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MOREHOUSE PARISH HOSPITAL
SERVICE DISTRICT NO. 1 d/b/a

MOREHOUSE GENERAL HOSPITAL

Years Ended May 31, 2006 and 2005
With Report of Independent Auditors

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 2/14/07

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LAPORTE SEHRT ROMIG HAND
CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditor's Report

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

We have audited the accompanying basic financial statements of Morehouse Parish Hospital Service District No. 1 (d/b/a Morehouse General Hospital) (the "Hospital") as of and for the years ended May 31, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these basic 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 audits 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 basic financial statements referred to above present fairly, in all material respects, the financial position of the Hospital as of May 31, 2006 and 2005, and the respective changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 4 to the financial statements, in 2005, the Hospital adopted GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, which required additional disclosures regarding risks related to credit risk, interest rate risk, and foreign currency risk. Additionally, the Hospital adopted the provisions of GASB Statement No. 42, *Accounting and Financial Reporting of Capital Assets and for Insurance Recoveries*, related to impairment of capital assets and insurance recoveries.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2006, on our consideration of the Hospital's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. 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 audit.

The Hospital has not presented management's discussion and analysis that the Governmental Accounting Standards Board has determined is required to supplement, although not required to be a part of, the basic financial statements.

A Professional Accounting Corporation
Metairie, LA

November 15, 2006, except for Note 7, Item (A),
as to which the date is December 18, 2006

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

Balance Sheets
May 31, 2006 and 2005

Assets	2006	2005
Current assets:		
Cash and cash equivalents	$ 1,672,006	$ 2,961,627
Patient accounts receivable, less allowances for uncollectible accounts of $2,143,997 in 2006 and $1,868,534 in 2005	3,959,852	4,870,558
Inventories	714,854	729,744
Designated cash and investments required for current liabilities	331,020	314,157
Prepaid expenses and other assets	505,074	457,320
Total current assets	7,182,806	9,333,406
Noncurrent assets:		
Designated cash and investments	466,380	486,794
Amounts due from physicians, net of allowance for uncollectible accounts of $460,000 in 2005 and 2004	329,362	577,060
Capital assets, net	7,226,291	8,040,531
Total noncurrent assets	8,022,033	9,104,385
Total assets	$ 15,204,839	$ 18,437,791

See notes to the basic financial statements.

Liabilities and Net Assets	2006	2005
Current liabilities:		
Accounts payable	$ 3,066,552	$ 4,139,922
Employee compensation and payroll tax liabilities	1,218,049	1,448,343
Other accrued liabilities	877,909	549,646
Settlements due to third-party payors	1,012,424	143,048
Current portion of capital lease obligations	554,401	569,691
Current portion of long-term debt	2,831,020	2,814,157
Total current liabilities	9,560,355	9,664,807
Noncurrent liabilities		
Settlements due to third-party payors	170,491	180,926
Capital lease obligations, less current portion	662,008	598,799
Long-term debt, less current portion	2,241,149	2,572,169
Total noncurrent liabilities	3,073,648	3,351,894
Total liabilities	12,634,003	13,016,701
Net assets		
Invested in capital assets, net of related debt	3,437,163	3,985,715
Restricted net assets	515,450	522,890
Unrestricted net assets	(1,381,777)	912,485
Total net assets	2,570,836	5,421,090
Total liabilities and net assets	$ 15,204,839	$ 18,437,791

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

Statements of Revenues, Expenses, and Changes in Net Assets
Years Ended May 31, 2006 and 2005

	2006	2005
Operating revenue:		
Net patient service revenues, net of provision for bad debts of $2,149,702 in 2006 and $1,774,164 in 2005	$ 23,125,168	$ 25,416,819
Other operating revenue	1,469,574	1,532,614
Total operating revenue	24,594,742	26,949,433
Operating expenses:		
Salaries and benefits	14,223,567	14,899,361
Outside services	4,000,905	3,890,756
Medical supplies and drugs	3,571,443	3,738,077
Other operating expenses	3,233,574	2,911,447
Other supplies	405,915	683,542
Depreciation and amortization	1,454,694	1,142,672
Insurance	454,144	362,773
Interest	229,084	263,578
Total operating expenses	27,573,326	27,892,206
(Loss) from operations	(2,978,584)	(942,773)
Nonoperating revenue:		
Investment earnings	37,463	42,610
Grant revenue	88,712	62,313
Contributions	2,155	10,861
Total nonoperating revenue	128,330	115,784
Change in net assets	(2,850,254)	(826,989)
Net assets:		
Beginning	5,421,090	6,248,079
Ending	$ 2,570,836	$ 5,421,090

See notes to the basic financial statements.

