STATE OF LOUISIANA
LEGISLATIVE AUDITOR

Louisiana State University System
State of Louisiana
Baton Rouge, Louisiana

January 15, 2003

Financial and Compliance Audit Division

Daniel G. Kyle, Ph.D., CPA, CFE
Legislative Auditor

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LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA
Baton Rouge, Louisiana

Basic Financial Statements and
Independent Auditor's Reports
As of and for the Year Ended June 30, 2002

Under the provisions of state law, this report is a public document. A copy of this report has been submitted to the Governor, to the Attorney General, and to other public officials as required by state law. A copy of this report has been made available for public inspection at the Baton Rouge, New Orleans, and Shreveport offices of the Legislative Auditor.

January 15, 2003

LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA

Basic Financial Statements and
Independent Auditor's Reports
As of and for the Year Ended June 30, 2002

CONTENTS

OFFICE OF
LEGISLATIVE **A**UDITOR
STATE OF LOUISIANA
BATON ROUGE, LOUISIANA 70804-9397

DANIEL G. KYLE, PH.D., CPA, CFE
LEGISLATIVE AUDITOR

1600 NORTH THIRD STREET
POST OFFICE BOX 94397
TELEPHONE: (225) 339-3800
FACSIMILE: (225) 339-3870

December 17, 2002

Independent Auditor's Report
on the Financial Statements

LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA
Baton Rouge, Louisiana

We have audited the accompanying basic financial statements of the Louisiana State University System, a component unit of the State of Louisiana, as of and for the year ended June 30, 2002, as listed in the foregoing table of contents. These financial statements are the responsibility of management of the Louisiana State University System. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of the Louisiana State University School of Medicine in New Orleans Faculty Group Practice (doing business as LSU Healthcare Network), included within the basic financial statements of the Louisiana State University System. As discussed in notes 1-B and 19, the LSU Healthcare Network is a nonprofit corporation included as a part of the Louisiana State University System, Louisiana State University Health Sciences Center, and represents 1% of total assets, 2.5% of total revenues, and 2.6% of total expenses of the Louisiana State University System. The financial statements of the LSU Healthcare Network were audited by another auditor whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the LSU Healthcare Network, is based on the report of the other auditor.

Except as discussed in the following paragraphs, 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. 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 audit and the report of the other auditor provide a reasonable basis for our opinion.

The Louisiana State University Health Sciences Center - Health Care Services Division (HCSD) was unable to provide adequate support for an adjustment to restate capital assets as of June 30, 2001. HCSD changed accounting systems used for financial reporting purposes for capital assets, which increased the value of the capital assets reported as of June 30, 2001, by $88,463,827, at cost (from $378,654,254 to $467,118,081). As described in Exhibit A of this report, HCSD was unable to reconcile the differences between the two accounting systems. As a result, we were unable to satisfy ourselves as to the accuracy of HCSD's adjusted capital assets of $467,118,081 and accumulated depreciation of $330,604,506, at June 30, 2001, and depreciation expense of $24,083,923 for the year ended June 30, 2002. HCSD's failure to perform a reconciliation may have resulted in an overstatement of capital assets, at cost, by as much as $78,756,758 in the financial statements for the fiscal year ended June 30, 2002. In addition, accumulated depreciation may be overstated, as well as the amount of depreciation expense claimed for financial statement and federal cost report purposes.

The Louisiana State University System did not present a statement of cash flows for the year ended June 30, 2002. Presentation of such a statement summarizing the Louisiana State University System's operating, non-capital financing, capital financing, and investing activities is required by accounting principles generally accepted in the United States of America. The omission of a statement of cash flows results in an incomplete presentation.

In our opinion, based on our audit and the report of the other auditor, except that the omission of the statement of cash flows results in an incomplete presentation, and except for the effects of such adjustments, if any, as might have been determined to be necessary had HCSD reconciled the differences between the two accounting systems for capital assets, the financial statements referred to previously present fairly, in all material respects, the financial position of the Louisiana State University System as of June 30, 2002, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis on pages 5 through 13 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board (GASB). We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

As discussed in notes 5 and 15 to the financial statements, the State of Louisiana changed its capitalization policy for fixed assets, and the Louisiana State University System adopted the provisions of GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, as amended by GASB Statement No. 35, as of July 1, 2001. This results in a change in the format and content of the basic financial statements.

LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA
Audit Report, June 30, 2002

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2002, on our consideration of Louisiana State University System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Respectfully submitted,

Daniel G. Kyle, CPA, CFE
Legislative Auditor

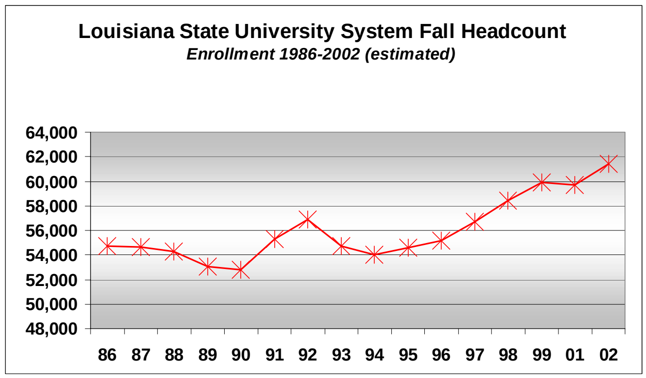
JPB:ES:RCL:dl

[LSU02]

INTRODUCTION

The following discussion and analysis provides an overview of the financial position and activities of the Louisiana State University System (the System) for the year ended June 30, 2002. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto which follow this section.

The Louisiana State University System is the state's flagship system. Enrollment is approximately 62,000 and degrees conferred range from Associate Degree to Doctor of Philosophy. In addition, professional degrees in Medicine, Dentistry, Veterinary Medicine, and Law are conferred. The System also includes such dedicated Centers as the Pennington Biomedical Research Center specializing in nutrition research and the LSU Agricultural Center providing statewide agricultural research and extension services to the residents of the state.



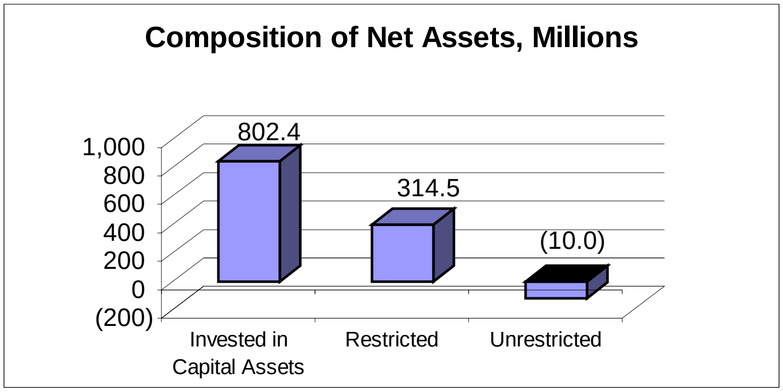
Moreover, the System is charged with the responsibility of administering ten public hospitals. These hospitals are the primary deliverer of health care services to the indigent population of the state and account for over one million in-patient and out-patient visits each year.

FINANCIAL HIGHLIGHTS

The System is transitioning this year to a new financial reporting format required by the Governmental Accounting Standards Board. Because only information for the year ending June 30, 2002, will be presented this year, comparisons to the preceding fiscal year will not be available.

Major changes from past financial reporting requirements include categorizing revenues and expenses as operating or non-operating, the reporting of capital assets net of depreciation, the reflecting of student tuition and fees at a level net of any scholarship allowances, the treatment of state appropriations as non-operating revenue to the System, and the allocating of summer term revenues and expenses between financial reporting periods rather than entirely in just one as in the past.

Overall, the System's financial position remained strong at June 30, 2002, with total assets of $1.76 billion and total liabilities of $0.66 billion. Net assets, which represent the residual interest in the System's assets after liabilities are deducted, increased by $76.1 million (7.4%) over the previous fiscal year to $1.1 billion. Shown on the following page is a chart illustrating the composition of the System's net assets as of June 30, 2002.



OVERVIEW OF THE FINANCIAL STATEMENTS

The System's financial report consists of two sections, Management's Discussion and Analysis (this section) and the basic financial statements including the notes to the financial statements. The basic financial statements are the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows.

The System did not prepare the Statement of Cash Flows for the year ending June 30, 2002, as the time frame for completion would not permit validation of the methodology used to complete the statement and inaccuracies would likely have occurred. The System is arguably the most complex financial institution in the state. The System will begin including the Statement of Cash Flows for the fiscal year ending June 30, 2003, and all subsequent years thereafter.

BASIC FINANCIAL STATEMENTS

The basic financial statements present information for the System as a whole. The Statement of Net Assets presents the financial position of the System at the end of the fiscal year and includes all assets and liabilities of the System. The difference between total assets and total liabilities is one way to measure the System's financial health or position, while the change in net assets is a useful indicator of whether the financial condition of the System is improving or deteriorating. Over time, increases or decreases in the System's net assets can be useful in assessing whether its financial health is improving. Other non-financial factors such as the trend in enrollment and the condition of the physical plant are also useful in evaluating the overall financial health of the System.

Net assets are divided into three major categories.

> Invested in capital assets, net of debt - provides the institution's equity in property, plant and equipment owned by the System.
>
> Restricted net assets - represent those assets that are not available for spending as a result of legislative requirements, donor agreements, grant requirements, et cetera.

Unrestricted net assets - represent those assets that are available to the System for any lawful purpose of the System.

From the data presented, readers of the Statement of Net Assets are able to determine the following:

The assets available to continue the operations of the System

The liabilities of the System which include the amount owed vendors and lending institutions

The net assets and their availability for expenditure by the System

Current assets total $517 million and consist primarily of cash and cash equivalents, net receivables, investments, and inventories. Current liabilities total $340 million and consist primarily of accounts payables and accrued liabilities, deferred revenues, amounts due to the State Treasury, and a contingent amount for uncompensated absences. Other assets total $240.3 million and include cash and investments that are externally restricted to make debt service payments or to maintain sinking or reserve funds.

Noncurrent liabilities total $317.4 million and include (1) principal amounts of revenue bonds payable, notes payable, and capital lease obligations with contractual maturities greater than one year; (2) estimated amounts for accrued compensated absences and other liabilities that will not be paid within the next fiscal year; and (3) other liabilities that while scheduled to be paid within one year are to be paid from funds classified as noncurrent assets.

Restricted nonexpendable net assets total $110.2 million and consist of endowment and similar type funds which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained intact and invested for the purpose of producing income that may either be expended or added to principal.

Restricted expendable net assets total $204.3 million and include resources that the System is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties. A summarized listing of the System's assets, liabilities, and net assets at June 30, 2002 is as follows:

Statement of Net Assets
As of June 30, 2002

Assets	
Current assets	$517,362,066
Capital assets	1,007,044,756
Other assets	240,320,910
Total Assets	1,764,727,732
Liabilities	
Current liabilities	340,466,475
Noncurrent liabilities	317,383,377
Total Liabilities	657,849,852
Net Assets	
Invested in capital assets, net of debt	802,407,410
Restricted - nonexpendable	110,218,459
Restricted - expendable	204,256,374
Unrestricted	(10,004,363)
Total Net Assets	$1,106,877,880

The Statement of Revenues, Expenses, and Changes in Fund Net Assets (SRECNA) displays information on how the System's assets changed as a result of current year operations. This statement presents the revenues received by the System, both operating and nonoperating, and the expenses paid by the System, operating and nonoperating.

Generally, operating revenues are received for providing goods and services to various customers and constituencies of the System. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues and to carry out the mission of the System. Nonoperating revenues are revenues received for which goods and services are not provided as an exchange transaction. For example, state appropriations are nonoperating because they are provided by the Legislature to the System without the Legislature directly receiving commensurate goods and services for those revenues.

The consolidated SRECNA at June 30, 2002, for the System indicates a net operating loss of $561,287,000, calculated in the new operating statement model without including appropriations, gifts, or investment earnings and before subtracting interest expenses on debt. However, after adding state appropriations ($534,458,000), gifts ($20,559,000), and investment income ($16,847,000) and after subtracting interest expenses ($9,912,000), the loss before other revenues, expenses, gains or losses is reduced to a gain of $954,586.

In addition, note 5 on capital assets provides summarized data relating to depreciation charges recorded as operating expenses during fiscal 2001-02. Depreciation expense on facilities (i.e., infrastructure, land improvements, and buildings) accounts for $35,065,322 in additional operating charges to the functional category of Operation and Maintenance of Plant (O&MP). Moreover, the new operating statement now requires that all non-capitalized plant fund expenditures be reported as operating charges to O&MP. Historically, such expenditures, most of which are typically funded from auxiliary enterprise fund balances, were reported in the unexpended plant fund statements and not included in the University's operating statement.

Summarized below is the Statement of Revenues, Expenses, and Changes in Net Assets.

Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2002

Operating revenues	$1,759,509,092
Operating expenses	(2,320,796,691)
Operating income (loss)	(561,287,599)
Nonoperating revenues	562,242,185
Income before other revenues, expenses, gains or losses	954,586
Other revenues, expenses, gains or losses	75,232,765
Increase in net assets	76,187,351
Net assets at beginning of the year - restated	1,030,690,529
Net assets at the end of the year	$1,106,877,880

Operating Revenues

Operating revenues for the System totaled $1.8 billion at June 30, 2002. Major components of operating revenue are hospital income, representing 54.5% of the total; grants and contracts, 19.6% of the total; and tuition and fees, 10.7% of the total. The following table summarizes the System's operating revenue for the year ending June 30, 2002.

Operating Revenues (in millions)
June 30, 2002

Tuition and fees	$188.80
Grants and contracts	344.50
Federal appropriations	11.00
Sales and services of educational departments	125.90
Auxiliary enterprises	116.30
Hospital income	959.50
Other	13.50
Total operating revenues	$1,759.50

Operating Expenses

Total operating expenses for the System amounted to $2.3 billion as of June 30, 2002. Hospital expenses represented 43.7% of all operating expenses and is the largest functional component of them. Other major components are instructional expenses, 16.8%; research expenses, 10.2%; and public service expenses, 7.6%. Shown in the table below is a summary of the System's operating expenses for the fiscal year ending June 30, 2002.

Operating Expenses (in millions)
June 30, 2002

Instruction	$389.80
Research	237.60
Public service	176.00
Academic support	110.60
Student services	27.00
Institutional support	108.20
Operation and maintenance of plant	115.50
Scholarships and fellowships	33.50
Auxiliary enterprises	108.70
Hospital	1,014.00
Total operating expenses	$2,320.90

CAPITAL ASSET AND DEBT ADMINISTRATION

At June 30, 2002, the System has $1.007 billion (including $39.7 billion in assets under capital leases) invested in a broad range of capital assets including land, buildings and improvements, equipment, and infrastructure, net of accumulated depreciation of $1.377 billion (see table on the following page).

Capital Asset Summary
June 30, 2002

Capital assets not being depreciated	$195,859,979
Other Capital Assets:	
Infrastructure	47,117,152
Land improvements	59,337,016
Buildings	1,213,389,038
Equipment	700,273,477
Library books	168,207,384
Total Other Capital Assets	2,188,324,067
Total cost of capital assets	2,384,184,046
Less accumulated depreciation	(1,377,139,289)
Capital assets, net	$1,007,044,757

Capital assets not being depreciated total $195.9 million. This represents land and construction in progress.

Significant capital asset additions in fiscal year 2002 included $3.5 million for construction in progress converting the old Delgado Nursing Building into a combination of Residence Hall, Fitness Facility and Day Care Center at the New Orleans campus of the Health Sciences Center. At the Shreveport campus of the Health Sciences Center, $3.8 million was recognized as construction in progress for the Regional Cancer Center.

Major additions at the Health Sciences Center's Health Care Services Division included $23.3 million for various purchases of medical equipment (including $19.1 million through capital lease agreements) and $7.6 million in construction in progress for building renovations.

At LSU and A&M, major buildings that were placed in service in fiscal year 2001-2002 were the Life Sciences Building Annex, $20.8 million, and the Central Utilities Plant, $2.0 million. In addition, major construction in progress projects added include the Wetlands Environmental Sciences Building, $18.5 million, the James W. Nicholson Hall Renovation, $11.7 million, the Campbell B. Hodges Hall Renovations for academic use, $5.2 million, and the West Campus Apartments, $3.2 million.

At the LSU Agricultural Center a major construction in progress project that was added was the Southeast - Franklin - Dairy Research Facility, $2.3 million.

For the Paul M. Hebert Law Center, construction in progress of $8.7 million for renovations was added, as well as construction in progress of $2.3 million at LSU in Eunice for the Acadian Center.

In addition, the University of New Orleans had the following major additions to its buildings during the same time period: Wellness Center, $5.9 million, and the Center for Energy Resource Management, $7.0 million.

At June 30, 2002, the System had $168,439,000 in bonds outstanding; $25,242,324 in notes payable outstanding; and $1,074,503 in reimbursement contracts payable outstanding.

ECONOMIC OUTLOOK

The System's economic outlook is not only closely tied to the overall economic condition prevailing in the state but is also strongly dependent on the ability to self-generate funds. The authority granted by the Legislature for the System to increase tuition and fees by up to 3% a year for the next three years will help. In addition, recent investments in the System's research infrastructure will increase grant and contract income.

