledge that they have read the policy and understand the Company's position on data security.

- *A formal procedure should be drafted such that the Human Resources department will notify the EDP Department of all employee hirings, terminations and transfers in order that system security can be updated in a timely manner.

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- *Written authorization forms should be utilized when establishing or changing user access to LSU Healthcare Network applications. The form should be signed by the appropriate data owner (e.g. department manager) and the security administrator when the action has been completed.

- *Data access rules should be periodically reviewed by data owners (i.e. end users). This review should serve to ensure data access is current and sufficiently restricted. Users no longer requiring access should be removed from the system.

- *Access logs should be reviewed to identify unauthorized attempts to gain access to the system.

- Periodic reviews should be performed to ensure adherence to all software licensing guidelines. Software licensing agreements should also be centrally stored. Documentation regarding the software inventories should include but not be limited to the following:
  - product name,
  - date of purchase,
  - date of installation,
  - location being used,
  - version number and
  - user assignment.

- Proper controls over user logins and passwords used by all software applications should be established and maintained. These controls include but are not limited to the following:
  - limit the number of unsuccessful login attempts,
  - require that passwords be changed periodically,
  - restrict the repeated use of passwords within a specified period,
  - automatically disconnect user after specified period of inactivity,
  - restrict the knowledge of network and application passwords to individual users.

- Proper controls over remote dial-up access to software are not in use. Dial-up lines represent another path by which perpetrators, such as hackers, can gain unauthorized access. Exposure is increased since dial-up ports bypass physical controls.

• *Continuity of Operations* - Dedicated planning and a commitment of resources is a prerequisite if an organization is to survive and continue operations should a disastrous event occur. A contingency plan allows for processing of critical applications in the event of a major hardware or software failure or temporary or permanent destruction of facilities.

  - *Backup policies and procedures regarding user data are not documented. The Computer Services' backup documentation should be reviewed for completeness and supplemented, if necessary, with policies and procedures specific to the LSU Healthcare Network.

    Additionally, backup tapes should be periodically tested (i.e. restored) to ensure the completeness of the backup and data integrity.

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- *A written contingency plan has not been prepared. This plan should include a risk ranking/prioritization of critical systems and be coordinated with the backup and off-site storage procedures. Specific responsibilities should be outlined in the plan, which should be tested at least on an annual basis to ensure it is adequate.

- *EDP insurance coverage (e.g. software reconstruction, business interruption, extra expense of continuing operations following damage, etc.) should be reviewed for adequacy.

• *Physical and Environmental Controls* - Physical and environmental exposures can result in financial loss (e.g. damage to equipment and property, theft, etc.), legal repercussions, loss of credibility, or loss of competitive edge. These exposures can be due to both natural and man-made hazards.

  - *An inventory of hardware and software has been partially documented but is not complete and lacks detail.

  - Physical access to wiring closets has not been uniformly restricted. Vandalism of the network wiring or connections can bring down the system and require the replacement of expensive equipment.

  - Smoke detectors, fire suppression equipment, manual fire alarms, fire extinguishers, water detectors should be installed in the server and network closets and tested by the fire department on a periodic basis.

• *Organization and Management of EDP Activities* - Organization and management controls should provide for an efficient and effective EDP function staffed with qualified and dependable personnel.

  - *The Company should establish an EDP steering committee composed of management representatives of the various business areas. EDP steering committees are typically responsible for ensuring efficient use of EDP resources and provide support and direction for various projects. The goal of this committee is to evaluate and prioritize requests for new systems or enhancements in accordance with the corporate business objectives.

  - *A documented information systems plan could provide the Company with additional guidance and control over the EDP function. An information systems plan should identify technology projects necessary to adequately support the Company. The information systems plan should include the long-range and short-range technology goals, annual operating budgets, hardware/software acquisition plans, and capacity management of hardware. The plan should be reviewed and updated at least annually.

  - *A formal training plan should be developed to support the information systems plan. The plan should include management, project management and technical training. The objective of the plan should be to maintain the knowledge, skills and abilities of EDP personnel.

  - *The Company should evaluate the risk of loss and the corresponding need for bonding of EDP employees. Fidelity coverage usually takes the form of bankers blanket bonds, excess fidelity

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insurance, and commercial blanket bonds. Coverage includes loss from dishonest or fraudulent acts by employees.

- *EDP employees should be required to sign confidentiality agreements.

- *There is an overall lack of policies and procedures. Policies and procedures should exist to serve as a basis for management planning, control, and help convey management's attitudes and expectations with respect to issues which are important to the EDP function. Policy and procedure manuals can also mitigate the risks associated with the sudden turnover of key EDP personnel. The Company should initially focus its efforts on documenting critical areas such as backup and restore procedures.

- Security checks should be performed prior to hiring to EDP employees.

- EDP personnel should be required to take annual vacations. Required vacation ensures that once a year, at a minimum, someone other than the regular employee will be required to perform a job function. This provides an opportunity for an individual other than the regular employee to notice any possible irregularities.

- There are no formal job descriptions for EDP personnel. Formal documentation of job descriptions for all EDP personnel establishes responsibility and accountability over all tasks related to operating the EDP department.

- Currently, a number of financial accounting packages are used to perform the Company's accounting function. However, the Company plans to select and implement an integrated financial accounting system in the next year. At this time, an application has not yet been selected.

Significant Progress Points from Last Year's General Controls Review

- In June 1998, the Company converted to version 8.4 of the IDX billing system. This upgrade was required due to the fact that the prior version utilized by the Company was not Year 2000 compliant. The Company has obtained, in writing, assurances that this version of the software is Year 2000 compliant.

- At the time of last year's general controls review, the Company had a number of temporary or shared user profiles such as "STUDENT1", "STUDENT2", etc. The Company has since resolved this exposure and thereby ensured an clear audit trail.

- The Company has determined that the SBT financial software is year 2000 compliant through a review of vendor-provided literature.

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