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

Statements of Cash Flows
Years Ended May 31, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Receipts from patients and third-party payors	**$ 26,364,389**	$ 26,970,274
Payments to employees and for employee-related costs	**(13,797,924)**	(14,487,169)
Payments for operating expenses	**(12,852,191)**	(11,541,938)
Net cash (used in) provided by operating activities	**(285,726)**	941,167
Cash flows from capital and related financing activities:		
Purchases of property, building and equipment	**(38,203)**	(127,885)
Payments on capital lease obligations	**(554,331)**	(424,212)
Payments on note payable and long-term debt	**(314,157)**	(298,153)
Interest Expense Paid	**(204,084)**	(234,701)
Net cash used in capital and related financing activities	**(1,110,775)**	(1,084,951)
Cash flows from non-capital financing activities:		
Proceeds from certificates of indebtedness	**2,500,000**	4,500,000
Payments on certificates of indebtedness	**(2,500,000)**	(2,000,000)
Grants received	**88,712**	62,313
Contributions received	**2,155**	10,861
Interest expense paid	**(25,000)**	(24,739)
Net cash provided by non-capital financing activities	**65,867**	2,548,435
Cash flows from investing activities:		
Decrease (increase) in designated cash and investments, principally restricted cash and equivalents	**3,550**	(1,071)
Investment income received	**37,463**	42,610
Net cash provided by investing activities	**41,013**	41,539
(Decrease) increase in cash and cash equivalents	**(1,289,621)**	2,446,190
Cash and cash equivalents:		
Beginning	**2,961,627**	515,437
Ending	**$ 1,672,006**	$ 2,961,627

See notes to the basic financial statements.

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

Statements of Cash Flows (Continued)
Years Ended May 31, 2006 and 2005

	2006	2005
Reconciliation of operating loss to net cash (used in) provided by operating activities		
Cash flows from operating activities:		
Loss from operations	$ (2,978,584)	$ (942,773)
Adjustments to reconcile loss from operations to net cash (used in) provided by operating activities		
Depreciation and amortizaton	1,454,694	1,142,672
Interest expense paid	205,252	259,440
Provision for uncollectible accounts	2,149,702	1,774,164
Loss on disposal of capital assets	-	366
Changes in:		
Patient accounts receivable	(1,238,996)	(2,000,858)
Inventories, prepaid expenses and other assets	214,834	(73,723)
Third-party payor settlements	858,941	247,169
Accounts payable	(1,073,370)	80,775
Employee compensation, payroll taxes, and other accrued liabilities	121,801	453,935
Net cash (used in) provided by operating activities	$ (285,726)	$ 941,167
Supplemental disclosures of non-cash Financing and investing activities:		
Fully depreciated capital assets disposed	$ 946,359	$ 283,940
Capital lease obligation incurred for acquisition of equipment	$ 602,250	$ 1,305,039

See notes to the basic financial statements.

Note 1. Description of Reporting Entity and Summary of Significant Accounting Policies

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

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.

Enterprise fund accounting: The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Hospital has elected not to apply Financial Accounting Standards Board pronouncements issued after November 30, 1989. As a governmental entity, the Hospital also follows certain accounting and disclosure requirements promulgated by the GASB.

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

Capital assets: The Hospital's capital assets are reported at historical cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using these asset lives:

Land improvements	15 to 20 years
Buildings and improvements	20 to 40 years
Equipment, computers, and furniture	3 to 7 years

Assets held under capital lease obligations are included in equipment. These assets have been recorded at the present value of the minimum lease payments, which approximates the fair market value of the leased assets (see Note 8). Amortization of leased assets is provided for using the straight-line method over the term of the related lease and is included in depreciation expense.

Cost of borrowing: Except for capital assets acquired through gifts, contributions, or capital grants, interest cost on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. None of the Hospital's interest cost was capitalized in either 2006 or 2005.

Note 1. Description of Reporting Entity and Summary of Significant Accounting Policies (Continued)

Grants and contributions: From time to time, the Hospital receives grants from the State of Louisiana, as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

Restricted resources: When the Hospital has both restricted and unrestricted resources available to finance a particular program, it is the Hospital's policy to use restricted resources before unrestricted resources.

Net assets: Net assets of the Hospital are classified in three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Hospital, including amounts deposited with trustees as required by revenue bond indentures, discussed in Note 8. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Operating revenues and expenses: The Hospital's statement of revenues, expenses and changes in net assets distingulshes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services—the Hospital's principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues, when present. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Compensated Absences: The Hospital's employees earn paid time off (PTO) at varying rates depending upon length of service and other factors. Amounts earned but net yet used totaled $665,428 and $646,018 as of May 31, 2006 and 2005, respectively. These amounts are reported as a component of *employee compensation and payroll tax liabilities* on the Hospital's balance sheets.

Risk management: The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims have not exceeded this commercial coverage in any of the three preceding years.

Investments in debt and equity securities: Investments in debt and equity securities, when present, are reported at fair value except for short-term highly liquid investments that have a remaining maturity at the time they are purchased of one year or less. These investments are carried at amortized cost. Interest, dividends, and gains and losses, both realized and unrealized, on investments in debt and equity securities are included in nonoperating revenue when earned. Unrealized gains (losses) reflected in investment income were not significant in 2006 and 2005.

Note 1. Description of Reporting Entity and Summary of Significant Accounting Policies (Continued)

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

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

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

Net patient service revenue: 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 with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods, as final settlements are determined. Net patient service revenue is reported net of provision for bad debts.

