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Iberia Medical Center

September 30, 2000

Audited Financial Statements

Report on Compliance and on Internal Control Over Financial Reporting

Letter of Recommendations
(including management's response to
our Letter of Recommendations)

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 4/4/01

Financial Statements

Iberia Medical Center

Years ended September 30, 2000 and 1999
with Report of Independent Auditors

Iberia Medical Center

Financial Statements

Years ended September 30, 2000 and 1999

Contents

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Report of Independent Auditors

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

We have audited the accompanying balance sheets of Iberia Medical Center (Hospital Service District No. 1 of Iberia Parish, State of Louisiana) as of September 30, 2000 and 1999, and the related statements of operations and changes in fund balance and cash flows for the years then ended. These financial statements are the responsibility of the Medical Center'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 Iberia Medical Center as of September 30, 2000 and 1999, 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 dated December 8, 2000 on our consideration of the Medical Center's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts. 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.

Ernst & Young LLP

December 8, 2000

Iberia Medical Center

Balance Sheets

	September 30 2000	1999
Assets		
Current assets:		
Cash and cash equivalents	$ **825,000**	$ 660,671
Assets limited as to use	**710,995**	935,105
Patient accounts receivable, less allowance for doubtful accounts of $3,893,000 and $2,595,000 in 2000 and 1999, respectively	**6,661,261**	6,208,509
Other receivables	**232,816**	99,201
Inventories	**1,003,016**	1,120,032
Prepaid expenses	**131,733**	89,806
Total current assets	**9,564,821**	9,113,324
Assets limited as to use	**4,629,121**	4,612,190
Property and equipment, net	**21,280,853**	23,125,919
Other assets	**248,351**	240,807
Bond issuance costs, net	**399,316**	423,597
Total assets	**$ 36,122,462**	$ 37,515,837
Liabilities and fund balance		
Current liabilities:		
Accounts payable	$ **4,271,816**	$ 4,747,168
Accrued expenses	**1,497,617**	1,384,757
Due to third-party payors	**1,315,482**	1,616,997
Accrued interest payable	**454,814**	470,153
Current installments of long-term debt	**745,863**	698,024
Notes payable to banks	–	500,000
Total current liabilities	**8,285,592**	9,417,099
Amount due to Iberia Parish	**1,000,000**	1,000,000
Long-term debt, excluding current installments	**17,605,364**	18,363,228
Total liabilities	**26,890,956**	28,780,327
Fund balance	**9,231,506**	8,735,510
Total liabilities and fund balance	**$ 36,122,462**	$ 37,515,837

See accompanying notes.

Iberia Medical Center

Statements of Operations and Changes in Fund Balance

	Year ended September 30	
	2000	**1999**
Net patient service revenue	**$ 35,603,795**	$ 32,295,255
Other revenue	**460,499**	356,274
Total revenue	**36,064,294**	32,651,529
Operating expenses:		
Salaries, wages and benefits	**15,628,790**	14,591,453
Supplies and other expenses	**12,403,204**	12,442,134
Depreciation and amortization	**2,173,787**	2,139,401
Interest expense	**1,417,470**	1,335,848
Provision for doubtful accounts	**4,217,770**	3,613,971
Total expenses	**35,841,021**	34,122,807
Gain (loss) from operations	**223,273**	(1,471,278)
Nonoperating gains, net	**272,723**	155,618
Revenue and gains in excess of expenses (expenses in excess of revenue and gains)	**495,996**	(1,315,660)
Fund balance at beginning of year	**8,735,510**	10,051,170
Fund balance at end of year	**$ 9,231,506**	$ 8,735,510

See accompanying notes.

