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ST. TAMMANY PARISH HOSPITAL SERVICE DISTRICT NO. 1 d/b/a ST. TAMMANY PARISH HOSPITAL

December 31, 2003

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

Release Date 7-28-04

Consolidated Financial Statements

December 31, 2003
and
December 31, 2002

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MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of St. Tammany Parish Hospital Service District No. 1's (the Hospital) annual financial report presents background information and our analysis of the Hospital's financial performance during the fiscal year that ended on December 31, 2003. Please read it in conjunction with the financial statements in this report.

FINANCIAL HIGHLIGHTS

The Hospital's total net assets increased by approximately $3.5 million, or 4.5%, from the prior year.

The assets of the Hospital exceeded liabilities at the close of the 2003 fiscal year by $81.4 million. Of this amount, $34 million (unrestricted net assets) may be used to meet ongoing obligations to the Hospital District's patients and creditors, and $42.6 million is invested in capital assets, net of related debt.

Net patient service revenue increased $20.3 million, or 18.2%, from prior year. Operating expenses increased $16.5 million, or 14.9%, from prior year. Other revenue (including non-operating revenue) decreased $.4 million, or 25%, from prior year related to the steady decrease in interest rates. In total, the Hospital experienced an increase in net income of $2.06 million, as compared to the fiscal year 2002 operations.

During the year, the Hospital made the following significant capital acquisitions:

- Materially completed Phase III of the Millennium Project which consisted of demolishing and renovating the original portion of the Hospital building. The renovations materially enhanced Radiology Services.
- Placed into service a new MRI and CT Scan.
- Opened the Outpatient Pavillion, which consolidated outpatient diagnostic services such as outpatient rehabilitation, diagnostic radiology, diabetic education and wound care into one location.
- Opened a 19 bed Inpatient Rehabilitation Unit.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of four components – the Management's Discussion and Analysis of Financial Condition and Operating Results (this section), the Independent Auditors' Report, the Consolidated Financial Statements, and Supplementary Information.

The Consolidated Financial Statements of St. Tammany Parish Hospital report the consolidated financial position of the Hospital and the consolidated results of its operations and its cash flows. The consolidated financial statements are prepared on the accrual basis of accounting. These statements offer short-term and long-term financial information about the Hospital's activities.

The Consolidated Balance Sheets includes all of the Hospital's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to the Hospital's creditors (liabilities) for both the current year and the prior year. It also provides the basis for evaluating the capital structure of the Hospital, and assessing the liquidity and financial flexibility of the Hospital.

All of the current year's revenues and expenses are accounted for in the Consolidated Statements of Revenues, Expenses, and Changes in Net Assets. This statement measures the performance of the Hospital's operations over the past two years and can be used to determine whether the Hospital has been able to recover all of its costs through its patient service revenue and other revenue sources.

The primary purpose of the Consolidated Statements of Cash Flows is to provide information about the Hospital's cash from operations, investing, and financing activities. The cash flow statements outline where the cash comes from, what the cash is used for and the change in the cash balance during the reporting period.

The annual report also includes Notes to Consolidated Financial Statements that are essential to gain a full understanding of the data provided in the consolidated financial statements. The notes to the consolidated financial statements can be found immediately following the basic financial statements in this report.

Following the notes to consolidated financial statements is a section containing supplementary information that further explains and supports the information reported in the consolidated financial statements. This section includes optional schedules showing Gross Revenue and Expenses by Cost Center as well as statistical information.

FINANCIAL ANALYSIS OF THE HOSPITAL

The Consolidated Balance Sheets and the Consolidated Statements of Revenue, Expenses, and Changes in Net Assets report information about the Hospital's activities. These two statements report the net assets of the Hospital and changes in them. Increases or improvements, as well as decreases or declines in the net assets, are one indicator of the financial state of the Hospital. Other non-financial factors that should also be considered include changes in economic conditions, population growth (including uninsured and working poor) and new or changed government legislation.

Net Assets

A summary of the Hospital's balance sheets is presented in the following table:

Condensed Consolidated Balance Sheets
(In Thousands)

	December 31, 2003	December 31, 2002	Dollar Change	Total % Change
Current and Other Assets	$ 59,961	$ 62,821	$ (2,860)	-5%
Capital Assets	93,797	89,706	4,091	5%
Total Assets	$ 153,758	$ 152,527	$ 1,231	0%
Long-Term Debt Outstanding	$ 56,938	$ 58,033	$ (1,095)	-2%
Other Liabilities	15,469	16,615	(1,146)	-7%
Total Liabilities	$ 72,407	$ 74,648	$ (2,241)	-9%
Invested in Capital Assets, Net of Related Debt	$ 42,626	$ 42,549	$ 77	0%
Restricted	4,640	4,915	(275)	-6%
Unrestricted	34,085	30,415	3,670	12%
Total Net Assets	$ 81,351	$ 77,879	$ 3,472	7%

As noted above, current and other assets decreased 5% while capital assets increased by 5%. These variances were primarily due to bond proceeds being used to complete the renovation and construction of the Hospital.

Summary of Revenue, Expenses, and Changes in Net Assets

The following table presents a summary of the Hospital's historical revenues and expenses for each of the fiscal years ended December 31, 2003 and 2002:

Condensed Consolidated Statements of Revenue, Expenses, and Changes in Net Assets (In Thousands)

	For The Years Ended December 31, 2003	2002
Net Patient Service Revenue	$ 132,069	$ 111,744
Other Operating Revenue	908	891
Total Operating Revenue	132,977	112,635
Maintenance and Operation Expenses	109,112	99,616
Bad Debt Expenses	10,725	4,832
Depreciation Expense	7,226	6,138
Total Operating Expenses	127,063	110,586
Operating Net Income	5,914	2,049
Investment Income, Net	276	687
Interest Expense, Net	(2,718)	(1,326)
Change in Net Assets	3,472	1,410
Total Net Assets - Beginning of Year	77,879	76,469
Total Net Assets - End of Year	$ 81,351	$ 77,879

The information in the following sections summarizes, the Hospital's basic consolidated statements of revenue, expenses, and changes in net assets between 2003 and 2002:

Operating Revenue

During fiscal year 2003, the Hospital derived approximately 99.3% of its total revenues from operating revenues. Operating revenues include revenues from the Medicare and Medicaid programs, patients, or their third-party carriers who pay for care in the Hospital's facilities.

The following table represents the relative percentage of gross charges billed for patient services by payor for the fiscal years ended December 31, 2003 and 2002:

	December 31,	
	2003	2002
Medicare	43 %	38 %
Medicaid	9	8
Managed Care and Commercial Insurance	42	48
Self-Pay	4	4
Other	2	2
Total Gross Charges	100 %	100 %

During 2002, the two large Medicare risk plans discontinued operations at the Hospital. One provider entered bankruptcy proceedings, while the other's relationship with the Hospital was ended by mutual agreement. These two plans had a large percentage of the Managed-Medicare population. As these providers left the Hospital, a large portion of the population moved back to the traditional Medicare program.