Charity care: The Hospital provides care without charge, or at amounts less than established rates, to patients who meet certain criteria under its charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify for charity care, they are not reported as revenue. The Hospital maintains records to identify and monitor the level of charity care it provides. These records reflect the amount of charges foregone ($147,920 in 2006, and $334,589 in 2005) for services and supplies furnished under its charity care policy.

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

Note 2. Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts billed to patients, third-party payors, and others for services rendered. The Hospital provides medical services to government program beneficiaries and has agreements with other third-party payors that provide for payments at amounts different from established rates. These payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. The Hospital's provision for bad debts is classified as a reduction to net patient service revenue. During the years ended May 31, 2006 and 2005, approximately 71% of the Hospital's gross patient revenue was derived from Medicare and Medicaid program beneficiaries.

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

Note 2. Net Patient Service Revenue (Continued)

Retroactive settlements are provided for in some of the government payment programs outlined above, based on annual cost reports. Such settlements are estimated and recorded as amounts due to or from these programs in the accompanying financial statements. The differences between these estimates and final determination of amounts to be received or paid are based on audits by fiscal intermediaries and are reported as adjustments to net patient service revenue when such determinations are made. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term. Estimated settlements through May 31, 2004, for the Medicare program and through May 31, 2002, for the Medicaid program have been reviewed by program representatives, and adjustments have been recorded to reflect any revisions to the recorded estimates. These adjustments resulted in a decrease in net patient service revenue of $624,208 in 2006, and $-0- in 2005. The effect of any adjustments that might be made to cost reports still subject to review will be reported in the Hospital's financial position or results of operations as such determinations are made.

The Hospital receives payments from the Louisiana State Department of Health and Hospitals for Medicaid and self-pay uncompensated care service costs. The Hospital receives interim amounts each October that are appropriated in the State's current fiscal year based on an estimate utilizing the facility's costs incurred in the previous fiscal year. The Hospital recognized interim amounts of $3,640,211 and $2,809,479, in the fiscal years ended May 31, 2006 and 2005, respectively.

Current regulations require retroactive audit of the claimed uncompensated cost and comparison to the interim amounts paid in each fiscal year. Any overpayments will be recouped by Medicaid and the Hospital has not made any provisions for such recoupments. Management contends that interim amounts paid reasonably estimate the settlement. To the extent managements' estimates differ from actual results, the differences will be used to adjust income for the period when differences arise.

Note 3. Operating Results and Liquidity

As shown in the accompanying financial statements, the Hospital incurred an overall decrease in net assets of $(2,850,254) during the year ended May 31, 2006, and as of that date, the Hospital's current liabilities exceed its current assets by $2,377,549. As of the date of these financial statements, the Hospital has again received reimbursements provided by the Louisiana Rural Hospital Preservation Act. While continued legislative appropriation of these funds cannot be assured, management expects to continue to derive a significant portion of revenue from this program in future years to fund a portion of its operating costs. Additionally, management has implemented several other initiatives to improve operating results, including the following:

- In November of 2006, the Hospital board entertained a proposal from a national Hospital consulting company to review the Hospital's services and delivery processes for possible improvements in efficiency and cost. We believe there are significant opportunities in this area. A decision on this engagement is anticipated by January of 2007.

- Through attrition, the Hospital has eliminated two administrative positions since May 31, 2006.

Note 3. Operating Results and Liquidity (Continued)

- The Hospital Board of Commissioners approved a Hospital strategic initiative in July of 2006. The Hospital will be seeking a guaranteed loan through the USDA's community facilities program, with the loan proceeds being used to construct a medical office building and recruit physicians. The Hospital will also refinance its annual operating credit facility and other debt in order to improve liquidity and cash position. The Hospital believes the additional revenue from the new physicians will be more than sufficient to provide cash flow for the debt service.

- In March of 2006, the Hospital implemented a full time hospitalist program with the goals of reducing transfers from the emergency room and stimulating additional utilization of hospital services.

- The Hospital has employed a new ob/gyn physician who is scheduled to open his practice in Bastrop in January of 2007. This physician will replace an existing ob/gyn who is leaving in December of 2006.

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

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

Note 4. Deposits and Investments

Louisiana state statutes authorize the Hospital to invest in direct obligations of the U.S. Treasury and other federal agencies, time deposits with state banks and national banks having their principal office in the State of Louisiana, guaranteed investment contracts issued by highly rated financial institutions, and certain investments with qualifying mutual or trust fund institutions.

In 2006, the Hospital adopted GASB Statement No. 40 (GASB 40), *Deposit and Investment Risk Disclosures*, which requires additional disclosures of investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk associated with interest-bearing investments. Such disclosures required by GASB 40 and applicable to the Hospital are reflected below.

Interest Rate Risk: The Hospital does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from changing interest rates.

Credit Risk: Louisiana's statutes also require that all the deposits of the Hospital be protected by insurance or collateral. The market value of collateral pledged must equal 100% of the deposits not covered by insurance. The Hospital's bank deposits consist of demand deposit accounts and certificates of deposit. These bank deposits are included in cash and cash equivalents and designated cash, and, as of May 31, 2006, the Hospital's deposits were fully insured or collateralized with securities held by the agent of the pledging banks in the Hospital's name.