Enrollment growth continues to be another avenue to obtain marginal revenues for those campuses that provide instruction. Our campuses have been implementing more rigorous admission criteria with the result that more students are being retained and thereby adding to the available self-generated funds.

There are significant financial problems appearing in the Health Sciences Center's Health Care Services Division (HCSD). This Division (which manages nine of the state's ten public hospitals) is responsible for delivering health care to the state's indigent population. Also, HCSD serves a key role in providing the clinical material and experiences necessary for the medical education of students within the Health Sciences Center. The current model used to reimburse the HCSD does not fully reimburse all costs incurred. Accordingly, a serious financial episode is looming for the HCSD and must be addressed. The System has formed a committee representing broad interests to examine the entire HCSD and to report to the Executive and Legislative branches of government on what needs to be done to stabilize the HCSD's eroding financial base. The HCSD continues to work with state and federal officials to correct this flawed reimbursement methodology. A committee as proscribed by SCR 27 of 2002 mandates a review and recommendation relative to the development of a uniform acute care payment methodology for all hospitals and the work being performed may provide a payment methodology that will correct the existing situation. The HCSD has also been working with state and federal officials to include professional service costs as an allowable cost for cost reporting purposes. If approved that action would resolve the less than full reimbursement the HCSD is receiving relative to the UCC revenue source.

While the HCSD's current fiscal situation is problematic, it is important to note that legislation protects the academic (non-hospital) portion from any potential deficit incurred in the hospitals. The state's current health care delivery financing model requires fundamental restructuring. In addition, there is growing national concern over the entire issue of health care reimbursements. The System will be an active participant in shaping the future of the HCSD.

In conclusion, while there are potential risks in the near future, the long-term outlook for the System remains bright. Enrollments are expected to grow, research capability is expected to increase, and the System will continue to provide excellent public service to the residents of the state. The System plays an important role in the economic development of the state. LSU researchers are actively contributing to the economic diversification of the state. Increased research productivity coupled with a renewed effort to improve technology transfer activities will most definitely result in an enhanced financial position not only for the System but for the state as well.

LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA

Statement of Net Assets, June 30, 2002

ASSETS	
Current Assets:	
Cash and cash equivalents (note 2)	$198,981,322
Investments (note 3)	61,165,298
Receivables, net (note 4)	203,094,542
Due from state treasury	2,786,719
Inventories	41,251,835
Deferred charges and prepaid expenses	4,821,952
Notes receivable	4,369,195
Other current assets	891,203
Total current assets	517,362,066
Noncurrent Assets:	
Restricted cash and cash equivalents (note 2)	45,654,636
Investments (note 3)	156,961,879
Notes receivable	26,579,915
Capital assets, net (note 5)	967,347,180
Assets under capital leases (note 5)	39,697,576
Other noncurrent assets	11,124,480
Total noncurrent assets	1,247,365,666
Total assets	1,764,727,732
LIABILITIES	
Current Liabilities:	
Accounts payable and accrued liabilities	230,466,496
Due to state treasury (note 13)	72,322
Deferred revenues	76,603,748
Amounts held in custody for others	3,832,260
Compensated absences (note 9)	7,548,107
Capital lease obligations (note 12)	7,525,667
Notes payable (note 12)	6,333,992
Contracts payable (note 12)	362,414
Bonds payable (note 12)	7,312,417
Other current liabilities	409,052
Total current liabilities	340,466,475
Noncurrent Liabilities:	
Compensated absences (note 9)	105,182,185
Capital lease obligations (note 12)	29,594,334
Notes payable (note 12)	18,908,332
Contracts payable (note 12)	712,089

(Continued)

The accompanying notes are an integral part of this statement.

LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA
Statement of Net Assets, June 30, 2002

LIABILITIES (CONT.)	
Noncurrent Liabilities: (Cont.)	
Bonds payable (note 12)	$161,126,583
Other noncurrent liabilities	1,859,854
Total noncurrent liabilities	317,383,377
Total liabilities	657,849,852
NET ASSETS	
Investment in capital assets, net of related debt	802,407,410
Restricted for:	
Nonexpendable (note 14)	110,218,459
Expendable (note 14)	204,256,374
Unrestricted	(10,004,363)
Total net assets	$1,106,877,880

(Concluded)

The accompanying notes are an integral part of this statement.

LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA

Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended June 30, 2002

OPERATING REVENUES	
Student tuition and fees	$220,708,383
Less scholarship allowances	(31,930,917)
Net student tuition and fees	188,777,466
Federal appropriations	10,981,636
Federal grants and contracts	169,316,760
State and local grants and contracts	88,815,975
Nongovernmental grants and contracts	86,341,388
Sales and services of educational departments	125,910,889
Hospital income	959,498,584
Auxiliary enterprise revenues (including revenues pledged to secure debt per note 21)	120,171,797
Less scholarship allowances	(3,809,482)
Net auxiliary revenues	116,362,315
Other operating revenues	13,504,079
Total operating revenues	1,759,509,092
OPERATING EXPENSES	
Educational and general:	
Instruction	389,825,158
Research	237,576,392
Public service	176,031,564
Academic support	110,571,426
Student services	27,039,403
Institutional support	108,167,409
Operation and maintenance of plant	115,471,513
Scholarships and fellowships	33,506,255
Auxiliary enterprises	108,684,823
Hospital	1,013,922,748
Total operating expenses	2,320,796,691
Operating Loss	(561,287,599)
NONOPERATING REVENUES (Expenses)	
State appropriations	534,458,439
Gifts	20,558,708
Net investment income	16,847,362
Interest expense	(9,912,218)
Other nonoperating revenues	289,894
Net nonoperating revenues	562,242,185

(Continued)

The accompanying notes are an integral part of this statement.

LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA
Statement of Revenues, Expenses,
and Changes in Net Assets, 2002

Income Before Other Revenues, Expenses, Gains and Losses	$954,586
Capital appropriations	48,458,358
Capital gifts and grants	12,949,565
Additions to permanent endowments	15,948,459
Other additions, net	(2,123,617)
Increase in Net Assets	76,187,351
Net Assets at Beginning of Year, Restated (note 15)	1,030,690,529
Net Assets at End of Year	$1,106,877,880

(Concluded)

The accompanying notes are an integral part of this statement.

INTRODUCTION

The Louisiana State University (LSU) System is a publicly supported institution of higher education. The university is a component unit of the State of Louisiana, within the executive branch of government. The system is under the management and supervision of the LSU Board of Supervisors; however, certain items such as the annual budgets of the universities and changes to the degree programs and departments of instruction require the approval of the Board of Regents for Higher Education. The board of supervisors is comprised of 16 members appointed for a six-year term by the governor, with the consent of the Senate, and one student member appointed for a one-year term by a council composed of the student body presidents of the universities. As state universities, operations of the universities' instructional programs are funded through annual lapsing appropriations made by the Louisiana Legislature. The chief executive officer of the university system is the president.

The university system is comprised of nine institutions on ten campuses in five cities and nine state hospitals. The system includes LSU and A&M College, the Paul M. Hebert Law Center, and the Pennington Biomedical Research Center, all in Baton Rouge; the LSU Agricultural Center (including the Louisiana Agricultural Experiment Station and the Louisiana Cooperative Extension Service) with headquarters in Baton Rouge; the University of New Orleans; LSU in Shreveport; LSU at Alexandria and LSU at Eunice, both two-year institutions; and the LSU Health Sciences Center which includes schools of Medicine, Dentistry, Nursing, and Allied Health Professions, and a Graduate School in New Orleans, the Louisiana State University School of Medicine in New Orleans Faculty Group Practice (a Louisiana nonprofit corporation doing business as LSU Healthcare Network), the Health Care Services Division, and a School of Medicine and Hospital in Shreveport. Student enrollment for the university system for the 2001 fall semester totaled 61,422. During September 2001, the university system had approximately 5,400 full-time and part-time faculty members, including associates and affiliated faculty.

Louisiana Revised Statute 17:1519.1 provides for the operation of Louisiana's public hospitals by the LSU Health Sciences Center - Health Care Services Division, under the overall management of the LSU Board of Supervisors. The LSU Health Sciences Center - Health Care Services Division is comprised of nine hospitals throughout the state and a central administrative unit located in Baton Rouge. The state hospitals include E. A. Conway Medical Center in Monroe, Earl K. Long Medical Center in Baton Rouge, Huey P. Long Medical Center in Pineville, University Medical Center in Lafayette, W. O. Moss Regional Medical Center in Lake Charles, Lallie Kemp Regional Medical Center in Independence, Washington-St. Tammany Regional Medical Center in Bogalusa, Leonard J. Chabert Medical Center in Houma, and Medical Center of Louisiana at New Orleans.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. BASIS OF PRESENTATION

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, *Basic Financial Statements-and Management Discussion and Analysis-for State and Local Governments*. This was followed in November 1999 by GASB Statement No. 35, *Basic Financial Statements-and Management's Discussion and Analysis-for Public Colleges and Universities*. As a component unit of the State of Louisiana, the Louisiana State University System is required to adopt GASB Statement Nos. 34 and 35, as amended by GASB Statement Nos. 36, 37, and 38. The financial statement presentation required by GASB Statement Nos. 34 and 35 provides a comprehensive, entity-wide perspective of the university's assets, liabilities, net assets, revenues, expenses, and changes in net assets and replaces the fund-group perspective previously required.

B. REPORTING ENTITY

GASB Codification Section 2100 has defined the governmental reporting entity to be the State of Louisiana. The university system is considered a component unit of the State of Louisiana because the state exercises oversight responsibility and has accountability for fiscal matters as follows: (1) a majority of the members of the governing board are appointed by the governor; (2) the state has control and exercises authority over budget matters; (3) state appropriations provide the largest percentage of total revenues; (4) the state issues bonds to finance certain construction; and (5) the university system primarily serves state residents. The accompanying financial statements present information only as to the transactions of the programs of the Louisiana State University System, a component unit of the State of Louisiana.

The Louisiana State University School of Medicine in New Orleans Faculty Group Practice (a Louisiana nonprofit corporation doing business as LSU Healthcare Network) is considered a blended component unit of the university system and is included in the financial statements. The component unit is included in the reporting entity because of the significance of its operational and financial relationships with the Louisiana State University System, LSU Health Sciences Center. Although the LSU Healthcare Network is legally separate, it is reported as a part of the university system because its purpose is to assist the LSU Health Sciences Center in carrying out its medical, educational, and research functions.

Annually, the State of Louisiana issues a comprehensive annual financial report, which includes the activity contained in the accompanying financial statements. These financial statements are audited by the Louisiana Legislative Auditor.

C. BASIS OF ACCOUNTING

For financial reporting purposes, the university system is considered a special-purpose government engaged only in business-type activities. Accordingly, the university system's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. All significant intra-agency transactions have been eliminated.

The university system has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The university system has elected to not apply FASB pronouncements issued after the applicable date.

D. BUDGET PRACTICES

The appropriations made for the General Fund of the Louisiana State University System are annual lapsing appropriations established by legislative action and by Title 39 of the Louisiana Revised Statutes. The statute requires that the budget be approved by the Board of Regents for Higher Education and certain legislative and executive agencies of state government. Budget revisions are granted by the Joint Legislative Committee on the Budget. In compliance with these legal restrictions, budgets are adopted on the accrual basis of accounting, except that (1) depreciation is not recognized; (2) leave costs are treated as budgeted expenditures to the extent that they are expected to be paid; (3) summer school tuition and fees and summer school faculty salaries and related benefits for June are not prorated, but are recognized in the succeeding year; and (4) inventories in the General Fund are recorded as expenditures at the time of purchase.

The original approved budgets and subsequent amendments approved are as follows:

Original approved budget	$933,061,511
Increases:	
State General Fund	34,677,873
Self-generated	732,629
Interagency transfers	2,371,553
Federal Funds	1,000,000
Interim Emergency Board	563,100
Other	75,792,875
Final budget	$1,048,199,541

The other funds of the university system, although subject to internal budgeting, are not required to submit budgets for approval through the legislative budget process.

E. CASH AND CASH EQUIVALENTS AND INVESTMENTS

Cash includes cash on hand, demand deposits, and interest-bearing demand deposits. Cash equivalents include amounts in time deposits and money market funds. Under state law, the Louisiana State University System may deposit funds within a fiscal agent bank organized under the laws of the State of Louisiana, the laws of any other state in the Union, or the laws of the United States.

The university system may invest in certificates of deposit of state banks organized under Louisiana law and national banks having their principal offices in Louisiana. In accordance with Louisiana Revised Statute (R.S.) 49:327(C), the university system is authorized to invest funds in direct United States Treasury obligations and, in addition, funds derived from gifts and grants, endowments, and reserve funds established in accordance with bond issues may be invested as stipulated by the conditions of the gift instrument or bond indenture. The majority of these investments are United States Treasury securities, mutual funds, and investments held by private foundations and are reported at fair value on the balance sheet. Changes in the carrying value of investments, resulting in unrealized gains or losses, are reported as a component of investment income in the Statement of Revenues, Expenses, and Changes in Net Assets.

F. INVENTORIES

Inventories are valued at cost or replacement cost, except for livestock at the LSU and A&M College and the LSU Agricultural Center and the inventory of the Dental School of the LSU Health Sciences Center - New Orleans. These inventories are valued at current market prices. The university system uses periodic and perpetual inventory systems and values its various other inventories using the first-in, first-out and weighted-average valuation methods. The university system accounts for its inventories using the consumption method.

G. NONCURRENT CASH AND INVESTMENTS

Cash and investments that are externally restricted for endowments or similar accounts to make debt service payments, to maintain sinking or reserve funds, or to purchase or construct capital or other noncurrent assets are classified as noncurrent assets in the statements of net assets.

H. CAPITAL ASSETS

Capital assets are reported at cost at the date of acquisition or their estimated fair value at the date of donation. For movable property, the university system's capitalization policy includes all items with a unit cost of $5,000 or more and an estimated useful life greater than one year. Renovations to buildings, infrastructure, and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense was incurred. Depreciation is computed using the straight-line method over the estimated useful life of the assets, generally 40 years for buildings and infrastructure, 20 years for depreciable land improvements, and 3 to 10 years for most movable property. Depreciation expense is included in the various functional categories of operating expenses on the Statement of Revenues, Expenses, and Changes in Net Assets.

I. DEFERRED REVENUES

Deferred revenues include amounts received for tuition and fees and certain auxiliary activities prior to the end of the fiscal year, but are related to the subsequent accounting period. Deferred revenues also include amounts received from grant and contract sponsors that have not yet been earned.

J. NONCURRENT LIABILITIES

Noncurrent liabilities include (1) principal amounts of revenue bonds payable, notes payable, and capital lease obligations with contractual maturities greater than one year; (2) estimated amounts for accrued compensated absences and other liabilities that will not be paid within the next fiscal year; and (3) other liabilities.

K. COMPENSATED ABSENCES

Employees accrue and accumulate annual and sick leave in accordance with state law and administrative regulations. Faculty with 12-month appointments who have over 10 years of state service, non-classified employees with over 10 years of state service, and classified employees regardless of years of state service accumulate leave without limitation. According to the university system leave schedule, faculty with 12-month appointments who have less than 10 years of state service and non-classified employees with less than 10 years of state service can only accumulate 176 hours of annual leave; sick leave is accumulated without limitation. Effective January 1, 1994, academic and unclassified employees were given the opportunity to elect to remain under the university leave schedule or change to the Louisiana State Civil Service annual leave accrual schedule under which there is no limit on the accumulation of annual leave. Nine-month faculty members accrue sick leave but do not accrue annual leave; however, they are granted faculty leave during holiday periods when students are not in classes. Upon separation of employment, both classified and non-classified personnel or their heirs are compensated for accumulated annual leave not to exceed

300 hours. In addition, academic and unclassified personnel or their heirs are compensated for accumulated sick leave not to exceed 25 days upon retirement or death. Unused annual leave in excess of 300 hours plus unused sick leave are used to compute retirement benefits.

L. NET ASSETS

The university system's net assets are classified as follows:

(1) Invested in Capital Assets, Net of Related Debt

This represents the university system's total investment in capital assets, net of accumulated depreciation and reduced by outstanding debt obligations related to acquisition, construction, or improvement of those capital assets.

(2) Restricted Net Assets - Expendable

Restricted expendable net assets include resources that the university system is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

(3) Restricted Net Assets - Nonexpendable

Restricted nonexpendable net assets consist of endowment and similar type funds that donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to principal.

(4) Unrestricted Net Assets

Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the university system and may be used at the discretion of the governing board to meet current expenses and for any purpose.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the university system's policy is to first apply the expense toward unrestricted resources, and then toward restricted resources.

M. CLASSIFICATION OF REVENUES

The university has classified its revenues as either operating or nonoperating revenues according to the following criteria:

(a) **Operating Revenue -** Operating revenue includes activities that have the characteristics of exchange transactions, such as (1) student tuition and fees, net of scholarship discounts and allowances; (2) sales and services of auxiliary enterprises, net of scholarship discounts and allowances; (3) hospital income; and (4) most federal, state, and local grants and contracts and federal appropriations.

(b) **Nonoperating Revenue -** Nonoperating revenue includes activities that have the characteristics of nonexchange transactions, such as gifts and contributions, state appropriations, and investment income.

