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MANAGEMENT'S DISCUSSION AND ANALYSIS AND BASIC FINANCIAL STATEMENTS

Hospital Service District No. 1 of the Parish of Tangipahoa, State of Louisiana
(d/b/a North Oaks Health System)
Years ended June 30, 2004 and 2003, with Report of Independent Auditors

Hospital Service District No. 1 of the Parish of Tangipahoa,
State of Louisiana (d/b/a North Oaks Health System)

Management's Discussion and Analysis and
Basic Financial Statements

Years ended June 30, 2004 and 2003

Contents

Hospital Service District No. 1 of the Parish of Tangipahoa, State of Louisiana (d/b/a North Oaks Health System)

Management's Discussion and Analysis

This section of the annual financial report of Hospital Service District No. 1 of the Parish of Tangipahoa, State of Louisiana (d/b/a North Oaks Health System) (the "Hospital"), presents background information and management's analysis of the Hospital's financial performance during the fiscal year that ended on June 30, 2004. Please read it in conjunction with the financial statements in this report.

Financial Highlights

- The Hospital's total assets increased by approximately $47,819,000, or approximately 26%, primarily due to cash generated by bond issuances.

- During the year, the Hospital's total operating revenue increased approximately $11,912,000, or 9%, to $149,519,000 from the prior year while expenses increased $11,200,000, or 8%, to $144,877,000. The Hospital had income from operations of $4,642,000, which is approximately 3% of total operating revenue. This compares to the prior fiscal year's income from operations of approximately $3,931,000, or 3% of operating revenue.

- The Hospital received approximately $2,000,000 and $1,977,000 in 2004 and 2003, respectively, in intergovernmental transfer funds that were offset against Medicaid contractual adjustments, resulting in an increase in net patient service revenue.

- During the fiscal year, the Hospital made capital investments for a total of approximately $14,678,000. The following is a list of significant items:

Capital Investments	2004 Cost
Multi slice CT Scanner	$ 1,340,500
Air Handler Construction	232,031
Cysto Unit	245,771
Aquatic Center	725,493
Chemistry Analyzers	370,525
Outpatient Diagnostic Center	5,894,020
Hematology Analyzer	204,500
Pnuematic Tube System	182,079

The source of the funding for these projects was derived from operations.

Required Financial Statements

The basic financial statements of the Hospital report information about the Hospital using Governmental Accounting Standards Board ("GASB") accounting principles. These statements offer short-term and long-term financial information about its 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 past 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 statements of cash flows. The primary purpose of this statement is to provide information about the Hospital's cash from operations, investing, and financing activities and to provide answers to questions such 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. These two statements report the net assets of the Hospital and changes in them. 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.

Net Assets

A summary of the Hospital's balance sheets are presented in Table 1 below:

TABLE 1
Condensed Balance Sheets

	June 30		Dollar	Percent
	2004	**2003**	**Change**	**Change**
Total current assets	**$ 45,525,680**	$ 39,048,567	$ 6,477,113	17%
Capital assets – net	**87,071,022**	81,701,787	5,369,235	7%
Other assets, including board-designated investments	**97,162,907**	61,074,528	36,088,379	59%
Total assets	**$ 229,759,609**	$ 181,824,882	$ 47,934,727	26%
Current liabilities	**$ 19,578,984**	$ 19,239,732	$ 339,252	2%
Long-term debt outstanding and other long-term liabilities	**97,576,852**	55,744,901	41,831,951	75%
Total liabilities	**117,155,836**	74,984,633	42,171,203	56%
Net assets:				
Invested in capital assets, net of related debt	**16,047,760**	27,229,911	(11,182,151)	(41)%
Restricted net assets	**8,134,464**	6,741,359	1,393,105	21%
Unrestricted net assets	**88,421,549**	72,868,979	15,552,570	21%
Total liabilities and net assets	**$ 229,759,609**	$ 181,824,882	$ 47,934,727	26%

As can be seen in Table 1, total assets increased by approximately $47,935,000 to $229,760,000 in fiscal year 2004, from approximately $181,825,000 in fiscal year 2003. The change in total net assets is primarily due to the excess of revenues over expenses in fiscal year 2004.

Hospital Service District No. 1 of the Parish of Tangipahoa,
State of Louisiana (d/b/a North Oaks Health System)

Management's Discussion and Analysis (continued)

Summary of Revenue, Expenses, and Changes in Net Assets

The following table presents a summary of the Hospital's revenues and expenses for each of the fiscal years ended June 30, 2004 and 2003:

TABLE 2
Condensed Statements of Revenue, Expenses, and Changes in Net Assets

	Year ended June 30		Dollar	Percent
	2004	**2003**	**Change**	**Change**
Revenue:				
Net patient service revenue	**$ 147,044,877**	$ 135,174,144	$ 11,870,733	9%
Other	**2,474,235**	2,433,455	40,780	2%
Total operating revenue	**149,519,112**	137,607,599	11,911,513	9%
Expenses:				
Salaries and employee benefits	**90,729,290**	83,355,005	7,374,285	9%
Supplies, contract services, equipment, and fees	**31,708,469**	30,197,246	1,511,223	5%
Other operating expenses	**8,712,347**	7,308,230	1,404,117	19%
Depreciation	**9,147,406**	9,240,647	(93,241)	(1)%
Interest	**4,579,343**	3,575,952	1,003,391	28%
Total operating expenses	**144,876,855**	133,677,080	11,199,775	8%
Operating income	**4,642,257**	3,930,519	711,738	18%
Investment income	**1,121,544**	1,806,577	(685,033)	(38)%
Excess of revenue and investment income over expenses	**5,763,801**	5,737,096	26,705	–%
Increase (decrease) in restricted net assets	**(277)**	369	(646)	(175)%
Net assets – beginning of year	**106,840,249**	101,102,784	5,737,465	6%
Net assets – end of year	**$ 112,603,773**	$ 106,840,249	$ 5,763,524	5%

