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AUDIT REPORT NO. 68-8
APRIL 1968

FINANCIAL AUDIT OF THE HILO HOSPITAL

FOR THE FISCAL YEAR ENDED JUNE 30, 1967

A REPORT TO THE GOVERNOR AND THE
LEGISLATURE OF THE STATE OF HAWAII



SUBMITTED BY THE LEGISLATIVE AUDITOR OF THE STATE OF HAWAII

**THE OFFICE
OF THE LEGISLATIVE AUDITOR**

ORIGINAL

The office of the legislative auditor is a public agency attached to the Hawaii State legislature. It is established by Article VI, Section 8, of the Constitution of the State of Hawaii. The expenses of the office are financed through appropriations made by the legislature.

The primary function of this office is to strengthen the legislature's capabilities in making rational decisions with respect to authorizing public programs, setting program levels, and establishing fiscal policies and in conducting an effective review and appraisal of the performance of public agencies.

The office of the legislative auditor endeavors to fulfill this responsibility by carrying on the following activities.

1. Conducting examinations and tests of state agencies' planning, programming, and budgeting processes to determine the quality of these processes and thus the pertinence of the actions requested of the legislature by these agencies.
2. Conducting examinations and tests of state agencies' implementation processes to determine whether the laws, policies, and programs of the State are being carried out in an effective, efficient and economical manner.
3. Conducting systematic and periodic examinations of all financial statements prepared by and for all state and county agencies to attest to their substantial accuracy and reliability.
4. Conducting tests of all internal control systems of state and local agencies to ensure that such systems are properly designed to safeguard the agencies' assets against loss from waste, fraud, error, etc.; to ensure the legality, accuracy and reliability of the agencies' financial transaction records and statements; to promote efficient operations; and to encourage adherence to prescribed management policies.
5. Conducting special studies and investigations as may be directed by the legislature.

Hawaii's laws provide the legislative auditor with broad powers to examine and inspect all books, records, statements, documents and all financial affairs of every state and local agency. However, the office exercises no control functions and is restricted to reviewing, evaluating, and reporting its findings and recommendations to the legislature and the governor. The independent, objective, and impartial manner in which the legislative auditor is required to conduct his examinations provides the basis for placing reliance on his findings and recommendations.



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FOREWORD

This is a report on our examination of the financial books and accounts of Hilo Hospital and the transactions noted therein for the fiscal year ended June 30, 1967. The purpose of our examination was to determine the legality of the hospital's financial transactions, the accuracy and reliability of its financial records, the efficiency and economy of its operations, and the adequacy of the hospital's controls to safeguard its assets against loss, waste, fraud and extravagance.

The format of this report assumes that the reader has no working knowledge of accounting theory and concepts and that he has no prior acquaintance with Hilo Hospital and its financial system. Thus we have included in our narrative a considerable amount of descriptive and explanatory material not ordinarily found in an audit report. Those who must read in haste, therefore, may find it practical to refer to Part III of this report, beginning on page 27, to find a quick summary of our major findings and recommendations.

Although the hospital has concurred with most of our findings and recommendations and has reported that it has taken or intends to take appropriate corrective actions, it has indicated its disagreement with us in several respects. A brief discussion on these points of dispute and the full text of Hilo Hospital's response to our audit report are appended to this report as *Part IV. A Memorandum on the Comments Made by the Affected Agency.*

No audit could be very satisfactorily completed without the full cooperation and assistance of the agency affected. We are pleased to note that the expeditious handling of this audit was largely attributable to the warm and efficient assistance we received from Mr. Frank E. Keifer, Superintendent of Hilo Hospital, and members of his staff. To these dedicated public servants we extend our deepest appreciation.

Clinton T. Tanimura
Legislative Auditor

TABLE OF CONTENTS

		Page
PART I. INTRODUCTION AND SOME BACKGROUND		
Chapter		
1	Introduction	1
2	Some Background	1
PART II. FINDINGS AND RECOMMENDATIONS ON INTERNAL CONTROL, FUND MANAGEMENT AND OPERATION, AND OPINION ON FINANCIAL STATEMENTS		
3	Internal Control	5
4	Special Fund	7
5	Other Funds and Property Inventory	19
6	Selected Problems	22
PART III. SUMMARY		
		27
PART IV. A MEMORANDUM ON THE COMMENTS MADE BY THE AFFECTED AGENCY		
		33
Attachment No. 1 – Auditor’s Transmittal Letter to		
Hilo Hospital		37
Attachment No. 2 – Hilo Hospital’s Comments		
		38

PART I. INTRODUCTION AND SOME BACKGROUND

Chapter 1

INTRODUCTION

This is a report on our post-audit of the transactions, books and accounts of Hilo Hospital. The audit was conducted pursuant to section 32, chapter 2, Revised Laws of Hawaii 1955, as amended, which requires the office of the auditor to conduct post-audits of all transactions and of all books and accounts kept by State departments and county agencies.

Purpose of Audit

The purpose of our audit was to examine the legality of the hospital's financial transactions, the accuracy and reliability of its financial records, the efficiency and economy of its operations, and the adequacy of the hospital's controls to safeguard its assets against loss, waste, fraud and extravagance.

Scope of Audit

This audit examined the hospital's financial records for, and the transactions had during the fiscal year July 1, 1966 to June 30, 1967. Our examination was made in accordance with generally accepted auditing standards as adopted by the American Institute of Certified Public Accountants and as set forth in the *Manual of Guides of the Office of the Legislative Auditor*. It included tests of the accounting records and the use of such auditing procedures as we considered necessary.

Organization of the Report

This report is organized into three parts. Part I consists of this introduction (chapter 1) and some background on the Hilo Hospital (chapter 2).

Part II (chapters 3 through 5) contains our opinions, findings and recommendations, regarding the hospital's system of internal control, its financial statements, and its transactions.

Part III contains a summary of the findings and recommendations.

