April 20, 2001

Dr. Roxane Spitzer, Chief Executive Officer
Board of Trustees
Hospital Authority of the Metropolitan Government of
  Nashville and Davidson County
1818 Albion
Nashville, TN 37208

<u>Report of Internal Audit Section</u>

Dear Dr. Spitzer and Hospital Authority Board of Trustees:

We have recently completed a performance audit of Bordeaux Hospital. According to the *Government Auditing Standards* issued by the Comptroller General of the United States, "a performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action." A performance audit is different than financial statement audits, which are limited to auditing financial statements and controls, without reviewing operations and performance. In performing this audit, we retained KPMG to perform specified work under our direction. Their Benchmarking Analysis dated April 2001 is included with this report.

The Hospital Authority is a component unit of the Metropolitan Government and was created in 1999 to operate General Hospital, a full service medical facility, and Bordeaux Hospital. The Hospital Authority is governed by a seven member board appointed by the Mayor and approved by the Metropolitan Council. The Metropolitan Government approves and partially funds the Hospital Authority's annual operating budget. Bordeaux Hospital currently operates a 528 bed nursing home that provides intermediate and skilled nursing services. Additionally, 60 beds are licensed as a long-term acute care (LTAC) hospital. Bordeaux has a total staff of approximately 580.

Based on the most recent audited financial statements, Bordeaux's total operating results for both the nursing facility and the LTAC for the 2000 and 1999 fiscal years were as follows:

	June 30, 2000	June 30, 1999
Operating Revenues	$23,149,256	$22,716,018
Operating Expenses	38,034,119	35,543,962
Operating Loss	($14,884,863)	($12,827,944)
Appropriation from Metro's General Fund	$13,045,898	$14,679,892

The former Director of Bordeaux, who was responsible for managing Bordeaux when this audit began, retired effective December 31, 2000. Upon his retirement, the Hospital Authority appointed a Chief Executive Officer to be responsible for both General and Bordeaux Hospitals.

Objectives, Scope, and Methodology

This audit represents the first comprehensive performance audit of Bordeaux Hospital. The overall objectives of this performance audit were as follows:

- Determine which operations contribute to Bordeaux's operating losses.
- Conduct a peer group benchmarking analysis.
- Identify and review key operating and financial controls.
- Develop findings and recommendations for any areas where performance could be improved.

The scope of the work included Bordeaux's primary operations, and the benchmarking focused on fiscal year 1999 financial results, which was the most recent full year available for Bordeaux and the selected peers when the work began. Certain other audit work and analyses required the consideration of financial results, performance and operations outside of that time period.

The methodology employed throughout this audit was one of objectively reviewing various forms of documentation, including written policies and procedures, financial information, Board minutes and various other forms of data, reports and information available from State and other outside sources and maintained by Bordeaux and other Metro Departments. Various aspects of Bordeaux's operations were observed. Additionally, Bordeaux and peer data obtained from Medicare and Medicaid cost reports were summarized and compared, and telephone interviews with peer facilities were conducted.

We performed the audit procedures in accordance with generally accepted government auditing standards.

Findings and Recommendations

KPMG's Benchmarking Analysis resulted in findings and recommendations that are addressed in detail in their April 2001 report that is included with this report. Following is an overview of the findings and recommendations resulting from KPMG's benchmarking analysis and from Internal Audit's review of operations and controls.

1. <u>Opportunities for immediate cost savings should be investigated and considered as the fiscal year 2002 budget is developed.</u>

   KPMG's benchmarking analysis identified three areas where Bordeaux's nursing facility costs significantly exceeded the peers' average costs as follows.

   <u>Medical and nursing staffing</u> – Bordeaux's nursing facility staff to patient ratios for both Bordeaux employees and contract staff exceeded those of the peers. The analysis suggests that if Bordeaux's staffing ratios, including contract labor, were in line with the average peer staffing ratios, the related expenses would be approximately $2,269,000 less annually.

   <u>Pharmacy</u> – Bordeaux operates an in-house pharmacy, while the more common practice is to contract for nursing facility pharmacy services. The annual cost of operating the pharmacy of approximately $916,000 would be avoided if pharmacy services were contracted.

   <u>Physician services</u> – Bordeaux employs staff physicians who see nursing facility patients, a practice that none of the peers follows. If Bordeaux were to follow the common practice of having patients arrange for their own physician services, the related annual cost of approximately $724,000 would not be incurred.

   With regard to contract labor, because Bordeaux was not verifying charges for contract nurses prior to paying related invoices, one contractor's labor charges during January through September 2000 included $235,000 in fraudulent charges for fictitious employees. After Bordeaux employees discovered these overcharges, proper steps were taken to notify appropriate law enforcement authorities and to attempt to recoup the overcharges.