N. SCHOLARSHIP DISCOUNTS AND ALLOWANCES

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the Statement of Revenues, Expenses, and Changes in Net Assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the university and the amount that is paid by students and/or third parties making payments on the student's behalf.

O. ELIMINATING INTERFUND ACTIVITY

All activities among departments, campuses, and auxiliary units of the Louisiana State University System are eliminated for purposes of preparing the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets.

2. CASH AND CASH EQUIVALENTS

At June 30, 2002 the university system has cash and cash equivalents (book balances) of $244,635,958.

Cash includes cash on hand of $1,863,353; demand deposits of $55,088,791; and interest-bearing demand deposits of $56,718,614. Cash equivalents include time deposits of $85,863,235 and mone y market funds of $7,675,645. These deposits are stated at cost, which approximates market.

Under state law, these deposits (or the resulting bank balances) must be secured by federal deposit insurance or the pledge of securities owned by the fiscal agent bank. The market value of the pledged securities plus the federal deposit insurance must at all times equal the amount on deposit with the fiscal agent. At June 30, 2002, the university system has $226,234,405 in deposits (collected bank balances), excluding amounts held within the state treasury as follows:

Risk Category	Cash Demand Deposits	Certificates of Deposit	Cash Equivalents - Money Market Fund	Total
1. Insured by federal deposit insurance or collateralized with securities held by the entity or its agent in the entity's name	$77,319,835	$84,714,546		$162,034,381
2. Collateralized with securities held by the pledging institution's trust department or agent in the entity's name	63,000,212	600,000		63,600,212
3. Uncollateralized, including any securities held for the entity but not in the entity's name			$599,812	599,812
Total	$140,320,047	$85,314,546	$599,812	$226,234,405

Included in cash and cash equivalents is cash available to the university system within the state treasury totaling $37,426,320. Securities pledged for cash in the state treasury are not included in the above computations as these amounts are secured by fiscal agent banks established by the state treasury independent of the university system.

3. INVESTMENTS

At June 30, 2002, the university system has investments reported at fair market value totaling $218,127,177 as follows:

	Category 1	Category 2	Category 3	Total
United States government securities		$28,201,542	$23,869,807	$52,071,349
Repurchase agreements			22,383,593	22,383,593
Stock	$5,691,203		367,665	6,058,868
Commercial paper			245,808	245,808
Accrued interest		193,769		193,769
Other	108,246			108,246
Total categorized investments	$5,799,449	$28,395,311	$46,866,873	$81,061,633
Investments not categorized:				
Funds held by private foundation				$69,786,871
Real estate				3,456,881
Mutual funds				55,522,670
Trustee project accounts				7,921,859
Other				377,263
Total investments not categorized				137,065,544
Total investments				$218,127,177

The credit risk of GASB Codification Section I50.125-126 was applied to the university system's investments. Descriptions of these categories are as follows:

<u>Category 1</u> - Insured or registered in the university system’s name or securities held by the entity or its agent in the university system's name

<u>Category 2</u> - Uninsured and unregistered with securities held by the counterparty's trust department or agent in the university system’s name

<u>Category 3</u> - Unsecured and unregistered with securities held by the counterparty or by its trust department or agent but not in the university system’s name

The investments are reported at fair value as required by GASB Statement No. 31. Investments held by private foundations in external investment pools are managed in accordance with the terms outlined in management agreements executed between the university and the foundations. Each university is a voluntary participant.

4. ACCOUNTS RECEIVABLE

Accounts receivable, which are scheduled for collection within one year, are shown on Statement A net of an allowance for doubtful accounts as follows:

	Accounts Receivable	Allowance for Doubtful Accounts	Net Accounts Receivable
Student tuition and fees	$11,198,101		$11,198,101
Auxiliary enterprises	7,753,978	($88,587)	7,665,391
Contributions and gifts	106,281		106,281
Federal, state, and private grants and contracts	67,920,779		67,920,779
Federal appropriations	1,132,985		1,132,985
Clinics	1,649,684,231	(1,543,522,564)	106,161,667
Other	8,910,395	(1,057)	8,909,338
Total	$1,746,706,750	($1,543,612,208)	$203,094,542

5. CHANGES IN CAPITAL ASSETS

A summary of changes in capital assets is as follows:

	Balance June 30, 2001	Prior Period Adjustment	Restated Balance June 30, 2001
Capital assets not being depreciated:			
Land	$91,605,828	($1,787,345)	$89,818,483
Construction in progress	22,900,980	54,019,532	76,920,512
Total capital assets not being depreciated	$114,506,808	$52,232,187	$166,738,995
Other capital assets:			
Infrastructure	$15,614,064	$29,946,319	$45,560,383
Less accumulated depreciation		(15,949,766)	(15,949,766)
Total infrastructure	15,614,064	13,996,553	29,610,617
Land improvements	44,676,513	14,209,966	58,886,479
Less accumulated depreciation		(42,447,849)	(42,447,849)
Total land improvements	44,676,513	(28,237,883)	16,438,630
Buildings	1,264,118,339	(102,231,619)	1,161,886,720
Less accumulated depreciation		(632,884,442)	(632,884,442)
Total buildings	1,264,118,339	(735,116,061)	529,002,278
Equipment	755,772,121	(95,931,645)	659,840,476
Less accumulated depreciation		(470,802,399)	(470,802,399)
Total equipment	755,772,121	(566,734,044)	189,038,077
Library books	159,028,962	50,014	159,078,976
Less accumulated depreciation		(142,920,970)	(142,920,970)
Total library books	159,028,962	(142,870,956)	16,158,006
Total other capital assets	$2,239,209,999	($1,458,962,391)	$780,247,608
Capital asset summary:			
Capital assets not being depreciated	$114,506,808	$52,232,187	$166,738,995
Other capital assets, at cost	2,239,209,999	(153,956,965)	2,085,253,034
Total cost of capital assets	2,353,716,807	(101,724,778)	2,251,992,029
Less accumulated depreciation		(1,305,005,426)	(1,305,005,426)
Capital assets, net	$2,353,716,807	($1,406,730,204)	$946,986,603

Additions	Transfers	Retirements	Balance June 30, 2002
$251,634			$90,070,117
58,932,211	($30,062,861)		105,789,862
$59,183,845	($30,062,861)	NONE	$195,859,979
$1,556,769			$47,117,152
(990,708)			(16,940,474)
566,061	NONE	NONE	30,176,678
434,962	$15,575		59,337,016
(1,539,529)			(43,987,378)
(1,104,567)	15,575	NONE	15,349,638
21,465,832	30,047,286	($10,800)	1,213,389,038
(32,535,085)		9,529	(665,409,998)
(11,069,253)	30,047,286	(1,271)	547,979,040
67,636,057		(27,203,056)	700,273,477
(51,102,824)		22,155,685	(499,749,538)
16,533,233	NONE	(5,047,371)	200,523,939
9,178,337		(49,930)	168,207,383
(8,132,624)		1,693	(151,051,901)
1,045,713	NONE	(48,237)	17,155,482
$5,971,187	$30,062,861	($5,096,879)	$811,184,777
$59,183,845	($30,062,861)		$195,859,979
100,271,957	30,062,861	($27,263,786)	2,188,324,066
159,455,802	NONE	(27,263,786)	2,384,184,045
(94,300,770)		22,166,907	(1,377,139,289)
$65,155,032	NONE	($5,096,879)	$1,007,044,756

The June 30, 2001, balance of capital assets has been adjusted to reflect a change in the university's capitalization policy, to recognize accumulated depreciation, and to reflect a change in accounting systems of the LSU Health Sciences Center - Health Care Services Division. The State of Louisiana, Division of Administration, Office of Statewide Reporting and Accounting Policy (OSRAP) revised its capitalization policy to include only those equipment items with an original acquisition cost of $5,000 or more and only those buildings with an original acquisition cost of $100,000 or more in the balance of fixed assets on which depreciation is calculated. GASB Statement No. 34 requires the capitalization of infrastructures, and OSRAP policy requires reporting infrastructure with an original cost of $3,000,000 or more. GASB Statement No. 34 also requires the depreciation on fixed assets, resulting in the recognition of accumulated depreciation for prior years. With the implementation of GASB Statement No. 34, the LSU Health Sciences Center - Health Care Services Division changed the capital assets accounting system used for financial statement purposes from the systems maintained by the Louisiana Property Assistance Agency and State Land and Buildings to the system maintained by American Appraisal Associates.

6. PENSION PLANS

Plan Description. Substantially all employees of the university system are members of two statewide, public employee retirement systems. Academic employees are generally members of the Teachers Retirement System of Louisiana (TRSLA), and classified/unclassified state employees are members of the Louisiana State Employees Retirement System (LASERS). Both plans are cost-sharing, multiple-employer defined benefit pension plans administered by separate boards of trustees. TRSLA and LASERS provide retirement, disability, and survivors' benefits to plan members and beneficiaries. Benefits granted by the retirement systems are guaranteed by the State of Louisiana by provisions of the Louisiana Constitution of 1974. Generally, all full-time employees are eligible to participate in the systems, with employee benefits vesting after 5 years of service for TRSLA and 10 years of service for LASERS. Article 10, Section 29 of the Louisiana Constitution of 1974 assigns the authority to establish and amend benefit provisions to the state legislature. The systems issue annual publicly available financial reports that include financial statements and required supplementary information for the systems. The reports may be obtained by writing to the Teachers Retirement System of Louisiana, Post Office Box 94123, Baton Rouge, Louisiana 70804-9123, or by calling (225) 925-6446, and/or the Louisiana State Employees Retirement System, Post Office Box 44213, Baton Rouge, Louisiana 70804-4213, or by calling (225) 922-0600.

Funding Policy. The contribution requirements of employee plan members and the university system are established and may be amended by the state legislature. The legislature annually sets the required employer contribution rate equal to the actuarially required employer contribution as set forth in R.S. 11:102. Employees contribute 8% (TRSLA) and 7.5% (LASERS) of covered salaries. The state is required to contribute 13.1% of covered salaries to TRSLA and 13% of covered salaries to LASERS. The employer contribution is funded by the State of Louisiana through the annual appropriation to the university system. The employer contributions to TRSLA for the years ended June 30, 2002, 2001, and 2000, were $20,461,711, $21,529,238, and $23,257,121, respectively, and to LASERS for the years ended June 30, 2002, 2001, and 2000, were $58,650,468, $57,193,840, and $54,420,020, respectively, equal to the required contributions for each year.

Optional Retirement System

R.S. 11:921 created an optional retirement plan for academic and administrative employees of public institutions of higher education. This program was designed to aid universities in recruiting employees who may not be expected to remain in TRSLA for 10 or more years. The purpose of the optional retirement plan is to provide retirement and death benefits to the participants while affording the maximum portability of these benefits to the participants.

The optional retirement plan is a defined contribution plan that provides for full and immediate vesting of all contributions remitted to the participating companies on behalf of the participants. Eligible employees make an irrevocable election to participate in the optional retirement plan rather than the TRSLA and purchase retirement and death benefits through contracts provided by designated companies.

Total contributions by the university system are 13.1% of the covered payroll. The participant's contribution (8%), less any monthly fee required to cover the cost of administration and maintenance of the optional retirement plan, is remitted to the designated company or companies. Upon receipt of the employer's contribution, the TRSLA pays over to the appropriate company or companies, on behalf of the participant, an amount equal to the employer's portion of the normal cost contribution as determined annually by the actuarial committee. The TRSLA retains the balance of the employer contribution for application to the unfunded accrued liability of the system. Benefits payable to participants are not the obligations of the State of Louisiana or the TRSLA. Such benefits and other rights of the optional retirement plan are the liability and responsibility solely of the designated company or companies to whom contributions have been made. Employer and employee contributions to the optional retirement plan totaled $36,902,577 and $22,538,310, respectively, for the year ended June 30, 2002.

7. POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

The university system provides certain continuing health care and life insurance benefits for its retired employees. Substantially all of the university system's employees become eligible for these benefits if they reach normal retirement age while working for the university system. These benefits for retirees and similar benefits for active employees are provided through a state-operated group insurance program and various insurance companies whose monthly premiums are paid jointly by the employee and the university system. The university system recognizes the cost of providing these benefits to retirees (university's portion of premiums) as an expense when paid during the year. These retiree benefits totaled $20,993,417 for the year ended June 30, 2002.

8. CONTINGENT LIABILITIES AND RISK MANAGEMENT

At June 30, 2002, the university system is contingently liable for $269,292 as guarantor of mortgage loans on sorority and fraternity houses built on university property. This amount has not been accrued in the accompanying financial statements. In addition, the university system is involved in numerous lawsuits at June 30, 2002. In the opinion of legal counsel for the university system, the ultimate outcome of these lawsuits cannot be determined; however, any losses, with few exceptions, would be fully covered by insurance. Losses arising from judgments, claims, and similar contingencies are paid by either private insurance companies or through the state's self-insurance fund operated by the Office of Risk Management, the agency responsible for the state's risk management program, or by General Fund appropriation. The university system is involved in 696 lawsuits at June 30, 2002, of which 16 lawsuits are handled by contract attorneys. The remainder of the lawsuits are handled by the Office of Risk Management. Of the lawsuits being handled by contract attorneys, the attorneys have estimated a possible liability of $850,000 relating to three of the lawsuits. This amount has not been accrued in the accompanying financial statements.

9. COMPENSATED ABSENCES

At June 30, 2002, employees of the university have accumulated and vested annual, sick, and compensatory leave benefits of $77,722,412, $29,620,113, and $5,387,767, respectively, which were computed in accordance with GASB Codification Section C60. The leave payable is recorded in the accompanying financial statements.

10. OPERATING LEASES

For the year ended June 30, 2002, the total rental expenses for all operating leases, except those with terms of a month or less that were not renewed, is $8,521,450. The following is a schedule by years of future minimum annual rental payments required under operating leases that have initial or noncancelable lease terms in excess of one year as of June 30, 2002:

Nature of Operating Lease	2003	2004	2005	2006	2007	2008-2012	2013-2017	Total Minimum Payments Required
Office space	$4,831,430	$3,695,766	$3,424,469	$3,386,671	$3,261,677	$15,201,872	$9,090,000	$42,891,885
Equipment	372,724	282,040	98,285	41,173	41,173			835,395
Other	3,107,990	2,585,556	1,740,192	1,557,354	1,483,410	4,533		10,479,035
Total	$8,312,144	$6,563,362	$5,262,946	$4,985,198	$4,786,260	$15,206,405	$9,090,000	$54,206,315

The lease agreements have non-appropriation exculpatory clauses that allow lease cancellation if the legislature does not make an appropriation for its continuation during any future fiscal period.

11. LESSOR LEASES

The university system's leasing operations consist primarily of the leasing of property for the purposes of providing food services to students; bookstore operations; land for fraternity and sorority houses and parking spaces to foundations; office space for postal services, banking services, and university affiliated organizations; space on rooftops for communication towers; and mineral leases.

The following schedule provides an analysis of the cost and carrying amount of the university system's investment in property on operating leases and property held for lease as of June 30, 2002:

Nature of Lease	Cost	Accumulated Depreciation	Carrying Amount
Office space	$13,206,681	($6,419,382)	$6,787,299
Land	6,324,221		6,324,221
Total	$19,530,902	($6,419,382)	$13,111,520

The following is a schedule by years of minimum future rentals on noncancelable operating leases as of June 30, 2002:

Nature of Operating Lease	2003	2004	2005	2006	2007	2008-2012	2013-2017	Total Minimum Future Rentals
Office space	$1,727,379	$1,693,638	$1,518,058	$241,121	$173,588	$162,085	$500	$5,516,369
Land	124,053	123,911	123,911	123,211	122,911	418,805	368,305	1,405,107
Total	$1,851,432	$1,817,549	$1,641,969	$364,332	$296,499	$580,890	$368,805	$6,921,476

Minimum future rentals do not include contingent rentals, which may be received as stipulated in the lease contracts. These contingent rental payments occur as a result of sales volume, customer usage of services provided, or as a result of the drilling operations on mineral leases. Contingent rentals amounted to $998,382 for the year ended June 30, 2002.

12. LONG-TERM LIABILITIES

Notes Payable

The university has entered into a number of installment purchase agreements for the purchase of computer equipment, copiers, vehicles, et cetera. These agreements require scheduled payments either on a monthly, semiannual, or annual basis and have interest rates ranging from zero to 10.5%. The following is a summary of installment notes payable by the university for the year ended June 30, 2002:

Balance at July 1, 2001	$14,258,648
Installment purchases in 2002	298,798
Installment payments in 2002	(6,228,455)
Installment notes payable at June 30, 2002	$8,328,991

The following is a summary of future minimum installment payments as of June 30, 2002:

Fiscal Year Ending June 30:	
2003	$4,997,265
2004	1,178,113
2005	831,047
2006	763,922
2007	646,346
2008	646,346
Total minimum installment payments	9,063,039
Less - amount representing interest	(734,048)
Total	$8,328,991

The majority of the installment purchase agreements have non-appropriation exculpatory clauses that allow for lease cancellation if the Louisiana Legislature does not make an appropriation for its continuation during any future fiscal period.