Definition of Terms

There are certain accounting terms which are used throughout this report. The terms and their definitions are as follows:

Encumbrances means obligations in the form of purchase orders, contracts, or commitments which are chargeable to the year in which they are budgeted. These obligations cease to be an encumbrance when paid or when they become actually due and payable.

Exception means the auditor's disagreement with an entry, item, or figure contained in a financial statement.

Chapter 2

SOME BACKGROUND

Hilo Hospital is a government-operated long-term and short-term care institution located at Hilo in the county of Hawaii. It was established in

compliance with section 60, chapter 146, RLH 1955, as amended, which combined Puumaile Hospital and the Hilo Memorial Hospital. Originally, Puumaile was established to isolate and treat tubercular patients, while Hilo Memorial was established as a general hospital. Today, Hilo Hospital is a multiple-program institution, which provides tubercular and nontubercular long-term, as well as short-term, hospital care.

Hilo Hospital's Programs

Tuberculosis Program. From 1911 through the later part of the 1950's, Puumaile served almost exclusively as a tubercular hospital. Tubercular patient load was at capacity in the 1930's and 1940's even with the construction of a new 216-bed facility in 1947. In 1955, new and more effective drugs were introduced in the treatment of tuberculosis and, as a result, by 1958 the average daily patient census dropped to 110. Today, the number of beds allocated to T.B. patients constitutes only 15% (54) of the 359 total hospital beds. The average daily census of tubercular patients for year ended June 30, 1967 was 40. Treatment for tuberculosis is rendered free of charge as provided under section 71, chapter 49, RLH 1955, as amended.

Extended Care Program. This program was first established in 1938 with 24 residents and patients. Presently, this program is implemented in a 112-bed unit, with an additional 28 beds from other units being used to accommodate patient overflow. The daily average census for the long-term care and post-hospital medicare patients of this program was 131 during the

year ended June 30, 1967 as compared to 128 for 1966. Most of the patients in this program are financially assisted (wholly or partially) by the State department of social services.

The purpose of this program is to make the lives of our elder citizens, who are sick, as comfortable as possible during their remaining years and to provide them with the highest possible capacity for self-care, recreation and normal living situation.

Psychiatric Care Program. The First State Legislature in 1960, in a conference committee report, expressed the intent that the department of health may place in T.B. hospitals selected mental health patients from the State Hospital, if the T.B. hospitals consent to such an arrangement and can care for patients within their appropriations. As a result, there are presently 30 beds allocated to this program which had an average daily census of 20 patients for the year ended June 30, 1967. Professional psychiatric services are provided these patients by a psychiatrist while other patient care services are furnished by Hilo Hospital.

General Hospital Program. Under the general hospital program, the hospital allocated 135 beds for medical, obstetrics, pediatric and intensive care purposes. This program also provides clinical services such as x-ray and laboratory tests and emergency ambulance services. During the year ended June 30, 1967, the hospital maintained an average daily census for general patients of 104 (excluding newborns) and a newborn census of 8 as compared to 85 and 8, respectively, for 1966.

A schedule, summarizing the statistical data of the hospital, is shown on Exhibit I attached at the end of this chapter.

Recent Legislation

During the past three years, there were several legislation affecting the hospital's status. Act 97, SLH 1965, transferred the functions of planning, construction, improvement, maintenance and operation of Hilo Hospital from the county of Hawaii to the State of Hawaii, effective July 1, 1965. However, in order to provide an un-interrupted continuation of services, the State of Hawaii contracted with the county of Hawaii to perform the above functions, with certain restrictions, for the period July 1, 1965 to June 30, 1966.

Act 14, SLH 1966, authorized the governor to re-enter into the contract described in the preceding paragraph with the county of Hawaii for the period July 1, 1966 to June 30, 1967.

Finally, Act 203, SLH 1967, provided that the county of Hawaii operate and maintain Hilo Hospital on behalf of the State, with all costs to be paid for by the State. This act also provided for the establishment of a Hawaii county hospital advisory council to serve without compensation and to advise the director of health of the State on matters concerning the planning, construction, improvement, maintenance and operation of Hilo Hospital. The department of health has reported that this council is in the process of being formed.

In addition to the above mentioned council, the county of Hawaii by its resolution no. 282,

dated November 22, 1967, established an eleven-member board called the "Governing Board of Hawaii County Hospital System"¹ to establish policies, guidelines, rules, regulations, and directives for the management of the hospital system and to enforce recommendations and regulations as prescribed by ordinances or directives adopted by the board of supervisors of the county of Hawaii. The resolution also created a five-member trustee committee for each of the four public hospitals and for the privately-owned Kau Hospital. The function of these trustee committees is to advise the governing board and to enforce the policies, guidelines, rules, regulations, and directives of the governing board of the Hawaii county hospital system.²

Funding

The day-to-day operations of Hilo Hospital are funded primarily by money received as a result of services rendered to patients. However, these hospital receipts are not sufficient to finance the entire cost of operating and maintaining the hospital. Therefore, funds from the State general fund are appropriated annually by the legislature to the hospital as a supplement to hospital receipts.

¹Consists of Hilo, Kona, Honokaa, and Kohala hospitals.

²For a general discussion of the various county hospital councils and boards, see our report to the legislature of the State of Hawaii entitled, *Status Report on the Implementation of Act 203, Session Laws of Hawaii 1967*, dated February 1968.

**PART II. FINDINGS AND RECOMMENDATIONS ON INTERNAL CONTROL,
FUND MANAGEMENT AND OPERATION, AND OPINION ON FINANCIAL STATEMENTS**

EXHIBIT I

**Statistical Data
Year Ended June 30, 1967
With Comparative Figures for 1966**

	1966	1967
Number of beds	358	359
Number of bassinets	20	20
Number of incubators	7	7
Number of employees	358	366
Nursing personnel:		
Registered nurses	84 ^a	83 ^a
Practical nurses	119	119
Others	-	2
Meals served	306,452	317,989
Pounds laundered	869,043	981,956
Out-patient visits	18,840	18,899
Emergency visits	2,912	3,442
Patients admitted	5,163	5,383
Newborn babies delivered	720	661
Patient-days of care—adult	103,938	107,642
Patient-days of care—newborn	3,870	2,816
Average length of stay—days ^b	6.1	7.0
Daily average number of patients, including newborns	288.3	297.5
Number of operations	3,356	3,570
X-ray examinations	5,383	5,706
X-ray therapy treatments	1,472	1,630
Laboratory examinations	53,251	58,255
Total patients treated with physical therapy	7,416	10,589

^aIncludes nurses in administration.

