
SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2009

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

Release Date 5/5/10



SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2009

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INDEPENDENT AUDITORS' REPORT

The Board of Trustees
Southwest Louisiana Health Care System, Inc.

We have audited the accompanying consolidated balance sheets of Southwest Louisiana Health Care System, Inc. and its affiliates (the System) as of December 31, 2009 and 2008, and the related consolidated statements of changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the System'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 of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 consolidated financial position of Southwest Louisiana Health Care System, Inc. and its affiliates as of December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 12, 2010, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. 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 audits.

Postlethwaite & Netterville

Baton Rouge, Louisiana
April 12, 2010

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2009 AND 2008

ASSETS

<i>(in thousands)</i>	<u>2009</u>	<u>2008</u>
<u>CURRENT ASSETS</u>		
Cash and cash equivalents	\$ 16,843	\$ 10,781
Investment in Louisiana Hospital Investment Pool	7,102	10,869
Patient accounts receivable, net of allowances for contractual adjustments and doubtful accounts of approximately \$56,534 and \$57,642 at December 31, 2009 and 2008, respectively	27,491	24,575
Assets limited as to use - current portion	899	1,215
Inventory	3,227	2,229
Other current assets	2,832	2,929
Total current assets	<u>58,394</u>	<u>52,598</u>
<u>ASSETS LIMITED AS TO USE</u>		
Held by trustee in accordance with bond indentures	9,884	11,115
Internally designated for malpractice claims	1,411	1,350
Internally designated for the Foundation	500	-
Total assets whose use is limited	11,795	12,465
Less: amounts required to meet current liabilities	(899)	(1,215)
Noncurrent assets limited as to use	<u>10,896</u>	<u>11,250</u>
<u>PROPERTY AND EQUIPMENT, net</u>		
Total property and equipment, net	<u>76,883</u>	<u>79,959</u>
<u>OTHER ASSETS</u>		
Deferred financing costs	2,438	2,599
Other	319	566
Total other assets	<u>2,757</u>	<u>3,165</u>
TOTAL ASSETS	<u>\$ 148,930</u>	<u>\$ 146,972</u>

The accompanying notes are an integral part of these statements.

LIABILITIES AND NET ASSETS

<i>(in thousands)</i>	<u>2009</u>	<u>2008</u>
<u>CURRENT LIABILITIES</u>		
Current portion of long-term debt	\$ 4,396	\$ 3,357
Accrued interest payable	486	497
Accounts payable	5,170	5,588
Accrued compensation and benefits	6,755	5,748
Estimated third-party payor settlements	2,858	1,230
Other accrued expenses	4,918	5,542
Credit balances in patient accounts receivable	393	412
Total current liabilities	<u>24,976</u>	<u>22,374</u>
<u>LONG-TERM DEBT, net of current portion</u>	<u>96,733</u>	<u>100,714</u>
Total long-term debt, net of current portion	<u>96,733</u>	<u>100,714</u>
Total liabilities	<u>121,709</u>	<u>123,088</u>
<u>MINORITY INTEREST</u>	<u>184</u>	<u>(76)</u>
<u>UNRESTRICTED NET ASSETS</u>	<u>27,037</u>	<u>23,960</u>
Total net assets	<u>27,037</u>	<u>23,960</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 148,930</u>	<u>\$ 146,972</u>

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS
YEARS ENDED DECEMBER 31, 2009 AND 2008

(in thousands)

	<u>2009</u>	<u>2008</u>
<u>OPERATING REVENUES</u>		
Net patient service revenue	\$ 211,356	\$ 185,888
Other operating revenues	6,601	7,133
Total operating revenues	<u>217,957</u>	<u>193,021</u>
<u>OPERATING EXPENSES</u>		
Salaries and wages	80,533	68,413
Employee benefits	17,580	13,162
Contract labor	5,935	6,030
Supplies	43,437	38,354
Professional fees	2,954	3,190
Service contracts	2,850	2,663
Purchased services	14,768	16,119
Management fees	1,892	3,635
Depreciation and amortization	11,162	10,785
Interest expense	6,446	6,929
Provision for doubtful accounts	15,374	14,152
Insurance	3,954	3,720
Other	10,097	10,804
Total operating expenses	<u>216,982</u>	<u>197,956</u>
INCOME (LOSS) FROM OPERATIONS	975	(4,935)
<u>NONOPERATING REVENUES (EXPENSES)</u>		
Contributions	100	77
Other revenues - net	2,577	2,847
Loss on early distinguishment of debt	-	(104)
	<u>2,677</u>	<u>2,820</u>
REVENUES OVER (UNDER) EXPENSES	3,652	(2,115)
Change in fair value of investments	104	(4)
Minority interest	<u>(679)</u>	<u>(256)</u>
CHANGE IN NET ASSETS	3,077	(2,375)
Net assets - beginning of year	<u>23,960</u>	<u>26,335</u>
NET ASSETS - END OF YEAR	<u>\$ 27,037</u>	<u>\$ 23,960</u>

The accompanying notes are an integral part of these statements.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2009 AND 2008