Iberia Medical Center

Statements of Cash Flows

	Year ended September 30 2000	1999
Operating activities		
Gain (loss) from operations	$ 223,273	$ (1,471,278)
Adjustments to reconcile gain (loss) from operations to net cash provided by operating activities:		
Depreciation and amortization	2,173,787	2,139,401
Loss on sales of equipment	–	20,247
Provision for doubtful accounts	4,217,770	3,613,971
Interest received	(221,924)	(155,222)
Interest payments	1,351,187	1,349,818
Changes in operating assets and liabilities:		
Patient receivables, net	(4,670,522)	(4,110,226)
Other receivables	(133,615)	4,320
Prepaid expenses	(41,927)	(75,988)
Inventories	117,016	206,009
Amounts due to/from third-party payors	(301,515)	963,997
Accounts payable and accrued expenses	(362,492)	916,069
Net cash provided by operating activities	2,351,038	3,401,118
Noncapital financing activities		
Other nonoperating income received	248,752	147,807
Net cash provided by noncapital financial activities	248,752	147,807
Capital and related financing activities		
Purchases of property, plant and equipment	(298,191)	(2,505,149)
Proceeds from sales of property, plant and equipment	1,721	459,184
Transfer from Iberia Parish Government	–	1,000,000
Proceeds from the issuance of debt	–	500,000
Decrease in notes payable to banks	(500,000)	(1,000,000)
Principal payments on debt incurred for capital purposes	(593,571)	(558,795)
Principal payments on capital lease obligations	(129,603)	(172,500)
Interest payments on debt and capital lease obligations	(1,361,979)	(1,399,488)
Net cash used in capital and related financing activities	(2,881,623)	(3,676,748)
Investing activities		
Interest received on investments	245,896	163,032
Increase in assets limited as to use	(2,624)	(27,741)
Investments in joint ventures	(7,544)	(240,807)
Net cash provided by (used in) investing activities	235,728	(105,516)
Net decrease in cash and cash equivalents	(46,105)	(233,339)
Cash and cash equivalents at beginning of year	4,314,122	4,547,461
Cash and cash equivalents at end of year	$ 4,268,017	$ 4,314,122
Reconciliation of cash and cash equivalents to the balance sheet:		
Cash and cash equivalents in current assets	$ 825,000	$ 660,671
Cash and cash equivalents in assets limited as to use:		
By board for capital improvements	1,001,153	1,178,649
Held by trustee under bond indenture	1,874,224	2,097,359
Under self-insurance trust arrangements	567,640	377,443
	$ 4,268,017	$ 4,314,122

See accompanying notes.

1. Organization and Significant Accounting Policies

Organization

Iberia Medical Center (the Medical Center) is a 130-bed acute-care hospital with related outpatient care facilities principally located in New Iberia, Louisiana. The Medical Center operates under the jurisdiction of the Iberia Parish Council of Iberia Parish, Louisiana (the Parish) as Iberia Parish Hospital Service District No. 1, and is a component unit of the Parish as defined by Statement of Governmental Accounting Standards (SGAS) No. 14, *The Financial Reporting Entity*. The Medical Center's component unit relationship to the Parish is principally due to the Medical Center's financial accountability to the Parish as defined in SGAS No. 14. The Medical Center is operated by a nine-member board of commissioners, all of whom are appointed by the Iberia Parish Council.

Basis of Accounting

The Medical Center uses the accrual basis of accounting for proprietary funds. Under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Activities That Use Proprietary Fund Accounting*, the Medical Center has elected to apply the provisions of all relevant Financial Accounting Standards Board (FASB) pronouncements, including those issued after November 30, 1989 except for those that conflict with or contradict GASB pronouncements.

Use of Estimates

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

Cash Equivalents

Cash equivalents include investments in highly liquid investments with maturities of three months or less when purchased.

1. Organization and Significant Accounting Policies (continued)

Assets Limited as to Use

Assets limited as to use include:

- assets set aside by the Medical Center's board of commissioners for future capital improvements, over which the board retains control and may at its discretion subsequently use for other purposes;
- assets held by bond trustees under related indenture agreements; and
- assets held under self-insurance trust arrangements.

Investments and Investment Income

All investments are stated at fair value, based on quoted market price. Changes in the fair value of investments are included in investment income.

Investment income from unrestricted and board-designated investments is reported as nonoperating gain. Investment income from trusteed investments held under a related bond indenture is reported as other revenue.

Net Patient Service Revenue and Related Receivables

The Medical Center has entered into agreements with third-party payors, including government programs and managed care health plans, under which the Medical Center 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 net realizable amounts due from patients, third-party payors and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated contractual adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted as final settlements are determined.

1. Organization and Significant Accounting Policies (continued)

Inventories

Inventories, consisting principally of medical supplies and pharmaceuticals, are stated at the lower of cost (first-in, first-out) or replacement market.

Property and Equipment

Property and equipment are recorded at cost, or if donated, at fair value at date of receipt. Depreciation is provided over the useful life of each class of depreciable asset using the straight-line method. Equipment held under capital lease obligations is amortized using the straight-line method over the shorter of the lease term or estimated useful life of the equipment and is included in depreciation and amortization expense.

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized, net of income earned on related trusteed assets, as a component of the cost of acquiring those assets. Net interest expense of approximately $9,000 and $121,000 were capitalized during 2000 and 1999, respectively.

Unamortized Bond Issuance Costs

Bond issuance costs have been deferred and are being amortized using the interest method over the period the related bonds will remain outstanding.

Charity Care

The Medical Center 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 Medical Center does not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue.

Income Taxes

As a political subdivision, the Medical Center qualifies as tax-exempt under existing provisions of the Internal Revenue Code and its income is not generally subject to federal or state income taxes.