OPERATING AND FINANCIAL PERFORMANCE

The following summarizes the Hospital's Statements of Revenue, Expenses, and Changes in Net Assets between 2003 and 2002:

- During 2003, the Hospital had patient days and admissions of 51,228 and 10,335, respectively. This is an increase of 11.3% and 3.3%, respectively from fiscal year 2002. The Hospital opened a dedicated 17 bed Inpatient Rehabilitation Unit in January 2003 and fully utilized the 20 bed ICU/CCU unit that was completed in late 2002. Both of these incidents accounted for the increase in admissions and patient days.
- Outpatient and emergency visits were 110,930 and 24,168, respectively in 2003. This is an increase of 9.8% and 5.2%, respectively from fiscal year 2002.
- Net patient service revenue increased $20.3 million in 2003.
- Employee Compensation increased $3.2 million to reflect merit increases driven by a major market adjustment for professional staff and to address the competitive nursing market.
- Supplies and other professional services increased approximately 15.95%, which was materially related to increased volume and opening of the Rehabilitation Unit.
- Provision for bad debts increased by 122% from prior year due to additional reserves related to rising percentage of bad debts and as a direct result of rate increases applied December 2002.
- Depreciation and amortization increased 17.7% due to a four-story addition being placed into service in October 2002.
- Investment income declined $411,000 from prior year due to declining interest rates in 2003.

CURRENT BUDGET (IN THOUSANDS)

In comparing actual versus budgeted 2003 results, the following is noted:

	For The Years Ended December 31,		Favorable (Unfavorable) Variance
	Budget 2003	Actual 2003	
Revenues:			
Net Patient Service Revenue	$ 125,724	$ 132,069	$ 6,345
Other Operating Revenue	895	908	13
Total Revenues	126,619	132,977	6,358
Operating Expenses			
Salaries, Wages and Benefits	62,813	62,781	32
Supplies and Other	35,164	36,724	(1,560)
Provision for Bad Debts	8,504	10,725	(2,221)
Professional and Contractual Services	8,112	9,607	(1,495)
Depreciation and Amortization	7,175	7,226	(51)
Total Operating Expenses	121,768	127,063	(5,295)
Non-Operating Expenses, Net	(2,068)	(2,442)	(374)
Excess of Revenues Over Expenses	2,783	3,472	689
Change in Net Assets	$ 2,783	$ 3,472	$ 689

- Increase in Net Patient Service Revenue of $6.3 million is due to Hospital obtaining increased reimbursement on the managed care contracts, canceling managed care contracts that were not profitable and downsizing the Skilled Nursing Unit to implement an Inpatient Rehabilitation Unit.

- Increase in Supplies and Other of $1.5 million is related to rising costs and usage of stents, implants, defibrillators and pharmaceuticals. While cost reduction strategies are in place, future savings will be mitigated by increases in inflation and new technology associated with medical supplies and drugs.

- Professional and Contractual services increased by $1.5 million due to increased usage of specialists to assist in developing the Inpatient Rehabilitation Unit.

- Provision for Bad Debt increased by $2.2 million due to higher than expected occurrence of bad debts. This increase in bad debts is consistent with national trends and with cuts being seen in the State Charity systems.

CAPITAL ASSETS (IN THOUSANDS)

	For The Years Ended December 31, 2003	2002	Dollar Change	Percent Change
Land and Improvements	$ 3,104	$ 3,104	$ -	0%
Buildings	82,158	81,552	606	1%
Equipment	49,452	47,568	1,884	4%
Construction in Progress	6,912	1,195	5,717	478%
Subtotal	141,626	133,419	8,207	6%
Less: Accumulated Depreciation and Amortization	(47,829)	(43,713)	(4,116)	9%
Property, Plant and Equipment, Net	$ 93,797	$ 89,706	$ 4,091	5%

Net Property, Plant, and Equipment increased due to the completion of Phase III of the Millennium Project. Phase III materially consisted of renovating Radiology and the remaining portion of the original Hospital. The renovation of Radiology consisted of the purchase of a new state of the art CT Scan and MRI.

Projected Capital Expenditures for FY 2004

Replacement Equipment	$ 2,000,000
Phase III Millennium Project – Construction	2,200,000
Phase III Millennium Project – Equipment	1,000,000
3rd Floor & Emergency Room Renovations	2,200,000
Miscellaneous Facility Renovations	250,000
Information System Technology	1,500,000
Total	$ 9,150,000

The Hospital projects spending of $9.2 million on capital projects during FY 2004. Of this amount, $2.2 million will be financed through the remainder of the 1998 Bond issue. $7 million is expected to be financed from operations and existing cash reserves.

LONG-TERM DEBT

At year-end, the Hospital had $56.9 million in long-term debt. Total debt represents 78% of the Hospital's total liabilities as of year-end. No new long-term debt was incurred in the current year. More detailed information about the long-term debt is presented in the Notes to Consolidated Financial Statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

The Hospital's Board and Management considered many factors when setting the fiscal year 2004 budget. Of primary importance in setting the 2004 budget is the status of the economy, which takes into account market forces and environmental factors such as:

- Medicare reimbursement changes and reductions
- Medicaid reductions
- Increased number of uninsured and working poor
- Workforce shortages
- Cost of supplies
- Cost of drugs
- Opening a new Outpatient Diagnostic and Wound Therapy center
- Increased competition in the marketplace

CONTACTING THE HOSPITAL FINANCIAL MANAGER

This financial report is designed to provide our citizens, customers, and creditors with a general overview of the Hospital's finances. If you have any questions about this report or need additional financial information, please contact the Chief Financial Officer, St. Tammany Parish Hospital, 1202 S. Tyler Street, Covington, LA 70433.

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CERTIFIED PUBLIC ACCOUNTANTS

Members of the Board of Commissioners
St. Tammany Parish Hospital Service District No. 1
St. Tammany Parish, Louisiana

Independent Auditor's Report

We have audited the accompanying basic consolidated financial statements of St. Tammany Parish Hospital Service District No. 1 of St. Tammany Parish, Louisiana (St. Tammany Parish Hospital), as of December 31, 2003, and for the year then ended, as listed in the foregoing table of contents. These basic consolidated financial statements are the responsibility of St. Tammany Parish Hospital's management. Our responsibility is to express an opinion on these basic consolidated financial statements based on our audit. The consolidated financial statements of St. Tammany Parish Hospital, for the year ended December 31, 2002, were audited by other auditors whose report, dated April 11, 2003 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *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 basic consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic consolidated 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 basic consolidated financial statements referred to above present fairly, in all material respects, the financial position of St. Tammany Parish Hospital as of December 31, 2003, and the results of its operations, changes in its net assets, and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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Management's discussion and analysis, on pages i through viii, is not a required part of the basic consolidated financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have issued our report dated April 13, 2004, on our consideration of St. Tammany Parish Hospital's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. 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.