<i>(in thousands)</i>	<u>2009</u>	<u>2008</u>
<u>CASH FLOWS FROM OPERATING ACTIVITIES</u>		
Change in net assets	\$ 3,077	\$ (2,375)
Adjustments to reconcile the changes in net assets to net cash provided by operating activities:		
Depreciation and amortization	11,162	10,785
Net unrealized losses (gains) on investments	(104)	4
Provision for doubtful accounts	15,374	14,152
Noncash portion of minority interest	679	256
Noncash portion of loss on defeasance of debt	-	104
Changes in operating assets and liabilities:		
Patient accounts receivable	(18,290)	(12,340)
Inventories and other current assets	(901)	(305)
Other assets	241	(132)
Accounts payable and accrued expenses	(65)	500
Third party payor settlements	1,628	(705)
Net cash provided by operating activities	<u>12,801</u>	<u>9,944</u>
<u>CASH FLOWS FROM INVESTING ACTIVITIES</u>		
Acquisitions of property and equipment	(7,170)	(2,343)
Sale of investments	3,871	-
Purchase of investments	-	(5,245)
Net cash invested in assets whose use is limited	670	264
Net cash used in investing activities	<u>(2,629)</u>	<u>(7,324)</u>
<u>CASH FLOWS FROM FINANCING ACTIVITIES</u>		
Principal payments on revenue bonds and notes	(3,691)	(4,011)
Cash paid to minority shareholders	(419)	(271)
Deferred financing costs paid	-	(168)
Net cash used in financing activities	<u>(4,110)</u>	<u>(4,450)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		
	6,062	(1,830)
Cash and cash equivalents at beginning of year	<u>10,781</u>	<u>12,611</u>
Cash and cash equivalents at end of year	<u>\$ 16,843</u>	<u>\$ 10,781</u>
<u>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</u>		
Cash paid during the year for interest	<u>\$ 6,457</u>	<u>\$ 7,107</u>

During the year ended December 31, 2009 the hospital had capital leases totalling approximately \$1,015,000.

The accompanying notes are an integral part of these statements.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies

Southwest Louisiana Health Care System, Inc. (the System) is organized as a Louisiana not-for-profit corporation for the purpose of conducting charitable, scientific, and educational activities. The System is legally designated as the "sole member" of its affiliates and, through the actions of its Board of Trustees, has the power to change or elect the Board of Trustees, approve certain corporate actions, and amend the articles of incorporation of its affiliates, thereby functioning in the capacity of sole shareholder.

The accounting and reporting policies of the System conform to accounting principles generally accepted in the United States of America and the prevailing practices within the healthcare industry. The significant accounting policies used by the System in preparing and presenting its financial statements are summarized as follows:

Principles of consolidation

The consolidated financial statements include the Southwest Louisiana Hospital Association, d/b/a Lake Charles Memorial Hospital (the Hospital), the major operating unit in the System. The Hospital provides a wide range of inpatient and outpatient services through a 362-bed acute care facility, a 29 bed long term acute facility and satellite locations. Also included in the consolidated financial statements are the Lake Charles Memorial Heart and Vascular Center, a tax paying Louisiana corporation operating cardiology clinics, which was originally incorporated as a not-for-profit organization; SWLHS Oncology, Inc., a tax paying Louisiana corporation operating oncology clinics, which was originally incorporated as a not-for-profit organization; and SWLHS, Inc., a wholly-owned corporation formed for the purpose of entering into for-profit healthcare ventures. Through these entities, the System provides integrated healthcare services in southwest Louisiana and southeast Texas.

The System is also a 51% owner in an MRI joint venture, which began operations in January of 2006. The joint venture has a capital lease for equipment in the original amount of approximately \$2,100,000 (See Note 6) and is consolidated in the accompanying financial statements due to the System's ownership percentage exceeding 50%.

During 2009, the System established the Southwest Louisiana Hospital Association Foundation, Inc. The Foundation is organized as a nonprofit corporation established to operate exclusively for the charitable, benevolent, educational and scientific purposes of Lake Charles Memorial Hospital. The Foundation has applied for exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code.

The accompanying consolidated financial statements include the accounts of the System and its controlled affiliates. All significant intercompany accounts and transactions have been eliminated in consolidation.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. **Summary of significant accounting policies** (continued)

Use of estimates

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

Cash and cash equivalents

Cash and cash equivalents includes all checking accounts and certain investments in highly liquid debt instruments which had maturities of three months or less at the time of purchase.

Short term investments

Short term investments include all savings accounts, money market funds, and Louisiana Hospital Investment Pool investments (See Note 4).

Investments and investment income

The System follows the provisions of the accounting guidance contained in the Accounting Standards Codification (ASC) for investments in equity securities with readily determinable fair values and all investments in debt securities which requires them to be measured at fair value in the balance sheets.

Investment income or loss (including realized gains and losses on investments, interest, and dividends) is recorded as an increase in unrestricted net assets, unless the use is restricted by the donor or law. Investment income on proceeds of borrowings that are held by a trustee, to the extent not capitalized, are reported as other operating revenues. Unrealized gains and losses on investments are excluded from the excess of revenues over expenses unless the investments are trading securities.

