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MANAGEMENT'S DISCUSSION AND ANALYSIS
AND BASIC FINANCIAL STATEMENTS

Morehouse Parish Hospital Service District No. 1
(d/b/a Morehouse General Hospital)
Years ended May 31, 2004 and 2003, with Report of Independent Auditors

Morehouse Parish Hospital Service District No. 1
(d/b/a Morehouse General Hospital)

Management's Discussion and Analysis and Basic Financial Statements

Years ended May 31, 2004 and 2003

Contents

Morehouse Parish Hospital Service District No. 1
(d/b/a Morehouse General Hospital)

Management's Discussion and Analysis

May 31, 2004

This section of Morehouse Parish Hospital Service District No. 1's (the "Hospital") annual financial report provides important background information and management's analysis of the Hospital's financial performance for the year ended May 31, 2004. Please read this section in conjunction with the basic financial statements beginning on page 3 and the notes to the basic financial statements beginning on page 7 in this report.

Required Financial Statements

The basic financial statements in this report are presented using Governmental Accounting Standards Board ("GASB") accounting principles. These financial statements offer short-term and long-term financial information about the Hospital's activities.

The balance sheets include all of the Hospital's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to Hospital creditors (liabilities). It also provides the basis for computing rate of return, 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 statements of revenue, expenses, and changes in net assets. This statement measures changes in the Hospital's operations over the current and prior 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 final required financial statement is the statement of cash flows. The primary purpose of this statement is to provide information about the Hospital's cash from operating, investing, and financing activities and to provide answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

Financial Analysis of the Hospital

The balance sheets and the statements of revenue, expenses, and changes in net assets report information about the Hospital's activities. Increases or decreases in the Hospital's net assets are one indicator of whether its financial health is improving or deteriorating. However, other nonfinancial factors such as changes in the health care industry, changes in Medicare and Medicaid regulations, and changes in managed care contracting should also be considered.

Morehouse Parish Hospital Service District No. 1
(d/b/a Morehouse General Hospital)

Management's Discussion and Analysis (continued)

May 31, 2004

Balance Sheets

The Hospital's condensed balance sheets are presented below:

TABLE 1

	May 31 2004	May 31 2003	Dollar Change	Percent Change
	(In Thousands)			
Total current assets	$ 9,319	$ 9,972	$ (653)	(7)%
Property, building, and equipment - net	7,751	8,800	(1,049)	(12)%
Other assets, including assets whose use is limited	1,140	1,602	(462)	(29)%
Total assets	$ 18,210	$ 20,374	$ (2,164)	(11)%
Total current liabilities	$ 6,193	$ 7,400	$ (1,207)	(16)%
Long-term debt and capital lease obligations	2,960	3,320	(360)	(11)%
Total liabilities	9,153	10,720	(1,567)	(15)%
Net assets	9,057	9,654	(597)	(6)%
Total liabilities and net assets	$ 18,210	$ 20,374	$ (2,164)	(11)%

As shown in Table 1, total assets decreased by $2,164,000, or 11%, to $18,210,000 at May 31, 2004, down from $20,374,000 at May 31, 2003. The change in total assets results primarily from the Hospital generating cash from operations and investing activities in amounts less than that used to fund investments in capital assets. Further, depreciation expense exceeded purchases of property, building, and equipment by approximately $1,046,000.

Current Assets

The net decrease in current assets during 2004 resulted primarily from the collection of the amounts due from third-party payors. At May 31, 2004, current assets exceeded current liabilities as they did at May 31, 2003. The current ratio increased to 1.52 at May 31, 2004, versus 1.35 at May 31, 2003. The increase in this ratio indicates a positive trend. However, these calculations exclude consideration of the investments designated by the board of commissioners for future expansion and equipment additions. Including these liquid investments in the calculations would yield higher ratios.

Property, Building, and Equipment

The following table presents the components of the Hospital's property, building, and equipment at May 31, 2004 and 2003.

TABLE 2

	May 31	
	2004	2003
	(In Thousands)	
Land and improvements	**$ 898**	$ 889
Building and equipment	**36,867**	36,787
Subtotal	**37,765**	37,676
Less accumulated depreciation	**(30,015)**	(28,876)
Net property, building, and equipment	**$ 7,750**	$ 8,800

During fiscal year 2004, the Hospital invested $412,000 in a broad range of property, building, and equipment. Property, building, and equipment has increased as the Hospital has enhanced existing facilities and equipment and is in the process of building new space to accommodate inpatient services. These additions did not exceed the current fiscal year's depreciation expense, resulting in a lower net balance.

In Table 3, the Hospital's fiscal year 2005 capital budget projects spending up to $4,857,000. These projects are expected to be financed from operations or additional borrowings if available. More information about the Hospital's property, building, and equipment is presented in the notes to the basic financial statements.

TABLE 3

Equipment purchases	$ 3,457,000
Construction/renovation	1,400,000
Total	$ 4,857,000

Long-Term Debt

At year end, the Hospital had $3,184,000 in debt outstanding. In addition to the scheduled debt payments made during 2004, the Hospital repaid a capital-related note payable in advance of the instrument's due date.

The Hospital borrowed and repaid $2,500,000 during the fiscal year. The uncompensated care reimbursement funds were used to repay this borrowing. Total debt outstanding represented approximately 17% of the Hospital's total assets at May 31, 2004 and 2003.