Sources of Revenue

Operating Revenue

During fiscal years 2004 and 2003, the Hospital derived the majority, approximately 98% and 98%, respectively, of its total revenue from patient service revenue. Patient service revenue includes revenue from the Medicare and Medicaid programs and patients, or their third-party payors. Reimbursement for the Medicare and Medicaid programs and the third-party payors is based upon established rates and contracts. The difference between the covered charges and the established contract is recognized as a contractual allowance.

Table 3 presents the relative percentages of gross charges billed for patient services by payor for the fiscal years ended June 30, 2004 and 2003:

TABLE 3
Payor Mix by Percentage

	Year ended June 30	
	2004	**2003**
Managed care	**18%**	20%
Medicare	**49**	47
Medicare HMO	**1**	1
Medicaid	**20**	22
Commercial insurance	**7**	6
Self-pay and other	**5**	4
Total patient revenues	**100%**	100%

Other Revenue

The following table summarizes other revenue:

TABLE 4
Other Revenue

	Year ended June 30 2004	2003
Cafeteria	**$ 1,010,057**	$ 917,522
Day care	**520,496**	505,591
Gift shop	**274,382**	334,003
Rental income	**378,119**	459,425
X-ray school income	**136,832**	135,025
Miscellaneous	**154,349**	81,889
Total other revenue	**$ 2,474,235**	$ 2,433,455

Investment Income

The Hospital holds designated and restricted funds that are invested primarily in money market funds and securities issued by the U.S. Treasury and other federal agencies. These investments had a total return of $1,121,544 and $1,806,577 during fiscal years 2004 and 2003, respectively.

Operating and Financial Performance

The following summarizes the Hospital's statements of revenue, expenses, and changes in net assets between 2004 and 2003:

Overall activity at the Hospital, as measured by patient discharges, improved 6.11% to 14,786 discharges in 2004 from 13,935 discharges in 2003. Patient days increased 10% over the prior year from 74,926 in 2003 to 82,200 in 2004. The average length of stay for all patients (excluding newborns) increased to 5.56 days in 2004 from 5.38 days in 2003.

TABLE 5
Patient and Hospital Statistical Data

	Year ended June 30	
	2004	**2003**
Admissions:		
Adult and pediatric	**12,419**	11,420
Newborn and NICU	**1,441**	1,367
Extended care unit	**–**	325
Psychiatric care	**403**	286
CMR services	**622**	587
Patient days:		
Adult and pediatric	**63,313**	54,942
Medicare (included in adult and pediatric)	**36,740**	30,171
Medicaid (included in adult and pediatric)	**12,725**	11,611
Newborn and NICU	**6,468**	5,871
Extended care unit	**–**	4,269
Psychiatric care	**5,583**	4,032
CMR services	**6,836**	5,812
Operating room patients	**9,151**	8,487
Outpatient registrations	**71,386**	68,320
Emergency room visits	**69,422**	70,170
Average daily census:		
Adult and pediatric	**173**	151
Extended care unit	**–**	12
Psychiatric care	**15**	11
CMR services	**19**	16
Average length of stay (excluding newborn):		
All patients	**5.56**	5.38
Medicare patients	**6.6**	6.2
Medicaid patients	**4.0**	3.8
Extended care unit	**–**	12.7
Psychiatric care	**13.9**	14.1
CMR services	**10.7**	10.0
Percentage of total patient days:		
Medicare	**58.0%**	59.0%
Medicaid	**20.1%**	20.0%
Home health visits	**8,613**	9,909
Family medicine clinic	**25,466**	18,952
Full-time equivalents (FTEs)	**1,743**	1,689

Increases in net patient service revenue primarily were due to volume increases as depicted on the proceeding page, Table 5, Patient and Hospital Statistical Data. While gross patient revenue increased $66,901,500, or 20%, from prior year due to increased volume and rate increases, net patient service revenue only increased $11,870,700 due to increases in contractual allowances.

Allowances increased over prior year as described in the table below:

TABLE 6
Allowance Summary

	Year ended June 30	
	2004	**2003**
Allowances:		
Provision for bad debts	**$ 15,216,336**	$ 13,283,408
Charity care	**6,292,764**	4,106,852
Other adjustments	**1,661,223**	1,168,873
Blue Cross, Louisiana State Employees Group benefits, and other contractual allowances	**36,335,296**	31,450,475
Medicaid contractual allowances	**61,389,482**	47,802,590
Medicare contractual allowances	**134,735,524**	102,787,697
	$255,630,625	$200,599,895

As a result of increase in revenues, net days in accounts receivable increased from 63.6 days to 67.1 days. Excluded from net patient service revenue are charges forgone for patient services falling under the Hospital's charity care policy. Based on established rates, gross charges of $6,292,800 were forgone during 2004, compared to $4,106,900 in 2003, or a 53% increase from the prior fiscal year.