Donated investments are recorded at their market value at the date of receipt, which is then treated as cost. Realized gains and losses on dispositions are based on the net proceeds and the adjusted cost basis of the securities sold, using the specific identification method. These realized gains and losses flow through the System's yearly activities.

Assets limited as to use

Assets limited as to use primarily include assets held by trustees under indenture agreements and designated assets set aside by the Board of Trustees, over which the Board retains control and may at its discretion subsequently use for other purposes. Amounts required to meet current liabilities of the System have been reclassified in the consolidated balance sheets.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies (continued)

Patient accounts receivable

The System provides credit in the normal course of operations to patients located primarily in southwestern Louisiana and southeastern Texas and to third party payors conducting operations in these areas.

The System maintains allowances for contractual adjustments, doubtful accounts, and charity care based on management's assessment of collectability, current economic conditions, and prior experience. The System determines if patient accounts receivable are past-due based on the discharge date; however, the System does not charge interest on past-due accounts. The System charges off patient accounts receivable if management considers the collection of the outstanding balances to be doubtful.

Inventories

Inventories consist primarily of drugs, medical supplies, and general supplies and are stated at the lower of cost (using the first-in, first-out method) or market.

Property and equipment

Property and equipment are stated at historical cost. Donated property is recorded at its estimated fair value on the date of receipt, which is then treated as cost. Additions, renewals, and betterments that extend the lives of assets are capitalized. Maintenance and repair expenditures are expensed as incurred.

Depreciation has been provided using the straight-line method over the estimated useful lives of the related assets, which range from 2 to 40 years. Equipment under capital lease obligations is amortized on the straight-line method over the shorter period of the lease term or the estimated useful life of the equipment.

When assets are retired or otherwise disposed of, the costs and related accumulated depreciation are removed from the accounts, and any resulting gains and losses are recognized in the System's yearly operations.

Other assets

Other assets consist primarily of investments in affiliated entities, including Lake Charles Pharmaceutical and Medical Supply Company, LLC (50% ownership) and Louisiana Pet Imaging of Lake Charles, LLC (24.5% ownership). The System accounts for investments in affiliated entities of which it owns more than 20% but no more than 50%, using the equity method.

Costs of borrowing

Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Financing costs are amortized on a straight-line basis over the period that the related obligation is outstanding.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies (continued)

Temporarily and permanently restricted net assets

Temporarily restricted net assets are those whose use by the System has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the System in perpetuity. The System did not have any temporarily restricted or permanently restricted net assets at December 31, 2009 or 2008.

Income (loss) from operations

The statements of operations and changes in net assets include the line item entitled income (loss) from operations. Operating revenues include, but are not limited to, patient revenues, investment income from unrestricted assets, cafeteria revenues, and insurance proceeds. Changes in unrestricted net assets which are excluded from income (loss) from operations include contributions, rental revenues, and other non-operating activities.

Net patient service revenue

The System has agreements with third-party payors that provide for payments to the System at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period that the related services are rendered and adjusted in future periods as final settlements are determined or as years are no longer subject to examination. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. Consequently, there is at least a reasonable possibility that recorded estimates could change by a material amount.

Charity care

The System provides care to patients who meet certain criteria established under its charity care policy without expected reimbursements or at reimbursement rates substantially lower than its prevailing rates. The related amounts are not reported as net revenues because the System does not pursue collection of amounts determined to qualify as charity care.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. **Summary of significant accounting policies (continued)**

Donor-restricted gifts

Unconditional promises to give cash and other assets to the System are reported at their fair values at the date the promises are received. Conditional promises to give and indications of intentions to give are reported at their fair values at the date the gifts are received. The gifts are reported as either temporarily or permanently restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the statements of operations and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as unrestricted contributions in the accompanying financial statements.

Professional liability claims

The provision for estimated malpractice claims includes estimates of the ultimate cost for both reported claims and claims incurred but not reported. The System has not experienced material losses from professional liability claims in the past.

Income Taxes

The Hospital and certain other affiliates are not-for-profit organizations as described in Section 501(c)(3) of the Internal Revenue Code and are exempt from federal and state income taxes on related income pursuant to Section 501(a) of the Internal Revenue Code. Certain other affiliates are either not-for-profit entities or for-profit tax paying entities. Federal income tax liabilities generated by the System's taxable activities, if any, is insignificant. Accordingly, no provision for income taxes on related income has been included in the consolidated financial statements.

The System has evaluated its position regarding the accounting for uncertain income tax positions. The System recognizes the effect of income tax positions only if the positions are more likely than not of being sustained. Recognized income tax positions are recorded at the largest amount that is greater than 50% likely of being realized. Changes in the recognition or measurement are reflected in the period in which the change in judgment occurs.

With few exceptions, the System and its subsidiaries are not subject to examination by tax authorities for years before 2006.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of significant accounting policies (continued)

Recent accounting pronouncements

Effective July 1, 2009, the System adopted new accounting guidance related to U.S. Generally Accepted Accounting Principles (GAAP). This guidance establishes Financial Accounting Standards Board (FASB) ASC as the source of authoritative U.S. GAAP recognized by FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. FASB ASC supersedes all existing non-SEC accounting and reporting standards. All other nongrandfathered, non-SEC accounting literature not included in FASB ASC has become nonauthoritative. FASB will no longer issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. Instead, it will issue Accounting Standards Updates (ASUs), which will serve to update FASB ASC, provide background information about the guidance and provide the basis for conclusions on the changes to FASB ASC. FASB ASC is not intended to change U.S. GAAP or any requirements of the SEC. This guidance is effective for the System as of December 31, 2009.