Laporte, Sehrt, Romig & Hand

A Professional Accounting Corporation

April 13, 2004

ST. TAMMANY PARISH HOSPITAL
SERVICE DISTRICT NO. 1
d/b/a
ST. TAMMANY PARISH HOSPITAL
CONSOLIDATED BALANCE SHEETS (IN THOUSANDS)

ASSETS

	December 31, 2003	December 31, 2002
CURRENT ASSETS		
Cash and Cash Equivalents	$ 8,164	$ 1,741
Investments	11,982	15,646
Assets Whose Use is Limited and Required for Current Liabilities	2,703	2,173
Patient Accounts Receivable, Net of Allowance for Doubtful Accounts of $10,559 in 2003 and $5,968 in 2002	19,295	20,016
Inventories	3,144	3,025
Prepaid Expenses and Other Receivables	1,835	1,678
Total Current Assets	47,123	44,279
ASSETS WHOSE USE IS LIMITED:		
Under Bond Indenture Held by Trustee for Construction	5,767	10,876
Under Bond Ordinances - Held by Trustee	4,165	4,165
By Board for Capital Improvements, and Facility Enhancements	4,004	3,676
By Others for Professional and Other Liability Claims	475	750
Total Assets Whose Use is Limited	14,411	19,467
Less: Assets Whose Use is Limited and Required for Current Liabilities	(2,703)	(2,173)
Total Noncurrent Assets Whose Use is Limited	11,708	17,294
CAPITAL ASSETS:		
Land and Improvements	3,104	3,104
Buildings	82,158	81,552
Equipment	49,452	47,568
Construction in Progress	6,912	1,195
Less: Accumulated Depreciation and Amortization	(47,829)	(43,713)
Total Capital Assets, Net	93,797	89,706
OTHER ASSETS	1,130	1,248
TOTAL	$ 153,758	$ 152,527

See notes to consolidated financial statements.

LIABILITIES AND NET ASSETS

	December 31, 2003	December 31, 2002
CURRENT LIABILITIES		
Accounts Payable and Accrued Expenses	$ 8,104	$ 6,582
Accrued Employee Compensation	2,320	3,812
Accrued Vacation	1,960	1,829
Settlements Due to Medicare and Medicaid Intermediaries	2,317	3,550
Amounts Due Within One Year on Long-Term Debt	1,245	1,195
Total Current Liabilities	15,946	16,968
ACCRUED PROFESSIONAL LIABILITY CLAIMS	768	842
LONG-TERM DEBT		
Less: Unamortized Issuance Discount ($288 in 2003 and $305 in 2002) and Unamortized Loss on Advance Refunding ($1,464 in 2003 and $1,547 in 2002) and Amounts Due Within One Year	55,693	56,838
Total Liabilities	72,407	74,648
NET ASSETS:		
Invested in Capital Assets, Net of Related Debt	42,626	42,549
Restricted for Debt Service and Capital Projects	4,640	4,915
Unrestricted	34,085	30,415
Total Net Assets	81,351	77,879
TOTAL	$ 153,758	$ 152,527

ST. TAMMANY PARISH HOSPITAL
SERVICE DISTRICT NO. 1
d/b/a
ST. TAMMANY PARISH HOSPITAL
CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS (IN THOUSANDS)

	For The Years Ended December 31, 2003	2002
OPERATING REVENUES:		
Net Patient Service Revenue	$ 132,069	$ 111,744
Other Revenue	908	891
Total Operating Revenues	132,977	112,635
OPERATING EXPENSES		
Salaries, Wages and Benefits	62,781	59,569
Supplies and Other	36,724	31,672
Professional and Contractual Services	9,607	8,375
Provision for Bad Debts	10,725	4,832
Depreciation and Amortization	7,226	6,138
Total Operating Expenses	127,063	110,586
OPERATING INCOME	5,914	2,049
NON-OPERATING REVENUES (EXPENSES):		
Investment Income and Gains and Losses	276	687
Interest Expense	(2,718)	(1,326)
Total Non-Operating Revenues (Expenses)	(2,442)	(639)
INCREASE IN NET ASSETS	3,472	1,410
NET ASSETS AT BEGINNING OF YEAR	77,879	76,469
NET ASSETS AT END OF YEAR	$ 81,351	$ 77,879

See notes to consolidated financial statements.

ST. TAMMANY PARISH HOSPITAL
SERVICE DISTRICT NO. 1
d/b/a
ST. TAMMANY PARISH HOSPITAL
CONSOLIDATED STATEMENTS OF CASH FLOWS (IN THOUSANDS)

	For The Years Ended December 31, 2003	2002
OPERATING ACTIVITIES:		
Cash Received from Patient Services	$ 121,794	$ 106,641
Cash Paid to or on Behalf of Employees	(64,142)	(58,919)
Cash Paid for Supplies and Services	(45,084)	(44,187)
Net Cash Provided by Operating Activities	12,568	3,535
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of Capital Assets	(11,299)	(17,881)
Principal Payments on Long-Term Debt	(1,195)	(1,180)
Interest Payments	(2,645)	(2,997)
Net Cash Used in Capital and Related Financing Activities	(15,139)	(22,058)
INVESTING ACTIVITIES:		
Net Change in Assets Whose Use is Limited	5,054	14,031
Net Change in Investments	3,664	(3,601)
Interest Earned on Investments	276	2,228
Net Cash Provided by Investing Activities	8,994	12,658
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	6,423	(5,865)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	1,741	7,606
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 8,164	$ 1,741
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating Income	$ 5,914	$ 2,049
Adjustments to Reconcile Operating Income to Net Cash		
Provided by Operating Activities:		
Provision for Bad Debts	10,725	4,832
Depreciation and Amortization	7,226	6,138
Loss on Disposal of Equipment	55	31
Changes in Operating Assets and Liabilities:		
Patient Accounts Receivable	(9,930)	(6,228)
Inventories, Prepaid Expenses and Other Receivables	(276)	(1,217)
Accounts Payable and Accrued Expenses	1,522	(2,896)
Accrued Employee Compensation and Vacation	(1,361)	650
Net Settlements Due to Medicare and Medicaid Intermediaries	(1,233)	203
Accrued Professional Liability Claims	(74)	(27)
Net Cash Provided by Operating Activities	$ 12,568	$ 3,535

See notes to consolidated financial statements.