Salaries expense increased $5,042,600, or 7%, to $75,419,200 in 2004 from $70,376,500 in 2003. As a percentage of net patient service revenue, salary expense was approximately 51% and 52% for the fiscal years ended June 30, 2004 and 2003, respectively. This increase was primarily due to an increase in volume.

Employee benefit expense increased $2,331,600, or 18%, from prior year. Employee benefit expense represented 20% and 18% of salaries expense in the current and prior fiscal years, respectively. This increase was primarily due to an increase in employee medical insurance costs.

Supplies expense increased $2,519,800, or 12%, from prior year. As a percentage of net patient service revenue, supplies expense remained consistent at 16% each year. The increase in supplies expense was primarily due to volume increases and cost increases of medical supplies.

Contract services, equipment, and fees decreased $1,008,600, or 11%, from prior year. This decrease was primarily a result of the costs associated with the termination of the Hospital's management contract.

Other operating expenses increased approximately $1,404,100 from prior year, which represents 6% of operating revenue, consistent with the prior-year percentage.

Depreciation expense remained relatively flat compared to the prior year.

Interest expense increased $1,003,400, or 28%, from prior year. This increase is primarily due to additional interest on the 2003 bonds issued during the current fiscal year.

Total operating expenses increased by $11,200,000 for the year ended June 30, 2004, for the reasons discussed above.

Investment income consists of interest earnings on funds designated by the board of commissioners and funds held by trustee under bond resolution. Additionally, the realized and net unrealized gain or loss on the fair market value adjustments are also included in this amount. Total investment income decreased from the prior year due primarily to changes in interest rates earned on investments.

Capital Assets

During fiscal year 2004, the Hospital invested $14,678,000 in a broad range of property, plant, and equipment included in Table 7 below.

TABLE 7
Property, Plant, and Equipment

	June 30 2004	June 30 2003	Dollar Change	Percent Change
Land	**$ 4,119,404**	$ 4,119,404	$ –	–%
Building and equipment	**168,050,183**	161,930,060	6,120,123	4%
Subtotal	**172,169,587**	166,049,464	6,120,123	4%
Less accumulated depreciation	**95,597,010**	86,749,918	8,847,092	10%
Construction in progress	**10,498,445**	2,402,241	8,096,204	337%
Net property, plant, and equipment	**$ 87,071,022**	$ 81,701,787	$ 5,369,235	7%

Net property, plant, 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.

In Table 8, the Hospital's fiscal year 2005 capital budget projects spending up to $14,228,300 for capital projects. These projects will be financed from operations and bond receipts. More information about the Hospital's capital assets is presented in the notes to the basic financial statements.

TABLE 8
Fiscal Year 2005 Capital Budget

Equipment purchases	$ 5,098,261
Hospital renovations/others	830,000
NOMC Expansion	2,000,000
NORH Renovations	3,000,000
Heart Health Center Equipment/Renovations	3,000,000
Walker Clinic Building	300,000
Total	$ 14,228,261

Long-Term Debt (Excluding Capital Leases)

In July 2003, $70,000,000 of Hospital Revenue bonds were sold, and in August 2003, an additional $20,000,000 of bonds were sold. The net proceeds of these sales will be used to fund additions, renovations, and improvements to the Hospital's facilities. Additionally, approximately $47,500,000 of the Series 1994 bonds were repaid by the 2003 issues. Further, in June 2004, $5,000,000 of Hospital Refunding Bonds were sold. The net proceeds of these sales were used to repay additional amounts of Series 1994 Bonds.

At year end, the Hospital had $96,238,000 in short-term and long-term debt. Total debt has increased by $41,966,000 in fiscal year 2004, which was due to the bond issuances. More detailed information about the Hospital's long-term liabilities is presented in the notes to basic financial statements. Total debt outstanding represents approximately 48% of the Hospital's total assets at June 30, 2004, as compared to 30% at June 30, 2003.

Contacting the Hospital's Financial Manager

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, contact Hospital administration.

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Report of Independent Auditors

The Board of Commissioners
Hospital Service District No. 1 of the
Parish of Tangipahoa, State of Louisiana
(d/b/a North Oaks Health System)

We have audited the accompanying balance sheets of Hospital Service District No. 1 of the Parish of Tangipahoa, State of Louisiana (d/b/a North Oaks Health System) (the "Hospital"), as of June 30, 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 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 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 June 30, 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.

In accordance with *Government Auditing Standards*, we have also issued our report as of and for the year ended June 30, 2004, on our consideration of the 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.