1. Organization and Significant Accounting Policies (continued)

Operating and Nonoperating Revenue

The Medical Center's primary purpose is to provide diversified health care services to individuals, physicians, and businesses in Iberia Parish and the surrounding communities. As such, activities related to the ongoing operations of the Medical Center are classified as operating revenues. Operating revenues include those generated from direct patient care, related support services, gains or losses from disposition of operating properties and sundry revenues related to the operation of the Medical Center. Investment income, gains and losses not directly related to the ongoing operations of the Medical Center or that occur infrequently, and gifts, grants and bequests not restricted by donors for specific purposes, are reported as nonoperating income.

2. Working Capital and Liquidity

The Medical Center experienced an improvement in working capital during 2000. In addition to increased revenue, management's initiatives implemented during the period contributed to the improved working capital position. Management believes the Medical Center's operations will continue to generate sufficient cash flow to fund operating expenditures and meet all debt service requirements during fiscal 2001.

3. Net Patient Service Revenue

Net patient service revenue for 2000 and 1999 was comprised of the following:

	2000	1999
Gross patient service charges (excluding charity care of $122,000 and $262,000 for 2000 and 1999, respectively)	$ 78,501,520	$ 64,139,011
Contractual and other allowances:		
Medicaid	8,723,891	6,369,362
Medicare	24,460,754	19,230,093
Managed care organizations	9,026,749	5,841,674
Other	686,331	402,627
Total contractual and other allowances	42,897,725	31,843,756
Net patient service revenue	$ 35,603,795	$ 32,295,255

3. Net Patient Service Revenue (continued)

The Medical Center participates in the Medicare and Medicaid programs as a provider of medical services to program beneficiaries. During the years ended September 30, 2000 and 1999, approximately 64% and 68%, respectively, of the Medical Center's gross patient service charges were related to services provided to Medicare and Medicaid program beneficiaries.

Revenues derived from government programs are subject to audit. Settlements for the years ended through September 30, 1997 for the Medicare and Medicaid programs have been reviewed by program representatives. Adjustments resulting from these reviews decreased net patient service revenue by $430,000 in 2000 and $470,000 in 1999.

4. Charity Care

The Medical Center maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. Charges foregone, based on established rates, approximated $122,000 in 2000 and $262,000 in 1999.

The Medical Center provides four full-time nurses at the Parish Criminal Justice Facility for medical assistance to the individuals in the facility. The Medical Center does not maintain records to identify and monitor the level of charity care it provides under this program; however, the total cost of providing this service approximated $140,000 in 2000 and $139,000 in 1999.

5. Cash and Investments

Governmental accounting standards require that the carrying amounts of cash and investments as of the balance sheet date be categorized according to the level of credit risk associated with the Medical Center's cash and investments at that time. The level of credit risk is defined as follows:

Category 1 - Insured (including government securities), registered or collateralized with securities held by the Medical Center or its agent in the Medical Center's name.

5. Cash and Investments (continued)

Category 2 - Uninsured and unregistered, collateralized with securities held by the counter-party's trust department or agent in the Medical Center's name.

Category 3 - Uncollateralized, including balances collateralized with securities held by the pledging financial institution.

A summary of cash and investments at September 30, 2000 follows:

	Category			
	1	2	3	Total
Cash and cash equivalents	$ 200,797	$ 624,203	$ –	$ 825,000
Board-designated for capital improvements:				
Cash and cash equivalents	$ 101,153	$ 900,000	$ –	$ 1,001,153
Held by trustee under bond indenture:				
Cash and cash equivalents	95,488	–	1,778,736	1,874,224
U. S. Treasury Notes	1,897,099	–	–	1,897,099
	1,992,587	–	1,778,736	3,771,323
Held under self-insurance trust arrangements:				
Cash and cash equivalents	–	567,640	–	567,640
Total assets limited as to use	$ 2,093,740	$ 1,467,640	$ 1,778,736	$ 5,340,116

A summary of cash and investments at September 30, 1999 follows:

	Category			
	1	2	3	Total
Cash and cash equivalents	$ 200,776	$ 459,895	$ –	$ 660,671
Board-designated for capital improvements:				
Cash and cash equivalents	$ 200,000	$ 978,649	$ –	$ 1,178,649
Held by trustee under bond indenture:				
Cash and cash equivalents	260,646	–	1,836,713	2,097,359
U. S. Treasury Notes	1,893,844	–	–	1,893,844
	2,154,490	–	1,836,713	3,991,203
Held under self-insurance trust arrangements:				
Cash and cash equivalents	–	377,443	–	377,443
Total assets limited as to use	$ 2,354,490	$ 1,356,092	$ 1,836,713	$ 5,547,295

5. Cash and Investments (continued)

The Medical Center's U. S. Treasury Notes mature in May 2006.