Net Assets

The following table presents the components of the Hospital's net assets at May 31, 2004 and 2003.

TABLE 4

	May 31	
	2004	**2003**
	(In Thousands)	
Invested in property, building, and equipment, net of related debt	**$ 4,279**	$ 4,294
Restricted	**523**	529
Unrestricted	**4,255**	4,832
Total net assets	**$ 9,057**	$ 9,655

During 2004, total net assets decreased $597,000, or 6%, as a result of expenses exceeding total revenue.

Statements of Revenue and Expenses

A summary of the Hospital's revenues and expenses for fiscal years 2004 and 2003 are presented below.

TABLE 5

	Year ended May 31		Dollar	Percent
	2004	**2003**	**Change**	**Change**
	(In Thousands)			
Revenue:				
Net patient service revenue	**$ 24,874**	$ 23,959	$ 915	4%
Other revenue	**2,157**	1,766	391	22%
Total operating revenue	**27,031**	25,725	1,306	5%
Expenses:				
Salaries and benefits	**14,494**	13,102	1,392	11%
Other operating expenses	**11,370**	11,607	(237)	(2)%
Depreciation	**1,459**	1,653	(194)	(12)%
Interest	**328**	350	(22)	(6)%
Total operating expenses	**27,651**	26,712	939	4%
Operating expenses in excess of operating revenue	**(620)**	(987)	367	37%
Investment income	**23**	53	(30)	(57)%
Expenses in excess of revenue and investment income	**$ (597)**	$ (934)	$ 337	36%

Net Patient Service Revenue

During fiscal year 2004, the Hospital derived 92% of its total operating revenue from net patient service revenue compared to 93% in the prior year. Total net patient service revenue increased $915,000, or 4%, in 2004. Increases in net patient service revenue are primarily due to higher volumes and rate increases more than offsetting increased charity care and provision for bad debts.

Morehouse Parish Hospital Service District No. 1
(d/b/a Morehouse General Hospital)

Management's Discussion and Analysis (continued)

May 31, 2004

Table 6 presents the relative percentages of gross charges billed for patient services by payor for fiscal years 2004 and 2003.

TABLE 6

	Year ended May 31	
	2004	**2003**
Medicare	**57%**	55%
Managed care	**22%**	24%
Medicaid	**18%**	17%
Self-pay and other	**3%**	4%
	100%	100%

The following table presents the components of net patient service revenue for fiscal years 2004 and 2003.

TABLE 7

	Year ended May 31		Change	
	2004	**2003**	**Dollar**	**Percent**
	(In Thousands)			
Gross patient service charges	**$ 51,311**	$ 46,570	$ 4,741	10%
Contractual and other allowances:				
Medicare	**16,310**	13,646	2,664	20%
Managed care	**3,720**	4,262	(542)	(13)%
Medicaid	**4,084**	2,924	1,160	40%
Total contractual allowances	**24,114**	20,832	3,282	16%
	27,197	25,738	1,459	6%
Provision for bad debts	**2,323**	1,779	544	31%
Net patient service revenue	**$ 24,874**	$ 23,959	$ 915	4%

While gross patient service charges increased $4,741,000, or 10%, from prior year due to increased volume and rates, net patient service revenue, before provision for bad debts, increased only $1,459,000, or 6%, due to the Hospital not being able to fully realize the rate increase as the majority of the Hospital's revenue have payment rates not based on gross charges.

Excluded from gross patient service charges are amounts forgone for patient services falling under the Hospital's charity care policy. These amounts are based on established rates for the services provided. Gross charges of $192,000 were forgone in 2004 and $166,000 in 2003.

The provision for bad debts increased to $2,323,000 from the prior year amount of $1,779,000. This $544,000, or 31%, increase is driven primarily by the deterioration in collection percentages which are consistent with the current industry trends.

Other Operating Revenue

Other operating revenue includes income primarily generated by rent receipts from the Hospital's professional office buildings as well as income from other miscellaneous services, such as the cafeteria.

Operating Expenses

Employee-related expenses increased $1,392,000, or 11%, to $14,494,000 in the current fiscal year from $13,102,000 in the prior fiscal year. As a percentage of net patient service revenue, these expenses were approximately 58% in 2004 and 55% in 2003. The increase related primarily to pay rate increases in 2004.

Other operating expense decreased $237,000, or 2%, from prior year. As a percentage of net patient service revenue, these expenses were approximately 46% in 2004 and 48% in 2003. The decrease is mainly due to the efforts of management during the year to reduce operating expenses.

Depreciation and amortization expense decreased $194,000, or 12%, from prior year. The decrease is due to disposal of capital assets and capital assets becoming fully depreciated during 2004.

Interest expense decreased to $22,000, or 6%, from the prior year. The decrease is due to a lower average balance of debt outstanding during 2004.

Contacting the Hospital's Administration

This financial report is designed to provide our citizens, customers, and creditors with a general overview of the Hospital's finances and to demonstrate the Hospital's accountability for the money it receives. If you have questions about this report or need additional financial information, please contact the Hospital's Administration.