Management's discussion and analysis on pages i through xi 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

October 1, 2004

Hospital Service District No. 1 of the Parish of Tangipahoa,
State of Louisiana (d/b/a North Oaks Health System)

Balance Sheets

	June 30	
	2004	**2003**
Assets		
Current assets:		
Cash and cash equivalents	**$ 2,801,206**	$ 3,792,319
Short-term investments	–	700,000
Patient accounts receivable, net of estimated uncollectibles of $9,633,000 in 2004 and $8,091,000 in 2003	**33,502,857**	28,657,844
Estimated third-party payor settlements – Medicare and Medicaid	**1,801,330**	–
Current portion of assets whose use is limited	**2,255,380**	1,978,441
Inventories	**2,506,928**	2,185,332
Prepaid expenses and other current assets	**2,657,979**	1,734,631
Total current assets	**45,525,680**	39,048,567
Assets whose use is limited:		
Under bond indenture agreement held by trustee	**33,449,912**	6,722,885
By board for plant and equipment additions and replacements	**55,804,482**	50,237,631
By board for self-insurance claims	**1,568,022**	1,492,076
	90,822,416	58,452,592
Less current portion of assets whose use is limited	**2,255,380**	1,978,441
Noncurrent assets whose use is limited	**88,567,036**	56,474,151
Property, plant, and equipment:		
Land	**4,119,404**	4,119,404
Buildings and equipment	**168,050,183**	161,930,060
Construction in progress	**10,498,445**	2,402,241
	182,668,032	168,451,705
Less accumulated depreciation	**95,597,010**	86,749,918
Property, plant, and equipment, net	**87,071,022**	81,701,787
Unamortized financing costs, net	**5,194,895**	1,405,048
Note receivable	**424,134**	446,489
Deferred compensation plan investments	**2,976,842**	2,748,840
Total assets	**$229,759,609**	$181,824,882

	June 30	
	2004	**2003**
Liabilities and net assets		
Current liabilities:		
Accounts payable	**$ 8,722,834**	$ 5,893,783
Accrued salaries and payroll-related costs	**3,717,707**	5,755,111
Accrued interest payable	**1,505,429**	1,401,826
Accrued self-insurance claims	**3,876,834**	3,168,464
Estimated third-party payor settlements – Medicare and Medicaid	**–**	1,544,733
Current portion of capital lease obligations	**116,345**	100,815
Current portion of long-term debt	**1,639,835**	1,375,000
Total current liabilities	**19,578,984**	19,239,732
Capital lease obligations, excluding current portion	**1,354**	99,033
Long-term debt, net of unamortized bond premium of $202,000 in 2004 and discount of $590,000 in 2003, excluding current portion	**94,598,656**	52,897,028
Deferred compensation plan obligations	**2,976,842**	2,748,840
Total liabilities	**117,155,836**	74,984,633
Net assets:		
Invested in capital assets, net of related debt	**16,047,760**	27,229,911
Restricted net assets	**8,134,464**	6,741,359
Unrestricted net assets	**88,421,549**	72,868,979
Total net assets	**112,603,773**	106,840,249
Total liabilities and net assets	**$229,759,609**	$181,824,882

See accompanying notes.

Hospital Service District No. 1 of the Parish of Tangipahoa,
State of Louisiana (d/b/a North Oaks Health System)

Statements of Revenue, Expenses, and Changes in Net Assets

	Year ended June 30	
	2004	**2003**
Revenue:		
Net patient service revenue	**$ 147,044,877**	$ 135,174,144
Other	**2,474,235**	2,433,455
Total operating revenue	**149,519,112**	137,607,599
Expenses:		
Salaries	**75,419,181**	70,376,537
Employee benefits	**15,310,109**	12,978,468
Supplies	**23,418,307**	20,898,514
Contract services, equipment, and fees	**8,290,162**	9,298,732
Other operating expenses	**8,712,347**	7,308,230
Depreciation	**9,147,406**	9,240,647
Interest	**4,579,343**	3,575,952
Total operating expenses	**144,876,855**	133,677,080
Operating revenue in excess of operating expenses	**4,642,257**	3,930,519
Investment income (loss):		
Investment income	**1,572,364**	1,735,332
Unrealized (loss) gain on investments	**(511,024)**	71,245
Realized gain on investments	**60,204**	–
Total investment income	**1,121,544**	1,806,577
Excess of revenue and investment income over expenses	**5,763,801**	5,737,096
(Decrease) increase in restricted net assets	**(277)**	369
Net assets – beginning of year	**106,840,249**	101,102,784
Net assets – end of year	**$ 112,603,773**	$ 106,840,249

See accompanying notes.

Hospital Service District No. 1 of the Parish of Tangipahoa,
State of Louisiana (d/b/a North Oaks Health System)

Statements of Cash Flows

	Year ended June 30 2004	2003
Operating activities		
Revenue collected	**$ 141,838,997**	$ 129,851,712
Cash payments to employees and for employee-related costs	**(92,355,324)**	(83,355,005)
Cash payments for supplies, services, and other operating expenses	**(38,517,354)**	(41,390,790)
Net cash provided by operating activities	**10,966,319**	5,105,917
Capital and related financing activities		
Purchases of property, plant, and equipment	**(14,678,060)**	(11,027,328)
Proceeds from disposals of assets	**101,278**	124,752
Principal payments on long-term debt incurred for capital purposes	**(53,952,562)**	(1,310,000)
Principal payments on capital lease obligations	**(82,149)**	(86,225)
Interest payments on long-term debt and capital lease obligations	**(4,092,520)**	(3,450,903)
Debt financing costs	**(3,382,844)**	–
Proceeds from issuance of long-term debt	**95,128,802**	–
(Increase) decrease in restricted net assets for guild fund	**(277)**	369
Net cash provided by (used in) capital and related financing activities	**19,041,668**	(15,749,335)
Investing activities		
Investment income	**1,121,544**	1,877,813
Change in short-term investments	**700,000**	3,100,000
(Increase) decrease in assets whose use is limited:		
Purchases of assets whose use is limited	**(106,830,745)**	(60,609,817)
Proceeds from sales and maturities of assets whose use is limited	**74,010,101**	64,532,252
Net cash (used in) provided by investing activities	**(30,999,100)**	8,900,248
Net change in cash	**(991,113)**	(1,743,170)
Cash and cash equivalents at beginning of year	**3,792,319**	5,535,489
Cash and cash equivalents at end of year	**$ 2,801,206**	$ 3,792,319