ST. TAMMANY PARISH HOSPITAL
SERVICE DISTRICT NO. 1
d/b/a
ST. TAMMANY PARISH HSOPITAL
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2003 and 2002

NOTE A

ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

St. Tammany Parish Hospital (the Hospital) is owned and operated by St. Tammany Parish Hospital Service District No. 1 of St. Tammany Parish, Louisiana (a nonprofit corporation organized by the St. Tammany Parish Police Jury under provisions of Chapter 10 of Title 46 of the Louisiana Revised Statues of 1950). The Hospital is exempt from federal income taxes under Section 115 of the Internal Revenue Code. The governing authority of St. Tammany Parish Hospital Service District No. 1 (the District) is the St. Tammany Parish Hospital Board of Commissioners. The St. Tammany Parish Council appoints members of the Hospital Board of Commissioners.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the Hospital, St. Tammany Medical Services (STMS) and St. Tammany Physician Network (STPN). STMS and STPN are corporations, which are wholly-owned by the Hospital. STMS and STPN are not, however, exempt from federal taxation. No income taxes were paid or owed for the years ended December 31, 2003 and 2002, by STMS or STPN. All material intercompany accounts and transactions have been eliminated upon consolidation.

BASIS OF ACCOUNTING

The Hospital utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual. Pursuant to 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 to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), excluding those issued after November 30, 1989.

NET PATIENT SERVICE REVENUE AND RELATED RECEIVABLES

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

MEDICARE AND MEDICAID REIMBURSEMENT PROGRAMS

The Hospital is reimbursed under the Medicare Prospective Payment System (PPS) for acute care inpatient services provided to Medicare beneficiaries and is paid a predetermined amount for these services based, for the most part, on the Diagnosis Related Group (DRG) assigned to the patient.

NOTE A

ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

MEDICARE AND MEDICAID REIMBURSEMENT PROGRAMS (Continued)

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

Home health services rendered to Medicare beneficiaries are reimbursed under a per-episode prospective payment system. Outpatient services rendered to Medicare beneficiaries are reimbursed by the Outpatient Prospective Payment System (OPPS), which establishes a number of Ambulatory Payment Classifications (APC) for outpatient procedures in which the Hospital is paid a predetermined amount per procedure. Medicare and Medicaid outpatient clinical lab and Medicaid ambulatory surgery services are reimbursed based upon the respective fee schedules.

Retroactive cost settlements based upon annual cost reports are estimated for those programs subject to retroactive settlement and recorded in the consolidated financial statements. Final determination of retroactive cost settlements to be received under the Medicare and Medicaid regulations is subject to review by program representatives. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future period as final settlements are determined or determinable.

CHARITY CARE

The Hospital provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The Hospital maintains records to identify and monitor the level of charity care it provides to all of its qualifying patients. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The Hospital provided charity care of $2,065,000 and $2,547,000 for the years ended December 31, 2003 and 2002, respectively, based upon charges foregone using established rates.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include investments in highly liquid debt instruments and money market accounts with an original maturity of three months or less when purchased and exclude amounts whose use is limited by board designation or under bond ordinances.

INVESTMENTS

Investments include investments in certificates of deposit, U.S. Government and, federal agency securities with an original maturity of greater than three months and are stated at fair market value, which approximates cost or amortized cost. Interest, dividends, and gains and losses, both realized and unrealized, on investments are included in non-operating revenue when earned.

ST. TAMMANY PARISH HOSPITAL
SERVICE DISTRICT NO. 1
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ST. TAMMANY PARISH HSOPITAL
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2003 and 2002

NOTE A
ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

INVENTORIES

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

CAPITAL ASSETS

The Hospital records all capital asset acquisitions at cost and provides for depreciation using the straight-line method in amounts sufficient to amortize the cost of its assets over their estimated useful lives. Estimated useful lives for buildings are 15 to 40 years and 3 to 25 years for equipment. Assets held under capital lease obligations are recorded at the present value of the minimum lease payments and are included in equipment. Amortization of leased assets is included in depreciation and amortization expense.

UNAMORTIZED LOSS ON ADVANCE REFUNDING

The loss incurred in connection with the advance refunding of the Hospital's revenue bonds has been deferred and is being amortized over the life of the refunded bond issue. Accumulated amortization on this deferred loss was $459,000 and $376,000 at December 31, 2003 and 2002, respectively. Amortization is included in interest expense.

EMPLOYEE HEALTH AND WORKERS' COMPENSATION INSURANCE

The Hospital is self-insured for hospitalization and workers' compensation claims. Estimated amounts for claims incurred but not reported are calculated based on claims experience and, together with unpaid claims, are included in Accrued Employee Compensation And Accounts Payable and Accrued Expenses, respectively, on the Consolidated Balance Sheets.

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

All revenues and expenses directly related to the delivery of health care services are included in operating revenues and expenses in the Statements of Revenues, Expenses and Changes in Net Assets. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from non-exchange transactions or investment income. When an expense is incurred for purposes for which there are both restricted and unrestricted net assets available, it is the Hospital's policy to apply those expenses to restricted net assets to the extent such are available and then to unrestricted net assets.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE A
ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

NEW ACCOUNTING PRONOUNCEMENT

Effective January 1, 2002, the Hospital adopted Governmental Accounting Standards Board Statement (GASBS) No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. GASBS No. 34 established standards for external financial reporting for all state and local governmental entities. It requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- *Invested in Capital Assets, Net of Related Debt* - This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

- *Restricted* - This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

- *Unrestricted* - This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

The adoption of GASBS No. 34 had no effect on the basic consolidated financial statements except for the classification of net assets in accordance with the Statement, the reflection of capital contributions and additions to endowments as changes in net assets, the reclassification of interest income to non-operating revenue, the reclassification of interest expense to non-operating expenses, and the change from the indirect to the direct method of reporting cash flows from operating activities.

NOTE B
CASH AND CASH EQUIVALENTS, AND INVESTMENTS

DEPOSITS

Louisiana Statutes require that all of the Hospital's deposits be protected by insurance or collateral. The market value of collateral pledged must equal 100% of the deposits not covered by insurance. As of December 31, 2003 and 2002, all of the Hospital's bank balances (including cash, money market accounts and certificates of deposit) were entirely insured or collateralized by investments held by the Hospital's third-party agent in the Hospital's name.

NOTE B

CASH AND CASH EQUIVALENTS, AND INVESTMENTS (Continued)

INVESTMENTS

The Hospital may invest idle funds as authorized by Louisiana Statutes, as follows:

a. Direct United States Treasury obligations, the principal and interest of which are fully guaranteed by the government of the United States.

b. United States government agency obligations, the principal and interest of which are fully guaranteed by the government of the United States, or United States government obligations.

c. Direct security repurchase agreements of any federal book entry only securities enumerated in paragraphs (a) and (b).

d. Time certificates of deposit of state banks organized under the laws of Louisiana and national banks having their principal office in the State of Louisiana.

e. Mutual or trust funds, which are registered with the Securities and Exchange Commission under the Securities Act of 1933, and the Investment Act of 1940 and, which have underlying investments consisting solely of and limited to securities of the United States government or its agencies.