With regard to the pharmacy, Internal Audit determined that there was no perpetual inventory control over the non-schedule II pharmacy inventory and that the pharmacy storeroom area was not properly restricted to authorized personnel. Additionally, returned drugs were processed by a contractor, and there was no evidence that the returns were independently verified by Bordeaux personnel.

Consideration should be given to implementing operational changes in staffing formulas and to outsourcing pharmacy and physician services for the 2002 fiscal year. Additionally, control procedures should be put in place to verify that contract nursing services were actually received before the related invoices are paid. Finally, until such time as the pharmacy is outsourced, controls over pharmacy inventory should be implemented, and access to the pharmacy storeroom should be restricted.

2. <u>Bordeaux's cash position and cash flow needs should be considered in developing the fiscal year 2002 budget.</u>

   Bordeaux's cash and investments balance has been increasing. For the fiscal years ending June 30 1998, 1999 and 2000, the balances were $2,860,538, $4,204,633 and $4,395,163, respectively, and the balance during the 2001 fiscal year has continued to increase. Because Bordeaux's budgeted operating losses are budgeted and appropriated from Metro's General Fund, the increasing cash balance indicates that the General Fund has been overfunding Bordeaux in recent years. The Hospital Authority's and Metro's financial staffs should work together to develop a budget for the 2002 fiscal year and beyond that begins to reverse Bordeaux's previous years' cash build up.

3. <u>All significant cost variances, as compared to the peers, should be investigated further for additional cost savings opportunities.</u>

   In addition to the cost savings opportunities outlined in the first recommendation above, several other large variances between Bordeaux and average peer nursing facility costs were identified as follows.

Salaries	$2,130,365
Plant maintenance expenses	722,288
Laundry and linen expenses	690,166

These variances are not as likely to result in significant cost savings as the variances discussed in the first recommendation. Salary variances, for example, could be the result of differences in Bordeaux and peer staffs' experience and longevity, and the plant maintenance variance could be due to the age, size and layout of Bordeaux's physical plant. Additionally, some of the peers used prison labor for laundry, which may not be an option for Bordeaux. It should be noted, however, that Bordeaux had not been verifying laundry services costing approximately $500,000 per year by independently weighing the laundry.

Bordeaux should consider whether savings could be achieved by outsourcing therapy and other services and should further analyze all significant variances for additional operational opportunities.

4. Opportunities to increase revenue should be identified.

Bordeaux's nursing services operating losses and government subsidies, both in total and on a per patient, per day basis, are excessive in comparison to the peers. The peers total adjusted expenses ranged from $121.05 to $141.86 on a per patient day basis, while Bordeaux's total adjusted expenses per patient day were $193.66. Two of the five peer facilities did not receive a local government subsidy, and the other three received subsidies ranging from $1,200,000 to $2,524,952. This compares to Bordeaux's subsidy from Metro of $14,309,528. Much of this can be attributed to the cost variances addressed above, but Bordeaux should also develop strategies to increase revenues by evaluating the payor mix and increasing the total number of patients. Additionally, the LTAC only has a 15% occupancy rate. Opportunities to increase LTAC occupancy should be identified, or alternative uses for the space should be considered.

5. Financial and management reporting should be enhanced.

We noted that Bordeaux maintains its own general ledger system, and the Metro Finance Department maintains a general ledger for Bordeaux in the central FASTnet accounting system. This results in duplication of effort and necessitates a lengthy, complicated reconciliation between the two general ledgers at year end. Additionally, we noted that budget to actual expenses are not reported to Bordeaux management on a timely basis. Hospital Authority and Metro financial staffs should work together to eliminate the duplicate general ledgers and to develop meaningful, timely financial reports for management.

6. <u>Basic internal controls should be enhanced in several areas.</u>

We noted a lack of adequate controls in several areas, as follows.

- In addition to payments being made for contract labor and laundry without proper verification as discussed above, 12 paid invoices out of 19 tested were paid without documentation that goods or services had been received.
- The patient cash account was not fully reconciled, and the same person who maintained the account also shopped for the patients, which is an inappropriate segregation of duties. Additionally, the cash balance on hand for the patient account was approximately twice the amount necessary for patient use.
- There was no periodic inventory of fixed assets, and obsolete and unused equipment was noted.
- Written operating procedures were not current for several areas of operation.

Internal controls should be implemented and/or enhanced for the above areas.

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Management's response to the audit recommendations follow this report.

We greatly appreciate the cooperation and help provided by the management and staff of Bordeaux Hospital throughout the course of this audit.

This report is intended for the information of the management of the Metropolitan Government of Nashville and Davidson County. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Internal Audit Section

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