^bGeneral—adults and pediatrics.

Source: Data compiled by Hilo Hospital from its records and reports.

Chapter 3

INTERNAL CONTROL

This chapter contains our findings and recommendations regarding Hilo Hospital's internal control system. Our findings and recommendations with respect to specific transactions, statements and funds are noted in subsequent chapters.

By the term, *system of internal control*, we refer to the plan of organization and all of the methods and measures adopted within the hospital to check the accuracy and reliability of accounting data; to promote operational efficiency; and to encourage adherence to prescribed laws, policies, and rules and regulations of Hilo Hospital, county of Hawaii, and the State of Hawaii. A sound system of internal control includes two basic elements. The first is a system of authorizations and recording procedures to provide adequate and reasonable accounting control over assets, liabilities, revenues and expenditures in accordance with generally accepted accounting principles, the laws, policies and rules and regulations of the hospital, county of Hawaii, and the State of Hawaii. The second is an appropriate segregation of duties assigned in a manner that no one individual controls all phases of a transaction without the interrelated function of a cross check by some other individual.

Handling of Mail Receipts

At the time of our audit, we noted that cash receipts received through the mail were being handled as follows. Mail was generally sorted by

the billing and collection clerk and opened by the senior account clerk in the business office. Both of the above persons handled cash, and the latter also made the deposit ticket and recorded the cash received. This procedure did not provide for sufficient separation of duties to meet the tests of a sound system of internal control.

We recommended to the hospital that the above duties be separated by delegating the responsibility for sorting and opening the daily mail to a person who does not handle or record cash. We also recommended that the person opening the daily mail prepare a list or tape of cash, checks, or money orders received through the mail; that the cash and cash items be routed by the mail sorter to the senior account clerk, who should record the receipt of, and deposit the cash; and that the list or tape of cash, checks or money orders should be routed by the mail sorter to the senior accountant who should periodically compare such lists or tapes with the recorded and deposited cash to insure that all receipts of cash are being properly recorded and deposited. These recommendations were adopted by the hospital prior to the writing of this report.

Transporting Daily Cash Deposits

At the time of our audit, daily deposits were being made by the hospital's senior accountant personally hand-carrying the cash receipts from the hospital to the county treasurer's office. The distance between the hospital and the treasurer's office is approximately three miles. This hand-carrying of hospital deposits by the hospital employee constituted an open invitation

to possible foul play. For the personal safety of the senior accountant, and to prevent possible loss of cash, we recommended to the hospital that this practice be discontinued and that an armored car service be contracted to transport daily deposits. We are pleased to report that prior to the writing of this report, this recommendation was also adopted by the hospital.

Control of Storeroom Inventory

The storeroom maintains an inventory of hospital supplies under a perpetual inventory system. Under this system, a running summary of inventory items on hand is maintained. As inventory items are added or withdrawn, the net total on hand is calculated and recorded.

The perpetual inventory records are maintained by the custodians of the inventory goods. Since the perpetual inventory records serve as the primary control over storeroom inventory, these records should be maintained by someone other than the custodians of the inventory goods. However, because of limited personnel, a complete segregation of the above duties does not appear to be workable. Therefore, we recommend that someone, other than the custodians of the actual goods, periodically and on a test basis, check the postings and mathematical accuracy of the perpetual records and compare the balance noted on the perpetual records with the results of a physical count. This practice should provide some control over inventory items. Material differences, if discovered, should be immediately investigated and the deficiencies, if any, brought to the attention of proper authority.

Maintenance of Books of Accounts

Hilo Hospital maintains two sets of books of accounts. One set reflects the operations of the hospital as a single unit, with costs of operations broken down and categorized by types of service. This system is recommended by the *Hospital Association of Hawaii's Uniform Accounting and Cost Analysis Manual*. This set of books also accumulates the data necessary for medicare purposes. The second set reflects the operations of the hospital by three divisions: general, tuberculosis, and extended care. The costs of the hospital are allocated to these three divisions on the basis of certain percentages obtained from a study of cost allocation made by the hospital in 1965. This second set of books is a carry-over from the days prior to Act 97, when the hospital was under the ultimate jurisdiction of the county. Two sets of books were then required since the county and the State were responsible for different parts of the hospital's fiscal requirements. (For example, the State paid for the cost of the hospital's tuberculosis program, and the county paid for the cost of the hospital's general program.) Since Act 97, however, now that the State is solely responsible for the hospital's fiscal requirements, there is no longer any need for the hospital to maintain its records by divisions.

We believe that the maintenance of two sets of books is unnecessary and results in a poor utilization of manhours in the accounting department. We recommend that the maintenance of the second set of books described in the preceding paragraph be discontinued. If desired, the various costs noted in the first set of books can be readily allocated to the separate divisions by the application of reasonable percentages.

Destruction of Accounting Records and Documents

Hilo Hospital does not have an effective program of ridding itself of old records. It has on hand accounting records and documents which are more than 20 years old. Keeping outdated records creates storage problems and leads to poor utilization of space. We recommend that the hospital initiate action to destroy old records and documents in accordance with section 8, chapter 138, RLH 1955, as amended.

Chapter 4

SPECIAL FUND

The operations of Hilo Hospital are financed through a special fund created by section 63, chapter 146, RLH 1955, as amended. All expenses of the hospital (including the expenses of its various programs) are paid out of this special fund. The fund derives its resources primarily from charges made to patients for services rendered. It is supplemented by State appropriations. The State legislature appropriates for each fiscal year a sum equal to the excess of estimated expenditures over estimated hospital receipts (the amount of the appropriation is reduced, however, to the extent that the actual excess is less than the estimate). Whenever it appears that actual requirements will exceed the estimated expenditures, the hospital seeks the prior approval of the State department of budget and finance to utilize any receipts in excess of the estimated amount to pay for such additional requirements.