Statutes authorize the Authority to invest in obligations of the U.S. Treasury, agencies, and instrumentalities, commercial paper rated A-1 by Standard & Poor's Corporation or P-1 by Moody's Commercial Paper Record, and bankers' acceptances.

Note 4. Deposits and Investments (Continued)

Concentration of Credit Risk: The Hospital places no limit on the amount it may invest in any one issuer. At May 1, 2006, the Hospital's invested funds consisted of certificates of deposit included in cash and cash equivalents. The Hospital maintained deposits in one financial institution in excess of FDIC insurance limits, however, as discussed above, the funds were covered by collateral held by the financial institution in the Hospital's name.

As of May 31, 2006 and 2005, all of the Hospital's deposits and short term investments were considered cash and cash equivalents and are included in the Hospital's balance sheets as follows:

	May 31,	
	2006	2005
Current assets:		
Cash and cash equivalents	**$ 1,672,006**	$ 2,961,627
Designated cash and equivalents required for current liabilities	**331,020**	314,157
Noncurrent assets:		
Designated cash and equivalents	**466,380**	486,794
	$ 2,469,406	$ 3,762,578

Note 5. Designated Cash and Investments

The terms of the Hospital's 1997 Revenue Bonds require funds to be maintained on deposit in certain accounts with the trustee (see Note 8). The funds on deposit in the accounts are required to be invested by the trustee in accordance with the terms of the bond resolution. In addition, the Hospital's Board of Commissioners has designated certain assets to be used for future expansion and equipment additions. The composition of assets whose use is limited as of May 31, 2006 and 2005, was as follows:

	May 31,	
	2006	2005
By board for specific purposes		
Certificates of deposit	**$ 281,949**	$ 278,060
Trusted funds (principally interest bearing cash and certificates of deposits)		
Debt service fund	**39,007**	40,552
Debt service reserve fund	**462,005**	461,521
Capital additions and contingencies fund	**14,439**	20,818
	515,451	522,891
Total designated cash and investments	**797,400**	800,951
Less: Amount required for current liabilities	**(331,020)**	(314,157)
Noncurrent designated cash and investments	**$ 466,380**	$ 486,794

Note 6. Capital Assets

Capital assets activity as of and for the year ended May 31, 2006, is as follows:

	May 31, 2005	Additions	Transfers and Disposals	May 31, 2006
Capital assets, not being depreciated:				
Land	$ 272,384	$ -	$ -	$ 272,384
Total capital assets, not being depreciated	272,384	-	-	272,384
Capital assets, being depreciated:				
Land improvements	625,500	-	-	625,500
Buildings	14,400,347	10,548	-	14,410,895
Equipment	23,616,066	663,020	(979,473)	23,299,613
Total capital assets, being depreciated	38,641,913	673,568	(979,473)	38,336,008
Less: accumulated depreciation	(30,873,766)	(1,454,694)	946,359	(31,382,101)
Total capital assets, being depreciated, net	7,768,147	(781,126)	(33,114)	6,953,907
Hospital capital assets, net	$ 8,040,531	$ (781,126)	$ (33,114)	$ 7,226,291

Capital assets activity as of and for the year ended May 31, 2005, is as follows:

	May 31, 2004	Additions	Transfers and Disposals	May 31, 2005
Capital assets, not being depreciated:				
Land	$ 272,384	$ -	$ -	$ 272,384
Total capital assets, not being depreciated	272,384	-	-	272,384
Capital assets, being depreciated:				
Land improvements	625,500	-	-	625,500
Buildings	14,360,449	39,898	-	14,400,347
Equipment	22,506,980	1,393,026	(283,940)	23,616,066
Total capital assets, being depreciated	37,492,929	1,432,924	(283,940)	38,641,913
Less: accumulated depreciation	(30,014,668)	(1,142,672)	283,574	(30,873,766)
Total capital assets, being depreciated, net	7,478,261	290,252	(366)	7,768,147
Hospital capital assets, net	$ 7,750,645	$ 290,252	$ (366)	$ 8,040,531

Note 6. Capital Assets (Continued)

The Hospital leases certain major movable and other nonmovable equipment under operating leases and capital leases. Refer to Note 7 for amounts relating to these leases.

Note 7. Long-Term Liability Activity

Long-term liability activity as of and for the years ended May 31, 2006 and 2005, was as follows:

	May 31, 2005	Additions	Reductions	May 31, 2006	Due Within One Year	Long-Term Portion
Bonds payable and capital leases:						
Hospital revenue bonds, Series 1997	$ 2,886,326	$ -	$ (314,157)	$ 2,572,169	$ 331,020	$ 2,241,149
Certificate of indebtedness, Series 2005b	2,500,000	-	(2,500,000)	-	-	-
Certificate of indebtedness, Series 2006	-	2,500,000	-	2,500,000	2,500,000	-
Capital lease obligations	1,168,490	47,919	-	1,216,409	554,401	662,008
Total bonds payable and capital leases	6,554,816	2,547,919	(2,814,157)	6,288,578	3,385,421	2,903,157
Other liabilities:						
Settlements due to third-party payors	323,974	858,941	-	1,182,915	1,012,424	170,491
Total long-term liabilities	$ 6,878,790	$ 3,406,860	$ (2,814,157)	$ 7,471,493	$ 4,397,845	$ 3,073,648