Hospital Service District No. 1 of the Parish of Tangipahoa,
State of Louisiana (d/b/a North Oaks Health System)

Statements of Cash Flows (continued)

	Year ended June 30 2004	2003
Reconciliation of income from operations to net cash provided by operating activities		
Operating revenue in excess of operating expenses	**$ 4,642,257**	$ 3,930,519
Adjustments to reconcile operating revenue in excess of operating expenses to net cash provided by operating activities:		
Depreciation	**9,147,406**	9,240,647
Unrealized loss (gain) on investments	**511,024**	(71,245)
Realized gain on sale of investments	**(60,204)**	–
Bad debt expense	**15,216,335**	13,283,410
Net loss (gain) on disposals of assets	**60,141**	(32,242)
Amortization of financing costs	**395,284**	67,710
Amortization of (premium) discount on long term debt	**(12,064)**	46,440
Interest expense on long-term debt and capital lease obligations	**4,196,123**	3,461,802
Changes in operating assets and liabilities:		
Patient accounts receivable	**(20,061,348)**	(15,479,245)
Inventories, prepaid expenses, and other assets	**(1,222,589)**	(646,354)
Estimated third-party payor settlements	**(3,346,063)**	(5,488,807)
Accounts payable, accrued salaries, and payroll-related costs and other accrued expenses	**1,500,017**	(3,206,718)
Net cash provided by operating activities	**$ 10,966,319**	$ 5,105,917

See accompanying notes.

1. Organization and Significant Accounting Policies

Organization

Hospital Service District No. 1 of the Parish of Tangipahoa, State of Louisiana (the "Hospital" or the "District"), is a nonprofit public corporation organized under powers granted to parish police juries or councils by Chapter 10, Title 46 of the Louisiana Revised Statutes of 1950, as amended. The District is a political subdivision of the State of Louisiana. All corporate powers are vested in the board of commissioners appointed by the Tangipahoa Parish Council. The District owns and operates North Oaks Medical Center, a 269-bed acute-care hospital, and North Oaks Rehabilitation Hospital, a 27-bed hospital that provides rehabilitation services. The hospitals are located on two campuses in the city of Hammond, Louisiana. As a political subdivision of the State of Louisiana, the Hospital is exempt from federal income taxes under Section 115 of the Internal Revenue Code and from state income taxes.

Basis of Accounting

The Hospital reports in accordance with accounting principles generally accepted in the United States as specified by the American Institute of Certified Public Accountants' *Audits of Providers of Health Care Services* and, as a governmental entity, also reports in accordance with accounting principles promulgated by the Governmental Accounting Standards Board ("GASB").

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

Cash and Cash Equivalents

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

1. Organization and Significant Accounting Policies (continued)

Investments

All investments are stated at fair market value based on quoted market prices. Changes in the difference between the cost and the fair market value of the investments are included in investment income.

Inventories

Inventories are valued at the latest invoice price, which approximates market.

Property, Plant, and Equipment

The Hospital records all property, plant, and equipment acquisitions at cost except for assets donated to the Hospital. Donated assets are recorded at appraised value at the date of donation. The Hospital provides for depreciation of its plant and equipment using the straight-line method based on the estimated useful lives of the assets as suggested by the American Hospital Association. Equipment recorded under capital lease obligations is included in buildings and equipment, and the associated amortization of these assets is included in depreciation expense.

The cost of leased assets included in capital assets totaled $480,500, and related accumulated amortization was $323,100. The related equipment collateralizes the capital lease obligations. Total capital lease obligations were $117,700 at June 30, 2004, compared to $199,800 at June 30, 2003.

Unamortized Financing Costs

The Hospital defers costs incurred in connection with the issuance of the bonds and amortizes such costs using the effective interest method over the life of the bond issue. The amortization is included in interest expense. Additionally, the difference between the reacquisition price of the Series 1994 Bonds and the net carrying amount were deferred. Approximately $4,500,000 has been included in the unamortized financing costs and is being amortized as a component of interest expense over the original life of the Series 1994 Bonds.

1. Organization and Significant Accounting Policies (continued)

Self-Insurance Claims

Accrued self-insurance claims represent the Hospital's best estimate of incurred but unpaid expenses for professional liability, workers' compensation, and employee health claims.

Net Assets

The Hospital's net assets are classified into three components: invested in capital assets, net of related debt; restricted; and unrestricted. These components are defined as follows:

- Invested in capital assets, net of related debt — This component reports 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. If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds should not be included in this component of net assets. Rather, that portion of debt should be included in the same net asset component as the unspent proceeds. At June 30, 2004, approximately $25,333,000 of unspent bond proceeds were included in unrestricted net assets.