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Report of Independent Auditors

The Board of Commissioners
Morehouse Parish Hospital Service District No. 1

We have audited the accompanying balance sheets of Morehouse Parish Hospital Service District No. 1 (d/b/a Morehouse General Hospital) (the "Hospital") as of May 31, 2004 and 2003, and the related statements of revenue, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and in accordance with the standards for 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Hospital at May 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 1 to the financial statements, effective June 1, 2003, the Hospital changed its accounting policy related to financial statement presentation in order to comply with the provisions of Statement No. 34 of the Governmental Accounting Standards Board.

The accompanying financial statements have been prepared assuming that the Hospital will continue as a going concern. The Hospital has incurred significant losses and experienced deteriorating working capital since 2001. These conditions raise substantial doubt about the Hospital's ability to continue as a going concern. The financial statements do not include adjustments, if any, to reflect the possible future effects on the recoverability and the classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty. As more fully described in Note 2 to the financial statements, the Hospital received significant reimbursement under a state program. However, continued reimbursement under this program cannot be assured.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 19, 2004, on our consideration of the Hospital's internal control over financial reporting and on 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.

Management's discussion and analysis on pages i through viii is not a required part of the basic 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.

Ernst + Young LLP

November 19, 2004

Morehouse Parish Hospital Service District No. 1
(d/b/a Morehouse General Hospital)

Balance Sheets

	May 31 2004	May 31 2003
Assets		
Current assets:		
Cash and cash equivalents	**$ 415,437**	$ 471,196
Patient accounts receivable, less allowances for uncollectible accounts of $1,246,000 in 2004 and $1,327,000 in 2003	**4,643,864**	4,716,851
Uncompensated care reimbursement receivable	**2,809,479**	2,449,873
Settlements due from third-party payors	–	993,017
Inventories	**836,992**	862,252
Current assets whose use is limited	**299,455**	285,441
Prepaid expenses and other assets	**313,419**	193,535
Total current assets	**9,318,646**	9,972,165
Noncurrent assets whose use is limited	**600,425**	1,198,581
Amounts due from physicians, net of allowance for uncollectible accounts of $460,000 in 2004 and 2003	**539,990**	403,624
Property, building, and equipment:		
Land and improvements	**897,884**	888,635
Buildings	**14,360,449**	14,298,406
Equipment	**22,506,980**	22,488,713
	37,765,313	37,675,754
Less accumulated depreciation	**(30,014,668)**	(28,876,089)
	7,750,645	8,799,665
Total assets	**$ 18,209,706**	$ 20,374,035

	May 31	
	2004	**2003**
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 4,059,147**	$ 3,701,816
Employee compensation and payroll taxes	**1,419,856**	1,574,987
Other accrued liabilities	**124,198**	936,954
Settlements due to third-party payors	**76,805**	–
Current portion of note payable	–	200,328
Current portion of capital lease obligations	**214,335**	700,134
Current portion of long-term debt	**298,347**	285,441
Total current liabilities	**6,192,688**	7,399,660
Note payable, less current portion	–	51,765
Capital lease obligations, less current portion	**73,328**	108,821
Long-term debt, less current portion	**2,886,132**	3,158,997
Total liabilities	**9,152,148**	10,719,243
Net assets:		
Invested in property, building, and equipment, net of related debt	**4,278,503**	4,294,179
Restricted net assets	**523,222**	528,636
Unrestricted net assets	**4,255,833**	4,831,977
Total net assets	**9,057,558**	9,654,792
Total liabilities and net assets	**$ 18,209,706**	$ 20,374,035

See accompanying notes.

Morehouse Parish Hospital Service District No. 1
(d/b/a Morehouse General Hospital)

Statements of Revenue, Expenses, and Changes in Net Assets

	Year ended May 31	
	2004	**2003**
Net patient service revenue	**$24,874,437**	$23,958,761
Other revenue	**2,157,505**	1,766,047
Total operating revenue	**27,031,942**	25,724,808
Expenses:		
Salaries and benefits	**14,494,116**	13,102,213
Medical supplies and drugs	**3,083,977**	2,845,402
Outside services	**4,130,030**	3,906,605
Insurance	**300,093**	608,457
Other supplies	**959,434**	1,192,523
Other	**2,896,795**	3,054,355
Depreciation	**1,458,718**	1,652,831
Interest	**328,354**	349,707
Total operating expenses	**27,651,517**	26,712,093
Operating expenses in excess of operating revenue	**(619,575)**	(987,285)
Investment income	**22,341**	52,732
Expenses in excess of revenue and investment income	**(597,234)**	(934,553)
Net assets – beginning of year	**9,654,792**	10,589,345
Net assets – end of year	**$ 9,057,558**	$ 9,654,792

See accompanying notes.