This chapter displays the special fund financial statements. It contains our findings with respect to the items and figures noted therein. The statements are displayed on both the *accrual* and the *modified cash* bases of accounting. The differences between the two methods of accounting are explained in greater detail in the remaining portions of this chapter. Briefly, however, the financial statements on the *modified cash* basis reflect the actual cash transactions had by the hospital during the fiscal year—that is, the cash actually received, cash actually paid out, the legal obligations to pay cash assumed, and the cash amounts encumbered or set aside for future payment—and the cash position of the hospital at the end of the fiscal year—that is, the amount of cash on hand. The modified cash basis of accounting reflects the “pay as you go” concept, and it is used by the State for funding and budgeting purposes.

On the other hand, the financial statements on the accrual basis of accounting reflect the hospital's special fund total proprietary rights.¹ They display the rights acquired and the rights given away during the fiscal year—that is, the dollar value of the rights to payments for services rendered which accrued (although not necessarily paid), and the legal obligations to pay cash assumed—and the total proprietary position of the hospital at the end of the fiscal year—that is, the amount of property, including cash and the rights to cash.

¹Except that *fixed assets* such as land and buildings (if purchased with special fund monies), are not reflected even on the accrual basis. This omission, however, is not fatal, since the hospital, as in the case of other governmental agencies, accounts for fixed assets separately. Our comments regarding the hospital's fixed assets are noted in chapter 5, *infra*.

Balance Sheet

The balance sheet as of June 30, 1967, is shown in Table I.

TABLE I. BALANCE SHEET
Special Fund
June 30, 1967

Assets	Actual Amount	
	Accrual Basis	Modified Cash Basis
Cash:		
In treasury, County of Hawaii	\$ 29,395	\$ 29,395
On hand	1,000	1,000
Total cash	<u>30,395</u>	<u>30,395</u>
Accounts receivable:		
Inpatients	1,010,957	
Outpatients	36,422	
Inactive	598,920	
Total receivables	<u>1,646,299</u>	-
Balance of appropriation due from State general fund, Section 1, Act 8, SLH 1966	32,907	32,907
Inventories of drugs and supplies, at cost	147,155	-
Total assets	<u>1,856,756</u>	<u>63,302</u>
Liabilities and Fund Balance		
Accrued expenses payable	31,824	31,824
Reserve for encumbrances	-	30,478
Total liabilities	<u>31,824</u>	<u>62,302</u>
Fund balance:		
Balance, July 1, 1966	1,570,264	1,000
Add appropriation from State general fund, Section 1, Act 8, SLH 1966	921,050	921,050
Deduct excess of expenditures over revenue (Table II)	<u>[666,382]</u>	<u>[921,050]</u>
Balance, June 30, 1967	<u>1,824,932</u>	<u>1,000</u>
Total liabilities and fund balance	<u>\$1,856,756</u>	<u>\$ 63,302</u>

As noted in the balance sheet, the accrual method and the modified cash basis produce different results. This difference is attributable to the following. The accrual basis discloses as assets *all* items owned by the special fund; the modified cash basis includes only cash. The modified cash basis does not include "accounts receivable" as assets because accounts receivable are not cash, although presumably they will be converted to cash in the future. The modified cash basis also excludes "inventory" from assets because expenditures when made or obligated for inventorial items are monies out of pocket; they are thus treated as *expense* when made or obligated. Under the accrual basis, these expenditures are not treated as expense, and the items bought are considered "assets" until they are used. (The inventory of property of the hospital as a whole is not reflected in the special fund balance sheet. The special fund balance sheet lists only those items which are a part of the special fund. The property of the hospital as a whole is accounted for separately in governmental accounting and is discussed in chapter 5.)

It should be noted here that "balance of State appropriation due from State general fund" of \$32,907, is included as an "asset" under the modified cash basis (as well as under the accrual basis) even though it is not "cash" in the strict sense of the word. It is included under the modified cash basis because State appropriation ordinarily is received in cash by the hospital prior to June 30. Due to reasons which are explained later in this chapter, \$32,907 of the State appropriation for fiscal year 1966-1967 was received by the hospital after June 30, 1967.

Liabilities under both methods of accounting are basically similar in nature, except that encumbrances are included under the modified cash

basis, but not under the accrual basis. The reason for this is that government views encumbrances as firm commitments to expend cash, although the hospital is not obligated to anyone to do so.

A discussion on the various items on the balance sheet follows.

Cash

As of June 30, 1967, the total cash of the special fund amounted to \$30,395. Included in this amount are \$29,395 held in the county of Hawaii treasury and \$1,000 cash on hand. The cash on hand represents petty cash and change funds in the business office, storeroom, and admissions office. These cash and change funds are used to give change when payments for services are made and for minor expenses such as per diem, freight and postage.

Accounts Receivable

The balance sheet notes, on the accrual basis, accounts receivable of \$1,646,299 at June 30, 1967. This sum represents the uncollected balance of hospital charges in about 4,600 inpatient accounts (\$1,010,957) and about 1,700 outpatient accounts (\$36,422) and inactive accounts of both inpatients and outpatients (\$598,920). The number of inactive accounts is not available because these accounts have been accumulated over many years and adequate records were not maintained during the earlier years. ("Inpatients" are patients who are treated and hospitalized, whereas "outpatients" are patients who are treated but not hospitalized. "Inactive accounts" are explained later in this section.)

Our findings and recommendations with respect to the items included in accounts receivable are as follows.