- Restricted — This component reports those net assets with externally imposed constraints 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, "restricted" or "invested in capital assets, net of related debt."

Statements of Revenue, 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 operating revenue or expenses. All peripheral transactions are reported as a component of nonoperating income.

1. Organization and Significant Accounting Policies (continued)

Net Patient Service Revenue and Related Receivables

The Hospital has entered into agreements with third-party payors, including government programs, health insurance companies, and managed care health plans, under which the Hospital is paid based upon established charges, the cost of providing services, predetermined rates per diagnosis, fixed per diem rates, or discounts from established charges.

Net patient service revenue is reported at the estimated amounts realizable from patients, third-party payors, and others for services rendered. Settlements under reimbursement agreements with third-party payors are estimated and recorded in the period the related services are rendered and are adjusted in future periods as final settlements are determined. These adjustments resulted in a decrease to net patient service revenue of $405,000 in 2004 and an increase of $2,659,000 in 2003. The Hospital provides care to patients even though they are covered by contractual payment arrangements that do not pay full charges or might lack adequate insurance. As a result, the Hospital is exposed to certain credit risks. The Hospital manages such risks by regularly reviewing its accounts and contracts and by providing appropriate allowances.

Medicare and Medicaid Reimbursement

The Hospital is reimbursed under the Medicare Prospective Payment System ("PPS"), which reimburses the Hospital a predetermined amount for Medicare inpatient acute services rendered based, for the most part, on the Diagnosis Related Group ("DRG") assigned to the patient. Medicaid inpatient services are paid on a prospective per diem basis.

Medicare bad debts and Medicaid outpatient services were reimbursed on a tentative basis during the year, which is subject to a retroactive payment adjustment determined in accordance with appropriate Medicare or Medicaid program regulations. Retroactive cost settlements are accrued on an estimated basis in the period the related services are rendered and adjusted as necessary in future periods as final settlements are determined. Medicare and Medicaid settlements have been determined following the principles of reimbursement applicable to each program and have been recorded in the accounts of the Hospital. Estimated settlements for the years through June 30, 1999, for Medicare and

1. Organization and Significant Accounting Policies (continued)

June 30, 1997, for Medicaid have been audited or reviewed by program representatives. No significant differences are anticipated between the estimated settlements recorded and the final settlements expected to be determined by program representatives.

The Hospital is reimbursed for Medicare outpatient services under the Ambulatory Payment Classification ("APC") based on fixed rates per outpatient procedure and is reimbursed for home health services under the Prospective Payment System ("PPS") based on episodes of care adjusted by a case mix adjuster and the applicable geographic wage index.

During the years ended June 30, 2004 and 2003, approximately 70% and 70%, respectively, of the Hospital's gross patient revenue was derived from Medicare and Medicaid program beneficiaries.

Use of Estimates

The preparation of financial statements 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 and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Reclassifications

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

2. Cash, Investments and Assets Whose Use is Limited

The Hospital's cash, investments and assets whose use is limited are categorized below to give an indication of the level of risk assumed at June 30, 2004 and 2003. Category (1) includes investments that are insured or registered and for which the securities are held by the Hospital or its agent in the Hospital's name. Category (2) includes uninsured or unregistered investments for which the securities are held by the counterparty's trust department or agent in the Hospital's name. Category (3) includes uninsured or unregistered investments for which the securities are held by the counterparty or by its

2. Cash, Investments and Assets Whose Use is Limited (continued)

trust department or agent, but not in the Hospital's name. Category (2) investments are invested primarily in money market funds that invest in U.S. government securities. Balances at June 30 were as follows:

	Credit Risk Category			Carrying
	(1)	(2)	(3)	Amount
2004				
Securities type:				
Mutual funds and U.S. backed government obligations	$ –	$ 3,486,374	$ –	$ 3,486,374
Cash and cash equivalents, certificates of deposit, and accrued interest receivable	90,137,248	–	–	90,137,248
	$90,137,248	$ 3,486,374	$ –	$93,623,622
2003				
Securities type:				
Mutual funds and U.S. backed government obligations	$ –	$ 9,128,299	$ –	$ 9,128,299
Cash and cash equivalents, certificates of deposit, and accrued interest receivable	53,816,612	–	–	53,816,612
	$53,816,612	$ 9,128,299	$ –	$62,944,911

Louisiana statutes authorize the Hospital to invest in obligations of the U.S. Treasury and other federal agencies, time deposits with state banks and national banks having their principal offices in the State of Louisiana, guaranteed investment contracts issued by highly rated financial institutions, and certain investments with qualifying mutual or trust fund institutions. During the years ended June 30, 2004 and 2003, the Hospital invested primarily in money market funds and securities issued by the U.S. Treasury and other federal agencies. The Hospital's investments in U.S. government obligations are investments held by the Hospital or by its agent in the Hospital's name.

2. Cash, Investments and Assets Whose Use is Limited (continued)

Trustee-held investments consist primarily of funds invested through a trustee in qualifying investments as specified in the applicable revenue bond resolution. The 1994, 2003A and B, and 2004 Bond Agreements require the Hospital to maintain a Debt Service Reserve Fund at specified levels, which is to be used by the trustee to fund payments of principal and interest to the bondholders (see Note 4).