	May 31, 2004	Additions	Reductions	May 31, 2005	Due Within One Year	Long-Term Portion
Bonds payable and capital leases:						
Hospital revenue bonds, Series 1997	$ 3,184,479	$ -	$ (298,153)	$ 2,886,326	$ 314,157	$ 2,572,169
Certificate of indebtedness, Series 2005b	-	2,500,000	-	2,500,000	2,500,000	-
Certificate of indebtedness, Series 2005a	-	2,000,000	(2,000,000)	-	-	-
Capital lease obligations	287,663	1,305,039	(424,212)	1,168,490	569,691	598,799
Total bonds payable and capital leases	3,472,142	5,805,039	(2,722,365)	6,554,816	3,383,848	3,170,968
Other liabilities:						
Settlements due to third-party payors	76,805	315,738	(68,569)	323,974	143,048	180,926
Total long-term liabilities	$ 3,548,947	$ 6,120,777	$ (2,790,934)	$ 6,878,790	$ 3,526,896	$ 3,351,894

Long-term Debt Details: Long-term debt as of May 31, 2006 and 2005, consists of the following:

		2006	2005
Hospital revenue bonds, Series 1997	(A)	$ 2,572,169	$ 2,886,326
Certificate of indebtedness	(B)	2,500,000	2,500,000
Capital lease obligations	(C)	1,216,409	1,168,490
		6,288,578	6,554,816
Less current maturities		(3,385,421)	(3,383,848)
		$ 2,903,157	$ 3,170,968

Note 7. Long-Term Liability Activity (Continued)

(A) The Hospital Revenue Bonds, Series 1997, are term bonds with an annual interest rate of 5.24%. Payment of the scheduled principal and interest on these bonds is due in monthly installments of $38,159. The 1997 Revenue Bonds are obligations of the Hospital secured by a pledge of the Hospital's revenue. Under the terms of the bond indenture, the Hospital is required to maintain, among other provisions, a specified minimum debt service coverage ratio. The Hospital was not in compliance with the specified debt service coverage ratio as of May 31, 2006.

As of December 18, 2006, the Hospital had received a waiver from the bond holder for the covenant noncompliance for the year ended May 31, 2006. The bond indenture stipulates that if this covenant is not met that the Hospital will retain an independent consultant to make recommendations to increase the debt service coverage ratio to the required level, and that the Hospital will follow such consultant's recommendations to the extent feasible. As of the date of these financial statements, the Hospital's management had begun the process of interviewing such consultants, subject to approval by the Board of Commissioners.

(B) The Hospital adopted a resolution during May 2006, issuing $2,500,000 of certificates of indebtedness, Series 2006, dated May 11, 2005, secured by and payable from a pledge of all revenues accruing to the Hospital for the calendar year ending December 31, 2006. The bond matures March 1, 2007. The previous (Series 2005) $2,500,000 certificate of indebtedness matured and was retired during the fiscal year ended May 31, 2006. The 2005 issue bore interest at 4.626% per annum. The interest per annum on the 2006 issue is 4.79% and is payable upon maturity.

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

On June 27, 2004, the Hospital issued a certificate of indebtedness in the amount of $2,000,000 to a local financial institution. The Hospital repaid the $2,000,000 plus interest on October 21, 2004.

Long-term debt principal and interest maturities, inclusive of capital leases, as of May 31, 2006, are as follows:

Year ending May 31:	Principal	Interest
2007	$ 3,385,421	$ 257,775
2008	834,662	161,039
2009	448,705	117,043
2010	453,116	93,556
2011	437,083	69,560
2012	729,591	78,821
	$ 6,288,578	$ 777,794

Note 7. Long-Term Liability Activity (Continued)

The future minimum rental commitments payable as if May 31, 2006, on capital lease obligations are as follows:

Year ending May 31:		
2007	$	624,345
2008		506,044
2009		90,639
2010		70,639
2011		29,637
Total minimum lease payments		1,321,304
Less amount representing interest		(104,895)
Present value of minimum lease payments	$	1,216,409

During the year ended May 31, 2005, the Hospital entered into a master lease agreement and related supplements to obtain a new information system and related software. As of May 31, 2005, the Hospital had included under the caption "equipment," $683,865 of assets associated with the master lease. An additional supplement under this lease was executed during the year ended May 31, 2006, resulting in the capitalization of an additional $243,388. The cost of all leased assets included under the equipment caption totaled $2,000,175 and $3,418,534, and accumulated amortization was $819,506 and $2,857,954 at May 31, 2006 and 2005, respectively.

The Hospital has also entered into various cancelable operating leases for equipment. Operating lease expense was approximately $288,566 and $327,402 for the years ended May 31, 2006 and 2005, respectively.