Reclassifications

Certain reclassifications have been made to the 2008 financial statements to conform with the 2009 presentation.

2. Current operating environment

Early in 2008, the System negotiated a significant agreement with its primary software vendor, McKesson, to change the business and clinical information systems at all locations. The second phase of the System's conversion to this new software is scheduled to be completed in the third quarter of 2010. The conversion and upgrades to these systems over the next two years has a remaining cost of approximately four million dollars for related hardware, software, installation and training.

During 2009, the System experienced an increase in net patient revenue of approximately \$25,000,000 or 14% despite the reduction in Medicaid funding during the year. Operating costs also increased approximately \$19,026,000 or 10%. Total increase in net assets was approximately \$3,077,000 which is the first positive increase in net assets in the last five years. The System is aware of the need to continue to generate increases in net assets and will continue to evaluate revenue enhancements and cost control measures during 2010.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. Net patient service revenue

The System has agreements with governmental and other third-party payors that provide for payments to the System at amounts different from its established rates. Contractual adjustments under third-party reimbursement programs represent the differences between the System's billings at established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with third-party payors follows:

- *Medicare* - inpatient acute and sub acute care services, skilled nursing services, outpatient services, and home health services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain costs (Graduate Medical Education costs and for Medicare beneficiaries' bad debt) related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The System is paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare fiscal intermediary.
- *Medicaid* - inpatient services rendered to Medicaid program beneficiaries are reimbursed at a prospectively determined rate-per-diem. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain extraordinary inpatient costs for children under the age of one are eligible for additional reimbursement. Some outpatient services are reimbursed at a prospectively determined fee schedule. Where no fee schedule has been developed, outpatient services are paid based on a cost reimbursement methodology. The System is paid for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicaid fiscal intermediary.
- *Commercial and HMO* - the System has entered into agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. Payment methodologies under these agreements include prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

Revenue from the Medicare and Medicaid programs accounted for approximately 41% and 18%, respectively, of the Hospital's net patient revenue for the year ended 2009, and 42% and 19%, respectively, of the Hospital's net patient revenue, for the year ended 2008. Amounts receivable or payable under reimbursement agreements with the Medicare and Medicaid programs are subject to examination and retroactive adjustments. Provisions for estimated retroactive adjustments under such programs are provided for in the period the related services are rendered and adjusted in future periods as final settlements are determined. The settlements payable were approximately \$2,858,000 and \$1,230,000 at December 31, 2009 and 2008, respectively. The 2009 and 2008 net patient service revenue increased approximately \$492,000 and \$906,000 due to prior-year retroactive adjustments in excess of amounts previously estimated. As of December 31, 2009, final settlements had been made by the Medicaid program for all years ended through December 31, 2003, and final settlements had been made by the Medicare program for all years ended through December 31, 2006. Since the laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

3. Net patient service revenue (continued)

Presented below is a summary of net patient service revenue for the years ended December 31, 2009 and 2008 (in thousands):

	<u>2009</u>	<u>2008</u>
Gross patient service revenue	\$ 676,238	\$ 620,402
Less: contractual adjustments and other deductions	(464,882)	(434,514)
Net patient service revenue	<u>\$ 211,356</u>	<u>\$ 185,888</u>

4. Investments/Assets limited as to use

The composition of assets limited as to use at December 31, 2009 and 2008, is set forth in the following table. Investments are stated at fair value (in thousands).

	<u>2009</u>	<u>2008</u>
Assets held by the trustee in accordance with bond indenture agreements:		
Cash and cash equivalents	\$ 3,140	\$ 4,351
U. S. Government agencies	76	94
Investment agreements	<u>6,668</u>	<u>6,670</u>
	9,884	11,115
Less: amount classified as current	(899)	(1,215)
	<u>\$ 8,985</u>	<u>\$ 9,900</u>
Assets internally designated by the Board of Trustees for professional liability claims and other matters:		
Cash and cash equivalents	\$ 568	\$ 85
U.S. Government agencies	<u>1,343</u>	<u>1,265</u>
	<u>\$ 1,911</u>	<u>\$ 1,350</u>
Total non-current assets limited as to use	<u>\$ 10,896</u>	<u>\$ 11,250</u>

Use of the bond trust funds is generally limited to payment of debt service, maintenance of reserve funds, and security for bondholders. Use of the professional liability fund is limited by the Board of Trustees for the payment of professional liability claims and related expenses.

Other short-term investments, which represent the Louisiana Hospital Investment Pool, totaled approximately \$7,102,000 and \$10,869,000 at December 31, 2009 and 2008, and are comprised of U.S. Government agencies, mutual funds, and limited equity investments.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. Investments/Assets limited as to use (continued)

The System recognized investment revenues of approximately \$634,000 and \$991,000 during the years ended December 31, 2009 and 2008, respectively. These amounts are classified as other operating revenues in the statements of changes in net assets.