The Hospital's investments are categorized below to give an indication of the level of risk assumed at year-end. Category 1 includes investments that are insured or registered or for, which the securities are held by the Hospital or its agent in the Hospital's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the Hospitals' name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty, or by its trust department or agent, but not in the Hospital's name

Balances were as follows (in thousands):

	December 31, 2003			
	Credit Risk Category			Carrying
Securities Type	1	2	3	Amount
U.S. Government	$ -	$ 5,767	$ -	$ 5,767
Federal Agency	14,151	-	-	14,151
Certificates of Deposit	2,310	-	-	2,310
Cash and Cash Equivalents	-	4,165	-	4,165
Total	$ 16,461	$ 9,932	$ -	$ 26,393

NOTE B

CASH AND CASH EQUIVALENTS, AND INVESTMENTS (Continued)

INVESTMENTS (Continued)

	December 31, 2002			
	Credit Risk Category			Carrying
Securities Type	1	2	3	Amount
U.S. Government	$ -	$ 10,876	$ -	$ 10,876
Federal Agency	17,865	-	-	17,865
Certificates of Deposit	2,207	-	-	2,207
Cash and Cash Equivalents	-	4,165	-	4,165
Total	$ 20,072	$ 15,041	$ -	$ 35,113

These balances are presented in the consolidated balances sheets as summarized below:

	2003	2002
Investments	$ 11,982	$ 15,646
Assets Limited as to Use	14,411	19,467
	$ 26,393	$ 35,113

NOTE C

THIRD-PARTY PAYOR ARRANGEMETNS

The Hospital participates in the Medicare and Medicaid programs as a provider of medical services to program beneficiaries. During the years ended December 31, 2003 and 2002, approximately 48% and 35%, respectively, of the Hospital's net patient service charges were furnished to Medicare and Medicaid program beneficiaries. Revenue derived from the Medicare program is subject to audit and adjustment by the fiscal intermediary and must be accepted by the United States Department of Human Services before settlement amounts become final. Revenue derived from the Medicaid program is subject to audit and adjustment by the fiscal intermediary and must be accepted by the Department of Health and Hospitals of the State of Louisiana before settlement amounts become final. Estimated settlements for Medicare through December 31, 2000, have been reviewed by program representatives. Medicaid program representatives have reviewed estimated Medicaid settlements through December 31, 1998. Additionally, as a result of information related to other Medicare and Medicaid contractual arrangements, the Hospital recorded changes in estimates and increased net patient service revenue for the years ended December 31, 2003 and 2002, by $936,000 and $700,000, respectively. With respect to the settlements for years subsequent to those reviewed by program representatives, management does not anticipate any adjustments by program representatives that would have a material impact on the recorded Medicare and Medicaid settlements.

NOTE C
THIRD-PARTY PAYOR ARRANGEMETNS (Continued)

The Hospital has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. Inpatient and outpatient services rendered to managed care subscribers are reimbursed at prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

NOTE D
INVESTMENTS AND ASSETS WHOSE USE IS LIMITED

The details of investments and assets whose use is limited at December 31, 2003 and 2002 are as follows (in thousands):

	2003	2002
Investments		
Federal Agency Securities	$ 10,147	$ 14,189
Certificates of Deposit	1,835	1,457
	11,982	15,646
Assets Whose Use is Limited		
For Capital Improvements:		
Federal Agency Securities	4,004	3,676
For Professional and Other Liability Claims		
Certificates of Deposit	475	750
Debt Service and Construction Funds		
U.S. Government Securities	5,767	10,876
Cash	4,165	4,165
	9,932	15,041
Total Investments and Assets Whose Use is Limited	$ 26,393	$ 35,113

In connection with the issuance of the Series 1998 Hospital Revenue and Refunding Bonds, the Hospital established a Debt Service Fund for the purpose of making payments of principal and interest on the bonds if funds available for payment of principal and interest were insufficient. The funds held by the Trustee in this account are subject to a prior lien in favor of the owners of the bonds. A Construction Fund was also established in connection with the issuance in which funds are held by the Trustee for the financing of capital improvements. The Hospital is required to maintain a $275,000 certificate of deposit held by the Workers Compensation Fund as collateral against its self-insured portion of workers compensation claims. This investment is recorded in assets whose use is limited for professional and other liability claims.

NOTE D

INVESTMENTS AND ASSETS WHOSE USE IS LIMITED (Continued)

Also included in assets whose use is limited for professional and other liability claims is a $125,000 certificate of deposit held by the State Treasurer's Office on behalf of the Louisiana Patients' Compensation Fund. The Hospital is required to maintain this investment as collateral against its self-insured portion of professional liability claims.

Interest income was $276,000 and $687,000 for 2003 and 2002, respectively. Interest income is net of $1,179,000 and $1,541,000 in 2003 and 2002, respectively, of interest income capitalized as a component of construction costs (see Note F).

NOTE E

CAPITAL ASSETS

A summary of changes in the Hospital's capital assets during 2003 and 2002 is as follows (in thousands):

	Beginning Balance 2003	Additions	Retirements Transfers	Ending Balance 2003
Land and Improvements	$ 3,104	$ -	$ -	$ 3,104
Buildings and Improvements	81,552	695	(89)	82,158
Equipment	47,568	4,969	(3,085)	49,452
Construction in Progress	1,195	7,666	(1,949)	6,912
	$ 133,419	$ 13,330	$ (5,123)	$ 141,626

	Beginning Balance 2002	Additions	Retirements Transfers	Ending Balance 2002
Land and Improvements	$ 3,088	$ 16	$ -	$ 3,104
Buildings and Improvements	43,002	38,550	-	81,552
Equipment	43,089	8,920	(4,441)	47,568
Construction in Progress	30,564	15,473	(44,842)	1,195
	$ 119,743	$ 62,959	$ (49,283)	$ 133,419

The Hospital's New Millennium construction project is in process, funded by the issuance of its revenue bonds. The remaining estimated costs to be incurred related to Phase III of this project are approximately $5,767,000 as of December 31, 2003.

NOTE F

LONG-TERM DEBT

The details and balances of long-term debt at December 31, 2003 and 2002 are presented below:

	2003	2002
	(In Thousands)	
Hospital Revenue and Refunding Bonds, Series 1998, Net of Unamortized original issue discount of $288,000 and $305,000 at December 31, 2003 and 2002, Respectively	$ 58,402	$ 59,580
Less: Amounts Due with One Year	(1,245)	(1,195)
Unamortized Loss on Advance Refunding	(1,464)	(1,547)
	$ 55,693	$ 56,838

HOSPITAL REVENUE AND REFUNDING BONDS, SERIES 1998

On October 1, 1998, the Hospital issued $64,945,000 of tax-exempt Hospital Revenue and Refunding Bonds, Series 1998 (the bonds) comprised of $25,840,000 of serial bonds and $39,105,000 of term bonds with a final maturity of July 1, 2028. These bonds have stated interest rates ranging from 4.25% to 5.00% and are secured by a pledge of the Hospital's revenues. The bonds were issued at a discount of $379,000, and the discount is being amortized over the life of the bonds using the interest method. In connection with the issuance of the bonds, the Hospital is required to maintain a debt service coverage ratio (as defined by the Trust Indenture) of 110% and a day's cash on hand ratio (as defined by the Trust Indenture) of 60 days. As of December 31, 2003, the Hospital was in compliance with the provisions of the Trust Indenture. The bonds maturing on or after July 1, 2009 are subject to optional redemption prior to maturity at the option of the District on or after July 1, 2008, as a whole or in part at anytime. The 1998 bonds were issued to refund, in advance, the outstanding 1992 series bonds (which were paid in full in 2002) and to finance the acquisition and construction of improvements, renovations and extensions to the Hospital. As a result of this advance refunding of debt, the Hospital recorded a deferred loss on advance refunding of debt of $1,925,000 during 1998. This deferral is being amortized over 24 years (the original remaining life of the 1992 bonds) using the effective-interest method.