In addition to the installment purchase agreements, the university system has entered into loan agreements with the Louisiana Public Facilities Authority (LPFA) on October 31, 1988. The LPFA loan agreement totaling $28,500,000 is for financing, refinancing, or reimbursing the cost of facilities; improvements and expansions of the LSU Athletic Department; construction of the Student Recreation Sports Center for Louisiana State University and A&M College, improvements for parking and safety at Louisiana State University and A&M College, improvements to residential life facilities ($26,200,000); additions to the parking garage at the LSU Health Sciences Center in

New Orleans ($1,000,000); and building a child care center at the University of New Orleans ($1,300,000). The loan repayments are payable from the fees, rates, rentals, charges, grants, or other receipts or income derived by or in connection with the facilities, equipment, and improvements. According to terms of the loan agreement, the university system is to repay principal and interest on the obligation on the 28th day of each month for 20 years commencing August 28, 1991. The university system made principal payments during the year totaling $1,532,917. At June 30, 2002, the outstanding balance is $16,913,333.

Notes payable totaling $25,242,324 are reflected on Statement A.

Bonds and Contracts Payable

Detailed summaries, by issues, of all bond and reimbursement contract debt outstanding at June 30, 2002, including future interest payments of $63,702,332 for LSU and A&M College; $32,988,255 for the LSU Health Sciences Center; $20,890,192 for the University of New Orleans; and $678,518 for LSU at Eunice follow:

Bonds Payable

Issue	Date of Issue	Original Issue	Outstanding July 1, 2001
LSU and A&M College			
Student Housing System Bonds:			
1964:			
Series A	July 1, 1964	$900,000	$115,000
Series B	July 1, 1964	3,790,000	506,000
Building Bonds of 1965 -			
Series B	July 1, 1965	1,545,000	218,000
Student Housing System Bonds:			
1966:			
Series B	July 1, 1966	2,175,000	440,000
Series C	July 1, 1966	1,250,000	215,000
1968 - Series B	July 1, 1968	1,275,000	250,000
Auxiliary Revenue Bonds 1994	June 15, 1994	26,290,000	20,545,000
1996 Revenue Bonds	September 5, 1996	33,485,000	32,335,000
1997 Auxiliary Revenue Bonds	December 1, 1997	6,500,000	6,040,000
2000 Auxiliary Revenue Bonds	June 28, 2000	27,000,000	26,800,000
LSU Health Sciences Center			
New Orleans - Building Revenue			
Bonds - Series 2000	February 3, 2000	15,910,000	15,710,000
Health Care Services Division -			
Revenue Bonds, Series 1992	December 31, 1992	69,890,000	46,980,000
University of New Orleans			
Jefferson Center, 1996-A	August 1, 1996	4,485,000	2,900,000
Revenue Bonds of 1997 - Series A	January 15, 1997	5,965,000	5,600,000
Revenue Bonds of 1998	August 15, 1998	15,915,000	15,915,000
LSU at Eunice			
1998 Auxiliary Revenue Bonds	June 1, 1998	1,650,000	1,490,000
Total Bonds Payable		$218,025,000	$176,059,000

During the year ended June 30, 1993, the LPFA revenue bonds in the amount of $69,890,000 were issued for the Louisiana Department of Health and Hospitals Medical Center of Louisiana at New Orleans, the proceeds of which were used to purchase the former Hotel Dieu hospital. These bonds continued to be reported on the financial statements of the Department of Health and Hospitals, although the Medical Center of Louisiana at New Orleans was transferred to LSUHSC-Health Care Services Division during the year ended June 30, 1998, and the

Redeemed	Outstanding June 30, 2002	Maturities	Interest Rates	Future Interest Payments June 30, 2002
$40,000	$75,000	2002-2004	3.625%	$3,915
170,000	336,000	2002-2004	3.625%	18,198
60,000	158,000	2002-2005	3%	$8,820
85,000	355,000	2002-2006	3%	27,150
50,000	165,000	2002-2006	3%	10,800
45,000	205,000	2002-2008	3%	16,200
1,125,000	19,420,000	2002-2014	5% - 5.75%	7,920,374
1,250,000	31,085,000	2002-2026	4.3% - 5.5%	25,557,860
500,000	5,540,000	2002-2017	4% - 5%	2,419,015
200,000	26,600,000	2002-2030	Variable	27,720,000
200,000	15,510,000	2002-2031	4.4% - 6.375%	18,500,748
3,560,000	43,420,000	2003-2007	5.875%	14,487,507
60,000	2,840,000	2002-2026	3.85% - 5.5%	2,355,788
115,000	5,485,000	2002-2026	3.75% - 5.65%	4,599,795
100,000	15,815,000	2003-2030	3.9% - 5%	13,934,609
60,000	1,430,000	2002-2018	5%	678,518
$7,620,000	$168,439,000			$118,259,297

LSUHSC-Health Care Services Division has paid the bond servicing payments since that time. For the fiscal year ending June 30, 2002, these bonds payable are reported in the accompanying financial statements and are included in the previously presented bond payable schedule.

Reimbursement Contracts Payable

Issue	Date of Issue	Original Issue	Outstanding July 1, 2001
LSU and Related Campuses			
LSU Union Additions Bonds, Series 1984-B	July 31, 1984	$2,700,000	$1,140,075
Student Recreation Sports Center Bonds, Series 1984-A	April 1, 1984	750,000	202,421
LSU Union Additions Bonds, Series 1983-A	March 1, 1983	300,000	57,002
Building Bonds, Series 1977-C - Alexandria	October 1, 1977	100,000	13,429
Student Union Additions Bonds, Series 1979-B - Alexandria	June 15, 1979	1,410,000	285,000
LSU in Shreveport			
Building Bonds, Series 1977-C	October 1, 1977	1,000,000	134,285
Total Reimbursement Contracts Payable		$6,260,000	$1,832,212

Redeemed	Outstanding June 30, 2002	Maturities	Interest Rates	Future Interest Payments June 30, 2002
$235,656	$904,419	2002-2004	4.67% - 6.01%	$85,212
62,047	140,374	2002-2004	9.5%	20,276
27,292	29,710	2002-2003	8.125% - 8.2%	2,436
13,429				
285,000				
134,285				
$757,709	$1,074,503			$107,924

The annual requirements to amortize all bonds and reimbursement contracts outstanding at June 30, 2002, are as follows:

Fiscal Year	Principal	Interest	Total
2003	$7,674,831	$9,512,114	$17,186,945
2004	8,038,535	9,084,661	17,123,196
2005	8,575,971	8,627,245	17,203,216
2006	18,410,417	8,338,426	26,748,843
2007	21,290,000	8,118,769	29,408,769
2008-2012	24,142,085	30,961,519	55,103,604
2013-2017	23,322,085	20,170,537	43,492,622
2018-2022	20,919,579	14,277,195	35,196,774
2023-2027	24,475,000	7,628,187	32,103,187
2028-2032	12,665,000	1,648,568	14,313,568
Total	$169,513,503	$118,367,221	$287,880,724

The following is a summary of the debt service reserve requirements of the various bond issues at June 30, 2002:

Bond Issue	Cash/ Investment Reserves Available	Reserve Requirement	Excess
Auxiliary Plant:			
LSU and A&M College	$8,981,588	$6,014,162	$2,967,426
LSU at Eunice	85		85
University of New Orleans	528,691	528,691	
LSU Health Sciences Center - Health Care Services Division	6,450,210	6,439,060	11,150
Total	$15,960,574	$12,981,913	$2,978,661
Educational Plant - University of New Orleans	$346,303	$333,820	$12,483

As permitted by the Bond Resolution for the Revenue and Refunding Bonds, (Wellness Center Project) Series 1998, the university system obtained a surety bond issued by an insurance company as a substitute for the reserve requirement for the bonds. The surety bond meets the definition as a "Reserve Fund Investment" and guarantees payment of an amount not to exceed $1,041,250 to fund the Reserve Requirement.

As permitted by the Bond Resolution for the Revenue Bonds, Series 2000, the LSU Health Sciences Center obtained a surety bond issued by an insurance company as a substitute for the reserve requirement for the bonds. The surety bond meets the definition as a "Reserve Fund Investment" and guarantees payment of an amount not to exceed $1,176,841 to fund the Reserve Requirement.

Capital Leases

The university system records items under capital leases as assets and obligations in the accompanying financial statements. Assets under capital lease are included as capital assets in note 5. The following is a schedule of future minimum lease payments under capital leases, together with the present value of minimum lease payments at June 30, 2002:

Fiscal Year Ending June 30:	
2003	$9,399,866
2004	7,161,566
2005	5,827,081
2006	5,668,831
2007	5,376,468
2008-2012	5,887,025
2013-2017	7,653,125
Total minimum lease payments	46,973,962
Less - amounts representing executory costs	(2,497,288)
Net minimum lease payments	44,476,674
Less - amounts representing interest	(7,356,673)
Present value of net minimum lease payments	$37,120,001

13. DUE TO STATE TREASURY

As shown on Statement A, the university system has a total of $72,322 due to the state treasury at June 30, 2002. This amount consists of $38,349 of petty cash advances, $22,041 due for unclaimed property and $11,932 refund of prior year expenditures.

14. NET ASSETS

The university system had the following restricted expendable net assets as of June 30, 2002:

Account title	Amount
Student fees	$6,535,973
Grants and contracts	23,084,271
Gifts	5,573,104
Endowment earnings	20,267,366
Auxiliary enterprises	24,363,668
Student Loan Fund	35,608,423
Capital construction	34,412,269
Debt service	10,022,984
Endowment Fund	2,919,263
Other	41,469,053
Total	$204,256,374

The university system's restricted nonexpendable net assets of $110,218,459 as of June 30, 2002, is comprised entirely of endowment funds.

15. RESTATEMENT OF BEGINNING FUND BALANCES TO BEGINNING NET ASSETS

The beginning net assets as reflected on Statement B have been restated to reflect the implementation of GASB Statement Numbers 34 and 35 and the reporting of the university system as a business-type activity. In previous years, the university system reported in accordance with the American Institute of Certified Public Accountants College Guide model. The effect of this change in accounting principle is as follows:

Fund balances at June 30, 2001:	
General Fund	($158,211,965)
Auxiliary Enterprises	22,626,053
Restricted Fund	263,746,602
Student Loan Fund	34,705,067
Endowment Fund	94,263,874
Plant Fund	2,257,034,935
Total fund balance at June 30, 2001	2,514,164,566
Account balances affecting net assets at June 30, 2001:	
Deferred revenue - summer school	(17,614,362)
Deferred revenue - prior year unearned revenue	(16,428,357)
Prior year compensated absence liability	(1,715,554)
Prior year interest on bonds payable	(1,017,946)
Adjustment for bonds payable for Hotel Dieu (net of reserves)	(39,917,235)
Adjustments to capital assets, net	(1,406,730,204)
Miscellaneous	(50,378)
Net assets at July 1, 2001	$1,030,690,529

16. FOUNDATIONS

The accompanying financial statements do not include the accounts of the following foundations:

LSU Foundation
LSU Property Foundation
Tiger Athletic Foundation
LSU Alumni Association
Pennington Biomedical Research Foundation
Pennington Medical Foundation
Foundation for the LSU Health Sciences Center
LSU Medical Alumni Association
LSU School of Dentistry Alumni Association
LSU School of Nursing Alumni Association
University of New Orleans Alumni Association
University of New Orleans Foundation
UNO Athletic Association
University of New Orleans Research and Technology Foundation
University of New Orleans Property and Housing Development Foundation
LSU in Shreveport Foundation
LSU in Shreveport Alumni Association
LSU in Shreveport Realty, L.L.C.

LSU Health Sciences Center in Shreveport Foundation
Biomedical Research Foundation of Northwest Louisiana
Louisiana State University at Alexandria Foundation
Louisiana State University at Eunice Foundation
Health Care Services Foundation, Inc.

These foundations are separate corporations whose financial statements are subject to audit by independent certified public accountants.

17. DEFERRED COMPENSATION PLAN

Certain employees of the LSU System participate in the Louisiana Public Employees Deferred Compensation Plan adopted under the provisions of the Internal Revenue Code Section 457. Complete disclosures relating to the Plan are included in the separately issued audit report for the Plan, available from the Louisiana Legislative Auditor, Post Office Box 94397, Baton Rouge, Louisiana 70804-9397.

18. ON-BEHALF PAYMENTS

On-behalf payments for fringe benefits and salaries are direct payments made by one entity to a third party recipient for the employees of another legally separate entity. On-behalf payments include pension plan contributions, employee health and life insurance premiums, and salary supplements or stipends. The amount of on-behalf payments for fringe benefits and salaries included in Statement B for fiscal year ended June 30, 2002, is $519,659. There were no on-behalf payments made as contributions to a pension plan for which the university is not legally responsible.

19. LSU HEALTHCARE NETWORK

The financial statements of the Louisiana State University System, LSU Health Sciences Center included the LSU School of Medicine in New Orleans Faculty Group Practice, a nonprofit corporation doing business as the LSU Healthcare Network (LSUHN). The governing board of LSUHN was established in August 1995 and is comprised of 15 members, seven of which are appointed by LSU and eight of which are from the community and not members or employees of the LSU Board of Supervisors. LSUHN began operations in March 1997, providing health care to the general public and assisting the LSU Health Sciences Center in carrying out its medical, educational, and research functions.

A cooperative endeavor agreement, dated November 1, 1995, documents the relationship between the LSU Health Sciences Center and LSUHN. The agreement provides for the LSU Health Sciences Center and LSUHN to continue as autonomous organizations, with separate but complimentary missions. The agreement establishes a relationship in which the LSU Health Sciences Center will lease certain faculty, staff, and specific office space and equipment to LSUHN as its part of the agreement. LSUHN will reimburse the LSU Health Sciences Center for the use of its employees, facilities, and equipment; provide support to the academic programs; and provide access to a patient base that would not otherwise be available, as its part of the agreement.

20. IMPROVEMENTS TO PLANT ON BEHALF OF UNIVERSITY

Improvements at University of New Orleans

The University of New Orleans Research and Technology Foundation, a separate corporation created for or in behalf of the University of New Orleans, issued long-term debt instruments for infrastructure improvements and the construction of facilities on land owned by the university and leased to the foundation. The improvements, valued at $73,316,837 at June 30, 2002, were completely financed by the University of New Orleans Research and Technology Foundation through private lending and the sale of bonds through the Louisiana Public Facilities Authority, the Louisiana Local Government Environmental Facilities and Community Development Authority, and through bank notes. The university leases the land to the University of New Orleans Research and Technology Foundation in accordance with terms outlined in the ground leases. The improvements are owned by the University of New Orleans Research and Technology Foundation, but upon the expiration of the ground leases will revert to the university.

Expansion of Tiger Stadium

The Tiger Athletic Foundation, a separate corporation created in behalf of the university's intercollegiate athletics program, issued in March 1999, long-term debt instruments for the expansion of Tiger Stadium, located on the grounds of LSU and A&M College in Baton Rouge. The expansion, with an estimated value of $50 million, was completely financed by the Tiger Athletic Foundation through the sale of bonds through the Louisiana Public Facilities Authority and through a bank loan. The bonds financed 75% of the cost of the project and the bank loan financed the remaining balance. Commencing in January 1999 and for a term of 50 years, the university agrees to lease the land to the Tiger Athletic Foundation for the stadium improvements. Until the bonds are paid for by the Tiger Athletic Foundation, the rent paid is $1,000 per year. After the bonds are paid for in full, the rent is increased to $2 million per year. In turn, the university agrees to lease the completed stadium improvements for 35 years from the Tiger Athletic Foundation for $2 million per year with payments being due in September of each year. In addition, the university has granted the foundation certain rights to purchase tickets in the existing and newly expanded section of the stadium. The stadium improvements are owned by the Tiger Athletic Foundation, but upon payment of the bonds and expiration of the lease, the Tiger Athletic Foundation intends to donate the stadium improvements to the university. Revenues of the Tiger Athletic Foundation from the sale of the ticket premiums related to the stadium improvements are pledged to finance the debt service.

LSU Health Sciences Center - New Orleans
Cooperative Endeavor for District Energy Services

Effective November 1, 1998, the LSU Board of Supervisors on behalf of the LSU Health Sciences Center - New Orleans (LSUHSC) entered into a cooperative endeavor agreement with Entergy Thermal (Entergy), a division of Entergy Business Solutions, Inc., and New Orleans Medical Complex, Inc. (NORMC), a Louisiana private, nonprofit corporation. The term of the agreement ends September 30, 2020, with options to renew the lease for two 5-year periods.

Under the agreement, the LSUHSC leases to NORMC a parcel of land located in New Orleans at the northeastern corner of South Claiborne Avenue and Gravier Street. NORMC pays the LSU Health Sciences Center $40,000 annually for the lease, which may be adjusted every 5 years for inflation. NORMC is responsible for the construction of a combined use facility, which is comprised of its office, a multi-level parking garage, and a thermal energy production facility. For the period of the agreement, the LSUHSC and NORMC entered into a reciprocal lease, which, in lieu of rent, gives each the right of occupancy of the combined use facility. Upon the expiration or sooner termination of the ground lease, the title to the combined use facility will automatically become vested in the Board of Supervisors.

NORMC is subleasing the combined use facility to Entergy, which is responsible for the construction and financing of the thermal energy production facility within the combined use facility. Under the terms of the reciprocal lease, Entergy is also responsible for the operations, repair, replacement, and maintenance of the central plants located at the Medical Center of Louisiana at New Orleans and the LSUHSC (the central plants). For the term of the agreement, the LSUHSC is obligated to purchase its thermal energy from Entergy. The LSUHSC total monetary obligation is not determinable since the obligation will be based on energy consumption.