3. Concentration of Credit Risk

The Hospital grants credit without collateral to its patients, most of whom are local residents and who are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2004 and 2003, was as follows:

	2004	2003
Medicare 65	**1%**	1%
Medicare	**26**	22
Medicaid	**9**	9
Managed care payors	**16**	16
Other third-party payors	**14**	14
Patients	**34**	38
	100%	100%

4. Assets Whose Use Is Limited

The terms of the Hospital's Revenue Bonds (see Note 9) require funds to be maintained on deposit in certain accounts with the trustee. The funds on deposit in the accounts are required to be invested by the trustee in accordance with the terms of the related bond resolutions. As of June 30, 2004 and 2003, the funds were deposited as follows:

	2004	2003
Bond principal account	**$ 639,756**	$ 572,917
Bond interest account	**1,615,540**	1,402,773
Bond construction account	**25,333,012**	–
Reserve accounts and other	**5,861,604**	4,747,195
	$ 33,449,912	$ 6,722,885

4. Assets Whose Use Is Limited (continued)

The Hospital's board of commissioners has designated Hospital funds to be used for future plant and equipment additions, separate and apart from the expansion program (see Note 13), and to fund self-insurance claims. These funds, included in assets whose use is limited, were invested in certificates of deposit, U.S. Government obligations, and money market funds at June 30, 2004 and 2003.

5. Note Receivable

The Hospital entered into an agreement with the Cancer, Radiation, and Research Foundation (the "Foundation") for the purpose of constructing a facility that provides radiation oncology treatments on an outpatient basis. Under the terms of the agreement, the Hospital loaned funds to the Foundation to construct the facility on the Hospital campus. The note receivable is payable over 30 years and bears an annual interest rate of 5.5%. The Hospital holds a mortgage on the facility (excluding equipment, furniture, and fixtures) to collateralize the note receivable. In addition, the Hospital agreed to lease the land upon which the facility is located to the Foundation for a nominal annual rental fee. The initial lease term is for 30 years with three successive ten-year renewal options.

6. Property, Plant, and Equipment

The Hospital's investment in property, plant, and equipment consisted of the following as of June 30, 2004:

	Beginning Balance	Additions	Retirements	Transfers	Ending Balance
			(In Thousands)		
Land and land improvements	$ 4,119	$ –	$ –	$ –	$ 4,119
Buildings and fixed equipment	105,010	458	–	573	106,041
Equipment	56,920	5,551	462	–	62,009
Construction in progress	2,403	8,669	–	(573)	10,499
	168,452	14,678	462	–	182,668
Less accumulated depreciation	86,750	9,147	300	–	95,597
Property, plant, and equipment, net	$ 81,702	$ 5,531	$ 162	$ –	$ 87,071

7. Employee Retirement Plan

The Hospital has a defined contribution plan that covers all full-time employees who elect to participate after they have met certain eligibility requirements. Under the plan, the Hospital is required to contribute a specified percentage of eligible employees' salaries based on years of service. Participants may contribute up to the maximum level allowed by the Internal Revenue Code or 25% of gross salary, whichever is less. The participants vest immediately in all participant contributions and vest 100% over a five-year cliff vesting schedule in all Hospital contributions. The retirement benefits received by the participants will depend upon the accumulated value of their accounts at distribution upon termination, attaining age 59½, severe financial hardship, or death.

Retirement expense, included in employee benefit expense, was approximately $1,311,000 in 2004 and $1,161,400 in 2003, representing the required contributions in both years.

The Hospital also sponsors two deferred compensation plans covering substantially all employees. These plans were established under Section 457 of the Internal Revenue Code. The Hospital reports the plan assets and a corresponding liability in the accompanying financial statements. Accordingly, the Hospital has recorded an asset and a corresponding liability of $2,976,842 and $2,748,840 for the fair market value of the plans' combined assets as of June 30, 2004 and 2003, respectively.

8. Risk Management

The Hospital participates in the State of Louisiana Patient Compensation Fund (the "Fund"). The Fund provides malpractice coverage to the Hospital for claims in excess of $100,000, up to $500,000. According to current state law, medical malpractice liability (exclusive of future medical care awards) is limited to $500,000 per occurrence. Hospital management has no reason to believe that the Hospital will be prevented from continuing its participation in the Fund.

The Hospital is involved in litigation arising in the ordinary course of business. Claims alleging general and malpractice liability have been asserted against the Hospital and are currently in various states of litigation. The Hospital has accrued $1,757,000 and $1,149,000 as of June 30, 2004 and 2003, respectively, for the estimated losses and

8. Risk Management (continued)

expenses related to general and professional liability claims for which the Hospital is self-insured. Claims have been filed alleging damages in excess of the amount accrued for estimated malpractice costs. It is the opinion of management that estimated malpractice costs accrued are adequate to provide for probable losses resulting from pending or threatened litigation. Additional claims may be asserted against the Hospital arising from services provided to patients. The Hospital is unable to determine the ultimate cost of the resolution of such potential claims; however, an accrual has been made based on estimates for these claims.