5. Property and equipment

Property and equipment at December 31, 2009 and 2008 consisted of the following (in thousands):

	<u>2009</u>	<u>2008</u>
Land and land improvements	\$ 14,673	\$ 13,609
Buildings and improvements	129,884	129,817
Equipment, furniture, and fixtures	<u>109,220</u>	<u>106,000</u>
	253,777	249,426
Less: accumulated depreciation	<u>(177,667)</u>	<u>(169,818)</u>
	76,110	79,608
Construction-in-progress	<u>773</u>	<u>351</u>
Property and equipment, net	<u>\$ 76,883</u>	<u>\$ 79,959</u>

Depreciation expense amounted to approximately \$11,103,000 and \$10,760,000 during the years ended December 31, 2009 and 2008, respectively.

Approval was obtained from the board to begin a \$6.5 million dollar renovation of the Hospital's surgery department and a \$1.6 million dollar renovation of the Hospital's cafeteria. The surgery renovation will be accomplished in three phases over three years at a cost of approximately \$2.2 million per year. The cafeteria renovation is slated to begin early in 2010 and is expected to be completed by the end of the year.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. Long-term debt

A summary of long-term debt at December 31, 2009 and 2008 is as follows (in thousands):

	<u>2009</u>	<u>2008</u>
Hospital Revenue Bonds (Series 1992); term bonds due at various dates through December 1, 2018, at rates ranging from 6.5% to 6.375%.	\$ 15,215	\$ 16,440
Hospital Revenue Bonds (Series 1993); serial bonds due annually on November 30 th through November 30, 2018, at rates ranging from 5.0% to 5.6%.	9,560	9,995
Hospital Revenue Bonds (Series 2007); term bonds due annually on December 1 st through December 1, 2034, at rates ranging from 6.25% to 6.375%.	68,270	68,915
Lease due in monthly installments through October of 2013 at 4.09% (IMRT).	2,558	3,027
Lease due in monthly installments through August of 2011 at 4.49% (CT SCAN).	876	1,145
Lease due in monthly installments through February of 2011 at 6.69% (AMRI).	586	1,072
Lease due in month installments through May of 2013 at 9.06% (Ultrasound).	43	-
Lease due in monthly installments through November of 2014 at 6.01% (Toshiba Cath Lab).	838	-
Lease due in monthly installments through October of 2014 at 6.69% (GE Cath Lab).	116	-
Lease due in monthly installments through October of 2010 at 7.00% (McKesson).	307	620
Term loan due in monthly installments through April of 2022, at a fixed rate through July 2017 at 7.94%; secured by real estate.	<u>2,711</u>	<u>2,803</u>
	101,080	104,017
Less: current portion of long-term debt	(4,396)	(3,357)
Add: unamortized bond discounts and premiums, net	49	54
Long-term debt, net	<u>\$ 96,733</u>	<u>\$ 100,714</u>

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. **Long-term debt** (continued)

Under the terms of the revenue bond indentures, the restricted group was originally comprised of Southwest Louisiana Health Care System, Inc. and the Hospital. At the end of 2004, the System designated several new members to the restricted group. The restricted group currently consists of the System, the Hospital, SWLHS, Inc. and Lake Charles Medical Services, Inc.

The restricted group is required to maintain certain deposits with the Trustee, and such deposits are included with assets limited as to use. The revenue bond indentures also place limits on the incurrence of additional borrowings, place limits on the amount of assets that can be disposed of outside the normal course of business, and require the restricted group to satisfy measures of financial performance as long as the bonds are outstanding.

The long-term debt and capital lease obligations are scheduled to mature as follows (in thousands):

<u>Year ending December 31st,</u>	<u>Bonds & Notes Payable</u>	<u>Capital Leases</u>	<u>Total</u>
2010	\$ 2,795	\$ 1,955	\$ 4,750
2011	2,975	1,457	4,432
2012	3,170	882	4,052
2013	3,380	1,171	4,551
2014	3,605	370	3,975
Thereafter	<u>79,831</u>	<u>-</u>	<u>79,831</u>
	95,756	5,835	101,591
Less: interest	-	(511)	(511)
Add: unamortized bond discount and premiums, net	<u>49</u>	<u>-</u>	<u>49</u>
Total long-term debt	<u>\$ 95,805</u>	<u>\$ 5,324</u>	<u>\$ 101,129</u>

All capital leases are secured by equipment.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. Long-term debt (continued)

Hospital Revenue Bonds (Series 1992):

The Series 1992 tax-exempt bonds were issued by the Memorial Hospital Service District of the Parish of Calcasieu, Louisiana on behalf of the System. The payments to the bondholders are funded and guaranteed by the System under loan agreements with the trustees of the respective bond issues. The loan agreement is collateralized by the Hospital's gross receipts.

The Series 1992 bonds were issued to establish an irrevocable escrow to advance refund certain previous bonds, to provide funds for the System's additions and improvements, and to retire existing equipment notes. Payments of principal and interest on these bonds are insured under a municipal bond insurance policy. Approximately \$17,330,000 of these bonds were defeased by the 2007 bond series, and are no longer outstanding at December 31, 2009.