During the term of the agreement, title to the thermal equipment within the combined use facility is vested in Entergy Thermal. Upon the expiration or termination of the agreement, Entergy will have the right, but not the obligation, to remove equipment it has installed provided that the removal of the equipment does not materially damage the thermal energy production facility space in the combined use facility. The LSU Board of Supervisors has the option to purchase the equipment upon expiration or termination of the agreement. The title to the thermal equipment installed within the central plants is vested in NORMC until the expiration or termination of the agreement, at which time title shall automatically pass to and become vested in the LSU Board of Supervisors.

21. REVENUE USED AS SECURITY FOR REVENUE BONDS

The revenues of certain auxiliary enterprises at LSU A&M, LSU in Alexandria, LSU in Eunice, the University of New Orleans, and the LSU Health Sciences Center are restricted by terms in the covenants of certain debt instruments. The revenues reported on the Statement of Revenues, Expenses, and Changes in Net Assets include all auxiliary enterprise revenues of all campuses, but exclude sales to other LSU departments or campuses, in accordance with accounting principles generally accepted in the United States of America. The following represents those restricted auxiliary enterprise revenues of certain auxiliary enterprises at LSU A&M, LSU in Alexandria, LSU in Eunice, the University of New Orleans, and the LSU Health Sciences Center that are used as security for revenue bonds; however, these amounts do include sales to other LSU departments and campuses for the year ended June 30, 2002.

Auxiliary Enterprises	
Residential life	$22,066,526
Student union services, including bookstore	25,075,518
Health, physical education, and recreation	5,687,230
Athletics	47,103,958
Resident Food Services	1,828,344
Miscellaneous	40,286,665
Total	$142,048,241

OTHER REPORT REQUIRED BY

GOVERNMENT AUDITING STANDARDS

Exhibit A contains a report on compliance with laws and regulations and on internal control over financial reporting as required by *Government Auditing Standards*, issued by the Comptroller General of the United States. This report is based solely on the audit of the financial statements. Exhibit B includes any reportable conditions and/or material weaknesses in internal control or compliance matters that would be material to the presented financial statements.

OFFICE OF
LEGISLATIVE **A**UDITOR
STATE OF LOUISIANA
BATON ROUGE, LOUISIANA 70804-9397

DANIEL G. KYLE, PH.D., CPA, CFE
LEGISLATIVE AUDITOR

1600 NORTH THIRD STREET
POST OFFICE BOX 94397
TELEPHONE: (225) 339-3800
FACSIMILE: (225) 339-3870

December 17, 2002

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

LOUISIANA STATE UNIVERSITY SYSTEM
STATE OF LOUISIANA
Baton Rouge, Louisiana

We have audited the financial statements of the Louisiana State University (LSU) System, a component unit of the State of Louisiana, as of and for the year ended June 30, 2002, and have issued our report thereon dated December 17, 2002. Our report was qualified because of the omission of the statement of cash flows and uncertainties related to unreconciled differences between two accounting systems for capital assets of the LSU Health Sciences Center - Health Care Services (HCSD). The omission of the statement of cash flows results in an incomplete presentation, and the effects of adjustments, if any, needed in HCSD's capital assets cannot be determined. We did not audit the operations of the LSU School of Medicine in New Orleans Faculty Group Practice (doing business as LSU Healthcare Network). These amounts were audited by another auditor whose report has been furnished to us. This report, insofar as it relates to the LSU Healthcare Network, is based solely upon the reports of the other auditor. Except as described previously, 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.

Compliance

As part of obtaining reasonable assurance about whether the Louisiana State University System's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 the instances of noncompliance involving improper disproportionate share payments and internal control weaknesses in Cost Reimbursement Department, as disclosed in Exhibit B, that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Louisiana State University System'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. However, we noted certain matters, described in

Exhibit B, involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Louisiana State University System's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described in Exhibit B, we consider the findings involving improper disproportionate share payments, inadequate support for restatement of capital assets, internal control weaknesses in Cost Reimbursement Department, and untimely and inaccurate reconciliation of cash to be material weaknesses.

Other Reports

Other external auditors audited the LSU Healthcare Network, which is included in the Louisiana State University System's basic financial statements for the year ended June 30, 2002. To obtain the latest audit report of the LSU Healthcare Network, write to the LSU Healthcare Network, 2020 Gravier Street, Suite 507, New Orleans, Louisiana 70112.

As a part of our audit of the LSU System's financial statements for the year ended June 30, 2002, we performed certain procedures on campuses and hospitals within the LSU System. Our reports on those procedures for those campuses and hospitals are dated as follows:

LSU and Related Campuses	December 17, 2002
LSU Health Sciences Center - New Orleans	December 18, 2002
LSU Health Sciences Center - Shreveport	December 12, 2002
University of New Orleans	December 4, 2002
Medical Center of Louisiana at New Orleans	December 6, 2002
University Medical Center - Lafayette	September 4, 2002
W.O. Moss Regional Medical Center	July 31, 2002
Lallie Kemp Medical Center	March 20, 2002
Leonard J. Chabert Medical Center	March 20, 2002

These reports contained compliance and internal control findings relating to these facilities. Management's responses are also included in those reports. Copies of those reports are available for public inspection at the Baton Rouge, New Orleans, and Shreveport offices of the Legislative Auditor and can also be found on the Internet at www.lla.state.la.us\f&c.shtml.

This report is intended solely for the information and use of the Louisiana State University System and its 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 as a public document.

Respectfully submitted,

Daniel G. Kyle

Daniel G. Kyle, CPA, CFE
Legislative Auditor

JPB:ES:RCL:dl

[LSU02]

EXHIBIT A

Improper Disproportionate Share Payments

The Louisiana State University Health Sciences Center - Health Care Services Division (LSUHSC-HCSD) requested and was paid disproportionate share hospital (DSH) interim payments by the Department of Health and Hospitals that exceeded the maximum allowed by federal regulations for the DSH program. The DSH program originated with the Omnibus Budget Reconciliation Act of 1981 and allows for the reimbursement of uncompensated care costs (UCC) to hospitals serving disproportionate numbers of low-income patients with special needs. According to the Louisiana Medicaid State Plan, UCC is defined as the cost of furnishing inpatient and outpatient hospital services net of Medicare costs, Medicaid payments (excluding DSH payments), costs associated with patients who have insurance for services provided, private payor payments, and all other inpatient and outpatients payments received from patients.

The Omnibus Budget Reconciliation Act of 1993 mandates that payments to public hospitals under the DSH program be limited to 100% of UCC for the cost reporting period. In addition, the Louisiana Medicaid State Plan states that DSH payments to a hospital shall not exceed the hospital's UCC for the state fiscal year to which the payment is applicable. Although LSUHSC-HCSD was knowledgeable of federal regulations and the requirements outlined in the Louisiana Medicaid State Plan, it appears that HCSD prepared estimates of UCC that exceeded actual UCC by $257,222,818 for fiscal years 1996 through 2002 because state appropriations did not provide sufficient operating funds. The total actual UCC by year as of June 30, 2002, and the related interim payments are as follows:

Year	Total Actual UCC	Total Interim Payments	Dollar Difference	Percentage Difference
1996	$447,168,759	($472,392,834)	($25,224,075)	5.64%
1997	485,706,732	(495,756,671)	(10,049,939)	2.07%
1998	502,231,145	(521,158,884)	(18,927,739)	3.77%
1999	539,242,812	(569,398,826)	(30,156,014)	5.59%
2000	539,278,730	(595,471,519)	(56,192,789)	10.42%
2001	504,899,782	(569,748,926)	(64,849,144)	12.84%
2002	520,319,423	(572,142,541)	(51,823,118)	9.95%
Total	$3,538,847,383	($3,796,070,201)	($257,222,818)	

Before June 30 of each year, LSUHSC-HCSD prepares estimates of UCC for that year for all of the nine HCSD facilities. These estimates are used by the Department of Health and Hospitals to determine the amount of the DSH interim payments for each of the facilities for the subsequent year. Prudent business practices would mandate that the estimates prepared by HCSD closely approximate the actual UCC calculation that is prepared after the fiscal year-end, since any overpayment is required to be paid back at a later date. However, as the above comparisons for years 1996 through 2002 indicate, the estimated UCC, upon which the DSH payments were based, far exceeded the actual UCC. Despite the variance between the actual and estimated costs, HCSD continued to submit inflated estimates for payment purposes, causing overpayments ranging from 2.07% in 1997 to 12.84% in 2001.

HCSD management should develop and implement internal controls over estimates upon which DSH interim payments are based to ensure that all estimates of UCC can be supported by actual, allowable costs. Furthermore, HCSD should make arrangements to return any overpayments noted. Management concurred in part with the finding (see Appendix A, pages 1-5). However, management disagrees with the conclusion reached by the auditor, which infers that the reason that HCSD prepared estimates that exceeded actual UCC was because state appropriations did not provide sufficient operating funds.

Additional Comments: The UCC payments to HCSD based on estimates have been consistently higher than actual uncompensated care costs over a seven-year period. On December 2, 2002, the United States Department of Health and Human Services instructed the Louisiana Department of Health and Hospitals to set up a receivable from HCSD for overpayments of $290,154,502, which will result in a potential liability back to the federal government of $210,603,336. Obviously, this would have a considerable impact on the state's budget.

Inadequate Support for Restatement of Capital Assets

LSUHSC-HCSD was unable to provide adequate documentation to support its restatement of capital assets (at cost) as of June 30, 2001, from $378,654,254 to $467,118,081 (an increase of $88,463,827). The restatement included the nine hospitals under HCSD as well as its administrative unit and was reported in HCSD's Annual Fiscal Report (AFR) for the fiscal year ended June 30, 2002. The restatement reflected the results of a change in accounting systems used for financial statement purposes from the systems maintained by the Louisiana Property Assistance Agency (LPAA) and State Land and Buildings (SLABS) to the system maintained by American Appraisal Associates (AA). The decision to change reporting systems resulted from the implementation of Governmental Accounting Standards Board Statement No. 34. The cost amounts in the LPAA and SLABS systems were audited in prior years. The costs in the AA system had been used for Medicare and Medicaid cost reporting purposes and have not been previously audited.

The breakdown of the $88,463,827 increase is as follows:

	AA	LPAA/SLABS	Difference
Land	$24,087,523	$24,339,029	($251,506)
Land improvements	14,808,081		14,808,081
Buildings	153,097,750	177,507,126	(24,409,376)
Equipment	275,124,727	176,808,099	98,316,628
Total	$467,118,081	$378,654,254	$88,463,827

Since the majority of the difference between the two systems was related to equipment, this was the focus of our testing. In a review of high dollar assets, we were able to identify $26,950,346 of assets that were included on the AA system but were not included in the LPAA system. Of those assets, it was determined through observation or other support that $17,243,277 appears to be correctly included in the AA listing. However, it was also determined that the remaining $9,707,069 appears to be incorrectly included in AA. This reduced the unexplained increase from $88,463,827 to $78,756,758. However, five months after the end of the fiscal year, HCSD could not provide a reconciliation and we did not feel it was practical to continue our efforts to balance the two systems. Although it appears that capital assets under the AA system are overstated, the exact amount of the overstatement could not be determined.

Because HCSD could not support capital asset cost, depreciation expense for 2002 of $24,083,923 and accumulated depreciation as of June 30, 2001, of $330,604,506 reported in its AFR for June 30, 2002, as well as the depreciation expense reported by HCSD in its Medicare and Medicaid cost reports, may be overstated since both are based upon that cost. This may impact the allowability of those costs by the federal government.

A reconciliation should be performed when a change in accounting systems is made to ensure that the new system reflects correct and complete information. In addition, the agency should be able to provide an explanation for any differences noted in the reconciliation. However, since HCSD believes that the amounts in AA more accurately reflect its capital assets, it did not attempt to identify the reasons for the $88,463,827 restatement. HCSD's failure to perform a reconciliation may have resulted in an overstatement of its capital assets, at cost, by as much as $78,756,758 in its AFR for the fiscal year ended June 30, 2002. In addition, it may have overstated accumulated depreciation, as well as the amount of depreciation expense claimed for financial statement and cost report purposes.

If HCSD intends to continue to use the AA system to maintain its capital assets for financial statement and cost reporting purposes, management should perform a comprehensive inventory of the items in the system at each of the facilities to verify that the items exist and are recorded at their proper value. Any items previously disposed of should be removed from the system. In addition, HCSD should review Medicare and Medicaid cost reports submitted in prior years to ensure that the correct amount of depreciation was claimed on those reports.

Management concurred in part with this finding (see Appendix A, pages 6-9). Management agreed that a reconciliation between the systems should be performed but does not agree that there is inadequate support for the restatement of the capital assets or that HCSD did not attempt to identify reasons for the $88,463,827.

Additional Comments: We do not believe that support for the restatement is adequate because a reconciliation between the two systems was not performed. Until the specific differences between the two systems are identified and the causes of each difference examined, we cannot determine the accuracy of the AA system used by HCSD. HCSD personnel did attempt to identify the reasons for the $88,463,827 restatement after we began questioning the reasonableness of such restatement. However, HCSD did not attempt to do so between the time the decision was made to use the AA system and the time the auditors began questioning the propriety of the restatement of capital assets, even though HCSD personnel were aware that there were differences between the two systems.

Inadequate Collection Procedures for Self-Pay Patients

LSUHSC-HCSD does not have adequate collection procedures for amounts receivable from self-pay patients. Self-pay patients are those patients who are not eligible for free care but do not have any third-party coverage, such as Medicare, Medicaid, commercial insurance, or worker's compensation.

During fiscal year 2002, $166,614,173 was billed to self-pay patients and $2,909,063 was collected on the self-pay accounts. Subsequent to an adjustment of $17,380,021, to the amount owed by the patients based upon the Limited Liability Schedule, which reflects federal income poverty guidelines, $1,542,196 was considered to be a valid receivable at year-end. Therefore, HCSD had an uncollectible amount of $146,964,749 for fiscal year 2002. As a result, only $4,451,259 (or 2.9%) has been or is estimated to be collected on the $166,614,173 billed less the limited liability reduction.

The amounts by hospital are as follows:

LOUISIANA STATE UNIVERSITY
STATE OF LOUISIANA
Compliance and Internal Control Findings
Page 5

	Patient Billing		Limited Liability Adjustment		Collections		Accounts Receivable		Estimated Uncollectibles	
	Dollar	%	Dollar	%	Dollar	%	Dollar	%	Dollar	%
E. A. Conway Medical Center	$10,321,256	6.2%	$1,628,340	9.4%	$216,159	7.4%	$108,460	7.0%	$8,521,950	5.8%
Earl K. Long Medical Center	6,657,377	4.0%	1,969,069	11.3%	238,564	8.2%	146,944	9.5%	4,409,633	3.0%
Heuy P. Long Medical Center	10,744,543	6.4%	1,046,126	6.0%	208,004	7.2%	100,165	6.5%	9,493,990	6.5%
University Medical Center	9,842,549	5.9%	1,823,919	10.5%	403,181	13.9%	205,790	13.4%	7,717,539	5.2%
W. O. Moss Medical Center	2,642,259	1.6%	1,070,760	6.2%	177,355	6.1%	66,793	4.3%	1,414,442	1.0%
Lallie Kemp Medical Center	4,260,035	2.6%	798,642	4.6%	245,401	8.4%	161,235	10.5%	3,199,462	2.2%
Washington-St. Tammany Medical Center	1,651,657	1.0%	151,148	0.9%	74,697	2.6%	42,122	2.7%	1,425,112	1.0%
Leonard J. Chabert Medical Center	7,969,506	4.8%	1,879,727	10.8%	348,833	12.0%	220,623	14.3%	5,788,264	3.9%
Medical Center of Louisiana at New Orleans	112,524,991	67.5%	7,012,290	40.3%	996,869	34.2%	490,064	31.8%	104,994,357	71.4%
Total	$166,614,173	100%	$17,380,021	100%	$2,909,063	100%	$1,542,196	100%	$146,964,749	100%

The figures presented above do not include any amounts for patients who are eligible for free care since these patients are never billed. A review of self-pay billings and collections for the fiscal year ending June 30, 2001, yielded similar results as only $5,247,168 (or 2.7%) was collected or expected on the $210,412,959 billed less the limited liability reduction. HCSD has an estimated accounts receivable of $2,181,856 related to self-pay patients at June 30, 2001.

Louisiana Revised Statute 17:1519.1 (A) (1) states that the nine state hospitals under HCSD shall be operated primarily for the medical care of the uninsured and medically indigent residents of the state and others in need of medical care and as teaching institutions. The accounts of indigent patients are written off as uncollectible at the time the services are performed. However, the accounts of Medicare, Medicaid, commercial insurance, and self-pay patients are billed to the appropriate payor. Prudent business practices require the timely billing and collection of these amounts. However, management has not placed sufficient emphasis on the importance of timely collections on self-pay accounts. Instead, emphasis has been placed on collections from patients with third-party coverage. Management's failure to implement adequate collection procedures on self-pay accounts results in a significant loss of revenue to the hospitals.

Management should implement collection procedures on self-pay accounts to seek payment in a more timely and effective manner. In addition, the hospitals should consider limiting the services provided to self-pay patients to those that are emergency in nature unless the patients are able to demonstrate their ability and willingness to pay. Management concurred in part with this finding and stated that some patients are resistant or are unable to provide required documentation to support indigent status and qualify them for free care (see Appendix A, pages 10-12). Management outlined the current billing practices as well as initiatives that are currently in operation or in development to improve performance in this area.