1. **Collection procedure for delinquent receivables.** There is need to tighten the procedure by which delinquent accounts are collected. Currently, the hospital utilizes the services of collection agencies to pursue delinquent accounts, as authorized by section 65, chapter 146, RLH 1955, as amended. The credit clerk periodically prepares a list of delinquent receivables for submission to management for approval to transfer the listed accounts to a collection agency. This list, however, contains *only* those accounts on which no payment *whatsoever* has been made for at least 90 days. Thus, if an individual pays only a dollar a month on a one hundred dollar bill for several months or pays a dollar every three months on his account, his name is not included on any delinquency list. This means that all past due accounts are not subject to the same collection procedure. We recommend that the hospital tighten its delinquency policy to include grossly or unreasonably slow-paying as well as non-paying accounts for referral to a collection agency. The transfer of slow-paying accounts to the collectors should improve the collection of delinquent receivables; at least, it would relieve the credit department from the burdensome task of continually sending reminders and bills to these individuals.

2. **Collectibility of certain accounts receivable.** The hospital transfers receivables, which are deemed uncollectible for reasons such as death, statute of limitations, disappearance, and bankruptcy, to an inactive account. The accumulated balance of this inactive account was \$598,920 at June 30, 1967, as shown on Table I. In addition to this sum, specifically labeled, "inactive," there are two other groups of accounts included in inpatient accounts receivable of \$1,010,957, which are, for all practical purposes, uncollectible. These are \$12,913 of old accounts (patients

who received geriatric care many years ago) and \$125,082 in the hands of collection agencies.

We recognize that some collection will be made on these inactive, old, and collection agency accounts. However, based on the hospital's past collection experiences, it appears that any such recovery will be minimal. Therefore, we take *exception* to the inclusion of these accounts (summarized below) as assets of the special fund.

	Amount
Inactive	\$598,920
Old receivables	12,913
Collectors' accounts ...	<u>125,082</u>
Total	<u>\$736,915</u>

3. **Receivable from medicare.** During the year ended June 30, 1967, the hospital provided various services to patients that qualified for health insurance under the federal medicare program. The practice of the federal government is to make provisional medicare payments to the hospital during a fiscal year. Sometime after the end of the year, a settlement is made to reimburse the hospital for the difference between the actual cost of providing services to medicare patients and the provisional payments. The computation of actual cost is made by the hospital and is subject to an audit by medicare. The hospital's accountant estimates that the reimbursement for the year ended June 30, 1967, will total approximately \$100,000. This estimated reimbursement of \$100,000 is not shown on the balance sheet. We take *exception* to the non-inclusion of this item as an asset in the balance sheet on Table I and as a recovery of expenses on Table II, under the accrual basis of accounting. This reimbursable amount is a legal obligation of the federal government to the hospital. Of course, this item would not affect the

modified cash basis of accounting for reasons expressed earlier in this chapter.

Balance of Appropriation Due from the State General Fund

As of June 30, 1967, the hospital was due \$32,907 from the State as appropriated under section 1, Act 8, SLH 1966. The sum of \$18,875 of the above amount was received in July 1967. The reason for this delay is as follows. The final amount of the funds to be allotted to the hospital depends on actual hospital receipts, and the amount of these receipts was not determined until July 1, 1967, at which time the final allotment request was prepared by the hospital. The remaining balance of \$14,032 was received on September 20, 1967. This amount represents the practical nurses' retroactive pay increase for the six-month period, December 1, 1966 to June 30, 1967. The amount of the increase was not determined until sometime after June 30, 1967.

Inventories of Drugs and Supplies

Inventories on hand at June 30, 1967, (\$147,155) are valued at average cost and include a wide variety of items such as drugs and pharmaceuticals, groceries, hospital and office supplies, and linen.

Accrued Expenses Payable

Accrued expenses payable represent liabilities of the hospital which were incurred, but not paid, as of June 30, 1967. These liabilities include mostly payments due employees for overtime and the practical nurses' retroactive pay and fringe benefits.

Reserve for Encumbrances

The reserve for encumbrances of \$30,478, represents the cost of equipment, material and supplies, ordered but not yet received as of June 30, 1967.

Fund Balance

The fund balance on both the accrual and modified cash bases increased by \$921,050 and

decreased by the amount of the excess of expenditures over revenue for the year ended June 30, 1967. The increase represents the allotted portion of the State general fund appropriation, authorized by section 1, Act 8, SLH 1966. The decrease (excess of expenditures over revenue) is discussed later in this chapter.

As a result of this increase and decrease, the fund balance as of June 30, 1967, amounted to \$1,000 under the modified cash basis and \$1,824,932 under the accrual basis. The difference of \$1,823,932 (\$1,824,932 minus \$1,000) is due to non-recognition of inventories and accounts receivable on the modified cash basis and non-recognition of encumbrances on the accrual basis. A reconciliation of the accrual fund balance with the modified cash fund balance follows.

Fund balance, accrual basis		\$1,824,932
Deduct items not recognized as assets under the modified cash basis of accounting:		
Accounts receivable	\$1,646,299	
Inventories, at cost	<u>147,155</u>	
		1,793,454
Deduct encumbered items not recognized as a liability under the accrual basis of accounting	<u>30,478</u>	<u>1,823,932</u>
Fund balance, modified cash basis		<u>\$ 1,000</u>

As reflected on the balance sheet, the accumulated fund surplus of \$1,824,932, on the accrual basis, essentially represents the difference of all assets owned (whether in cash, accounts receivable, or inventory) and the liabilities incurred, and outstanding on June 30, 1967.

On the other hand, the accumulated fund surplus of \$1,000, on the modified cash basis, represents the excess of cash (\$63,302) required to meet liabilities and commitments (\$62,392) at June 30, 1967. This excess of \$1,000 actually

represents the amount of money that was set aside years ago in order to establish the change and petty cash funds, which purposes were described earlier in this chapter.

Statement of Revenue and Expenditures

The hospital's statement of revenue and expenditures for the fiscal year 1967 is in Table II.