Trusteed bond funds were established in accordance with the requirements of the indentures related to the Hospital Service District No. 1 of Iberia Parish, Louisiana Hospital Revenue Bonds.

A summary of the various trusteed funds at September 30, 2000 and 1999 follows:

	2000	1999
Debt service reserve funds	**$ 1,993,122**	$ 2,155,008
Principal and interest funds	**652,681**	642,904
Project fund	**24**	23
Depreciation reserve fund	**1,125,496**	1,193,268
	3,771,323	3,991,203
Less deposits classified as current assets	**710,995**	935,105
	$ 3,060,328	$ 3,056,098

The debt service reserve funds are generally equal to the maximum annual principal and interest requirements (as defined) for the bonds. Amounts in the principal and interest funds are used for the annual debt service of the bonds. The project fund is to be used to pay certain costs of construction and renovation projects at the Medical Center. The depreciation reserve fund is to be used for additions, improvements and replacements necessary to operate the Medical Center. Deposits classified as current assets represent funds to be used to pay debt service amounts classified as current liabilities at September 30.

6. Business and Credit Concentrations

The Medical Center grants credit to patients, substantially all of whom are local area residents. The Medical Center 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, Blue Cross Blue Shield of Louisiana and commercial insurance policies).

6. Business and Credit Concentrations (continued)

The mix of gross receivables from patients and third-party payors at September 30, 2000 and 1999 follows:

	2000	1999
Patients	38%	34%
Medicare	28	30
Other third-party payors	15	18
Commercial	4	6
Medicaid	7	6
Blue Cross Blue Shield of Louisiana	8	6
	100%	100%

7. Property and Equipment

A summary of property and equipment at September 30, 2000 and 1999 follows:

	2000	1999
Land and improvements	$ 1,380,089	$ 1,380,089
Building and improvements	22,579,445	22,137,789
Fixed equipment	4,382,800	4,382,800
Major movable equipment	17,577,472	17,452,456
Construction in progress	–	265,182
	45,919,806	45,618,316
Less accumulated depreciation and amortization	24,638,953	22,492,397
	$ 21,280,853	$ 23,125,919

Equipment under capital lease obligation totaling approximately $2,082,000 is included in major movable equipment at September 30, 2000 and 1999. Related accumulated amortization was approximately $1,340,000 at September 30, 2000 and $1,126,000 at September 30, 1999.

8. Long-Term Debt

A summary of long-term debt, including capital lease obligations, at September 30, 2000 and 1999 follows:

	2000	1999
Hospital Service District No. 1 of Iberia Parish, Louisiana Hospital Revenue Bonds - Series 1979, payable in semiannual installments, including interest at 6%, through November 2009	**$ 2,921,548**	$ 3,144,119
Hospital Service District No. 1 of Iberia Parish, Louisiana Hospital Revenue Bonds - Series 1980, payable in semiannual installments, including interest at 6%, through May 2010	**2,986,000**	3,197,000
Hospital Service District No. 1 of Iberia Parish, Louisiana Hospital Revenue Bonds - Series 1996, payable in semiannual installments, including interest at rates from 7.5% to 8%, through May 2010	**11,615,000**	11,775,000
Capital lease obligations, payable in various monthly installments through September 2008, including interest at rates from 6.5% to 7.9%.	**828,679**	945,133
	18,351,227	19,061,252
Less current installments	**745,863**	698,024
Long-term debt, excluding current installments	**$ 17,605,364**	$ 18,363,228

Under the terms of related revenue bond indentures, the Medical Center is required to maintain certain deposits with a trustee. The indentures also place limits on additional borrowings, require the maintenance of a minimum debt service coverage ratio and a days cash on hand amount. The Medical Center was in compliance with these covenants at September 30, 2000 and 1999.

The hospital revenue bonds are secured by the net revenues (as defined) of the Medical Center and the trusteed funds.

8. Long-Term Debt (continued)

Future maturities of long-term debt and payments on capital lease obligations at September 30, 2000 are as follows:

	Long-Term Debt	Capital Lease Obligations
2001	$ 635,125	$ 161,775
2002	678,505	129,602
2003	722,761	129,602
2004	764,956	129,601
2005	815,117	129,603
Thereafter	13,906,084	381,777
	$ 17,522,548	1,061,960
Less amounts representing interest on capital lease obligations		233,281
		$ 828,679

At September 30, 1999, the Medical Center had an available line of credit with a commercial bank for $500,000 at an interest rate of 7.3%. The outstanding balance at September 30, 1999 totaled $500,000. The line of credit was repaid in full and canceled in February 2000.