Morehouse Parish Hospital Service District No. 1
(d/b/a Morehouse General Hospital)

Statements of Cash Flows

	Year ended May 31	
	2004	**2003**
Operating activities		
Revenue collected	**$ 27,814,469**	$ 26,051,221
Cash payments to employees and for employee-related costs	**(14,649,247)**	(13,286,645)
Cash payments for operating expenses	**(12,056,744)**	(11,048,947)
Net cash provided by operating activities	**1,108,478**	1,715,629
Noncapital and related financing activities		
Proceeds from note payable	**2,500,000**	–
Payments on note payable	**(2,500,000)**	–
Interest expense paid	**(61,000)**	–
Net cash used in noncapital and related financing activities	**(61,000)**	–
Capital and related financing activities		
Proceeds from sale of property, building, and equipment	**3,450**	260,245
Purchases of property, building, and equipment	**(412,472)**	(680,353)
Payments on capital lease obligations	**(521,292)**	(700,525)
Payments on note payable and long-term debt	**(512,052)**	(429,147)
Interest expense paid	**(267,354)**	(349,707)
Net cash used in capital and related financing activities	**(1,709,720)**	(1,899,487)
Investing activities		
Purchases of investments	–	(250,000)
Proceeds from sales or maturities of investments	**584,142**	466,342
Investment income received	**22,341**	52,732
Net cash provided by investing activities	**606,483**	269,074
Net change in cash and cash equivalents	**(55,759)**	85,216
Cash and cash equivalents at beginning of year	**471,196**	385,980
Cash and cash equivalents at end of year	**$ 415,437**	$ 471,196
Reconciliation of loss from operations to net cash provided by operating activities		
Operating expenses in excess of operating revenue	**$ (619,575)**	$ (987,285)
Adjustments to reconcile expenses in excess of revenue to net cash provided by operating activities:		
Depreciation	**1,458,718**	1,652,831
Interest expense	**328,354**	349,707
Provision for uncollectible accounts	**2,323,242**	1,730,680
(Gain) loss on sale of building and equipment	**(676)**	10,249
Changes in operating assets and liabilities:		
Patient accounts receivable	**(2,250,255)**	(1,982,110)
Inventories, prepaid expenses, and other assets	**(230,990)**	(356,003)
Uncompensated care reimbursement receivable	**(359,606)**	874,950
Intergovernmental transfer program receivable	–	241,003
Settlements due from third-party payors	**1,069,822**	(538,110)
Accounts payable	**357,331**	801,746
Employee compensation, payroll taxes, and other accrued liabilities	**(967,887)**	(82,029)
Net cash provided by operating activities	**$ 1,108,478**	$ 1,715,629

See accompanying notes.

1. Organization and Description of Business

Morehouse Parish Hospital Service District No. 1 (d/b/a Morehouse General Hospital) (the "Hospital") was organized on December 17, 1982, under powers granted to parish police juries by the state of Louisiana. The geographical boundaries of the Hospital coincide with those of Morehouse Parish. All corporate powers are vested in a board of commissioners appointed by the Morehouse Parish Police Jury. The Hospital is exempt from income taxes as a political subdivision of the state of Louisiana under Section 115 of the Internal Revenue Code. The Hospital is also exempt from federal income tax under Section 501(a) as a hospital organization described in Section 501(c)(3). The federal income tax exemptions also extend to state income taxes.

Basis of Accounting

The Hospital uses the accrual basis of accounting for proprietary funds. Under Governmental Accounting Standards Board ("GASB") Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Hospital has elected not to apply Financial Accounting Standards Board pronouncements issued after November 30, 1989. As a governmental entity, the Hospital also follows certain accounting and disclosure requirements promulgated by the GASB.

New Accounting Standards

The GASB issued Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments;* Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments Omnibus;* and Statement No. 38, *Certain Financial Statement Note Disclosures* (collectively, the "Statements"), which establish financial reporting standards for state and local governments. These Statements establish that the financial statements and required supplementary information ("RSI") for general-purpose governments should consist of Management's Discussion and Analysis ("MD&A") to provide an analytical overview of the entity's financial activities, Basic Financial Statements, and RSI. The Statements were effective for the Hospital in fiscal year 2004. Adoption of these standards did not have any effect on the financial position or results of operations of the Hospital.

1. Organization and Description of Business (continued)

Statement No. 34 established standards for external financial reporting for all state and local governmental entities, which include a balance sheet; a statement of revenue, expenses, and changes in net assets; and a direct method statement of cash flows. It requires the classification of net assets into three components – invested in property, building, and equipment, net of related debt; restricted; and unrestricted. These components are defined as follows:

- Invested in property, building, and equipment, net of related debt – This component reports capital assets, including restricted property, building, and equipment, 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. If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds is excluded from this component of net assets. Rather, that portion of debt should be included in the same net assets component as the unspent proceeds.

- Restricted – This component reports those net assets with externally imposed constraints placed on their use 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 reports net assets that do not meet the definition of either of the other two components.

The adoption of the Statements resulted in the previously reported unrestricted fund balance amount being classified to conform to the above net asset components. Additionally, the Hospital restated the 2003 statement of cash flows to conform to the direct method of reporting cash receipts and disbursements.

The Statements also require that the Hospital recognize the provision for bad debts as a component of net patient service revenue.

2. Operating Results and Liquidity

Morehouse General Hospital continues to benefit from uncompensated care cost reimbursement provided by the Louisiana Rural Hospital Preservation Act. The Hospital recognized $2,809,000 of revenue in 2004 and $2,450,000 of revenue in 2003 pursuant to the provisions of the program. In future years, the Hospital expects to derive a significant portion of revenue from this program; however, guarantee of continued legislative appropriation of these funds cannot be assured.

In addition, the Hospital has implemented several other initiatives to improve operating results, including the following:

- Management is considering the development and implementation of a hospital-based rural health clinic.