TABLE II. STATEMENT OF REVENUE AND EXPENDITURES
Special Fund
Year Ended June 30, 1967

	Actual Amount ²		Budget	Modified Cash Basis Over [Under] Budget
	Accrual Basis	Modified Cash Basis		
Patient Services Revenue:				
Daily patient services	\$1,997,977	\$	\$	\$
Other nursing services	259,461			
Clinical services	<u>577,198</u>			
Total patient services revenue (Schedule I)	<u>2,834,636</u>			
Deductions from Revenue:				
Approved charity—State	434,001			
Contractual adjustments—State	78,699			
Policy discounts—employees	<u>6,669</u>			
Total deductions from revenue	<u>519,369</u>			
Net operating revenue	<u>2,315,267</u>	<u>2,033,917</u>	<u>1,770,374</u>	<u>263,543</u>
Expenditures:				
Nursing service (Schedule II)	1,467,332			
Clinical service (Schedule II)	540,391			
House service (Schedule III)	721,629			
General & Administrative (Schedule III)	<u>214,751</u>			
Total expenditures	<u>2,944,103</u>	2,940,159	2,712,816	227,343
Recoveries of expenditures:				
Rental of personnel quarters	18,530			
Vacation time transfers	5,152			
Non-patient sales of meals	1,957			
Rentals, outpatient facilities	1,228			
Physicians' fee recoveries	1,340			
Laundry services	607			
Others	<u>4,116</u>			
Total recoveries of expenditures	<u>32,930</u>	<u>32,930</u>	<u>32,930</u>	<u>-</u>
Net operating expenditures	<u>2,911,173</u>	<u>2,907,229</u>	<u>2,679,886</u>	<u>227,343</u>
Excess of operating expenditures over revenue	595,906	873,312	909,512	[36,200]
Equipment purchases and improvements to property	<u>70,476</u>	<u>47,738</u>	<u>15,000</u>	<u>32,738</u>
Excess of total expenditure over revenue (Table I)	<u>\$ 666,382</u>	<u>\$ 921,050</u>	<u>\$ 924,512</u>	<u>\$ [3,462]</u>

²The figures noted in the two columns entitled "accrual basis" and "modified cash basis" are not comparable. See the paragraphs immediately following this table for an explanation.

As in the case of the balance sheet, the statement of revenue and expenditures is displayed on both the accrual and modified cash bases of accounting. The transactions represented by the figures noted for each category under the accrual basis are not necessarily the same as those transactions represented by the figures under the modified cash basis. This is for the following reasons.

The statement on the *accrual* basis includes in "revenue," all amounts which were *earned* and thus *accrued* to the hospital during the fiscal year. Some of these may or may not have been paid during the fiscal year. The statement on the *modified cash* basis includes in "revenue," only those amounts which the hospital *actually collected* during the fiscal year. The receipts may have been for accounts which accrued in prior fiscal years.

The statement on the *accrual* basis includes in "expenditures," all amounts which were *incurred*³—that is, became *legally payable*—by the hospital during the fiscal year. The statement on the *modified cash* basis includes in "expenditures," all amounts which not only became legally payable during the fiscal year, but also all amounts which the hospital set aside or committed or *encumbered* to be used in the future for specific purposes.

On the accrual basis, the statement enables the hospital to determine how much revenue was generated as a result of the costs incurred (and

³Expenditures for supplies and other inventory items, when incurred under the accrual basis of accounting, are recorded as an asset until such time as the items are utilized in the operations of the hospital. Only as the items are used are the expenditures recognized as expense or cost of operations. Under the modified cash basis, all expenditures are considered as expense or cost when made, regardless of when the items for which the expenditures were made are used.

used) during the fiscal year. On the modified cash basis, the statement enables one to compare the actual cash transactions had by the hospital during the fiscal year with that anticipated in the budget. The cash basis is used by the State for budgeting and funding purposes. Thus, any comparison between what actually happened and what was budgeted must be confined to the amounts shown under the modified cash basis.

Specific variances between the accrual method and the modified cash basis of accounting for the hospital's revenue and expenditures and the variances between what actually took place under the modified cash basis and the budget, together with our comments, findings and recommendations are as follows.

1. **Patient services revenue.** The total revenue *earned* (not necessarily collected) by the hospital for the various services rendered to patients during fiscal year July 1, 1966 to June 30, 1967, was \$2,834,636. A breakdown of these various services are detailed on Schedule I of Table II on the following page.

2. **Deductions from revenue.** Deductions from revenue amounted to \$519,369 for the fiscal year. These deductions consist of amounts, which, although earned, did not and will not result in income to the hospital. They include (1) approved charity of \$434,001, which represents charges that are absorbed by the hospital for services rendered to tubercular and mental patients; (2) contractual adjustments of \$78,699, which represents the excess of charges for services rendered to patients under the State welfare programs over and above the per diem rate paid to the hospital by the State department of social services; and (3) policy discounts of \$6,669,

SCHEDULE I OF TABLE II
Schedule of Patient Services Revenue
Year Ended June 30, 1967

Daily Patient Services		
Medical and surgical	\$602,238	
Geriatrics	536,236	
Tuberculosis	321,216	
Chronic mentals	156,796	
Chronic medicals	115,062	
Pediatrics	84,695	
Obstetrics	56,198	
Intensive care	54,147	
Nurseries	28,160	
Physical rehabilitation	26,864	
Acute mentals	<u>16,365</u>	\$1,997,997
Other Nursing Services		
Central services and supply	130,820	
Operating room	85,603	
Emergency room	15,510	
Intravenous solutions	14,179	
Delivery room	<u>13,349</u>	259,461
Clinical Services		
Laboratory	155,661	
Pharmacy	141,632	
X-Ray	115,360	
Anesthesia	53,746	
Occupational therapy	40,982	
Physical therapy	32,787	
Blood bank	25,154	
Electrocardiogram	8,285	
Ambulance	<u>3,591</u>	577,198
Total patient services revenue		<u>\$2,834,656</u>

which represent a 50 per cent discount given to hospital employees for outpatient x-ray and laboratory fees.

3. **Net operating revenue.** The net operating revenue is the difference between "total patient services revenue" and "deductions from revenue." It represents, in effect, the "real" or "true" revenue or income to the hospital.