9. Asset Transfer from Iberia Parish

In August 1999, the Parish transferred certificates of deposit totaling $1,000,000 to the Medical Center. The amount due to the Parish is reflected as a long-term liability at September 30, 2000. The funds are invested in certificates of deposit and included in assets limited as to use at September 30, 2000. The terms of the transfer stipulate that interest earned on the these certificates of deposit will be paid to the Parish.

10. Pension Plan

The Medical Center contributes to the Parochial Employees Retirement System of Louisiana (the System), a cost-sharing multiple-employer defined benefit pension plan. The System is comprised of two district plans, Plan A and Plan B, with separate assets and benefit provisions. Employees of the Medical Center are members of Plan A. The System provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefit provisions are established by state law and may be amended only by the State of Louisiana Legislature. The System issues a publicly available financial report that includes financial statements and required supplementary information.

System members are required to contribute 9.5% of their annual covered salary and the Medical Center is required to contribute at an actuarially determined rate. The current rate is 7.75% of annual covered payroll. The Medical Center's pension cost and contributions to the System were $868,396 in 2000, $808,472 in 1999 and $990,431 in 1998. These amounts were equal to the required contributions for each year.

11. Contingencies

The Medical Center maintains insurance coverage for medical malpractice claims through the Louisiana Hospital Association Trust Fund and the State of Louisiana Patient Compensation Fund up to the statutory limit. As of September 30, 2000, there was certain litigation pending against the Medical Center and management believes the insurance coverage described previously adequately insures the Medical Center against these claims.

The Medical Center is self-insured for employee health coverage, up to a limit of $50,000 per individual claim. Excess coverage is maintained with a third-party carrier.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs. Changes in Medicare and Medicaid programs and reductions in funding could have an adverse impact on the Medical Center. It is the Medical Center's policy to be in compliance with these laws and regulations.

11. Contingencies (continued)

In July 2000, the Medical Center entered into a Corporate Integrity Agreement with Office of the Inspector General (OIG) of the U.S. Department of Health and Human Services to promote compliance by its employees with the statutes, regulations and written directives of Medicare, Medicaid, and all other federal health care programs. The agreement is a product of a settlement between the Medical Center and the OIG related to errors in Medicare reimbursements received during the period from 1992 through 1995.

The three-year agreement contains provisions specifying the components of the compliance program that the Medical Center is implementing. Failure of the Medical Center to comply with certain obligations set forth in the CIA may lead to the imposition of certain monetary penalties. Management believes that the Medical Center is in compliance with these obligations.

12. Operating Leases

The Medical Center leases office space and clinical facilities, generally to members of its medical staff, under operating leases with terms ranging from month-to-month up to five years. The future minimum lease payments to be received from these leases follow:

2001	$ 207,081
2002	198,780
2003	146,820
2004	67,192
	$ 619,873

The Medical Center leases various equipment and facilities under operating leases expiring at various dates through May 2002. The following is a schedule by year of future minimum lease payments under operating leases that have initial or remaining lease terms in excess of one year.

2001	$ 215,029
2002	208,949
	$ 423,978

Rental expense for operating leases was approximately $414,912 in 2000 and $456,000 in 1999.

13. Management Contract

The Medical Center has an agreement with Brim Healthcare, Inc. (Brim) under which Brim provides management services, including key personnel, to the Medical Center. The agreement, which expires in November 2001, can be extended through November 2003. Total fees paid to Brim were approximately $503,990 in 2000 and $415,000 in 1999.

Additionally, the Medical Center has an agreement with Servicemaster Management Services, Inc. (SMS), under which SMS provides management services for the housekeeping, plant operations, and maintenance departments. Total fees paid to SMS were $180,544 in 2000 and $98,135 in 1999.

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

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

We have audited the financial statements of Iberia Medical Center (Hospital Service District No. 1 of the Parish of Iberia, State of Louisiana) (the Medical Center) as of and for the year ended September 30, 2000, and have issued our report thereon dated December 8, 2000. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Medical Center'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 Medical Center's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to the board of commissioners and management of the Medical Center in a separate report dated December 8, 2000.

This report is intended 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.

Ernst + Young LLP

December 8, 2000

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The Board of Commissioners
Iberia Medical Center

In planning and performing our audit of the financial statements of Iberia Medical Center (the Medical Center) for the year ended September 30, 2000, we considered its internal control to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. Our consideration of internal control would not necessarily disclose all matters in internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the specific internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving internal control and its operation that we consider to be material weaknesses as defined above.

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

Significant Estimation Processes

Adequacy of the Allowance for Doubtful Accounts

The estimation of the allowance for doubtful accounts (AFDA) is a significant process which impacts the Medical Center's financial statements. The Medical Center's operating policies and procedures as well as environmental factors have a direct impact on the reasonableness of the estimation process. We believe the dynamic nature of change in the Medical Center's operations and the health care environment in general warrant continuing to assess the reasonableness of the allowance for doubtful accounts estimation methodology on a periodic basis.