Note 8. Employee retirement plans

The Hospital sponsors two pension plans. Under the provisions of the Hospital's pension plan documents, the Hospital is required to contribute 10.0% of the eligible employee's salary and 7.5% of the noneligible employee's salary annually. The plans provide for the contributions (and interest allocated to the employee's account) to become partially vested after three years of continuous employment and fully vested after seven years of continuous employment. The unvested portion of an account of an employee who terminates employment before becoming fully vested is used to reduce the Hospital's current year contribution. The Hospital's required contribution was $1,106,107 for 2006, and $1,190,794 for 2005.

Contributions made during the periods for the plans discussed above were $1,156,715 and $822,972 in 2006 and 2005, respectively. The Hospital's contribution payable related to the plan of $877,465 and $1,156,715 at May 31, 2006 and 2005, respectively, is included in accounts payable and accrued expenses on the accompanying balance sheets. Total payroll for all employees was $11,296,039 and $12,280,192 for the years ended May 31, 2006 and 2005, respectively. Substantially all employees of the Hospital are covered by the plan discussed above.

Note 7. Long-Term Liability Activity (Continued)

The Hospital established the Morehouse General Hospital Tax Deferred Savings Plan. This plan, which qualifies as a tax-sheltered annuity plan under Section 403(b) of the Internal Revenue Code, covers all employees who elect to participate. The plan allows participants to defer a portion of their annual compensation. The amount of annual contributions to the plan by participants is subject to certain limitations as defined in the plan agreement. The participants vest 100% immediately in their contributions and investment earnings of the plan. The plan agreement allows discretionary employer contributions to be made to the plan. No employer contributions were made during the years ended May 31, 2006 and 2005.

Retirement expense, net of forfeitures, related to the above plans included in salaries and benefits in the accompanying statements of revenues, expenses, and changes in net assets was $877,465 and $1,156,715 for the years ended May 31, 2006 and 2005, respectively.

Note 9. Commitments and Contingencies

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

The Hospital has purchased commercial insurance that provides first-dollar coverage for workers' compensation claims. The Hospital was previously self-insured for employee health insurance up to $75,000 per claim. A liability was recorded when it is probable that a loss had been incurred and the amount of that loss could be reasonably estimated. Liabilities for claims incurred were reevaluated periodically to take into consideration recently settled claims, frequency of claims, and other economic and social factors. During the year ended May 31, 2006, management purchased commercial insurance for employee health plan claims and, accordingly, was no longer self-insured.

Changes in the Hospital's aggregate claims liability for medical malpractice and employee health insurance in fiscal years 2006 and 2005, were as follows:

Year Ended May 31,	Beginning of Fiscal Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year Ending
2006	$ 275,837	$ 522,795	$ 798,632	$ -
2005	$ 362,000	$ 946,445	$ 1,032,608	$ 275,837

Note 10. Government Regulations

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

Legislation and regulation at all levels of government have affected and are likely to continue to affect the operation of the Hospital. Federal health care reform legislation proposals debated in Congress in recent years have included significant reductions in Medicare and Medicaid program reimbursement to hospitals and the promotion of a restructured delivery and payment system focusing on competition among providers based on price and quality, managed care, and steep discounting or capitated payment arrangements with many, if not all, of the Hospital's principal payors. It is not possible at this time to determine the impact on the Hospital of government plans to reduce Medicare and Medicaid spending, government implementation of national and state health care reform, or market-initiated delivery system and/or payment methodology changes. However, such changes could have an adverse impact on operating results, cash flows, and estimated debt service coverage of the Hospital in future years. The Health Insurance Portability and Accountability Act ("HIPAA") was enacted August 21, 1996, to assure health insurance portability, reduce health care fraud and abuse, guarantee security and privacy of health information, and enforce standards for health information. Organizations were required to be in compliance with certain HIPAA provisions beginning in April 2004. Provisions not yet finalized are required to be implemented two years after the effective date of the regulation. Organizations are subject to significant fines and penalties if found to be not compliant with the provisions outlined in the regulations.

Note 11. Concentrations of Credit Risk

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

	May 31,	
	2006	2005
Medicare	35%	34%
Medicaid	15	18
Managed Care	16	19
Self-Pay	34	29
	100%	100%

Note 12. New Governmental Accounting Standards Board (GASB) Statements and Pending Pronouncements

As of May 31, 2006, the Governmental Accounting Standards Board has issued several statements not yet implemented by the Hospital. The Statements which might impact the Hospital are as follows:

Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, issued April 2004, will be effective for the Hospital beginning with its year ending May 31, 2007. This Statement establishes uniform financial reporting standards for other postemployment benefit plans (OPEB plans) and supersedes existing guidance.

Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, issued June 2004, will be effective for the Hospital beginning with its year ending May 31, 2007. This Statement establishes standards for the measurement, recognition and display of other postemployment benefits, expenses and related liabilities or assets, note disclosures and, if applicable, required supplementary information in the financial reports.

Statement No. 46, *Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34*, will be effective for the Hospital beginning with its year ending May 31, 2007. The purpose of Statement No. 46 is to help organizations determine when net assets have been restricted to a particular use by the passage of enabling legislation and to specify how those net assets should be reported in financial statements when there are changes in the circumstances surrounding such legislation.