Internal Control Weaknesses in
Cost Reimbursement Department

The Cost Reimbursement Department of LSUHSC-HCSD did not prepare accurate estimates for the disproportionate share hospital (DSH) payable for the fiscal years ending June 30, 2001, and June 30, 2002, which were included in the Annual Fiscal Report (AFR) for the year ended June 30, 2002. In addition, it could not provide adequate supporting documentation for the net Medicaid cost report receivables estimate for June 30, 2002, which was included in the 2002 AFR.

Good internal control should ensure that the cost reimbursement personnel preparing the estimates understand the significance of providing accurate estimates to be reported in the AFR. In addition, good internal control should provide for adequate supervision and review of the estimate so that errors can be detected and corrected in a timely manner.

The Cost Reimbursement Department estimated a net DSH payable of $65,611,280 for the fiscal year ended June 30, 2001, and $50,182,863 for the fiscal year ended June 30, 2002, for all of the nine hospitals under HCSD. These estimates were reported in the 2002 AFR as a part of the net DSH payable of $114,760,041 for all years pending settlement.

Procedures performed during audit tests identified the following errors for the 2001 estimate:

- The DSH payable was overstated by $867,994 because the hospital expenditure, Medicaid cost, and private payor payment components of the calculation were overstated.

- The DSH payable was understated by $105,858 because the Medicare cost and Medicare fee schedule payment components of the calculation were understated.

As a result, the DSH payable for the fiscal year ended June 30, 2001, was overstated by $762,136.

Procedures performed during audit tests identified the following errors for the 2002 estimate:

- The DSH payable was understated by $16,072,121 because of errors in the hospital expenditure component of the calculation.

- The DSH payable was overstated by $14,781,515 because the division failed to include the medical malpractice component of the calculation and because of various other errors made in the calculation.

The net result of these errors was an understatement of the DSH payable for fiscal year 2002 of $1,290,606. Of significant concern was the magnitude of the errors noted. Although these errors partially offset each other, any of these errors alone could have resulted in a material misstatement of the payable in the 2002 AFR.

The Cost Reimbursement Department estimated a net Medicaid cost report receivable of $35,311,051 for the fiscal year ended June 30, 2002, for all of the nine hospitals under HCSD. This estimate was reported in the 2002 AFR as a part of the net cost report receivable of $141,584,661 for all years pending settlement. Although this estimate was generated using the same computer software that is used to generate the cost reports, the agency was unable to provide documentation to support the estimates. When the department attempted to re-create the estimates, the calculation was $35,654,600 (or $343,549 more than the estimate reported on the AFR). This increase in the estimate occurred because the software version used in the second estimate was an updated version of the software used in the estimate for the AFR.

Management has not placed sufficient emphasis on ensuring that the estimate is accurately prepared, adequately documented, and reviewed timely for errors and omissions. Inaccurate estimates provided by the Cost Reimbursement Department could cause material misstatements in the HCSD financial statements.

HCSD should implement policies and procedures that will ensure that calculations related to DSH and cost reports are prepared accurately, comply with the federal Medicare and Medicaid regulations, and are properly supported. In addition, HCSD should strengthen its procedures to ensure that adequate supervision and review of estimates are performed. Management substantially concurred with the finding but stated that the amounts when taken as a whole are not material under normal standards (see Appendix A, pages 13-15).

Additional Comments: As stated in the finding, the individual errors reflected both understatements and overstatements and, as such, substantially netted each other out. Management cannot rely on this “coincidence” in the future.

Untimely and Inaccurate Reconciliation of Cash

LSUHSC-HCSD was unable to provide an accurate reconciliation between cash reported on its financial statements for the fiscal year ended June 30, 2002, and cash in the bank as of June 30, 2002, in a timely manner. The financial statements, which were required to be submitted to the Division of Administration, Office of Statewide Reporting and Accounting Policy (OSRAP) by September 16, 2002, reported a cash balance of $106,107,122 for HCSD’s nine hospitals and its administration unit. However, audit procedures performed in early October 2002 determined that the cash amount reported on HCSD’s financial statements appeared to be overstated by approximately $6.2 million. It required an additional month for HCSD to identify unposted and inaccurate adjustments to its accounting records, resulting in a change in reported cash to $98,383,090 (or an overstatement of $7,724,032).

HCSD performed monthly reconciliations between cash in the PeopleSoft System (HCSD's general accounting system) and cash in the bank. However, it did not perform an accurate and timely reconciliation between cash in the bank and cash in the Shared Medical System (SMS), its system of record for financial reporting purposes, for the fiscal year ended June 30, 2002.

Prudent business practice would mandate that a reconciliation be performed to ensure that all transactions that affect both the accounting records and the bank accounts are in agreement and that no errors or fraud have occurred. Failure to perform an accurate and timely reconciliation between cash reported in the financial statements and cash in the bank could result in misreported financial data and undetected errors or fraud.

HCSD management should strengthen its reconciliation procedures to ensure that the reconciliation between cash reported for financial statement purposes and cash in the bank is performed timely and that any unposted or inaccurate adjustments are identified and appropriately reflected in the accounting records. Management concurred with the finding and outlined a plan of corrective action (see Appendix A, pages 16-18).

Inventory System Not Fully Functional

For the second consecutive year, the inventory component of the PeopleSoft System implemented in fiscal year 2001 by LSUHSC-HCSD was not fully functional. A proper system of internal control over inventory should include procedures to ensure that assets are safeguarded and that inventory losses, should they occur, are detected in a short period of time by normal business procedures. A perpetual inventory system is generally regarded as an acceptable method of controlling inventory and safeguarding assets. Use of a perpetual inventory system allows an entity to record receipt of goods at the time of purchase and the issuance of goods as they are withdrawn for use. At any point in time, a count of goods on hand should agree to the balance in the inventory system. Discrepancies should be investigated to determine if losses are due to theft or fraud.

The perpetual inventory component of the PeopleSoft System installed by HCSD has not functioned properly. As a result, the hospitals have had to rely on alternative methods of accounting for inventory. The problems with the PeopleSoft inventory system were caused by multiple inventory numbers assigned to inventory items in the purchasing system related to a single inventory number in the central purchase contract, as well as incorrect units of measure or conversions for inventory items in the purchasing system. Failure to provide adequate controls over inventory increases the risk that losses of inventory will occur and remain undetected.

Considering the magnitude of assets at risk ($20,374,100 at June 30, 2002), management should review the problems with the new system and provide a functioning inventory system to the hospitals as soon as possible. Management of HCSD concurred with the finding and outlined a plan of corrective action (see Appendix A, pages 19-22).

Lack of Internal Controls Over Certain Payroll Functions

Two campuses of the Louisiana State University System did not establish adequate internal controls to monitor changes made to payroll data. LSUHSC and the University of New Orleans (UNO) did not establish adequate controls over the payline function in the PeopleSoft Human Resource (HR) software application. The payline function allows the user to change gross pay, make one-time adjustments, and change other payroll information for any employee within the employee's campus during payroll processing. Effective internal controls include approval for changes made to payroll records, monitoring changes made, and sufficient document of changes to provide an adequate audit trail. We identified 137 employees with access to the payline function at LSUHSC and six employees with access to the payline function at UNO.

Neither LSUHSC nor UNO used an audit table to monitor the use of the payline function, and records of changes made using the payline function were not produced. The audit table was not used by either campus because it slows the system processing considerably. Failure to establish effective internal controls over the payline function could result in unauthorized changes to employee pay data being made and remaining undetected.

Each campus should ensure that approval is granted for all payroll changes made using the payline function, that changes are reviewed by management, and that adequate documentation of changes is produced. Management of LSUHSC and UNO concurred with the findings and recommendations and outlined plans of corrective action (see Appendix A, pages 23-25).

Inadequate Disaster Recovery Plan

Louisiana State University and Related Campuses (LSU) does not have a disaster recovery plan or an adequate backup supply of electrical power in place for its data processing operations. Backup tapes used in reestablishing critical systems are stored offsite; however, they are stored in a building that is also on the LSU campus. In the event that normal data processing facilities are unavailable for an extended period of time, good internal control requires that the university develop a disaster recovery plan, including an adequate backup supply of electrical power and remote offsite storage of backup tapes. In addition, LSU should periodically test and update the plan to ensure it continues to meet its needs.

University management reported that budget restrictions have not allowed them to implement a disaster recovery plan or obtain an adequate backup supply of electrical power and remote offsite storage. Failure to develop an updated, written, functional, and tested disaster recovery plan increases the risk that critical data may be lost or there may be an untimely or excessive delay in processing critical data. Failure to provide an adequate backup supply of electrical power and remote offsite storage of backup tapes increases the risk that normal operations will be interrupted for an unacceptable period of time.

LSU should develop a disaster recovery plan that identifies critical system hardware, software, and telecommunications components. The disaster recovery plan should include an adequate backup supply of electrical power and remote offsite storage to allow the university to re-establish its critical operations within an acceptable time frame should a disaster occur. The university should also test the plan to ensure that it provides for an orderly restoration of services in the event of an unexpected interruption in operations. Management of the university concurred with the finding and recommendation and outlined a plan of corrective action (see Appendix A, page 26).

Appendix A

Management's Corrective Action Plans and Responses to the Findings and Recommendations

LSU Health Sciences Center
HEALTH CARE SERVICES DIVISION

School of Medicine in New Orleans
School of Medicine in Shreveport
School of Dentistry
School of Nursing
School of Allied Health Professions
School of Graduate Studies
Health Care Services Division

December 11, 2002

Dr. Daniel G. Kyle, CPA, CFE
Office of the Legislative Auditor
1600 North Third Street
Post Office Box 94397
Baton Rouge, LA 70804-9397

Dear Dr. Kyle:

In response to your request dated November 26, 2002, please find below the information regarding the draft audit finding on the LSUHSC – Health Care Services Division for the period of July 1, 2001 through June 30, 2002:

RE: Audit Finding – Improper Disproportionate Share Payments

The Louisiana State University Health Sciences Center - Health Care Services Division, (LSUHSC-HCSD), concurs in part with the Legislative Audit finding regarding the Disproportionate Share Payments.

LSUHSC-HCSD management agrees with the auditor's interpretation of the Omnibus Budget Reconciliation Act of 1993 that mandates that payments to public hospitals under the DSH program be limited to 100% of UCC for the cost reporting period. But, LSUHSC-HCSD management disagrees with the conclusion reached by the auditor which infers that the reason that LSUHSC-HCSD prepared estimates that exceeded actual UCC was because state appropriations did not provide sufficient operating funds.

Timing of the reporting is a critical issue in determining overpayment. As with Medicaid, UCC interim payments are paid on a cash basis which is then cost settled through a cost report on a full accrual basis. Therefore, at the time LSUHSC-HCSD requested and was paid interim DSH payments by the Department of Health and Hospitals the estimated DSH interim payment was not estimated to exceed the maximum allowed by federal regulations for the DSH program. These estimates are usually done one or two months prior to the end of the fiscal year. The methodology used to estimate the amount of interim UCC payment began by estimating cash expenditures for the year then reduced this by the unallowable cost based on the latest "as filed" reports to get to total allowable cost. Total allowable cost estimates are then reduced by the estimated cash payments. These estimates were done on a cash basis because these payments were appropriated to the LSUHSC-HCSD on a cash basis and the assumption was made that the cash collections will equal the cost per the cost reports.

After the close of the books for the fiscal year in preparation of the financial statement, the LSUHSC-HCSD estimates Medicare cost, Medicaid cost and UCC for this fiscal year. LSUHSC-HCSD is required by law to prepare its financial statement on a full accrual basis. At this point, the estimates for Medicare cost, Medicaid cost and UCC are still estimated, because the cost reports for that year are not required to be submitted until 150 days following the close of the fiscal year.

The above explanation of the estimation methodology adhered to by LSUHSC-HCSD was in place for fiscal years 98 and forward. For fiscal year 96 and 97 actual payments were made based on what was appropriated to LSUHSC-HCSD from DHH and no comparison to estimate was required.

Of significance and overlooked by the auditor as a mitigating circumstance for fiscal year 2001 and 2002, is the fact that due to a change in provider methodology on a national level for outpatient reimbursement rates, the fiscal intermediaries around the country were unable to provide timely reports and information necessary to prepare the cost reports for fiscal year 2001 which would have been due November 30, 2001. Because of this inability, an extension was granted on a national basis.

Due to this delay, the filing date for LSUHSC-HCSD was extended from November 30, 2001, until August 5, 2002, or effectively an additional 8 months to submit the "as filed" actual cost reports for fiscal year 2001. Therefore, an "actual comparison" of the "as filed cost report" to the estimated UCC payments for fiscal year 2001, was not completed until this report was filed. The original estimate for fiscal year 2001 was prepared in June of 2001, or stated another way; this was 14 months following the computation of the estimated amount. We believe that this national issue contributed to the build up of the problem.

In addition, when you consider that DHH has at least 7 years of Medicaid cost reports outstanding that are currently not finalized, and that these settlements and finalized amounts have a significant impact retro-spectively on the amount of allowable cost for those years, then the interim numbers for those years are subject to significant adjustments.

The LSUHSC-HCSD has been reporting this liability on its financial statements since it were moved under the control of the LSU Board of Supervisors in FY 98. This issue has been discussed with the Division of Administration and before the Legislature on several occasions. As indicated below, the running total liability took a significant increase in FY 00. This increase was felt largely to be a one time adjustment. Due to the problems at the Federal level, the Cost Reports for FY 01 and FY 02 were delayed and the trend continued, therefore we agree with the auditor that the methodology for projecting UCC should be modified.

FY	Medicaid Cost Reports Receivables	Medicaid Cost Reports Payables	Medicaid UCC/DISPRO Receivables	Medicaid UCC/DISPRO Payables	Medicaid Total Net by Year	Medicaid Total Running Total
1992	23,770	(4,557,807)			(4,534,037)	(4,534,037)
1993	2,565,003	(6,508,585)			(3,943,582)	(8,477,619)
1994	8,599,708				8,599,708	122,089
1995	2,442,790				2,442,790	2,564,879
1996		(3,751,118)	10,419,762	(35,643,837)	(28,975,193)	(26,410,314)
1997	13,274,049		3,506,265	(13,556,204)	3,224,110	(23,186,204)
1998	12,084,262	(598,839)	3,478,019	(22,405,758)	(7,442,316)	(30,628,520)
1999	17,019,698	(73,630)	806,972	(30,962,986)	(13,209,946)	(43,838,466)
2000	26,967,163		3,681,764	(59,874,554)	(29,225,627)	(73,064,093)
2001	30,786,563	(32,958)	2,078,539	(67,689,821)	(34,857,677)	(107,921,770)
2002	35,499,410	(188,359)	9,488,832	(60,021,342)	(15,221,459)	(123,143,229)
	$149,262,416	$(15,711,296)	$33,460,153	$(290,154,502)	$(123,143,229)	

Further complicating the issue is that due to legislative and budgetary action in preceding fiscal years, monies that could have been remanded back to DHH to reduce the liability cited by the auditor were in fact remitted back to the state as surplus and/or appropriated directly to DHH as a funding source in the subsequent fiscal year. This process had the unintended consequence of placing LSUHSC-HCSD in a position of financial "double jeopardy" for the repayment of these monies a second time which is reflected in the aggregate amount below of $92,249,459.

Over collections & Transfers Remitted to DHH Since 1996		
FYE 6/30/96	Over collections/Surplus from Operations	35,397,001
FYE 6/30/97	Over collections/Surplus from Operations	20,671,903
FYE 6/30/98	Over collections/Surplus from Operations	4,275,892
FYE 6/30/99	Over collections/Surplus from Operations	7,575,165
FYE 6/30/00	Over collections/Surplus from Operations	27,630
FYE 6/30/01	Over collections/Surplus from Operations	-
FYE 6/30/02	Over collections/Surplus from Operations	-
	Total Over collections & Transfers Remitted to DHH from Operations	67,947,591

FYE 6/30/99	From Restricted Funds		2,824,805
FYE 6/30/00	From Restricted Funds		20,519,287
FYE 6/30/01	From Restricted Funds		957,776
FYE 6/30/02	From Restricted Funds		-
	Total Remitted to DHH from Restricted Funds		24,301,868
		Total	$92,249,459

Regardless of the contributing factors and other exacerbating circumstances, our corrective action plan to address the issues and deficiencies cited by the auditor includes, but is not limited to, the following on-going efforts and activities by the staff of the Health Care Services Division and the Department of Health and Hospitals:

- Develop an acceptable protocol and methodology, with assistance from DHH, for the estimation and payment process of "estimated DSH payments" in the future starting with the balance of fiscal year 2003.

- Aggressively pursue with assistance from DHH executive management, the transfer of LSUHSC-HCSD facilities to the prospective payment system methodology which would assist considerably in reducing large liabilities continuing to accrue in future years. In conference, DHH executive management has administratively agreed that this is the best solution and it is a matter of timing and resource allocation.

- Work aggressively with the Division of Administration -- Office of Planning and Budget and Legislative Leadership to address "unfunded or under-funded mandates" and secure adequate and reasonable state funding to support the mandates or alternatively allow LSUHSC-HCSD to secure legislative and administrative relief from the mandates.