The Hospital has commercial insurance that provides coverage for workers' compensation and employee health claims in excess of certain self-insured limits. The Hospital had accrued $2,120,000 and $2,019,000 at June 30, 2004 and 2003, respectively, for such claims.

The following table summarizes the changes in the self-insurance liability:

Year Ended June 30	Beginning of Fiscal Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year End
2004	**$3,168,000**	**$9,012,000**	**$8,303,000**	**$3,877,000**
2003	$4,137,000	$5,658,000	$6,627,000	$3,168,000

9. Long-Term Debt

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

	June 30	
	2004	**2003**
Hospital Revenue Bonds, Series 1994	**$ 1,215,000**	*$54,860,000*
Hospital Revenue Bonds, Series 2003A	**69,700,000**	–
Hospital Revenue Bonds, Series 2003B	**20,000,000**	–
Hospital Revenue Bonds, Series 2004	**5,000,000**	–
Premier Investment Debt	**121,240**	–
Total	**96,036,240**	54,860,000
Plus: unamortized bond premium on 2003 and 2004 bonds	**202,251**	–
Less: unamortized bond discount on 1994 bonds	–	587,972
	96,238,491	54,272,028
Less current portion	**1,639,835**	1,375,000
Long-term debt, less current maturities	**$94,598,656**	$52,897,028

On July 5, 1994, the District issued $61,535,000 of Hospital Revenue Bonds, Series 1994 (the "Series 1994 Bonds"). The Series 1994 Bonds originally consisted of $16,190,000 of serial bonds and $45,345,000 of term bonds. Portions of the 1994 bonds were repaid in 2004. Payments of the scheduled principal and interest on the 1994 Revenue Bonds are insured by AMBAC Indemnity Corporation.

On July 2, 2003, the District issued $70,000,000 of Hospital Revenue and Refunding Bonds, Series 2003A. Approximately $50,000,000 of the Series 2003A Bond proceeds were used to repay a portion of the Series 1994 Bonds. The Series 2003A Bonds originally consisted of $24,080,000 of serial bonds and $45,920,000 of term bonds. The serial bonds mature annually in amounts ranging from $670,000 in 2005 to $770,000 in 2010 and bear interest at rates ranging from 2.0% to 5.375%. The term bonds consist of $24,095,000 due February 1, 2025, bearing interest at 5.160% and $21,825,000 due February 1, 2030, bearing interest at 5.20%. Under the terms of the bond indenture, the Hospital is required to maintain, among other provisions, a certain debt service coverage ratio and minimum level of days cash on hand. The Hospital was in compliance with these provisions of the bond indenture at June 30, 2004.

9. Long-Term Debt (continued)

On August 28, 2003, the District issued $20,000,000 of Hospital Revenue Bonds, Series 2003B. These serial bonds mature annually in amounts ranging from $2,625,000 in 2030 to $5,920,000 in 2033 at variable interest rates not to exceed 12%. Under the terms of the bond indenture, the Hospital is required to maintain, among other provisions, a certain debt service coverage ratio and minimum level of days cash on hand. The Hospital was in compliance with these provisions of the bond indenture at June 30, 2004.

On June 30, 2004, the District issued $5,000,000 of Hospital Revenue Refunding Bonds, Series 2004. The net proceeds of these bonds were used to repay additional amounts of the Series 1994 Bonds. These serial bonds mature annually in amounts ranging from $80,000 in 2005 to $115,000 in 2010, bearing interest at 3.34%.

The estimated debt service requirements at June 30, 2004, were as follows:

	Principal	Interest
2005	$ 1,639,835	$ 4,671,514
2006	1,665,392	4,671,719
2007	1,740,962	4,613,999
2008	1,796,530	4,560,280
2009	1,858,521	4,489,104
2010 – 2014	10,685,000	21,181,350
2015 – 2019	13,765,000	18,146,644
2020 – 2024	17,630,000	14,294,250
2025 – 2029	24,995,000	9,422,750
2030 – 2033	20,260,000	2,795,051
	$ 96,036,240	$ 88,846,661

10. Operating Lease Obligations

The Hospital has entered into various cancelable operating leases for equipment. Operating lease expense was approximately $605,083 and $527,100 for the years ended June 30, 2004 and 2003, respectively.

11. 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, such amounts are not recorded 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, $6,292,800 in 2004 and $4,106,900 in 2003, for services and supplies furnished under its charity care policy.

12. 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. 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.

13. Commitments

The Hospital has various commitments totaling approximately $9,334,000 at June 30, 2004, and $3,799,000 at June 30, 2003. These commitments include renovation of the main building's fourth floor, various computer system upgrades, and various capital equipment purchases.

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Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of the Financial Statements in Accordance with *Government Auditing Standards*

The Board of Commissioners
Hospital Service District No. 1 of the Parish of
Tangipahoa, State of Louisiana

We have audited the financial statements of Hospital Service District No. 1 of the Parish of Tangipahoa, State of Louisiana (d/b/a North Oaks Medical Center) (the "Hospital"), as of and for the year ended June 30, 2004, and have issued our report thereon dated October 1, 2004. 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.

Compliance

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, and contracts, 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.*

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 assurance on the internal control over financial reporting. Our consideration of internal control over financial reporting would not necessarily disclose all matters of the internal control over financial reporting that might be material weaknesses. 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 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended 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

October 1, 2004