We suggest management consider adding additional criteria to the process such as hind-sight analysis, historical collection results, write-offs and recoveries by financial class to ensure that the various internal and external factors affecting collectibility are analyzed and considered in estimating the net realizable value of this asset.

Management's Response

During the past year, we implemented recommendations arising from the prior audit in modifying the methodology used to calculate the allowance. As a result, no audit adjustment was required this year. We will continue to monitor this issue to help ensure the adequacy of the allowance reflecting historical collections, write-offs, and recoveries.

Monitoring Third-Party Settlement Estimates

In the 1999 management letter, we recommended the Medical Center enhance its procedures for third-party accounting through a combination of interim cost report preparation and additional settlement analysis. Management implemented certain of these recommendations during fiscal 2000.

As a result of continued significant changes in reimbursement, including new methods, we recommend management continue to monitor and refine the third-party accounting process to ensure the accuracy of its interim financial reporting.

Management's Response

Management will continue to review and enhance its policies and procedures regarding the estimates of contractual expense and resulting settlements, including the use of interim cost reports and consultant reviews of the accuracy of methodologies used during the preparation of interim financial statements.

Other Matters

Investments in Joint Ventures

The Medical Center has several investments in joint ventures, which are accounted for under the equity method of accounting. Accordingly, the Medical Center's portion of the income or loss of the joint ventures should be recognized in its current year earnings. At September 30, 2000, an audit adjustment was required to record the Medical Center's income/loss from these ventures.

We recommend management periodically recognize in the Medical Center's financial statements these joint ventures' operating results. Additionally, we suggest management obtain pro-forma projections from the joint ventures to monitor their expected performance and properly include the expected results in the budget projections of the Medical Center.

Management's Response

Management will begin recognizing joint venture operating results on a quarterly basis. The results of this process will be monitored and adjusted if deemed appropriate.

Inventory

Based on our industry knowledge, the Medical Center's investment in inventory is significant compared to similar size hospitals. The majority of the inventory relates to the surgery department. Management anticipates a decrease in outpatient surgery volumes due to the Surgery Center Joint Venture. This could increase the potential for excess and or obsolete inventory.

We recommend that management continue to assess the appropriateness of the current inventory levels and continue to ensure that inventory obsolescence is reviewed on a periodic basis.

Management's Response

Inventory procedures for the current year end did allow for the recognition of obsolescence during the count and pricing processes. Management will continue to be sensitive to this issue as we proceed into the coming year.

Self-Insured Health Claims

Currently, management estimates the unpaid health insurance claims based on a factor of the average monthly claims paid. This estimation process could be enhanced through the inclusion of other analyses such as historical claims run-out analysis and hindsight analysis.

We recommend that management utilize additional analyses in the unpaid claims estimation process in order to facilitate a better understanding of the trends affecting these claims payments.

Management's Response

Management will review historical claims run-out history to help determine the appropriate amounts for estimates of unpaid health insurance claims.

Regulatory Environment Issues

Impact of the Pending and Final Health Insurance Portability and Accountability Act (HIPAA) Administrative Simplification Regulations

eCommerce in the health care industry is lagging behind other industries due to the fact there are no standards defined to uniformly process electronic transactions for the industry. The federal government has developed legislation designed to improve the efficiency and effectiveness of the health care and insurance industries, by standardizing the collection and transmission of certain electronic administrative and financial transactions. The legislation, found in the Administrative Simplification provisions of the Health Insurance Portability and Accountability Act (HIPAA) of 1996, also protects the privacy and security of the patient's health information. As a result, sweeping changes will need to be made to the systems that process these health care transactions and the methods an organization uses to ensure the privacy, security and confidentiality of the consumer's health information.

Under these new regulations, it is critical that every health care provider, payer and other organization that processes protected health information implement definitive actions over the next two to three years to comply with the standards proposed for electronic transactions, national identifiers, code sets, patient privacy and data security. The Standards for Electronic Transactions (including standards for code sets) were finalized and placed in the National Register in August 2000. Therefore, health care providers, payers and clearinghouses must comply with the electronic transaction and code set standards by October 2002. The Standards for Privacy of Individually Identifiable Health Information were published in final form on December 28, 2000, with compliance required by February 2003. The national identifier and security components of the HIPAA standards are expected to be finalized by early 2001. Health care providers, payers and clearinghouses will then have two years and two months to comply with those standards once they are placed in the *National Register*.

Most payer organizations have recognized the benefits and have already begun their assessments of the impact of HIPAA on their internal systems and processes. Most provider organizations have taken a cautious approach to addressing the HIPAA standards; however, most organizations are beginning to develop their plans and strategies for addressing HIPAA.