- The Hospital continues its physician recruiting efforts and the creation of a hospital list program. With the addition of new physicians to the Hospital service area, management believes there could be an increased demand for the Hospital's services.

- The Hospital will implement a new hospital information system, which is expected to be completed in March 2005. Management believes significant savings can be achieved with the improved integration offered by a new system.

- Management is implementing the use of swing bed services, which were implemented in November 2004.

- Management continues to review all of the Hospital's contracted services to identify cost-saving opportunities.

- Management intends to perform comprehensive reviews of the Hospital's charge capture process to ensure it is billing and collecting all charges earned.

Management believes that reimbursement under the Rural Preservation Act will continue to have a significant ongoing positive impact on the Hospital operations and, in conjunction with the effects of other initiatives, will allow the Hospital to continue to improve its operating performance as well as strengthen its financial position.

2. Operating Results and Liquidity (continued)

Therefore, management anticipates the Hospital's future operating results will allow it to meet its operational, debt service, and capital needs. However, there are no assurances that such results will be achieved.

3. Significant Accounting Policies

Net Patient Service Revenue and Related Receivables

Net patient service revenue is reported at the estimated net realizable amounts billed to patients, third-party payors, and others for services rendered. The Hospital provides medical services to government program beneficiaries and has agreements with other third-party payors that provide for payments at amounts different from established rates. These payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. The Hospital's provision for bad debts is classified as a reduction to net patient service revenue. The percentage of net patient service revenue derived from services furnished to Medicare and Medicaid program beneficiaries, combined, was approximately 73% in 2004 and 73% in 2003. During the years ended May 31, 2004 and 2003, approximately 75% and 72%, respectively, of the Hospital's gross patient revenue was derived from Medicare and Medicaid program beneficiaries.

The Hospital is unable to predict the future course of federal, state, and local regulation or legislation, including Medicare and Medicaid statutes and regulations. Future changes could have a material adverse effect on the future financial results of the Hospital.

Retroactive settlements are provided for in some of the government payment programs outlined above, based on annual cost reports. Such settlements are estimated and recorded as amounts due to or from these programs in the accompanying financial statements. The differences between these estimates and final determination of amounts to be received or paid are based on audits by fiscal intermediaries and are reported as adjustments to net patient service revenue when such determinations are made. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term. Estimated settlements through May 31, 2003, for the Medicare program and through May 31, 1999, for the Medicaid program have been reviewed by program representatives, and adjustments have been recorded to reflect any revisions to the recorded estimates. These adjustments resulted in an increase in net

3. Significant Accounting Policies (continued)

patient service revenue of $26,000 in 2004 and $152,000 in 2003. The effect of any adjustments that might be made to cost reports still subject to review will be reported in the Hospital's financial position or results of operations as such determinations are made.

Charity Care

The Hospital provides care without charge, or at amounts less than established rates, to patients who meet certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify for charity care, they are not reported as revenue. The Hospital maintains records to identify and monitor the level of charity care it provides. These records reflect the amount of charges foregone ($192,000 in 2004 and $166,000 in 2003) for services and supplies furnished under its charity care policy.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with original maturities of three months or less when purchased, excluding amounts whose use is limited by board designation or other arrangements under trust agreements.

Investments

Investments are carried at market value in the balance sheet. Investment income, including changes in the fair value of investments, is reported in investment income in the statements of revenue, expenses, and changes in net assets. Unrealized gains (losses) reflected in investment income were not significant in 2004 and 2003.

Cash and Investments

Louisiana state statutes authorize the Hospital to invest in United States government obligations, certificates of deposit of national banks located in Louisiana or banks organized under the laws of Louisiana, any federally insured investment, guaranteed investment contracts issued by a financial institution having one of the two highest rating categories of Standard & Poor's Corporation or Moody's Investors Services, or in mutual or trust institutions that are registered with the Securities and Exchange Commission

3. Significant Accounting Policies (continued)

under the Securities Act of 1933 and the Investment Act of 1940 and which have underlying investments consisting solely of securities of the United States government or its agencies.

Louisiana's statutes also require that all the deposits of the Hospital be protected by insurance or collateral. The market value of collateral pledged must equal 100% of the deposits not covered by insurance. The Hospital's bank deposits consist of demand deposit accounts and certificates of deposit. These bank deposits are included in cash and cash equivalents and assets whose use is limited. At May 31, 2004 and 2003, the Hospital's deposits were fully insured or collateralized with securities held by the agent of the pledging banks in the Hospital's name.

In addition to the bank deposits held, the Hospital had $580,201 at May 31, 2003, in a mutual fund whose underlying investments consisted solely of securities of the United States government or its agencies (see Note 4). These funds are recorded in assets whose use is limited in the balance sheet.

The Hospital's cash and investments are categorized below to give an indication of the level of risk assumed at May 31, 2004 and 2003. Category (a) includes investments that are insured, or registered in the Hospital's name, or for which the securities are held by the Hospital or its agent in the Hospital's name. Category (b) includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the Hospital's name. Category (c) 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:

	May 31, 2004		
	Credit Risk Category		
	(a)	(b)	(c)
Securities type:			
U.S. government and federal agencies' securities	$ –	$ 523,222	$ –
Money market funds and other cash equivalents	–	792,095	–
Total investments	$ –	$ 1,315,317	$ –

3. Significant Accounting Policies (continued)

	May 31, 2003					
	Credit Risk Category					
	(a)		(b)		(c)	
Securities type:						
U.S. government and federal agencies' securities	$	–	$	528,636	$	–
Money market funds and other cash equivalents		–		1,426,582		–
Total investments	$	–	$	1,955,218	$	–

Assets Limited as to Use

Assets limited as to use include cash, cash equivalents, and investments. These assets are designated as such in the accompanying balance sheets as they are held by bond trustees under related indenture agreements or designated as such by the board of commissioners.