Hospital Revenue Bonds (Series 1993):

The Series 1993 tax-exempt bonds were issued by the Memorial Hospital Service District of the Parish of Calcasieu, Louisiana on behalf of the System. The payments to the bondholders are funded and guaranteed by the System under loan agreements with the trustees of the respective bond issues. The loan agreement is collateralized by the Hospital's gross receipts.

The net proceeds from the Series 1993 bonds were used to advance refund previous bond issues and to provide funds for new capital improvements. During 2008, the Hospital converted the bonds to a fixed rate.

Hospital Revenue Bonds (Series 2000):

The Series 2000 tax-exempt bonds were issued by the Louisiana Public Facilities Authority. The payments to the bondholders were funded and guaranteed by the System under loan agreements with the trustees of the respective bond issues.

The net proceeds from the Series 2000 bonds were used to provide funds for new capital improvements. A portion of these funds was used by the System to acquire equipment for the Hospital, to construct the new healthcare facility (the Women's facility), and to acquire equipment for the new facility. These bonds were defeased in total with the 2007 bond series and are no longer included in the consolidated balance sheet. The unpaid principal balance as of December 31, 2009 was approximately \$40,900,000.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. Long-term debt (continued)

Hospital Revenue Bonds (Series 2007):

During November of 2007, the Hospital completed an offering of \$69,775,000 of hospital revenue and refunding bonds. The Series 2007 bonds are fixed rate term bonds with rates ranging from 6.25% to 6.375% and are scheduled to mature at various times through December 1, 2034. The loan agreement is collateralized by the Hospital's gross receipts.

The proceeds of the Series 2007 Bonds were used, along with other available funds, to advance refund previous bond issues and to provide funds for new capital improvements.

7. Insurance programs

Any exposure under \$100,000 per claim for professional liability is covered by the System. Additional professional liability coverage is provided by the Louisiana Patient's Compensation Fund up to the present statutory maximum of \$500,000 per claim (exclusive of additional amounts for future medical expense provided by law). The preceding policies are on an occurrence basis. The System has employed independent actuaries to estimate the ultimate costs, if any, of the settlement of such claims.

The System is self insured for group health insurance and pays all claims up to \$200,000 per person. A stop loss policy pays claims in excess of this amount. The System is also self insured for workers' compensation liability up to the deductible of its excess workers' compensation policy of \$250,000 per claim.

The System has reflected its estimate of the ultimate liability for known and incurred, but not reported, claims in the accompanying financial statements.

8. Retirement plans

The Hospital has a defined contribution plan under Code Section 401(a) that covers substantially all full-time employees who are over the age of twenty-one and who have met eligibility requirements. Discretionary contributions by the Hospital include matching contributions from the employee 403(b) plan up to certain limits of compensation and additional contributions made to all eligible employees. Total contributions were approximately \$1,416,000 and \$930,000 for the years ended December 31, 2009, and 2008, respectively.

The Hospital also maintains a pretax retirement plan under code Section 403(b) in which substantially all of the employees of the Hospital can participate. All contributions to the 403(b) are made by employees through tax deferred contributions and are 100% vested amounts.

9. Business and credit concentrations

Financial instruments which potentially subject the System to concentrations of credit risk consist principally of unsecured accounts receivable and temporary cash investments.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. **Business and credit concentrations** (continued)

The System maintains its cash investments with several financial institutions operating primarily in southern Louisiana. The balances, at times, may exceed federally insured limits. Management believes the credit risk associated with these deposits is minimal.

The System grants credit to patients, substantially all of whom are regional residents. The System generally does not require collateral or other security in extending credit to patients; however, it routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, and commercial insurance policies).

The mix of receivables from patients and third-party payors at December 31, 2009 and 2008, was as follows:

	<u>2009</u>	<u>2008</u>
Medicare	36.35%	36.81%
Medicaid	19.29%	16.05%
Commercial insurance and managed care organizations	30.17%	34.84%
Self-pay patients and other	<u>14.19%</u>	<u>12.30%</u>
	<u>100.0%</u>	<u>100.00%</u>

10. **Leases**

The Hospital leases various pieces of equipment and operating facilities under operating leases which expire at various dates through the year ending December 31, 2014. Total rental expenses under these leases totaled approximately \$1,288,000 and \$1,312,000 during the years ended December 31, 2009 and 2008, respectively.

The following is a schedule by year of future minimum lease payments required under all of these operating leases which have initial or remaining non-cancelable lease terms in excess of one year:

<u>Year ending December 31st</u>	<u>Amount</u>
2010	\$ 543,801
2011	291,609
2012	260,084
2013	234,684
2014	<u>39,114</u>
	<u>\$ 1,369,292</u>

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Classification of expenses

The following table approximates the classification of expenses incurred during the years ended December 31, 2009 and 2008 (in thousands):

	<u>2009</u>	<u>2008</u>
Patient related services	\$ 132,978	\$ 121,318
General and administrative expenses	<u>84,004</u>	<u>76,638</u>
Total operating expenses	<u>\$ 216,982</u>	<u>\$ 197,956</u>

12. Disclosures about the fair value of financial instruments

In Accordance with the *Fair Value Measurements and Disclosure* topic of FASB ASC, disclosure of fair value information about financial instruments, whether or not recognized in the balance sheet is required. Fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instruments. Therefore, the aggregate fair value amounts presented do not represent the underlying value of the System.

