

# OVERVIEW

THE AUDITOR  
STATE OF HAWAII

## Financial Audit of the Kona Community Hospital

### Summary

The Office of the Auditor and the certified public accounting firm of Coopers & Lybrand, L.L.P. conducted a financial audit of the Kona Community Hospital for the fiscal year July 1, 1995 to June 30, 1996. The audit examined the hospital's financial records and its systems of accounting and internal controls and tested these for compliance with applicable laws and regulations. In the opinion of Coopers & Lybrand L.L.P., the financial statements of the hospital present fairly the financial position and results of operations for the year ended June 30, 1996.

We found that the Kona Community Hospital could improve its business office operations by implementing or revising certain procedures. The audit identified two reportable conditions, which, taken together, constituted a material weakness in the hospital's internal control structure. A material weakness in the internal control structure means that significant errors or irregularities may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Specifically, we found that the hospital's financial accounting and reporting system needs to be improved and that improvements are also needed in the hospital's billing and collection system. Financial statements for management are not prepared in a timely manner and budgetary reporting should be improved. There are significant delays in charging patients' accounts for services provided, the billing system is not adequate to process long-term care charges, and certain rate charges to patients were less than the standard rate. Payments from third-party payors are not reviewed, other collections practices could improve collections, and there were delays in depositing certain cash receipts.

The audit identified other problems that limit the hospital's ability to limit costs or improve revenues. We found that an agreement for laboratory services is detrimental to the hospital. Cash discounts that amounted to approximately \$340,000 were taken by two third-party payors during the year. These discounts are not supported by written agreements. We also found that information system policies and procedures should be improved.

We noted that hospital management has begun to address many of the problems found. A new chief financial officer has been hired and, with support of the hospital administrator, has taken steps to make the needed improvements.

## Recommendations and Response

We recommend that management continue its efforts to improve the hospital's financial accounting and reporting system. We also recommend that improvements be made to its billings and collection system. Additionally, we recommend that the hospital be allowed to negotiate and enter into its own service contracts with vendors and ensure that rates under the contracts are fair. The hospital should seriously consider the need for the existing service contract. The hospital should also have the contractor bill patients and insurers for services directly, just as physicians do.

With respect to the cash discounts taken without support of written agreements, we recommend the Division of Community Hospitals continue to involve affected hospitals in resolving this issue, and that the hospital consider billing patients for any discounts taken.

With respect to the information system, we recommend that passwords for all computer applications be at least eight characters long and that they be changed periodically. We also recommend the development of a policy governing the use of the Internet and the development of a formal disaster recovery plan.

The department concurs with our findings and recommendations. The response by the department includes specific actions that are being taken to ensure that financial reporting objectives are met, resources are safeguarded, and operating efficiency is improved. Many of the actions are being taken through the newly organized Hawaii Health Systems Corporation established by Act 262 of the 1996 Legislature.

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