On the accrual basis, the net operating revenue was \$2,315,267, and on the modified cash basis, it was \$2,033,917. The difference in the two figures is because the transactions reflected in the \$2,315,267 are not the same as those transactions reflected in the \$2,033,917. The accrual based \$2,315,267 represents transactions which occurred during the fiscal year and gave rise to a right in the hospital to collect receipts; the modified cash based \$2,033,917 represents transactions on whose accounts actual payments were made to the hospital regardless of when the transactions occurred (some of them may have occurred during the fiscal year, others may have occurred in years prior to fiscal year 1966-1967).

The modified cash based, net operating revenue of \$2,033,917 (the amount actually collected during the fiscal year) is \$263,543 more than the \$1,770,374 budgeted for the year. This under-estimation of revenue was primarily due to the following: (1) revenue from the medicare program, effective July 1, 1966, was not considered in the budget; (2) an increase in per diem payments to the hospital by the State department of social services, effective July 1, 1966, for care of welfare patients was not anticipated; and (3) the actual patient daily census (298) was more than the budgeted census (286).

4. **Expenditures.** The total cost incurred (not necessarily paid) by the hospital for rendering nursing, clinical and house services to patients and for general and administrative expenses was \$2,944,103. Detailed listings of the above expenditures are contained in Schedules II and III of Table II.

SCHEDULE II OF TABLE II
Schedule of Nursing and Clinical Service Expenditures
Year Ended June 30, 1967

	Personal Services	Other Current Expenditures	Total
Nursing Services			
Medical and surgical	\$ 352,274	\$ 15,618	\$ 367,892
Geriatrics	212,515	15,108	227,623
Operating room	93,767	23,717	117,484
Tuberculosis	106,594	3,822	110,416
Intensive care	89,698	2,862	92,560
Central supply	25,067	58,222	83,289
Administrative office	79,356	2,513	81,869
Pediatrics	78,443	2,728	81,171
Nurseries	66,188	3,024	69,212
Chronic medicals	58,064	2,647	60,711
Chronic mentals	53,583	2,671	56,254
Obstetrics	39,885	2,608	42,493
Delivery room	26,589	2,262	28,851
Emergency room	13,909	2,170	16,079
Recovery room	14,884	681	15,565
Rehabilitation	8,964	608	9,572
Acute mentals	<u>5,955</u>	<u>336</u>	<u>6,291</u>
Total nursing service	<u>\$1,325,735</u>	<u>\$141,597</u>	<u>\$1,467,332</u>
Clinical Services			
Laboratory	\$ 76,628	\$ 50,383	\$127,011
Radiology	52,703	57,876	110,579
Pharmacy	15,425	60,109	75,534
Anesthesiology	49,482	17,776	67,258
House staff	37,889	1,767	39,656
Medical records	27,985	1,140	29,125
Occupational therapy	25,744	717	26,461
Physical therapy	19,485	1,401	20,886
Blood bank	-	20,399	20,399
Social service	14,856	367	15,223
Ambulance service	4,355	891	5,246
Dental	<u>2,880</u>	<u>133</u>	<u>3,013</u>
Total clinical service	<u>\$327,432</u>	<u>\$212,959</u>	<u>\$540,391</u>

SCHEDULE III OF TABLE II
Schedule of House Service and
General and Administrative Expenditures
Year Ended June 30, 1967

	Personal Services	Other Current Expenditures	Total
House Service			
Dietary	\$186,571	\$115,741	\$302,312
Housekeeping	111,460	16,961	128,421
Laundry and linen	67,932	19,799	87,731
Plant operation	11,286	75,759	87,045
Plant and equipment maintenance	47,775	33,113	80,888
Ground maintenance	15,420	1,748	17,168
Personnel quarters	4,284	4,836	9,120
Automotive service	5,220	3,724	8,944
Total house service	<u>\$449,948</u>	<u>\$271,681</u>	<u>\$721,629</u>
General and Administrative			
Fiscal service	\$ 72,327	\$ 11,524	\$ 83,851
Administrative service	57,704	6,578	64,282
Telephone and telegraph	26,140	9,001	35,141
Admitting office	19,912	2,348	22,260
Insurance	-	7,692	7,692
Dues	-	1,525	1,525
Total general and administrative	<u>\$176,083</u>	<u>\$ 38,668</u>	<u>\$214,751</u>

As Schedules II and III of Table II indicate, the major hospital expenditure consisted of salaries paid to approximately 366 employees, totaling \$2,279,198. This sum is 77 per cent of the hospital's total operating expenditures. The remaining expenditures consisted mainly of material and supplies used in the operation and maintenance of the hospital.

The amount of expenditures actually made during the fiscal year (modified cash basis) was \$2,940,159. This is \$3,944 less than on the accrual basis. There is no difference under either method of accounting as to the amounts paid for personal services. The difference of \$3,944 is in "other current expenditures" and is explained thus. Some of the *encumbrances* which

were reflected in the statement of revenue and expenditures for the prior fiscal year on the *modified cash* basis (but not on the accrual basis) became *legal obligations* payable by the hospital during fiscal year 1966-1967. These items thus show up in the statement of revenue and expenditures for fiscal year 1966-1967 on the *accrual* basis (but not on the modified cash basis). In addition, apparently, the encumbrances in fiscal year 1966-1967 totaled less than the amount of the prior year's encumbrances which became legally due and payable by the hospital in fiscal year 1966-1967.

The total expenditure of \$2,940,159, under the modified cash basis, is \$227,343 more than the budget amount of \$2,712,816. The follow-

ing is a summary of the expenditures on the modified cash basis and an explanation of the reasons for the excess of the actual over the budget.