Amounts classified as current assets represent amounts to be used to meet certain debt service requirements and other obligations classified as current liabilities.

Inventories

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

Property, Building, and Equipment

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

Assets held under capital lease obligations are included in equipment. These assets have been recorded at the present value of the minimum lease payments, which approximates the fair market value of the leased assets (see Note 7). Amortization of leased assets is provided for using the straight-line method over the term of the related lease and is included in depreciation expense.

3. Significant Accounting Policies (continued)

Statements of Revenues, Expenses, and Changes in Net Assets

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services are included in income or loss from operations; all peripheral transactions are reported as a component of nonoperating income.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

Reclassifications

The prior year financial statements have been reclassified to conform to their current year presentation.

4. Assets Whose Use Is Limited

The terms of the Hospital's 1997 Revenue Bonds require funds to be maintained on deposit in certain accounts with the trustee (see Note 8). The funds on deposit in the accounts are required to be invested by the trustee in accordance with the terms of the bond resolution.

4. Assets Whose Use Is Limited (continued)

In addition, the Hospital's board of commissioners has designated certain assets to be used for future expansion and equipment additions. The composition of assets whose use is limited as of May 31, 2004 and 2003, was as follows:

	May 31 2004	May 31 2003
Board-designated assets:		
Certificates of deposit	**$ 376,658**	$ 375,186
Mutual fund investments	**–**	580,200
	376,658	955,386
Trusteed funds (principally United States government obligations):		
Debt Service Fund	**40,420**	2,252
Debt Service Reserve Fund	**457,989**	524,473
Capital Additions and Contingencies Fund	**24,813**	1,911
	523,222	528,636
Total assets whose use is limited	**899,880**	1,484,022
Less current portion	**(299,455)**	(285,441)
Noncurrent assets whose use is limited	**$ 600,425**	$ 1,198,581

5. Property, Building, and Equipment

The following table summarizes the changes in net property, building, and equipment for the year.

	Beginning Balance	Additions	Reclassifications/ Retirements	Ending Balance
Land and improvements	$ 888,635	$ 9,249	$ –	$ 897,884
Buildings	14,298,406	62,043	–	14,360,449
Equipment	22,488,713	341,180	(322,913)	22,506,980
	37,675,754	412,472	(322,913)	37,765,313
Less accumulated depreciation	(28,876,089)	(1,458,718)	320,139	(30,014,668)
Property, buildings, and equipment, net	$ 8,799,665	$ (1,046,246)	$ (2,774)	$ 7,750,645

The Hospital leases certain major movable and other nonmovable equipment under operating leases and capital leases. Refer to Note 8 for amounts relating to these leases.

6. Employee Retirement Plan

The Hospital sponsors two pension plans. Under the provisions of the Hospital's pension plan documents, the Hospital is required to contribute 10.0% of the eligible employee's salary and 7.5% of the noneligible employee's salary annually. The plans provide for the contributions (and interest allocated to the employee's account) to become partially vested after three years of continuous employment and fully vested after seven years of continuous employment. The unvested portion of an account of an employee who terminates employment before becoming fully vested is used to reduce the Hospital's current year contribution. The Hospital's required contribution was $1,148,677 for 2004 and $969,861 for 2003.

Contributions made during the periods for the plans discussed above were $969,861 and $252,963 in 2004 and 2003, respectively. The Hospital's unfunded contribution requirement related to the plans of $822,972 and $969,861 at May 31, 2004 and 2003, respectively, is included in accounts payable on the accompanying balance sheets. Total payroll for all employees was $11,780,492 and $10,766,570 for the years ended May 31, 2004 and 2003, respectively. Substantially all employees of the Hospital are covered by the plan discussed above.

The Hospital established the Morehouse General Hospital Tax Deferred Savings Plan. This plan, which qualifies as a tax-sheltered annuity plan under Section 403(b) of the Internal Revenue Code, covers all employees who elect to participate. The plan allows participants to defer a portion of their annual compensation. The amount of annual contributions to the plan by participants is subject to certain limitations as defined in the plan agreement. The participants vest 100% immediately in their contributions and investment earnings of the plan. The plan agreement allows discretionary employer contributions to be made to the plan. No employer contributions were made during the years ended May 31, 2004 and 2003.

Retirement expense, net of forfeitures, related to the above plans included in salaries and benefits in the accompanying statements of revenue, expenses, and changes in net assets was $822,972 and $798,911 for the years ended May 31, 2004 and 2003, respectively.