We recommend your organization develop a detailed, sound HIPAA compliance program to enable you to comply with final and pending HIPAA regulations. The specific approach that we would recommend is to:

- Develop a steering committee with representatives from all key areas of the organization;
- Assemble a project team to focus their efforts on compliance with the HIPAA initiative and any related strategic initiatives the organization may be contemplating;
- Perform an initial assessment (i.e., inventory of systems that transmit HIPAA transactions and use the code sets and identifiers adopted by HIPAA, privacy and security policies and mechanisms and business partner relationships) of the impact of HIPAA on the organization's systems and business processes;
- Develop plans for addressing the HIPAA initiative taking into consideration the strategic and tactical plans the organization has contemplated (e.g., changes already underway for key systems);

- Renovate information systems hardware, software and database structures and data security and privacy processes and mechanisms to achieve compliance with the HIPAA regulations and any related strategic initiatives; and

- Implement those changes to the systems and processes of the organization and develop a plan for annual testing and certification of HIPAA compliance.

Management's Response

It is management's intent to comply with final and pending HIPPA regulations. Management is currently in the early stages of developing plans and strategies for addressing HIPPA. A general education session presented by the Health Care Compliance Association on HIPPA was attended by all directors and senior management. An initial assessment will be conducted to determine the need for appropriate actions, policies, and procedures. The Hospital's compliance officer will be involved in this process and reports will be presented to the compliance committee.

Cost Report Compliance

The Medical Center has just implemented written cost report compliance policies and procedures. Information included in the cost report is produced from various sources: financial data, such as, general ledger expenses and revenues, departmental statistics, contract information and so forth. The guidance is designed to decrease the risk that the information obtained from these sources and included on the cost report is not complete, current or in accordance with Medicare and Medicaid laws and regulations.

The Medicare cost report will continue to be required and is an important part of the prospective payment systems (PPS) for all patient types for future years. Data used for inpatient DRG recalibration and wage index updates, updates for skilled nursing (SNF) Resource Utilization Groups (RUG), updates for Outpatient PPS (APCs) and new payment systems that have not been established as yet, will continue to be extracted from the Medicare cost report for years to come.

Medicare and Medicaid reimbursement will continue to be an increasingly important source of net revenues. The federal government has and will continue to scrutinize cost reports for potential fraud and abuse. The Health Insurance Portability and Accountability Act of 1996 established civil money penalties for false claims. Medicare Conditions of Participation require the preparation and filing of a complete and accurate cost report.

We recommend the Medical Center continue to develop and enhance their cost report compliance policies and procedures. These policies and procedures should address methods for preparing the cost report, data collection and documentation for items such as revenues and expenses, adjustments to allowable costs, statistics, settlement data and information or compliance disclosures to the fiscal intermediary. Ongoing assessment and development of the cost report compliance policies and procedures and a method to monitor adherence to these polices and procedures should be an integral part of the overall corporate compliance program and will aid the Medical Center's efforts to reduce compliance risks.

Management's Response

As noted, the Medical Center has implemented written cost report compliance policies and procedures. It is management's intent to comply with all rules and regulations involving the preparation and submission of Medicare cost reports.

Information Systems

Formal Information Systems Policies and Procedures

During our review, we noted that there are currently no formalized corporatewide information security policies and procedures in place. A corporatewide information security policy provides the basis for management's directives to create and maintain an environment that protects the Medical Center's assets, ensures that all employees understand the importance of security to the organization, and sets standards for information system security.

We recommend that the Medical Center consider taking steps to document a formal, companywide Information Security Policy statement. This policy would serve as the basis for identifying the responsibilities of all groups within the Medical Center for data integrity and security. To demonstrate the importance attached to security, top management should promulgate such a policy and should issue the formal policy to all personnel.

The policy would perform several functions, including:

Protecting the Medical Center from unauthorized persons having access to sensitive financial or operating information. This objective may be accomplished by having employees sign confidentiality agreements on an annual basis, which includes provisions for confidentiality of passwords. **It is noted that employees currently sign a password confidentiality agreement upon employment.**

Providing guidelines with respect to standard system parameters such as password length, password randomness, password history, incorrect logins allowed, etc. that are standardized across all operating systems, sensitive programs and applications. Additional passwords and logins should still be required for users with access to sensitive applications.

Providing guidelines for granting, modifying, and deleting user access to the system so that management can be assured proper functions are assigned and proper approvals were obtained.

Ensuring that the system security structure is periodically reviewed to verify that privileges granted are appropriate for individuals in their current capacities and that changes in employment status do not result in individuals having excess access privileges or conflicting privileges.

Defining the responsibilities of the owners, users, and custodians of data, as well as providing guidelines for classifying data according to its sensitivity and confidentiality.