ST. TAMMANY PARISH HOSPITAL
SERVICE DISTRICT NO. 1
d/b/a
ST. TAMMANY PARISH HSOPITAL
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Years Ended December 31, 2003 and 2002

NOTE F
LONG-TERM DEBT (Continued)

HOSPITAL REVENUE AND REFUNDING BONDS, SERIES 1998 (Continued)

A summary of changes in long-term debt during 2003 and 2002 is as follows (in thousands):

	Beginning Balance 2003	Additions	Payments	Ending Balance 2003
Hospital Revenue and Refunding Bonds	$ 59,885	$ -	$ (1,195)	$ 58,690
	$ 59,885	$ -	$ (1,195)	$ 58,690

	Beginning Balance 2002	Additions	Payments	Ending Balance 2002
Hospital Revenue and Refunding Bonds	$ 61,050	$ -	$ (1,165)	$ 59,885
Certificate of Indebtedness	15	-	(15)	-
	$ 61,065	$ -	$ (1,180)	$ 59,885

Principal and interest payments due on long-term debt over the next five years, and in five year increments thereafter are as follows (in thousands):

Year Ended December 31,	Principal	Interest
2004	$ 1,245	$ 2,915
2005	1,300	2,863
2006	1,355	2,807
2007	1,425	2,740
2008	1,495	2,668
2009 – 2013	8,665	12,143
2014 – 2018	11,065	9,749
2019 – 2023	14,120	6,692
2024 – 2028	18,020	2,791
	$ 58,690	$ 45,368

NOTE F
LONG-TERM DEBT (Continued)

HOSPITAL REVENUE AND REFUNDING BONDS, SERIES 1998 (Continued)

A summary of interest cost and investment income on borrowed funds held by the trustee under the Hospital Revenue and Refunding Bonds during the years ended 2003 and 2002 follows (in thousands):

	2003	2002
Interest Cost:		
Capitalized	$ 382	$ 1,827
Charged to Non-Operating Expenses	2,718	1,326
Total	$ 3,100	$ 3,153
Investment Income:		
Capitalized	$ 1,179	$ 1,541
Credited to Non-Operating Income	276	687
Total	$ 1,455	$ 2,228

NOTE G
COMMITMENTS

Total rental expense incurred for all operating leases was $2,239,000 and $1,387,000 for the years ended December 31, 2003 and 2002, respectively.

The future minimum lease payments at December 31, 2003, for non-cancelable operating leases are as follows (in thousands):

2004	$ 3,120
2005	3,120
2006	2,637
2007	1,814
2008	1,087
Thereafter	1,058
	$ 12,836

NOTE H

EMPLOYEE BENEFIT PLANS

The Hospital has a noncontributory defined contribution plan (Plan) that covers substantially all of its employees. The Plan allows for employees age 21 or older with one year of service (defined as 1,000 hours of service in any one year) to participate. The Plan Agreement requires contributions to the Plan equal to 6% of the aggregate compensation of all participants. Participating employees with five or more years of service become 100% vested in their account balance. Employees terminating their employment prior to five years forfeit their account balance.

Total payroll and covered payroll for all Hospital employees during the year ended December 31, 2003 totaled approximately $50,584,000 and $39,880,000, respectively. Contributions during 2003 and 2002 required by the Plan document were approximately $2,393,000 and $2,221,000, respectively, which represents approximately 6% of covered payroll. Required contributions paid by the Hospital net of application of forfeiture of non-vested accounts were approximately $2,363,000 and $2,313,000, respectively, during the years ended December 31, 2003 and 2002.

Pension expense included in salaries, wages and benefits related to the Plan described above approximated $2,357,000 and $2,222,000 for the years ended December 31, 2003 and 2002, respectively.

NOTE I

LIABILITY SELF-INSURANCE

The Hospital participates in the Louisiana Patients' Compensation Fund for medical malpractice claims. As a participant, the Hospital has a statutory limitation of liability which provides that no award can be rendered against it in excess of $500,000, plus interest and costs. The Fund provides coverage on an occurrence basis for claims over $100,000 and up to $500,000. The Hospital is self-insured for costs up to $100,000 per claim.

The Hospital is involved in litigation arising in the ordinary course of business. Claims alleging malpractice have been asserted against the Hospital and are currently in various stages of litigation. It is the opinion of management that estimated malpractice costs resulting from pending or threatened litigation are adequately accrued at December 31, 2003. Losses from asserted claims and from unasserted claims identified under the Hospital's incident reporting system are accrued based on estimates that incorporate the Hospital's past experience as well as other considerations including the nature of each claim or incident and relevant trend factors. Additional claims may be asserted against the Hospital arising from service provided to patients through December 31, 2003, that have not been identified under the incident reporting system. The Hospital is unable to determine the ultimate cost of the resolution of such potential claims; however, management believes it has adequately provided for them.

NOTE I

LIABILITY SELF-INSURANCE (Continued)

The Hospital self-insures against losses related to workers' compensation and employee health claims. Excess loss coverage is purchased for workers' compensation in amounts of $300,000 and excess loss coverage for individual employee health claims is purchased in amounts of $150,000.

The following is a summary of the activity in the liability for medical malpractice, workers' compensation and employee health claims for the years ended December 31, 2003 and 2002 (in thousands):

	Beginning Balance	Expense and Changes in Estimates	Payments	Ending Balance
2003	$ 2,005	$ 4,938	$ 5,456	$ 1,487
2002	$ 1,629	$ 5,936	$ 5,560	$ 2,005

NOTE J

CONCENTRATIONS OF CREDIT RISK

The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at December 31 was as follows:

	2003	2002
Medicare	28%	31%
Medicaid	7	8
Insurance/Managed Care	40	41
Patients	18	15
Other	7	5
	100%	100%

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CERTIFIED PUBLIC ACCOUNTANTS

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

Members of the Board of Commissioners
St. Tammany Parish Hospital Service District No. 1
St. Tammany Parish, Louisiana

We have audited the basic consolidated financial statements of St. Tammany Parish Hospital Service District No. 1 of St. Tammany Parish, Louisiana (St. Tammany Parish Hospital), as of and for the year ended December 31, 2003, and have issued our report thereon dated April 13, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 St. Tammany Parish Hospital's basic consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted an immaterial instance of noncompliance that we have reported to management of St. Tammany Parish Hospital, in a separate letter dated April 13, 2004.