- Aggressively pursue with assistance from DHH executive management, legislative and legal representatives, and cooperation from the Dallas Regional Office of CMS, to resolve in a satisfactory and equitable manner to the State of Louisiana, the outstanding issue of Physician Part B and CRNA reimbursement as an "allowable cost". Precedence has been set in other areas of the country for this action

Based upon the quantity of issues, problems identified, and the involvement and cooperation of outside organizations beyond our control, (CMS, etc), it is currently estimated that completion of the above mentioned efforts and action steps to correct the deficiencies will not be completed until at least the end of Fiscal Year 2003 and potentially beyond that date for some of the activity.

Responsibility for the above action steps and activities represent a cross section of staffing within the LSUHSC-HCSD, DHH executive management, DOA—OPB, and other related parties as indicated above.

Should you have any questions or need additional information, please contact Don Elbourne, LSUHSC-HCSD Chief Financial Officer at (225) 922-1216.

Sincerely,

James L. Brexler
Chief Executive Officer

JLB:ADL:adl

cc: Dr. William Jenkins
William Silvia
Robert Plaisance
David Hood
Don Elbourne
Art Landry
Judy Albin
Nona Westmoreland
Don Hutchinson
Ken Laney

LSU Health Sciences Center
HEALTH CARE SERVICES DIVISION

School of Medicine in New Orleans
School of Medicine in Shreveport
School of Dentistry
School of Nursing
School of Allied Health Professions
School of Graduate Studies
Health Care Services Division

December 12, 2002

Dr. Daniel G. Kyle, CPA, CFE
Office of the Legislative Auditor
1600 North Third Street
Post Office Box 94397
Baton Rouge, LA 70804-9397

RE: Audit Finding – Inadequate Support for Restatement of Capital Assets

Dear Dr. Kyle:

In response to your request dated December 06, 2002, please find below the information regarding the draft audit finding on the LSUHSC – Health Care Services Division for the period of July 1, 2001 through June 30, 2002:

RE: Audit Finding – Inadequate Support for Restatement of Capital Assets

The Louisiana State University Health Sciences Center - Health Care Services Division, (LSUHSC-HCSD), concurs in part with the Legislative Audit finding stating that there is inadequate support for restatement of capital assets with the following exceptions.

In general, we do not agree that there is inadequate support for the restatement of the capital assets. American Appraisal and Associates provide hundreds of pages of detailed schedules on an annual basis with regard to HCSD's capital assets. American Appraisal and Associates are a professional third party entity who prepares depreciation calculations in accordance with industry guidelines and standards. They handle this task for a multitude of businesses, both public and private, throughout the United States. They have handled this task for the LSUHSC-HCSD system for over thirty-one years and to date, there has never been a Federal Audit finding in the area of capital assets and depreciation on the Medicare and Medicaid cost report settlements.

We agree that American Appraisal (AA) has a higher cost when compared to the Louisiana Property Assistance Agency (LPAA) and Statewide Land and Building Systems (SLABS) systems but feel that variables other than cost must be taken into consideration when arriving at the total variance. For the Statement of Net Assets, both cost and accumulated depreciation calculations must be utilized in order to arrive at the true net value. Many of the assets identified in the "high dollar asset" range were fully depreciated. As a result, the capital assets, or "cost", would be overstated as well as the accumulated depreciation resulting in a net financial statement impact of zero. Of the $28,722,924 in capital asset transactions that were provided to the auditor for review, $22,511,607, approximately 78%, of these assets were fully depreciated. Even if, though unlikely, such assets may be incorrectly listed on American Appraisal, they would not have an impact on the financial statements because $22,511,607 is included in the asset cost amount as well as the accumulated depreciation offset account.

Contributing factors that led to differences between AA, LPAA, and SLABS include:

- There are different reporting requirements for all of the systems noted above. AA schedules contain a large number of assets capitalized for Medicare and Medicaid cost reporting purposes that do not fall under the guidelines of LPAA or SLABS. Examples of this include but are not limited to the following: major fixed medical equipment, computer software, computer wiring, renovations to buildings, etc. LPAA is limited to the tracking of moveable property and SLABS generally tracks Land and Buildings.

- The SLABS system does not include Land Improvements whereas AA does.

- According to OSRAP staff, the SLABS system is no longer updated for LSUHSC-HCSD, effective for Fiscal Year 2002 and beyond, due to the fact that we are no longer on the state central system.

- In some instances it appears that SLABS has appraised values of assets rather than historical cost. Examples of this were noted at University Medical Center (UMC) in Lafayette where the SLABS value of the hospital building is $32,130,327 and the amounts in AA reflect a componentized cost of $16,285,005 for a building that was constructed during the late 1970s and early 1980s. Another example from UMC is the cost of the administrator's residence where SLABS has the original cost listed as $190,000 and AA shows the historical cost as $26,000 for a house that was built in 1957.

- University Hospital (UH) in New Orleans has a total AA value of $68,454,932 and approximately $15,000,000 of this was identified in LPAA. Historically there was no physical count of capital asset inventory with the acquisition of UH in December of 1992. Since LPAA only retains records for the past five years, it will be difficult to ascertain which assets from UH were added to LPAA versus the assets that were left off.

At a meeting held on March 27, 2002, members of LSUHSC-HCSD management announced that HCSD would utilize AA schedules for the computation of the GASB 34 Statement of Net Assets. Other individuals present at this meeting included those from OSRAP, Legislative Audit, and the LSU System office. LSUHSC-HCSD was granted verbal permission to utilize AA records because it was what we considered to be the best asset management record system available under the circumstances.

We do agree that reconciliation between the systems should be performed, but, that will be a tremendous undertaking involving considerable effort. A multi-system manual reconciliation will be a long and contentious process.

Finally, LSUHSC-HCSD management does not agree with the auditors finding that LSUHCS-HCSD "did not attempt to identify reasons for the $88,463,827 restatement". LSUHSC-HCSD management was officially notified the week ending October 25, 2002, that the asset numbers utilized for FYE June 30, 2002, financial statement presentation were unacceptable. Reconciliation of one medium sized hospital took approximately one hundred hours just to identify the variances between the different asset tracking systems. At some hospitals, reconciliation may go quicker whereas others will take considerably longer, depending on the quality of the data in each of the asset tracking systems. A complete reconciliation of the restatement of net capital assets with all asset tracking systems involved was not possible within the limited timeframe that was given to us by the Legislative Auditor. Efforts are continuing and ongoing to accomplish this task.

Our corrective plan of action will be to have the variances between AA, LPAA, and SLABS identified by June 30, 2003. Due to circumstances beyond our control, it may take considerably longer to update the records in each of the systems. Those circumstances include but may not be limited to the following:

- AA only updates their records on an annual basis.

- LPAA requires documentation in order to get updates processed in their system. In some cases, this documentation will be difficult to locate. The worse case scenario is that documentation may not exist due to the age of the asset.

- Since HCSD no longer has its SLABS records updated, the SLABS system may remain a permanent reconciling item.

We also intend to perform capital asset inventory counts at all of the LSUHSC-HCSD facilities as an additional phase of the reconciliation process. We are optimistic that the majority of the facilities can be inventoried by June 30, 2003, but it may take considerably longer due to the work schedules of all involved in the process. Once again, due to circumstances beyond our control, it may be difficult to discover the original cost of an item due to its age and the fact that acquisition documentation for such assets may no longer exist.

The resources that will be utilized to complete the reconciliation process will include those in HCSD Financial Asset Management, Internal Audit, Hospital CFOs and Property Managers, and outside independent consultants (i.e. American Appraisal staff).

Should you have any questions or need additional information, please contact Don Elbourne, LSUHSC-HCSD Chief Financial Officer at (225) 922-1216.

Sincerely,

James L. Brexler
Chief Executive Officer

JLB:ADL:adl

cc: Dr. William Jenkins
William Silvia
Robert Plaisance
Don Elbourne
Art Landry
Judy Albin
Don Hutchinson
Chris Bilski
Ken Laney

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November 27, 2002

Dr. Daniel G. Kyle, CPA, CFE
Legislative Auditor
1600 North Third Street
Post Office Box 94397
Baton Rouge, LA 70804-9397

RE: Audit Finding - Inadequate Collection Procedures for Self-Pay Patients

Dear Dr. Kyle:

The Louisiana State University Health Sciences Center – Health Care Services Division concurs in part with your finding regarding its low collection rate for accounts classified as self-pay. Some LSUHSC-HCSD's patients are resistant or are unable to provide required documentation to support indigent status and qualify them for free care. This causes self-pay charges to be inflated but we have no basis on which to classify the patients as indigent without the supporting information. This is not a new issue; the services of the "Charity System" have been historically viewed as "free services." As stated in R.S. 46:1, it is the policy and practice of the LSUHSC-HCSD hospitals to provide services to all individuals who present themselves for treatment regardless of income or financial status, as long as there is space available for these patients. LSUHSC-HCSD has consistently delivered patient care in accordance with this law. Although LUSHSC-HCSD has due diligence in its attempts to collect payments due on services rendered, we concur that there is need for change in this area.

The LSUSC-HCSD embarked on a plan to convert the "Charity System" to a "Public Health Care System" as evidenced by the "Business Enterprise Bill" (Act 1024) which was passed in the 2001 Regular Session of the Legislature. Under this new initiative, emphasis is being switched from the traditional uncompensated care and Medicaid funding streams to the Non-Medicaid revenues. It was estimated that the cultural change will take years to accomplish, therefore a "grass roots" approach would be taken. This approach includes the reengineering of the financial infrastructure, development of new policies and procedures, as well as the development of the skill sets of the employees. These changes are being implemented at the same time we are addressing tight budget constraints.

The current self-pay collection procedure within the hospitals begins at the point of registration when patients are screened as self-pay and informed that they are responsible for their hospital charges. After services are rendered, a series of three statements are mailed to the guarantors to provide notice of their payment responsibility and balance due for services rendered. The statements mailed to the guarantor include customized progressive dunning messages to prompt

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the patient to make payment on their outstanding account balance. The statement messages are based on previous payment activity notifying the patient of any delinquency status on the account. After an initial statement, second and third statements are mailed in 20-day increments. If there is no payment activity after 60 days from the bill date, the accounts are then transferred to LSUHSC-HCSD's contracted collection agency for further collection efforts and attempts to establish minimal payment arrangements.

In addition, LSUHSC-HCSD has proceeded with initiatives to improve self-pay collections, which include the following:

- Quarterly Patient Accounting Workshops have provided educational and training information to registration and screening personnel to convey proper application of the Liability Limitation Schedule and accurate assignment of payer classification, which includes self-pay patients.
- Credit card payment capability has been established at all nine HCSD hospitals to provide another opportunity for self-pay guarantors to pay on outstanding bills and expedite liquidation of their debt.
- Prompt payment incentives have been established on accounts transferred to the collection agency to further encourage patient willingness to pay.

In order to further enhance collections in this area and implement more timely collection efforts, LSUHSC-HCSD continues to provide guidance to the hospitals' Chief Financial Officers and Patient Accounting Managers in analyzing internal processes. In addition, the following action initiatives have been or are in the process of being developed.

- Revise current LSUHSC-HCSD policy and practice to strengthen our self-pay policy payment requirements for self-paying patients on non-emergency services.
- Design and display proper signage within our facilities informing our patients of LSUHSC-HCSD collection procedures and that self-pay patients are expected to pay at the time of service or make acceptable payment arrangements.
- Establish dedicated positions within the facilities to act as financial counselors and advise self-pay patients of their liability and establish reasonable monthly payment schedules.
- Define self-pay account minimum payment amounts and require deposits on identified co-pay and deductible amounts from self-pay patients upon registration.
- Install automated accounts receivable work-lists that identify and generates daily reports for easy follow-up of accounts with unpaid balances that need additional collection efforts before they become delinquent.
- Authorize contracted collection agency to begin reporting non-payment on accounts to the Credit Bureau.

As stated above, LSUHSC-HCSD continues to analyze internal collection processes at its facilities, revise current policy and practices, and take the necessary corrective actions to promote self-pay collection efforts and increase our collection rate on accounts classified as self-pay. Success of these initiatives will require significant coordination of efforts among financial staff at all nine hospitals and the administrative agency, along with cooperation from the patient population. Changing the culture of LSUHSC-HCSD patients will be an on-going improvement process, which will hopefully result in improved collections from year to year.

Despite these process improvements, the LSUHSC-HSCD believes that increased collection efforts without the ability to limit or refuse treatment to patients will produce limited results. Your statement recommending that the LSUHSC-HCSD limit services provided to self-pay patients reinforces management's decision to implement accelerated self-pay collection efforts and provides support to continue the ongoing discussions with legislators to make any necessary regulatory changes to allow LSUHSC-HCSD to implement additional recommendations. Limiting services provided to self-pay patients (patients that have the ability to pay) unless they demonstrate ability or willingness to pay should also encourage patients who are truly indigent to provide the required documentation to qualify for free care. Although these efforts are reasonable from a business point of view, they will be politically difficult to achieve absent support from the administration and legislature.

Thank you for your report and recommendations. Should you have any questions or need additional information, please contact either me or Don Elbourne.

Sincerely,

James L. Brexler
Chief Executive Officer

JLB/JMA/jma

cc: Don Elbourne
Art Landry
Guy LaBauve
Judy Albin
Ken Laney

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HEALTH CARE SERVICES DIVISION

School of Medicine in New Orleans
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Health Care Services Division

December 10, 2002

Dr. Daniel G. Kyle, CPA, CPE
Office of the Legislative Auditor
1600 North Third Street
Post Office Box 94397
Baton Rouge, LA 70804-9397

Dear Dr. Kyle:

In response to your request dated November 27, 2002, please find below the information regarding the audit finding on LSUHSC – Health Care Services Division for the fiscal year ending June 30, 2002.

RE: Audit Finding – Internal Control Weaknesses in Cost Reimbursement Department

The Louisiana State University Health Sciences Center - Health Care Services Division (LSUHSC-HCSD) concurs with the finding that there are internal control weaknesses. We agree with the audit adjustments as presented by the Legislative Auditor for FY 2001 and 2002 Uncompensated Care Cost (UCC) and Cost Report estimates; however, we do not agree that the amounts, when taken as a whole, are material under normal standards.

For the FY 2001 and 2002 estimates there were only four (4) cited errors that netted to the amount of $184,921 of $754,089,819 in actual revenue, which represents only .0245 % (percent). Cost Report preparation is not an exact science. The estimates that are prepared for end of the year financial reporting are a "snapshot in time". This annual estimate should not be confused or misinterpreted as the development of a "reserve cost report", which is strictly prohibited under federal regulations. The preparation of these reports requires many thousands of entries and hundreds of hours of effort for each report to calculate reimbursements. It is important to note that there are 18 separate cost reports (9 Medicaid and 9 Medicare) and a UCC report for each fiscal year making a total of 36 cost reports and two UCC reports and supporting documents for FY 2001 and 2002. Further, our due date for FY 2001 cost reports were delayed by Centers for Medicare and Medicaid Services, (CMS) until August 5, 2002, due to national changes being made to the Medicare outpatient reimbursement methodology. This one time unprecedented delay for the FY 2001 Cost Reports left us an unusually short period of time (approximately eighteen (18) days) to complete the fiscal year 2002 projections on August 23, 2002 for the June 30, 2002 Annual Financial Report (AFR).

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We concur with the comment that the Cost Reporting Staff could not immediately provide adequate supporting documentation upon request of the auditor for the net Medicaid cost report balances estimated for the Fiscal Year ending June 30, 2002, which was calculated for the FY02 Annual AFR. Standard operating practices of the Cost Reporting Section requires staff to keep this hard copy documentation. The Cost Reporting staff inadvertently did not keep the hard copy of that supporting documentation that was used by the Comptroller's Office in preparing the AFR.

Additionally, it is standard practice to install updated releases and software modifications to the KPMG CompuMax software package that performs the calculation for the Medicaid cost reports on a regular basis. These software updates are received regularly. Due to this practice, between the dates the financial statement estimates were originally prepared and the date the auditors request for the back up documentation was made, several updates to the CompuMax software had been made. These updates are required to properly calculate Cost Report Reimbursement. The Cost Reporting staff recreated the required documentation for the auditor based on the updated software package which changed the reimbursement amount by $343,549 of the total $35,654,600 or less than 1%. The software changes contributed significantly to the difference in the numbers.

We agree that good internal controls should provide adequate supervision and review of the estimates for the AFR. Verbal procedures were in place, but unfortunately, we did not detect these differences in this instance.

Regardless of the contributing factors and other exacerbating circumstances, our corrective action plan to address the issues and deficiencies cited by the auditor includes, but is not limited to, the following on-going efforts and activities by the Cost Reporting staff of the Health Care Services Division and the Comptroller's Office:

- Develop an acceptable protocol and methodology, with assistance from the HCSD Comptroller's Office, for the estimation and recordation of the balances necessary for Annual Financial Reporting at fiscal year end. An additional level of review and validation will be established in the Comptroller's Office.

- Insure that hard copy and or digital images of the supporting documentation for the entries that support the Annual Financial Report are maintained in the Cost Reporting Section and that a duplicate be given to the Comptroller's Office for their files.