Specifying methods of monitoring and investigating security breaches and unauthorized access attempts.

Management's Response

The Medical Center is in the initial stage of formulating and documenting written policies and procedures regarding corporate wide information security. Issues to be addressed will include the items mentioned in this comment such as guidelines for passwords, the granting, modifying, and deleting of user access, and data classification and sensitivity. Regarding confidentiality of information, as noted in this comment, employees are currently required to sign a password confidentiality agreement upon employment.

Business Continuity Planning

During our review, we noted that the Medical Center has no companywide business continuity plan formally documented. A comprehensive approach to recovery planning within the Medical Center would help ensure survivability following a significant disruption or disaster. The role of a business continuity plan is to facilitate recovery of time-critical *business processes* and *support services* (i.e., Information Systems, Communications Networks, etc.).

The initial phase of a comprehensive recovery-planning project is the determination of the degree and extent of impact associated with a loss of time-critical business processes and support services to the organization. These impacts are quantified in terms of both financial impacts (i.e., revenue loss, extraordinary expenses) and operational impacts (i.e., customer service impacts, loss of confidence impacts). These loss impact estimates are then used to determine the maximum-tolerable-downtimes, estimated over periods of time, that the organization could sustain without significantly impairing the ongoing viability of the enterprise. The business impact assessment would also serve to aid management in determining an appropriate cost-effective recovery strategy (i.e., redundant site, hotsite, in-house continuous availability, etc.) for that operation based upon empirical data gathered during this impact assessment.

Once a realistic recovery strategy is adopted using the impact assessment information, the recovery strategy should be implemented and recovery plans developed that will assist personnel in facilitating recovery efforts. The fundamental purpose of these plans is the survivability of the Medical Center's time-critical business processes and support services, and not necessarily addressing the recovery of every business process. The recovery plan is a focused approach for rapid recovery of those processes and systems that are considered most crucial to the Medical Center's operations.

Once the recovery plans are in place, the key to successful business continuity plan maintenance is ensuring that Medical Center personnel receive recovery plan execution training, as well as mandating that ongoing recovery plan testing strategies are formalized, executed, and measured.

We strongly recommend that the Medical Center perform business continuity planning and that recovery strategies, actions, and procedures be developed and tested to ensure that they address the time-critical business processes of the organization.

Management's Response

The Medical Center currently has a business continuity plan in place for nursing and ancillary departments which address continued patient care in the case of an information systems failure. We will begin to develop a comprehensive companywide business continuity plan to help minimize any clinical or financial losses in the event of a significant disruption or disaster.

Physical Security

Physical Access Restriction

During our review, it was observed that the data center remained unlocked during business hours. It is connected to the IS Department, which has card pad security, but remains open during business hours as well. It is noted that there are steps being taken to install card pads on the hardware room doors.

We recommend that management continue to evaluate the costs and benefits associated with equipping the door with a security keypad or some other security device. At a minimum, the door should remain locked at all times.

Management's Response

To facilitate physical access restriction, management will investigate the feasibility of installation of a card-swipe system on the door to the information services hardware room. At this time, a policy has been implemented requiring the door to be locked at all times when the department is unmanned.

Fire Protection

We noted during our walkthrough of the IS area that the computer systems are not adequately protected from fire. The current sprinkler systems use water, which can be damaging to hardware. The National Fire Prevention Association has established guidelines for fire safety in a data center.

We recommend management consider researching alternative fire suppression systems for use in the data processing area in order to protect data, reduce damage, and facilitate return to service in the event of a fire. This should significantly enhance the physical security of data operations.

Management's Response

To improve fire protection, management will research alternative fire protection systems such as Halon.

UNIX Security

etc/passwd

Multiple user IDs were setup with null passwords, as they were not yet using the system and had not requested specific passwords.

Null password allows access without requiring a password. We recommend these being removed. Per the IS Supervisor, random passwords have now been assigned.

Management's Response

The information services staff perform a daily review of the Unix operating system. At this time, the etc/passwd file is reviewed for null passwords and all system files are reviewed to ensure proper permission assignment for each file.

ROOT Directory Listing and /ETC Directory Listing World Writeables

World Writeable directories dev and mbase0205 in the ROOT Directory and services, services.111099, and services.sav were not needed per Keane Personnel.

We recommend that the Unix Administrator periodically review the list of files that are world writeable, using the find command, for inappropriate or excessive file permissions. All of these files should be investigated as to the reasonableness of the world writeable permission. In this way, accidental or intentional modifications to, or use of, program, data, and security files can be prevented.

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This report is intended solely for the information and use of the board of commissioners and management and is not intended to be and should not be used by anyone other than these specified parties.

We would be pleased to discuss the above matters or to respond to any questions, at your convenience.

Ernst & Young LLP

December 8, 2000