OVERVIEW

Audit of Selected Procurement, Human Resource, and Fiscal Issues of the Hawaii Health Systems Corporation

Report No. 04-03, February 2004

Summary

The Hawaii Health Systems Corporation was created in 1996 as an independent agency administratively attached to the Department of Health. It replaced the department's Division of Community Hospitals, which had been operating Hawaii's community hospital system since 1989. Act 262, Session Laws of Hawaii 1996, stated that the overriding goal in creating the corporation was to provide better health care for Hawaii's people, including those served by small rural facilities, by freeing the facilities from unwarranted bureaucratic oversight. However, Act 262 also requires the corporation to develop policies and procedures for procurement consistent with the goals of public accountability and public procurement practices, and encourages the use of provisions of the Hawaii Public Procurement Code.

The corporation, governed by a 13-member board of directors, operates 12 public hospitals and health facilities on five islands and is one of the largest public health systems in the country. The hospitals are divided into five regions, each managed by a chief executive officer under the overall management responsibility of the corporate president and chief executive officer. The corporation has about 3,200 employees and operates more than 1,100 beds, providing critical/acute inpatient care, skilled and intermediate nursing care, and ambulatory outpatient care.

Since its inception, the corporation has depended on subsidies from the Legislature for both operations and improvements to hospital infrastructures. The State's general fund subsidy has ranged from $8.2 million to over $29 million, comprising between 4 and 11 percent of the corporation's total appropriation. In addition, the corporation's function as a "safety-net" hospital contributes to its fiscal challenges.

Although reliance on some state subsidies is expected, weaknesses in the corporation's management of procurement add to its dependence on state funding. The corporation has not embraced the State's commitment to open, competitive bidding, but instead adopted procurement practices that clash with government accountability. Lenient policies and a lack of oversight facilitate discretionary contract abuses and result in millions of dollars in non-bid contract awards. Other local hospitals do use bidding in their procurement process. In addition to this long-standing problem, a business venture with a contractor raises questions about self-dealing.

We also found that the corporation's hiring practices increase costs, risk substantial liabilities and penalties, and may violate payroll tax laws and the State's Fair Treatment Standards. Hiring of expensive independent contractors to perform essentially the same functions as lower-paid employees illustrates an award process that emphasizes convenience over competition. Furthermore, misclassified independent contractors may expose the corporation to substantial liabilities for taxes and penalties and corporate perks to management-level employees are difficult to reconcile with government accountability.

The corporation uses municipal leases as a way to raise money for equipment and infrastructure improvements. Municipal leases are not subject to the legislative budget approval process and do not affect the State's debt ceiling; however, if the corporation is unable to make the required lease payments, the Legislature could find itself obliged to provide funding beyond intended levels to ensure medical services continue uninterrupted and hospitals remain open. The corporation has committed to over $53 million in municipal leases for equipment purchases, infrastructure improvements, and services expansions. In addition, we found that, in spite of its massive need for capital, the corporation does not have a comprehensive, long-term capital-spending plan for the entire hospital system, and cost-benefit projections for planned projects have been seriously flawed.

We also found that the corporation's inventory management lacks adequate, uniform standards and oversight to ensure that assets are properly accounted for and safeguarded. Critical accountability tasks are not properly segregated, inventory records are inaccurate or inadequate, and identification tags are not consistently used.

Recommendations and Response

To address the problems we identified, we recommended that the corporation's board strengthen oversight and improve policies on procurement; develop policies for hiring of independent contractors; reassess its termination and separation policies; and establish accountability standards for analyses and projections for capital investments. Our recommendations to the corporation's management include implementing open competitive procurement policies; ensuring that independent contractors are hired in accordance with applicable laws and regulations; developing a long-term capital spending plan; ensuring the accuracy and completeness of capital investment analyses and projections; using general obligation bonds for major infrastructure projects to the extent possible; and establishing uniform standards for accounting for and safeguarding capital assets. Finally, we recommended that the Legislature clarify its intent on the application of Chapter 103F, HRS, to the corporation and require the corporation to provide adequate information on new municipal leases for infrastructure improvement and service expansions as part of its budget review process.

The corporation and the members of its board generally disagreed with a number of our findings and recommendations. Their responses indicate that the corporation's procurement practices, which diverge from government norms, are justified by alleged statutory exemptions, a position not supported by our findings. Further, the responses differ from our recommendation to allow municipal leases to undergo the same budgetary scrutiny that applies to other long-term debt commitments.

Marion M. Higa
State Auditor
State of Hawaii

Office of the Auditor
465 South King Street, Room 500
Honolulu, Hawaii 96813
(808) 587-0800
FAX (808) 587-0830