7. Leases

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

Future minimum lease payments, by year and in the aggregate, under capital leases consisted of the following at May 31, 2004:

Fiscal year ending May 31:	
2005	$ 292,277
2006	64,881
2007	24,233
Total minimum lease payments	381,391
Amount representing interest (ranging from 2.08% to 13.54%)	93,728
Present value of net minimum lease payments (including $214,335 classified as current)	$ 287,663

The cost of leased assets included in equipment totaled $4,368,287 and $4,494,074 and accumulated amortization was $3,261,199 and $2,584,624 at May 31, 2004 and 2003, respectively. The equipment collateralizes the capital lease obligations.

The Hospital has entered into various cancelable operating leases for equipment. Operating lease expense was approximately $187,250 and $273,265 for the years ended May 31, 2004 and 2003, respectively.

8. Long-Term Debt

The Hospital's long-term debt consisted of the following:

	May 31	
	2004	**2003**
Hospital Revenue Bonds, Series 1997	**$ 3,184,479**	$ 3,444,438
Less amounts due within one year	**(298,347)**	(285,441)
	$ 2,886,132	$ 3,158,997

8. Long-Term Debt (continued)

The Hospital Revenue Bonds, Series 1997, are term bonds with an annual interest rate of 5.24%. Payment of the scheduled principal and interest on these bonds is due in monthly installments of $38,159. The 1997 Revenue Bonds are obligations of the Hospital secured by a pledge of the Hospital's revenue.

Under the terms of the bond indenture, the Hospital is required to maintain, among other provisions, a specified minimum debt service coverage ratio. In 2004 and 2003, the Hospital was in compliance with the covenants under the bond indenture.

The debt service requirements for annual periods after May 31, 2004 were as follows:

	Principal	Interest
2005	$ 298,347	$ 159,758
2006	314,157	143,754
2007	331,020	126,891
2008	348,788	109,123
2009	367,510	90,401
2010 – 2013	1,524,657	115,996
Total	$ 3,184,479	$ 745,923

9. Commitments and Contingencies

During the ordinary course of operations, the Hospital has been named a defendant in lawsuits alleging medical malpractice. Through October 31, 2002, the Hospital was insured for malpractice insurance coverage on a claims-made basis for individual claims up to $100,000, including a $50,000 deductible per claim. At November 1, 2002, the Hospital became self-insured for individual claims up to $100,000. For individual malpractice claims in excess of $100,000, the Hospital participates in the State of Louisiana Patient Compensation Fund (the "Fund"). The Fund provides malpractice insurance coverage on a claims-made basis for claims up to the statutory maximum exposure of $500,000, which currently exists under Louisiana law, plus interest and future medical costs. The Hospital has purchased additional malpractice insurance providing coverage up to $900,000 in the aggregate.

9. Commitments and Contingencies (continued)

The Hospital has purchased commercial insurance that provides first-dollar coverage for workers' compensation claims. The Hospital is self-insured for employee health insurance up to $75,000 per claim. A liability is recorded when it is probable that a loss has been incurred and the amount of that loss can be reasonably estimated. Liabilities for claims incurred are reevaluated periodically to take into consideration recently settled claims, frequency of claims, and other economic and social factors. The Hospital purchased commercial insurance that provides coverage for employee health claims in excess of the self-insured limits.

Changes in the Hospital's aggregate claims liability for medical malpractice and employee health insurance in fiscal years 2004 and 2003 were as follows:

Year Ended May 31	Beginning of Fiscal Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year End
2004	**$ 637,000**	**$ 1,084,000**	**$ 1,359,000**	**$ 362,000**
2003	$ 638,000	$ 1,434,000	$ 1,435,000	$ 637,000

10. Governmental Regulations

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers in recent years. Violations of these laws and regulations could result in expulsion from government health care programs, together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Hospital is in compliance with fraud and abuse as well as other applicable government laws and regulations. While no material regulatory inquiries have been made, 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.

10. Governmental Regulations (continued)

Legislation and regulation at all levels of government have affected and are likely to continue to affect the operation of the Hospital. Federal health care reform legislation proposals debated in Congress in recent years have included significant reductions in Medicare and Medicaid program reimbursement to hospitals 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 the Hospital's principal payers. It is not possible at this time to determine the impact on the Hospital of government plans to reduce Medicare and Medicaid spending, government implementation of national and state health care reform, or market-initiated delivery system and/or payment methodology changes. However, such changes could have an adverse impact on operating results, cash flows, and estimated debt service coverage of the Hospital in future years.

The Health Insurance Portability and Accountability Act ("HIPAA") was enacted August 21, 1996, to assure health insurance portability, reduce health care fraud and abuse, guarantee security and privacy of health information, and enforce standards for health information. Organizations were required to be in compliance with certain HIPAA provisions beginning in April 2003. Provisions not yet finalized are required to be implemented two years after the effective date of the regulation. Organizations are subject to significant fines and penalties if found to be not compliant with the provisions outlined in the regulations.

11. 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 payer agreements. The mix of receivables due from patients and third-party payers was as follows:

	May 31	
	2004	**2003**
Medicare	**40%**	41%
Medicaid	**14**	10
Managed care	**26**	21
Self-pay	**20**	28
	100%	100%

12. Subsequent Event

On June 27, 2004, the Hospital borrowed $2,000,000 from a local financial institution in conjunction with a certificate of indebtedness issued by Morehouse Parish Hospital Service District No. 1. The Hospital repaid the $2,000,000 plus interest on October 21, 2004.