The recent fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with this guidance, the System groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 – Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Disclosures about the fair value of financial instruments (continued)

Fair Value Hierarchy (continued)

Level 2 - Valuation is based on inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 - Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following methods and assumptions were used by the System in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents, accounts payable, accrued interest payable, other accrued expenses, and estimated third-party payor settlements - the carrying amounts approximate fair values because of the short maturity of these instruments.

Assets limited as to use and short-term investments - the carrying amounts reported on the balance sheets are fair values based on quoted market prices.

Long-term debt - the fair value of the Hospital's revenue bonds are estimated based on current traded value. The fair value of the hospital's remaining long term debt is estimated using discounted cash flow analyses, based on the hospital's current incremental borrowing rates for similar types of borrowing arrangements.

The Hospital's financial instruments whose estimated fair value differs from its carrying amount are summarized as follows at December 31st:

	<u>2009</u>		<u>2008</u>	
	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
Long-term debt (in thousands)	\$ <u>101,129</u>	\$ <u>92,195</u>	\$ <u>104,071</u>	\$ <u>84,401</u>

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

12. Disclosures about the fair value of financial instruments (continued)

Limitations - fair value estimates are made at a specific point in time, based on relevant market information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

The following table presents for each fair-value hierarchy level the System's financial assets and liabilities that are measured at fair value on a recurring basis at December 31, 2009 (in thousands).

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
December 31, 2009, Investments	\$ <u>5,892</u>	\$ <u>5,625</u>	\$ <u>7,380</u>
December 31, 2008, Investments	\$ <u>7,942</u>	\$ <u>7,995</u>	\$ <u>7,397</u>

The following table presents the changes in fair value for the year ended December 31, 2009, in Level 3 instruments that are measured at fair value on a recurring basis (in thousands):

Beginning balance	\$ 7,397
Unrealized gains (losses)	83
Purchases, sales, (net)	<u>(100)</u>
Balance, end of year	\$ <u>7,380</u>

13. Related party transactions

Certain members of the Board of Trustees are affiliated with organizations that provide services to the System and its affiliates. The System has a policy of periodically obtaining independent reviews of its insurance program, maintaining banking relationships with multiple financial institutions, and obtaining formal bids on all significant construction projects.

14. Commitments and contingencies

The System is involved in various legal actions and claims that arose as a result of events that occurred in the normal course of operations. The ultimate resolution of these matters is not ascertainable at this time; however, management is of the opinion that any liability or loss in excess of insurance coverage resulting from such litigation will not have a material effect upon the financial position of the System.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. Commitments and contingencies (continued)

As related to the 2002 reported failure of the System to meet certain indenture covenants and other matters, the System filed an action in 2005 in Federal Court against multiple entities. The matter was partially resolved with regard to several of the defendants previously. As of the date of this disclosure, a settlement agreement has been reached with the remaining defendant. The terms of this last settlement agreement, although confidential and not subject to disclosure, effectively put an end to the action filed in 2005.

15. Subsequent events

Management has evaluated subsequent events through the date that the financial statements were available to be issued April 12, 2010 and determined that there were no additional events that require disclosure.

16. Community service (unaudited)

As a non-profit, community based health system, the Hospital provides significant programs and health-related services for the indigent and medically underserved in southwest Louisiana, which represents the Hospital's financial commitment to those in our community with inadequate resources or who are uninsured or underinsured. In addition, the Hospital operates an emergency room which is open to the public, 24 hours a day and seven days a week.

Charity care represents the unpaid costs of free or discounted health related services for those who cannot afford to pay for services and who meet the Hospital's criteria for financial assistance. Under the Hospital's criteria for determining assistance, the Hospital provides full charity care funding for those whose income level is at or below 150% of the Federal Poverty Guidelines. Charity care services provided to these patients are not reported as revenue in the consolidated statements of operations and changes in net assets as there is minimal or no expectation of payment. In addition, unreimbursed costs of providing services to beneficiaries of Medicaid and other public programs for the indigent represent the amount of imputed costs that exceed state funding for these services. The Hospital also provides some services at a reduced rate that does not cover the costs. For example, the Hospital provides free or significantly discounted vaccinations for children and elderly patients. The Hospital also supplements professional medical staffing at community clinics.

The Hospital is also involved in providing services for the community at large through the provision of support group, community health education classes, staffing support at McNeese State University School of Nursing, investigational review board activities, and cash donations to local non-profit organizations. In addition, the Hospital provides the clinical and financial resources for the Memorial/LSUHSC Family Practice Residency Program, in affiliation with the academic resources of Louisiana State University Health Sciences Center-New Orleans, to train 24 family practice residents in 2009 and 2008; the Hospital also provides the clinical and financial resources for a Radiology Technology and Medical Technology program in affiliation with other state universities.