Statement No. 47, *Accounting for Termination Benefits*, will be effective for the Hospital beginning with its year ending May 31, 2007. This statement establishes the accounting standards for termination benefits.

The Hospital's management has not yet determined the effect these Statements will have on the Hospital's financial statements.

LAPORTE SEHRT
ROMIG HAND
CERTIFIED PUBLIC ACCOUNTANTS

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

The Board of Commissioners
Morehouse Parish Hospital Service District No. 1
(d/b/a Morehouse General Hospital)
Bastrop, Louisiana

We have audited the basic financial statements of Morehouse Parish Hospital Service District No. 1 (d/b/a Morehouse General Hospital) (the "Hospital") as of and for the year ended May 31, 2006, and have issued our report thereon dated November 15, 2006, except for Note 7, Item (A) as to which the date is December 18, 2006. 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 Hospital's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of 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 reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Hospital in a separate letter dated November 15, 2006.

Compliance and Other Matters
As part of obtaining reasonable assurance about whether the Hospital's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under Government Auditing Standards and are described below:

2006-1 Audit Report

We noted an instance of noncompliance regarding failure to submit the audited financial statements to the Office of the Legislative Auditor within six months of the close of the entity's fiscal year, as required by Louisiana Revised Statute 24:513.

Management Response and Corrective Action

The delay in the issuance of the audited financial statements was due to the need to resolve certain issues related to the Hospital's liquidity, and to request a waiver of certain bond covenant provisions. Measures are currently being undertaken to improve the Hospital's results of operations and financial position.

2006-2 Compliance with Bond Resolution

We noted that the Hospital was not in compliance with Section 5.1 of the Resolution relating to $4,750,000 Revenue Bonds (series 1997) reflecting the provisions of the resolutions adopted by Morehouse Parish Hospital Service District on November 3, 1997.

Management Response and Corrective Action

Management has begun to take steps its deems appropriate to eliminate the instance of noncompliance in the future related to Section 5.1 of the Bond Resolution for the Hospital Revenue Bonds.

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 those specified parties. Under Louisiana Revised Statute 24:513, this report is distributed by the Legislative Auditor of the State of Louisiana as a public document.

A Professional Accounting Corporation
Metairie, LA

November 15, 2006

LAPORTE SEHRT ROMIG HAND
CERTIFIED PUBLIC ACCOUNTANTS

Independent Auditor's Report
on Supplementary Information

To the Board of Commissioners
Morehouse Parish Hospital Service District No. 1
Bastrop, Louisiana

Our report on our audits of the basic financial statements of Morehouse Parish Hospital Service District No. 1 (d/b/a Morehouse General Hospital) (the "Hospital") for the years ended May 31, 2006 and 2005, appears on page 1. These audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information shown on page 23 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

LaPorte, Sehrt, Romig & Hand

A Professional Accounting Corporation
Metairie, LA

November 15, 2006

110 VETERANS MEMORIAL BOULEVARD, SUITE 200, METAIRIE, LA 70005-4958 • 504.835.5522 • FAX 504.835.5535
5100 VILLAGE WALK, SUITE 202, COVINGTON, LA 70433-4012 • 985.892.5850 • FAX 985.892.5956
WWW.LAPORTE.COM

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

Schedule of Board of Commissioners and Compensation
For the Year Ended May 31, 2006

Commissioner	Total Paid
Dr. Carter Cox	$0
Mattie Washington	$720
Alfred Twymon	$640
John Shackelford	$400
Randy Bowen	$680
Jack Scoggins	$280
Total	$2,720

See independent auditors' report on supplementary information

MOREHOUSE GENERAL HOSPITAL

MANAGEMENT LETTER

May 31, 2006

LAPORTE SEHRT ROMIG HAND
CERTIFIED PUBLIC ACCOUNTANTS

December 15, 2006

Members of the Board of Commissioners
Morehouse Parish Hospital Service District No. 1
Bastrop, Louisiana

In planning and performing our audit of the consolidated financial statements of **MOREHOUSE PARISH HOSPITAL SERVICE DISTRICT NO. 1 (d/b/a MOREHOUSE GENERAL HOSPITAL)** (the "Hospital") for the year ended May 31, 2006 (on which we have issued our report dated November 16, 2006), we developed the following recommendations concerning certain matters related to its internal control and certain observations and recommendations on other accounting, administrative, and operating matters. Additionally, we have included a section on general comments noted during the audit. A description of the responsibility of management for establishing and maintaining internal control, and the objectives and inherent limitations of internal control, is set forth in the attached Appendix, and should be read in conjunction with this letter. Our comments are presented in Exhibits I, and II and are listed in the table of contents thereto.

Exhibit III details the status of prior year comments.

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

LaPorte, Sehrt, Romig & Hand

A Professional Accounting Corporation

110 Veterans Memorial Boulevard, Suite 200, Metairie, LA 70005-4958 • 504.835.5522 • Fax 504.835.5535
5100 Village Walk, Suite 202, Covington, LA 70433-4012 • 985.892.5850 • Fax 985.892.5956
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MOREHOUSE GENERAL HOSPITAL
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EXHIBIT I

GENERAL COMMENTS

MANAGEMENT AND STAFF COOPERATION DURING THE AUDIT

We wish to extend our thanks to the Hospital's governing board for the confidence they have placed in us once again by allowing to serve the Hospital's compliance and assurance needs. That process requires us to work closely with the Hospital management, financial and accounting staff to staff accomplish the stated audit objectives. Once again this year we were greatly pleased with the assistance and patience afforded us in this process.