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Internal Control Over Financial Reporting

In planning and performing our audit, we considered St. Tammany Parish Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions 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 St. Tammany Parish Hospital, in a separate letter dated April 13, 2004.

This report is intended solely for the information and use of management, the Board of Commissioners, and the State of Louisiana Legislative Auditor and is not intended to be and should not be used by anyone other than these specified parties. Under Louisiana Revised Statute 24:513, this report is distributed by the Legislative Auditor of the State of Louisiana as a public document.

Laporte, Sehrt, Romig, & Hand

Laporte, Sehrt, Romig, & Hand, APAC

April 13, 2004

ST. TAMMANY PARISH HOSPITAL
MANAGEMENT LETTER
DECEMBER 31, 2003

LAPORTE SEHRT
ROMIG HAND
CERTIFIED PUBLIC ACCOUNTANTS

April 13, 2004

Members of the Board of
Commissioners
St. Tammany Parish Hospital
Service District No. 1:

In planning and performing our audit of the consolidated financial statements of St. Tammany Parish Hospital Service District No. 1 of St. Tammany Parish, Louisiana (The Hospital) for the year ended December 31, 2003 (on which we have issued our report dated April 13, 2004), we developed the following recommendations concerning certain matters related to its internal control and certain observations and recommendations on other accounting, administrative, and operating matters. Additionally, we have included a section on general comments noted during the audit. A description of the responsibility of management for establishing and maintaining internal control, and the objectives and inherent limitations of internal control, is set forth in the attached Appendix, and should be read in conjunction with this letter. Our comments are presented in Exhibits I, and II and are listed in the table of contents thereto.

Exhibit III details an immaterial instance of non-compliance with laws and regulations noted during the audit.

This report is intended solely for the information and use of the Board of Commissioners, management, others within the organization and the State of Louisiana Legislative Auditor and is not intended to be and should not be used by anyone other than these specified parties. We will be pleased to discuss these comments with you, and, if desired, to assist you in implementing any of the suggestions.

Sincerely,

Laporte, Sehrt, Romig, & Hand

Laporte, Sehrt, Romig, & Hand, APAC

ST. TAMMANY PARISH HOSPITAL
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EXHIBIT I

GENERAL COMMENTS

MANAGEMENT AND STAFF COOPERATION DURING THE AUDIT

Each year we perform numerous audits of healthcare and other types of entities throughout metropolitan New Orleans, and other areas of Louisiana and Mississippi. One of the challenges inherently involved is the difficulty of keeping abreast of not only the ever-changing audit and accounting requirements for each industry we audit, but the unique factors, and processes that affect each individual client. Typically it is especially challenging when we are involved in the audit of a particular client for the first time.

Usually the first year of any audit engagement involves much more documentation and effort than is required on a continuing engagement. These requirements, and the familiarization process in general, require increased effort by the audit staff and usually place substantial burdens on the entity's accounting staff as well.

Everyone involved on the audit team wishes to express their gratitude and recognize the efforts of the Finance Staff at STPH who were instrumental in bringing the audit to a successful conclusion this year. While we were greatly pleased with the cooperation we received throughout the Hospital, we wanted to specifically acknowledge the contributions of the Finance Staff for their efforts and patience this year in making the transition to LSRH.

EXHIBIT II

ADMINISTRATIVE, INTERNAL CONTROL, AND OTHER MATTERS

❖ RESERVES FOR SELF-INSURANCE CLAIMS INCURRED BUT NOT REPORTED

Observation

The Hospital remains self-insured for workers' compensation and malpractice liability claims up to $100,000 per occurrence, and the Hospital properly maintains reserves for this self-insurance risk. We noted that the predecessor auditor had made recommendations regarding the Hospital's reserve (liability) for claims incurred. Specifically, recommendations were made referring to the reporting or estimate of claims not yet reported to management at year-end for which a liability exists. We observed that the Hospital's management has developed a methodology to record these estimated liabilities.

Recommendation

The total reserve for claims to be reported in accordance with Generally Accepted Accounting Principles should consist of a liability for claims currently payable, which consists of specific claims reported to management as of the financial statement date which are probable losses, as well as an estimate of Incurred But Not Reported claims (IBNR). The portion of the reserve related to IBNR is managements' estimate of claims that have likely been incurred but have not yet been reported to management as of the financial statement date. This estimate would take into consideration such factors as prior rates of occurrence, lag time between the date the claim actually occurred and when it is ultimately reported, the dollar amounts associated with historical claims experience, and finally other internal and external demographic factors.

The Hospital currently takes the factors into consideration when estimating reserves for workers compensation, health insurance and malpractice reserves. While the delay between incidence and reporting of workers compensation and health insurance claims makes estimates of reserves for those types of claims less difficult, we concur with the prior year suggestion to consider having an actuarial valuation performed to assess the adequacy of the IBNR estimate for medical malpractice claims because of potential delays in reporting and complexity of the statistical calculations involved.

Management Response:

Management assesses the Self-Insurance Reserves on a quarterly basis. The materiality of claims and the loss potential on these claims is reviewed and assessed by Human Resources, Risk Management, Finance, and Senior Management. Also, the loss potential is reviewed and assessed by the Hospital with input from Hospital Counsel in reference to exposure or the potential thereof. If an increasing trend is noted or if claims appear to have a material impact, Management will consider having an actuarial evaluation performed on malpractice claims history.

❖ INVENTORY COUNTING AND RECORDATION

Observation

A full physical inventory count is performed each year at or near June 30th. Additionally, each department with an inventory balance of $100,000 or more is counted at or near December 31st of each year. Each department is responsible for counting its own inventory, and personnel from Finance later perform test counts. The Hospital makes adjusting journal entries based on its physical counts only when the variance between the dollar value of the counted inventory is judgmentally considered large by Management. Additionally, as a practical matter, the Hospital routinely expenses cost centers with estimated inventory carrying amounts of $100,000 or less.

Recommendation
Certain minimum inventory levels are required in order to maintain the day-to-day operations of health care providers. The levels of required inventory vary based on the type of health care services provided, the size of the entity, etc. While inventories are often material to the financial statements, they are not significant to the financial position of the health care provider to the degree that inventories are customarily significant to a manufacturer, wholesaler, retailer, etc. In addition, inventories of a health care provider are not normally subject to a significant fluctuation due to changes in quantities or prices.