SOUTHWEST LOUISIANA HEALTH CARE SYSTEM, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. Community service (unaudited) (continued)

The following is a summary of the Hospital's estimated costs of community benefits for 2009 and 2008:

	<u>2009</u>	<u>2008</u>
Programs for the Poor and Underserved:		
Charity Care	\$ 2,410,882	\$ 2,188,642
Unreimbursed Medicaid	13,629,853	11,563,842
Community services for the community at large		
Education and research	2,046,167	2,000,646
Other	<u>283,756</u>	<u>152,022</u>
Total	<u>\$ 18,370,658</u>	<u>\$ 15,905,152</u>

SUPPLEMENTARY INFORMATION

**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 Trustees
Southwest Louisiana Health Care System, Inc.

We have audited the financial statements of the Southwest Louisiana Health Care System, Inc. (the System) as of and for the year ended December 31, 2009, and have issued our report thereon dated April 12, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the financial statements of the System 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 or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the System, in a separate letter dated April 12, 2010.

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

Postlethwaite, Netterville

Baton Rouge, Louisiana
April 12, 2010

April 12, 2010

To Management and the Board of Directors
Lake Charles Memorial Hospital
Baton Rouge, LA

We have audited the financial statements of the Lake Charles Memorial Hospital, for the year ended December 31, 2009 and have issued our report thereon. As part of our examination, we made a study and evaluation of internal accounting control to the extent we considered necessary to evaluate the system as required by auditing standards generally accepted in the United States of America. Under these standards, the purposes of such evaluation are to establish a basis for reliance on the system of internal accounting control in determining the nature, timing, and extent of other auditing procedures that are necessary for expressing an opinion on the financial statements and to assist the auditor in planning and performing his audit of the financial statements.

The objective of internal control is to provide reasonable, but not absolute, assurance as to the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of the financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

No matter how good a system, there are inherent limitations that should be recognized in considering the potential effectiveness of internal accounting. In the performance of most control procedures, errors can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personal factors. Control procedures whose effectiveness depends upon segregation of duties can be circumvented by collusion. Similarly, control procedures can be circumvented intentionally by management either with respect to the execution and recording of transactions or with respect to the estimates and judgments required in the preparation of financial statements. Further, projection of any evaluation of internal accounting control to future periods is subject to the risk that the degree of compliance with the procedures may deteriorate. We say this simply to suggest that any system needs to be constantly reviewed and improved where necessary.

During the course of our audit, we made several observations which we feel should be brought to your attention. Concerning these matters, we offer the following comments and recommendations:

Supervisory Review

The allowance for doubtful accounts and contractual adjustments model is calculated using an excel spread sheet, which is reviewed at a high level by management personnel. During the audit, we noted that there was an error in the schedule relating to the aging categories for a payer classification. As with any manual process, the risk for input errors is higher than it would be if the process was automated. We recommend that someone independent of the calculation, periodically review the spread sheet to check for input errors. The review should include testing the adequacy of the payer percentages and the reasonableness of the assumptions used in the model as a whole, on at least a quarterly basis. This review will allow for changes in the estimate of the allowance and contractual adjustments on a timelier basis and also detect errors in the calculation.

During our audit process, we noted that the NICU outlier schedule is maintained using an excel spread sheet. We noted there is a review of the NICU outlier calculation on a monthly basis. These reviews are designed to catch errors in a timely manner. However, we also noted that an error in the calculation was not caught in a timely and therefore the review procedure was not operating effectively. We recommend that the review of the schedule be performed at a detailed level each month in order to detect and correct errors in a timely manner.

Management's Response

The allowance for doubtful accounts and contractual adjustments and the NICU Outlier schedules are prepared on a monthly basis by the Billing Office Director or her designee. On a monthly basis and subsequent to the preparation of these worksheets, the Controller and the Director of Reimbursement will review the worksheets for errors and/or omissions and will ensure that the accounts receivable worksheet ties to the Gross Accounts Receivable of the hospital and the LTAC. On a quarterly basis the Director of Reimbursement and Controller will review for appropriateness of percentages utilized for contractual adjustments and bad debt calculations as well as the overall assumptions used in developing the worksheet models.

Payroll System

It is our understanding that the deletion of terminated employees in the payroll system requires the deletion in the salary application as well as the PTO application of the payroll software. During the audit, we noted that there were terminated employees that were not being deleted from the PTO application and therefore were still included in the PTO liability at year end. We recommend that someone review the deletions of terminated employees in both applications of the payroll system to ensure that terminated employees are removed from all aspects of compensation accruals.



Management's Response

Upon presentation of a terminated employees' final paycheck, the PTO balances on those terminated employees who have received their final paycheck will be identified by the VP of Human Resources or her designee and deleted from the database so as to ensure that no accrual is made on PTO balances related to those employees. Periodically, our accounting department will sample test the PTO accrual report to search for terminated employees who have a balance on that report and report the results to the VP of Human Resources.

This communication is intended solely for the information and use of the audit committee, management, and others within the System, and is not intended to be and should not be used by anyone other than these specified parties.

Postlethwaite ; Netterville

Baton Rouge, Louisiana
April 12, 2010