- Develop written procedures and protocols with appropriate review check lists for quality control purposes to insure that all of the 18 separate cost reports and UCC report are prepared in an accurate and consistent manner for that year's update and that all calculation changes are likewise reviewed. That process potentially includes changes and updates for all open and "not final settled" prior years. The process will also include verification with the Department of Health and Hospitals for Medicaid Cost Report and UCC estimates.

- HCSD will solicit proposals from an independent accounting and/or consultant firm to conduct an independent review of our cost reports/UCC/AFR calculations and the processes used in developing these calculations and documentations. Additionally, HCSD management will request as part of this engagement, an operational review of the cost reporting section.

- We will insure that appropriate training and continuing education of the Cost Report section staff continues to be a major part of staff professional development.

Responsibility for the above action steps and activities represent a cross section of staffing within the LSUHSC-HCSD, including the Comptroller's Office, the Cost Reporting Section, the Budget Section, and others. Corrective actions should be in place and written procedures and controls established for the preparation of the Annual Financial Report for the fiscal year ending June 30, 2003.

Should you have any questions or need additional information, please contact Don Elbourne, LSUHSC-HCSD Chief Financial Officer at (225) 922-1216.

Sincerely,

James L. Brexler
Chief Executive Officer

JLB/AL

cc: Dr. William Jenkins
William Silvia
Robert Plaisance
Don Elbourne
Art Landry
Judy Albin
Nona Westmoreland
Don Hutchinson
Michael Carter
Ken Laney

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December 12, 2002

Dr. Daniel G. Kyle, CPA, CFE
Office of the Legislative Auditor
1600 North Third Street
Post Office Box 94397
Baton Rouge, LA 70804-9397

RE: Audit Finding – Untimely and Inaccurate Reconciliation of Cash

Dear Dr. Kyle:

In response to your request dated December 6, 2002, please find below the information regarding the audit finding on the LSUHSC – Health Care Services Division for the period of July 1, 2001 through June 30, 2002:

RE: Audit Finding – Untimely and Inaccurate Reconciliation of Cash

The Louisiana State University Health Sciences Center - Health Care Services Division, (LSUHSC-HCSD), concurs with the Legislative Audit finding regarding the Reconciliation of Cash.

LSUHSC-HCSD management agrees with the auditor's statement that we did not perform an accurate and timely reconciliation between cash in bank and cash per the Shared Medical System (SMS), which was the system of record for year end financial reporting purposes. However, it is important to note that for fiscal year ended June 30, 2002, PeopleSoft was the original book of entry for all detail level transactions. Monthly reconciliations were performed between cash in bank and cash in PeopleSoft. The monthly reconciliations did not detect any fraud or misappropriation of state funds. The internal control structure for cash receipts and disbursements was not circumvented at any time during the fiscal year. LSUHSC-HCSD management concurs that cash per the financial statements, as restated, is an accurate reflection of actual reconciled cash in bank.

Contributing factors led to the untimely reconciliation of cash in bank to cash per the financial statements. Those factors include, but are not limited to:

- For fiscal year ended June 30, 2002, three accounting systems were used by LSUHSC-HCSD. PeopleSoft was the original book of entry for all detail level transactions. All detail transactions recorded in PeopleSoft were then summarized and interfaced to the

Integrated Statewide Information System (ISIS) as per requirements from the Division of Administration and the State Central Systems Committee. The summary ISIS transactions were then interfaced to SMS, the system of record for financial reporting purposes for fiscal year ended June 30, 2002.

Because of the interface between PeopleSoft, ISIS and SMS, certain entries that had no effect on cash in PeopleSoft directly affected cash in ISIS and SMS. Identifying these entries was a time consuming and difficult process. No pre-established protocols were available and the process was developed as staff progressed on the project.

- Fiscal year ending June 30, 2002 was the first full year that all ten HCSD Business Units were using PeopleSoft as the original book of entry. The Medical Center of Louisiana at New Orleans (MCLNO) came "live" on PeopleSoft on July 1, 2001. The time and effort involved completing the monthly reconciliations between PeopleSoft and cash in bank was increased tremendously with the addition of MCLNO.

- Due to the interface requirements between PeopleSoft and ISIS, we had to close the 12th period in PeopleSoft as of June 26, 2002. However, we continued normal operations during the period June 26, 2002 through June 30, 2002. Identifying the transactions that occurred during this period that directly impacted cash in bank was a time consuming process. Again, no pre-established protocols were available and the process was developed as staff progressed on the project.

Regardless of the contributing factors, our corrective action plan to address the issues and deficiencies cited by the auditor includes, but is not limited to, the following on-going efforts and activities by the staff of the Health Care Services Division:

- For fiscal year ending June 30, 2003, PeopleSoft will be the system of record for financial reporting purposes. Effective July 1, 2002, the requirement by the Division of Administration to interface accounting information into ISIS has been rescinded. The early close of the 12th period will not be a factor for fiscal year ending June 30, 2003.

- Monthly reconciliations between cash in bank and PeopleSoft will continue to be prepared in a timely manner so that the year end reconciliation of cash in bank to cash per the financial statements will be completed in a timely and accurate manner.

- LSUHSC-HCSD is in the process of updating written policies and procedures relating to the reconciliation process.

The corrective action plan regarding monthly reconciliations had already been implemented by LSUHSC-HCSD during the previous fiscal year. The policies and procedures will be updated continuously until such time as the final year end reconciliation for fiscal year 2002-2003 has been performed and documented.

Responsibility for the above action steps and activities lies with the Cash Management Section within the Finance Division of LSUHSC-HCSD.

Should you have any questions or need additional information, please contact Don Elbourne, LSUHSC-HCSD Chief Financial Officer at (225) 922-1216.

Sincerely,

James L. Brexler
Chief Executive Officer

JLB:ADL:adl

cc: Dr. William Jenkins
William Silvia
Robert Plaisance
Don Elbourne
Art Landry
Judy Albin
Debbie Loper
Ken Laney

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October 18, 2002

Dr. Daniel G. Kyle, CPA, CFE
Office of the Legislative Auditor
1600 North Third Street
Post Office Box 94397
Baton Rouge, LA 70804-9397

RE: PeopleSoft Inventory System Not Fully Functional

Dear Dr. Kyle:

In response to your request dated October 7, 2002, please find below the information regarding the draft audit finding on the LSUHSC – Health Care Services Division for the period of July 1, 2001 through June 30, 2002:

RE: Audit Finding – <u>Inventory System Not Fully Functional</u>

The Louisiana State University Health Sciences Center - Health Care Services Division concurs with the Legislative Audit finding regarding the PeopleSoft Inventory System. The HCSD has taken many steps to correct the audit finding and continues to work to resolve the inventory system issues within the budgetary constraints associated with the availability of limited staffing and the technical parameters of the PeopleSoft System. However, at this time, the Inventory System is still not fully functional and facility staffs are not fully trained and proficient in the use of the PeopleSoft Inventory System.

Staff focus and efforts continue to implement a consistent, standardized inventory system in the LSUHSC - HCSD and this remains a high priority of both the Health Sciences Center – PeopleSoft Steering Committee and HCSD executive management since there was no standardized system for inventory management or integration available with a purchasing system on the previous statewide legacy system (ISIS). Each hospital had a separate and "non-integrated" inventory application. The purchasing integration and effort involved in training several hundred employees around the state for the establishment and set up of twenty-one separate perpetual inventories across nine hospitals was and continues to be a considerable challenge for the HCSD staff and the Health Sciences Center PeopleSoft Application Support Group. While the PeopleSoft Inventory system cannot guarantee that items are always procured and posted correctly, the integration features of the system provides edit points that validate that an item will be procured, received and issued according to the attributes defined at an item level.

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Our corrective action plan to address the PeopleSoft Inventory System deficiencies includes, but is not limited to, the following on-going efforts and activities by the staff of the Health Care Services Division and the Health Sciences Center PeopleSoft Application Support Group:

- Continuing and upgrading supply chain, (purchasing and inventory management), training and aggressively monitoring the entire procurement process and subsequent inventory process by the hospital purchasing and finance management staff and the Purchasing and Inventory Coordinators.

- Additionally, since the identification of the numerous errors and omissions were identified in the initial phased deployment of PeopleSoft during Fiscal Year 2001, we have strengthened our efforts to monitor the output of the inventory system. We have also taken steps to strengthen the central oversight and standardization protocols. Specific security restrictions and protocols have been implemented to insure that unauthorized and damaging system changes cannot be made by an uninformed and inexperienced staff member trying to make unauthorized adjustments and system changes. This security deficiency caused considerable damage to system and data integrity during the initial phased deployment of the Inventory System during Fiscal Year 2001, upon which the Legislative Auditors first reported.

- The LSUHSC-HCSD Purchasing/Inventory Coordinators and HCSD Administrative Support Staff are in the process of identifying all duplicate items; assigning uniform units of measure and making correct item associations to those areas of the inventory system wherein there are problems. This is a time consuming and labor intensive process with only one permanent staff member assigned with statewide responsibility to work within the HCSD facilities. Finance management has also been able to secure the services of one additional staff person on loan from one of the hospitals through the end of the current fiscal year to augment the process and speed the cleansing process within the inventory item master.

- Additionally, bi-monthly meetings are being held for the HCSD PeopleSoft Inventory End-User community by the HCSDA Inventory Coordinator to keep them updated on the progress, necessary steps required at the facility level and reference material to share with their staff to complete the transition to the correct item numbers.

- Efforts are also underway by HCSD Human Resources Staff and HCSD Administrative Support Staff to evaluate the staffing level configurations, the technical proficiencies required, and job allocations of using a highly complex inventory system like PeopleSoft. Preliminary data has been gathered at this time, and a review is currently being done by HCSD Human Resources Administrative Staff.

- Structural re-design efforts are also currently underway by HCSDA finance staff to point the procurement of perpetual inventory items and patient chargeable items to the appropriate General Ledger Balance Sheet accounts within the PeopleSoft System. The initial PeopleSoft system design was initially compromised due to the interface requirements externally imposed on HCSD by the Division of Administration as part of our separation from the ISIS System. Due to this requirement, we had to establish a structure within PeopleSoft that mirrored the ISIS stores increase/decrease functionality to effectively achieve a balanced interface. This significantly compounded the complexity of using the PeopleSoft Inventory system in a way it was not designed to function and caused considerable systematic errors and reconciliation issues. However, as of the end of Fiscal Year 2002, the ISIS interface requirement was removed, but too late to effectively re-design the PeopleSoft system structure for Fiscal Year 2003. Presently, plans include setting up the new inventory templates for the spring of 2003 to re-design the transaction flow for Fiscal Year 2004 procurement activity.

At fiscal year end June 30, 2002, all HCSD facilities took their required physical inventory counts and appropriate "book to physical" adjustments were made in the PeopleSoft System. As part of this process the HCSD Inventory Coordinator and HCSD Internal Audit staff monitored this activity and insured that unit of measure issues were successfully corrected. Therefore, for FY 2002 financial statements, actual recorded inventory balances, both physical counts and system balances, will agree. Additionally, no evidence of unaccounted for or missing inventory was observed or reported during this process.

For Fiscal Year 2003, all HCSD facilities have been instructed to use to its potential the PeopleSoft Inventory System even if they remain somewhat dependent in the short run on their old legacy systems. They have been instructed that they must reconcile both systems until they terminate their dependence on their old legacy systems and the issues with the PeopleSoft Inventory System have been successfully resolved. The first Inventory End-User Support meeting was held in the Month of July 2002, with a followup meeting held in September 2002. Instructions and communication have been given to each HCSD facility on available queries to be utilized in the daily/weekly/monthly reconciliation process. This reconciliation process involves balancing the beginning inventory balance, (+) Receipts, (-) Issues, with additional tools to locate any variances.

Based upon the quantity of issues, problems identified and the limitation of staffing resources, it is currently estimated that completion of the above mentioned efforts and action steps to correct the PeopleSoft Inventory System deficiencies will not be completed until the end of Fiscal Year 2003. Responsibility for the above action steps and activities represent a cross section of staffing within the Health Care Services Division as indicated above.

Should you have any questions or need additional information, please contact Art Landry, Director of Financial Services, at (225) 922-1157.

Sincerely,

James L. Brexler
Chief Executive Officer

JLB/ADL/adl

cc: Don Elbourne
Lanette Buie
Art Landry
Judy Albin

LSU Health Sciences Center
NEW ORLEANS

Administration and Finance
Office of the Vice Chancellor

School of Medicine
School of Dentistry
School of Nursing
School of Allied Health Professions
School of Graduate Studies

December 12, 2002

Re: Response to Audit Finding: Lack of Internal Controls Over Certain Payroll Functions

Dr. Daniel G. Kyle, CPA, CFE
Legislative Auditor
1600 North Third Street
Post Office Box 94397
Baton Rouge LA 70804-9397

Dear Dr. Kyle,

I concur with the finding and recommendations as presented.

Corrective action plan:

1) 137 employees have had access to the payline function.

   - The security class originally established which included payline functions also included activities essential to HR staff. This inflated the number of employees given this particular security class. A separate security class specific to payline functions will be established; allowing an estimated reduction in the number of employees who will have access to approximately 100.

2) When implemented, LSUHSC did not enable the security feature which restricts access to employees of their respective campus/business unit.

   - The PeopleSoft-delivered security for this functionality did not support security at the business unit (individual hospital and campus) or company (New Orleans, Shreveport and HCSD) level. The delivered view had to be modified to provide this additional level of security and was implemented on April 10, 2002.

3) When implemented, LSUHSC did not enable the audit feature to provide an audit trail of all changes made using the payline function.

   - The implementation partner (KPMG Consulting) warned LSUHSC that significant use of the field level audit feature was known to risk serious degradation of system response time. LSUHSC carefully assessed the specific fields needing field level audit and performed extensive testing to minimize the threat to system performance before implementing this feature. With very tight timeframes for current payroll processing, any significant degradation of the overall system performance could have threatened the timely completion of payrolls. The field level audit feature on payline functions was implemented on April 10, 2002.

Anticipated Completion Date:

Revisions to Security Class: Define and test new class and migrate employees to new classes. Complete by 1/17/2003.

Person responsible for corrective action:

Matthew Gedge
Phone: 504-568-4689
Email: mgedge@lsuhsc.edu

Respectfully,

Ronnie Smith
Vice Chancellor for Administration and Finance

cc: John A. Rock, MD
Matthew Gedge
David Dotter

Office of Financial Services

2010 Administration Bldg. • New Orleans, LA 70148-2010 • (504) 280-6207 • FAX (504) 280-7474

University of New Orleans

October 23, 2002

Dr. Daniel G. Kyle, CPA, CFE
Legislative Auditor
1600 North Third Street
P.O. Box 94397
Baton Rouge, LA 70804-9397

Dear Dr. Kyle:

Please find below our Management Response to the FY 2001-2002 audit finding of "Lack of Internal Controls Over Certain Payroll Functions".

The University concurs with the finding that the audit function was not activated in PeopleSoft to allow for the detection of unauthorized changes to the payroll. We will implement the Oracle trigger auditing function, which will allow us to monitor any changes to the payroll tables in question. A report will be generated after each payroll; reviewed by the Director of Accounting Services; and unusual transactions investigated immediately. This control will be implemented by November 15, 2002.

The individual responsible for the implementation of the corrective action is Patrick A. Casey, Director of Accounting Services.

The corrective measure described above will strengthen the existing controls and will assist us in preventing future occurrences.

Sincerely,

Linda K. Robison
Vice Chancellor for Financial Services,
Comptroller and Chief Financial Officer

A Member of the Louisiana State University System Committed to Equal Opportunity

LOUISIANA STATE UNIVERSITY
AND AGRICULTURAL AND MECHANICAL COLLEGE

Office of the Vice Chancellor for Finance and Administrative Services and Comptroller

October 16, 2002

Dr. Daniel G. Kyle, CPA, CFE
Legislative Auditor
P.O. Box 94397
Baton Rouge, LA 70804-9397

Dear Dr. Kyle,

In conjunction with the legislative audit of LSU and A&M College for the fiscal year ended June 30, 2002, we wish to respond to the audit finding concerning our disaster recovery plan. We concur with the finding in general. However, LSU has made and continues to make numerous improvements to our disaster recovery and business continuity plan. Since the last audit, much progress has been made in addressing this ongoing issue, which includes the following:

- A backup generator and chillers are now installed at LSU's Computing Center
- Critical backup data are rotated manually from the Computing Center to two remote sites on a periodic basis per standard procedure, and one of these remote sites is now located off-campus.
- Online logs are used to maintain a record of data base changes. These logs are used in conjunction with the latest backup to restore the integrity of the data bases in the event of a catastrophic hardware failure. To minimize the risk of losing data in the online logs, these data are transmitted on an hourly basis to a remote server.
- The University has re-instituted maintenance contracts on the fire detection/suppression system and the UPS for the Computing Center.
- The LSU OS/390 test system has been restored on the DSS enterprise server located in the Computing Center.
- LSU is now working with personnel at the Division of Administration, the Department of Public Safety, and the Office of Information Technology in the development of a proposal for a state-wide enterprise approach to providing disaster recovery services.

Please let me know if anything further is needed.

Sincerely,

Jerry J. Baudin
Vice Chancellor for Finance and Administrative Services
and Comptroller

xc: Chancellor Mark Emmert

330 Thomas Boyd Hall - Baton Rouge - Louisiana - 70803-2701 - 225/578-3386 - FAX 225/578-5403