Everyone involved on the audit team wishes to express their gratitude and recognize the efforts of the finance and accounting staff at MGH who were instrumental in bringing the audit to a successful conclusion this year. While we were greatly pleased with the cooperation we received throughout the Hospital, we wanted to specifically acknowledge the contributions of the finance and accounting staff for their efforts and assistance.

EXHIBIT II

ADMINISTRATIVE, INTERNAL CONTROL, AND OTHER MATTERS

None

EXHIBIT III

STATUS OF PRIOR YEAR COMMENTS

Included below is the status of prior year comments from the Hospital's fiscal year ended May 31, 2005 and 2004 audits:

2005 – 1 Check Signing Process

Observation:

We noted in a review of the Hospital's internal controls over disbursements and expenditures that all disbursements are electronically signed. At the present time, all checks irrespective of amount are valid when signed electronically.

Recommendation:

We recommend that policies or procedures be adopted which require a manual co-signature by an authorized check signer to accompany the electronic signature on all checks over a predetermined dollar threshold. This will significantly enhance internal control procedures over cash disbursements.

When strictly followed, this policy provides for strong control over the cash disbursements process, but it can hinder operations when there are a large number of checks requiring a manual signature and authorized check signers are unavailable. In an effort to relieve this problem while retaining strong controls, we suggest that the Hospital consider the following options:

- Require at least one manual signature for amounts exceeding $10,000 (the threshold is a matter of judgement. Many larger facilities have higher thresholds, not because their volume of activity is greater, but because they are able to achieve a greater segregation of duties and, therefore, often have stronger compensating controls.)

- Establish a strict list of exceptions to the manual signature requirement for normal and recurring monthly disbursements, such as rent, utilities, etc., upon identification and approval of the Board of Commissioners.

- Continue to permit both signatures to be electronically generated for disbursements under the threshold established above.

- Consider the need to add an additional authorized check signer to ensure that a manual signature can always be obtained when required. Care should be taken, however that any additional signer is separate from the purchasing and recordation functions.

We feel that the implementation of one or all of the above policies could strengthen the Hospital's authorization and approval process of disbursements while reducing some of the difficulties and problems associated with the implementation of the policy.

Management Response:

Management will recommend the following policy change:

- Require at least one manual signature for amounts exceeding a predetermined threshold.
- Establish a strict list of exceptions to the manual signature requirement for normal and recurring monthly disbursements.

Status – Resolved. After reviewing the existing processes in place regarding the issuance and signing of checks, the Hospital instituted a policy whereby at least one manual signature will be required for disbursements of cash in excess of established thresholds.

2005-2 Physical Inventory Process

Observation:

Currently, physical inventory counts are taken by department heads and\or department personnel - in practice, often the same staff responsible for ordering, receiving and storing the goods.

Recommendation:

While each department is responsible for the actual physical counts, and increased efficiencies are obtained by having department personnel involved, we suggest that an observer independent of the department be present at the time of counting. Additionally, we recommend that the Hospital's accounting staff obtain the physical count sheets and verify the accuracy of the amounts reported by the departments through test counts performed on a sample basis.

Management Response:

Management will appoint a representative independent of the department to observe the physical counts beginning with the FYE 5/31/06 inventory. Also, the accounting staff will begin verifying the accuracy through test counts performed on a sample basis.

Status – Resolved. During 2006 the Hospital implemented the above recommendation.

2004-1 Financial Statement Close Process

Observation:

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

Recommendation:

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

Management Response:

Management agrees that improving the accuracy of the interim financial statements is important. The most significant adjustment made in prior years after the closing of the interim financials was for the disproportionate share revenue received each October. Management instituted a change in accounting method for that revenue, and that entry s now made prior to year end.

Status – IN PROCESS. During 2005 management of the Hospital changed the methodology for recording the disproportionate share revenue received from the state. Additionally, management believes that the current accounting for this revenue will allow for a clearer picture of the Hospital's results of operations on a monthly basis. During 2005 and 2006, we noted that significant adjustments were still proposed by management well after year end. While some of these adjustments are attributable to the prior year adoption of the new accounting information system, and by Medicare and Medicaid settlements determined after the fiscal year, management is still implementing processes to fully implement this recommendation as it relates to some of the more routine account balances and estimates.

APPENDIX

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF INTERNAL CONTROL

The following comments concerning management's responsibility for internal control and the objectives and inherent limitations of internal control are adapted from the Statements on Auditing Standards of the American Institute of Certified Public Accountants.

Management's Responsibility:

Management is responsible for establishing and maintaining internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls.

Objectives:

The objectives of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Limitations:

Because of inherent limitations in any internal control, misstatements due to errors or fraud may occur and not be detected. Also, projection of any evaluation of internal control to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.