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

The Board of Commissioners
Morehouse Parish Hospital Service District No. 1

We have audited the financial statements of Morehouse Parish Hospital Service District No. 1 (d/b/a Morehouse General Hospital) (the "Hospital") as of and for the year ended May 31, 2004, and have issued our report thereon dated November 19, 2004. Our report has been modified to describe our substantial doubt about the Hospital's ability to continue as a going concern. Our report has also been modified to describe the Hospital's adoption of Governmental Accounting Standards Board Statement No. 34. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Hospital's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in a separate letter to you dated November 19, 2004.

A material weakness is a reportable 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 caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described in our separate letter dated November 19, 2004, is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospital's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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*. We noted certain matters that we reported to management of the Hospital in a separate letter dated November 19, 2004.

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

Ernst + Young LLP

November 19, 2004

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The Board of Commissioners
Morehouse Hospital Service District No. 1

In planning and performing our audit of the financial statements of Morehouse Parish Hospital Service District No. 1 (d/b/a Morehouse General Hospital) (the "Hospital") for the year ended May 31, 2004, we considered its internal control to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the specific internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

During our audit, we noted the following matter involving internal control and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants.

Financial Statement Close Process

Management made adjustments to the May 31, 2004, balances through November 2004. These adjustments were mainly based on the results of management's estimation processes supporting the financial statement close process. Management recorded significant adjustments as a result of finalizing these estimates.

We recommend that management adjust these accounts on a more timely basis to consider the results of management's estimation processes. Increased accuracy in the interim financial statements would provide decision makers with better information about the Hospital's operating results and financial position.

Additionally, during our audit, the following matters came to our attention that we believe merit your consideration.

Information Systems General Controls

During the testing of information systems general controls, we noted there was not a formal policy for establishing passwords and insufficient documentation kept by the Hospital to provide an audit trail. We recommend that management establish a formal policy for passwords within the organization, as well as requiring all personnel to sign security agreements that address the confidentiality of passwords. We also suggest that management require the information systems department to maintain at least minimal paper documentation to provide a sufficient auditable trail.

When performing our walkthrough of the Logical Access Process, we noted that no measures are taken to ensure that passwords are random and complex in nature. We also noted that the reactivation of user IDs does not require the involvement of information systems personnel as the user ID reactivates itself after one hour has elapsed. Based on this, we suggest that the information systems personnel enable the complexity feature on the password settings as well as require the involvement of information systems personnel for user ID reactivation. Implementation of such suggestions would reduce the opportunity for employees to perform fraudulent activity.

Check Signing Process

Through our testing of the cash disbursements process, we noted that all checks are electronically signed regardless of the disbursement amount. We recommend that management implement a formal policy which mandates the use of manual signatures or dual manual signatures on checks greater that a specified amount, deemed appropriate by management. The implementation of this control would ensure that checks greater than a certain dollar amount are reviewed and approved by management prior to disbursement.

Bank Reconciliation Preparation

During our testing of the November 30, 2003, payroll bank reconciliation, we noted that the reconciliation was not properly prepared. While the amount of the error was immaterial, we believe the nature of the error invalidated the control. We also noted that a detailed review and approval of the bank reconciliation is not being performed. We recommend that the reconciliations be prepared properly, that differences are investigated, and that management designate an appropriate level of personnel to perform a timely review of the reconciliations.

Monthly Budget to Actual Review

During our testing of the monthly budget to actual review process, we noted that department managers review the monthly profit and loss statements. They are responsible for explaining any variance from budget to actual greater than $500 to the Department Vice President.

Each month the Financial Analyst, in accounting, prepares a summary budget to actual variance report by financial statement account. Variances greater than $5,000 and 5% are investigated and explained. The Accounting Manager and Chief Financial Officer review the variance analysis. The explanations are also included in the monthly financial statement package, which is presented to the board of commissioners.

We noted that management does not maintain records of the monthly variance reports, with the variance explanations and signoffs. We recommend that management consider retaining this documentation of the operation of this key control.

* * * * * *

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

Ernst + Young LLP

November 19, 2004

MOREHOUSE
GENERAL HOSPITAL

The Regional Medical Facility for Northeast Louisiana & Southeast Arkansas

Re: Audit Fye 5/31/04; management response

In reference to the FYE May 31, 2004 audit management letter from Ernst & Young, please see below for management's responses.

Financial Statement Close Process
Management agrees that improving the accuracy of the interim financial statements is important. The most significant adjustment made each year after the closing of the interim financials is for the disproportionate share revenue received each October. Management recommended a change in accounting method for that revenue to Ernst & Young and was denied. Management acknowledges E&Y's reluctance to change methods, but doing so would eliminate that adjustment. E&Y and management will work together to develop a method to report the disproportionate share payment within our interim financials.

Information systems general controls
Management agrees with its auditors and will make the appropriate changes.

Check signing process
Management agrees with its auditors and will develop a formal policy to address this issue.

Bank reconciliation preparation
Management will make the appropriate changes.

Monthly budget to actual review
Management believes its process for investigating material differences from budget and or prior year to actual is sufficient. Management does maintain records of the variance reports but not variance explanations. We will incorporate this into our monthly routine.

If you need additional information or comments, please call at (318) 283-3892.

Sincerely,

Brad McCormick