While the above factors are relevant, we recommend that management consider the following:

- Moving the full count of inventory items to December 31st, from June 30th, each year to provide the most accurate assessment of inventory on hand at year-end.
- We also suggest that, while each department is responsible for the actual physical count, that an observer independent of the department be present at the time of counting. The Hospital's new internal auditor may be involved in the observation.
- The related general ledger accounts should be adjusted to reflect the inventory counted at year-end once verified by Finance.
- The Hospital should adopt a specific written policy regarding which departments or cost centers will not report capitalized inventory amounts on the financial statements. Whether this is done on the basis of estimated carrying amount or on the basis of specific cost center, it should be documented as a consistent policy.

We feel that because of the extent to which the inventory of Hospital is departmentalized that very effective analytical procedures can be applied by Management to support inventory levels and identify fluctuations in consumption. Accordingly, we feel that the suggestions above would serve to enhance the Hospital's existing control over financial reporting as well as physical control over assets.

Management Response:

Management will assess the entire process of physical inventory counts and procedures, Management has employed an Internal Auditor who will be assessing the physical inventory counts and making recommendations and adjustments as needed.

- **BALANCE SHEET ACCOUNT RECONCILIATIONS**

Observation
We noted that Finance prepares thorough detailed schedules of balances and subsidiary ledger reconciliations on a monthly basis as part of the closing process of most asset and liability accounts. Finance routinely books adjusting entries to the general ledger to balance those accounts. We did, however, note several instances where differences between general ledger account balances and the prepared detail schedules and reconciliations existed at year-end.

Recommendation
While the differences we noted are not material to the financial statements individually or collectively, we recommend that the Hospital's Management adjust the general ledger variances from the detail schedules at year end, and preferably quarterly. The benefit of routinely posting

these adjustments is that potential misstatements are not allowed to accumulate, are identified, and attributed to the particular period related. Posting these adjusting entries as a matter of policy on a routine basis will help ensure that significant corrections are not required at a later date. We noted that Management does routinely review the magnitude of unadjusted variances but we feel that routine adjustment of these items will reduce the potential for significant misstatements.

Management Response:
All general ledger accounts are reviewed periodically throughout the year. As these accounts are estimates at the time the financials are completed, some non-material variances may exist which are not known until after financials have been closed. Management does assess these accounts on a monthly basis to ascertain that the variances are within acceptable limits. General ledger control accounts will be adjusted to agree with the detailed subsidiary ledgers on a quarterly basis.

❖ INFORMATION SYSTEMS OPERATIONS

Observation
Backup policy -
Full daily backups are performed and kept for a two-week period. One full daily backup is stored off-site with the remaining thirteen tapes stored on-site. The backup tape stored off-site is the prior night's backup tape. In the event of a disaster, the Hospital will have to rely on the one backup tape stored off-site. If there is a problem with restoring from this tape the Hospital will be left without a backup, which leaves the Hospital vulnerable in the event of a disaster.

Recommendation
The Hospital should consider keeping additional tapes off-site. This would reduce the risk that a backup could not be performed due to a damaged tape.

The Hospital should also consider implementing a backup policy that will allow for recovery of files for periods beyond two weeks. For instance, the Hospital should consider performing weekly and monthly backups, in addition to the daily backups, and preserving these tapes for several periods. The monthly tapes should be stored off-site for a minimum of six months.

Management Response:
Since the audit, the Hospital has implemented a plan to perform a monthly backup with a six month rotation.

Observation
Off-Site Storage Facility-
The Hospital's off-site storage facility is located across the street from the Hospital's data center. In the event of a disaster, such as a tornado, both the off-site storage facility and the Hospital's data center could be damaged or destroyed.

Recommendation
To reduce the possibility of both the data center and the off-site storage facility being damaged or destroyed in the event of a disaster, the Hospital should consider utilizing an off-site storage facility that is physically located further away from the data center. The Hospital may alternatively consider supplementing their tape backup program with an online backup strategy via the Internet.

Management Response:
The Hospital is in the process of contracting with Iron Mountain for all off-site storage of backup tapes

Observation
Disaster Recovery Plan -
The Hospital's disaster recovery plan calls for testing at least on an annual basis. In addition, every third year the testing should involve a mock level 4 disaster and testing should be done at the Hospital's hot-site. This testing has not been performed to date.

Recommendation
The Hospital should perform testing of its disaster recovery plan to insure a smooth transition back to normal operations in the event of a disaster.

Management Response:
After the new backup plan is implemented, the Hospital will begin the process of updating the disaster recovery plan and testing procedures. In addition, the Hospital is currently in negotiations with Sunguard Disaster Recovery Solutions to ensure that the Hospital has the correct equipment under contract in case of a disaster.

EXHIBIT III
IMMATERIAL INSTANCE OF NON-COMPLIANCE WITH LAWS AND REGULATIONS

Finding 03-01 Unreported Instance of Alleged Misappropriation of Assets

Condition:
Management brought to our attention that during 2003 a financial counselor in the employ of the Hospital allegedly misappropriated $1,620 in cash received from a patient. Evidence surrounding the misappropriation was thoroughly reviewed by the Hospital's financial management and was reported to the Finance Committee but was not further reported.

Criteria:
The Louisiana Legislature has enacted Act 1101 of the 2001 Legislative Session, requiring that an agency head of an auditee who has actual knowledge of any misappropriation of the public funds or assets of his agency, shall immediately notify, in writing, the Legislative Auditor and the district attorney of the parish in which the agency is domiciled of such misappropriation.

Effect:
By failure to notify the Legislative Auditor immediately the Hospital did not comply with the provisions of Act 1101 of the 2001 Legislative Session.

Cause:
Management and the Board of Commissioners were unaware of the requirement to report the aforementioned matter in accordance with Act 1101. Management and the Board deliberated about bringing the matter before the Parish District Attorney and concluded based on the dollar amount involved that the best interest of the Hospital would be served by avoiding any further potential damage to the Hospital that may have been generated through bad publicity arising from the incident

Recommendation:
While indications are that the alleged misappropriation was an isolated incident, and was immediately addressed by remedial action of management, we recommend that in the future the *Hospital immediately notify the legislative auditor and the district attorney of* *__any__* *suspected or known misappropriation in accordance with State law.*

Management Response and Corrective Action:
Management indicated that the employee involved was terminated shortly after the discovery was made, and thoroughly investigated. Further, it was indicated that the employee would be ineligible for rehire. The policy regarding the processing of cash has since been changed so that a financial counselor is no longer able to accept cash. Cash may now only be accepted by a Hospital cashier. It was further indicated that it is a fairly rare occurrence that a patient pays for services in cash; especially in a substantial amount. Management emphasizes that the decision to not attempt prosecution of the matter was a judgment collectively made with the Hospital's best interest in mind. Management concurs with the recommendation to notify the legislative auditor and district attorney immediately upon the discovery of any future such events. Since the date of this incident in early 2003, there have been no further indications of any similar occurrences of this nature. Management upon notification of the reporting requirements related to the matter has since provided written details of to the Legislative Auditor's office and the District Attorney.