	Actual	Budget	Actual over Budget
Personal services	\$2,279,198	\$2,133,368	(a) \$145,830
Other current expenses	<u>660,961</u>	<u>579,448</u>	(b) <u>81,513</u>
Total	<u>\$2,940,159</u>	<u>\$2,712,816</u>	<u>\$227,343</u>

(a) The \$145,830 excess expenditure for personal services resulted, because the occurrence of the following events or their effects were not and could not be anticipated when the budget was prepared:

- . Act 40, SLH 1966, mandated the payment of cash, instead of compensatory time off, for all overtime worked by public officers and employees after July 1, 1966—\$66,359.
 - . Job rating reclassification for hospital support group became effective on December-1, 1966, resulting in an increase in salary payments of \$63,731.
 - . The hospital used three temporary help—\$10,990.
 - . Employee turnover savings did not materialize —\$4,750.
- (b) The \$81,513 excess in other current expenses was caused by the following:
- . The actual daily patient census of 298 was 12 more than the anticipated 286—\$34,357.

- . Certain workmen's compensation and health plan benefits, not budgeted for, were paid—\$39,885.
- . Insurance premiums not budgeted for were paid—\$7,271.

5. Recoveries of expenditures. The sum of \$32,920 was collected by the hospital as recoveries of expenditures for the fiscal year 1967. These recoveries were primarily charges for the use of hospital facilities by, and miscellaneous services rendered to various non-patients.

A major item of recovery was the rental of personnel quarters, which totaled \$18,530.⁴

6. Equipment purchases and improvements to property. During fiscal year 1966-1967, the hospital's special fund incurred a total liability of \$70,476 (accrual basis) for equipment purchases and improvements to property. It actually paid out \$47,738 (modified cash basis). The difference of \$22,728 is accounted for by the fact that prior year's encumbrances became the hospital's legal obligations in fiscal year 1966-1967, and the encumbrances for equipment purchases and improvements to property in fiscal year 1966-1967, if any, were less than the prior years' encumbrances which became legal obligations. Thus the larger figure on the accrual basis and the smaller figure on the modified cash basis.

The modified cash based expenditure of \$47,738 exceeded the budget by \$32,738. The reasons for this excess are detailed below.

⁴See chapter 6, *infra*, for our comments on the hospital's practice of renting housing quarters.

	Actual	Budget	Actual over Budget
Equipment	\$31,473	\$15,000	\$16,473
Improvements to grounds and buildings	<u>16,265</u>	<u>—</u>	<u>16,265</u>
Total	<u>\$47,738</u>	<u>\$15,000</u>	<u>\$32,738</u>

The excess of \$16,473 for equipment purchase was caused by the purchase of the following non-budgeted items:

- American Folestak Folder for laundry — \$15,672.
- Replacement of water-cooler condensing unit of a walk-in freezer—\$801.

The \$16,265 excess in improvements to building and grounds was paid for by the department of accounting and general services. Act 8, SLH 1966, appropriated \$5,711,825 to the department of accounting and general services for the repairs and maintenance of Act 97 schools and hospitals. The department of accounting and general services allocated and transferred \$16,265 of this amount to Hilo Hospital for improvements to its grounds and buildings.

7. Excess of total expenditures over revenue. The excess of all expenditures over revenue was \$666,382 on the *accrual* basis and \$921,050 on the *modified cash* basis. The \$666,382 excess, on the accrual basis, includes the hospital's operating loss of \$595,906 (net operating expenditure minus net operating revenue) and funds invested in equipment and physical improvements of \$70,476. Actually, there are several cost items which were incurred on behalf of the hospital that are not reflected in the financial statements presented in this chapter. If these items were reflected in the financial statements, the hospital's operating loss would have been \$915,090, rather

than \$595,906. These other cost items totaling \$319,184 (\$915,090 minus \$595,906) are as follows:

1. Fringe benefits for hospital employees, which include State's portion of FICA taxes, retirement system contributions, and dental and health insurance premiums ... (a) \$237,597
 2. County administrative cost, which is cost of staff services provided by the county of Hawaii to the hospital (a) 53,810
 3. Interest on bonds issued by the county of Hawaii to finance the construction of the hospital building (b) 27,777
- \$319,184

(a) Budgeted for and allotments are made to the State department of budget and finance.

(b) Budgeted for and allotments are made to the county of Hawaii.

The above items are not included in the hospital's financial statements because these items do not belong to the Hilo Hospital's special fund. As noted above, these items are budgeted for other State or county agencies and funds are allotted directly to these agencies. Hilo Hospital has no control over and no responsibility for expenditures applicable to these items.

The excess of total expenditures over revenue of \$921,050, on the *modified cash* basis, represents the amount of money needed by and paid to the hospital by the State as a supplement to the hospital receipts. This amount was \$3,462

less than the \$924,512 appropriated by the State legislature under Act 8, SLH 1966.

Opinion on Financial Statements

In our opinion, except as otherwise noted in this chapter, the financial statements of the special fund presented on the *accrual* basis of accounting fairly present the assets and liabilities of the fund and the results of the hospital's operations for the year July 1, 1966 to June 30, 1967.

As to the figures presented on the *modified cash* basis of accounting, it is our opinion that the financial statements of the special fund fairly present the cash balance, State appropriations due, liabilities, and commitments of the fund and the results of revenue collected and expenditures made and obligated on account of the fund for the fiscal year July 1, 1966 to June 30, 1967.

Chapter 5

OTHER FUNDS AND PROPERTY INVENTORY

This chapter contains a presentation and discussion of the financial statements of certain other funds for which the hospital is responsible and a brief discussion of the property under the control of the hospital.

Other Funds Described

In addition to the special fund for operations, the hospital has under its control certain trust funds and donation funds.

1. Trust Funds. There are two principal kinds of trust funds administered by the hospital. The first consists of monies belonging to individual patients which are held by the hospital for safe-

keeping. The second is a fund for occupational therapy activities. The fund for occupational therapy activities is used to purchase various materials and supplies with which patients manufacture handicraft products. Revenue for this activity is generated from the sale of the handicraft products and from a candy canteen maintained by the hospital's occupational therapy department.

2. Donation Funds. Donation funds consist of monies received as gifts by the hospital from various organizations and individuals. The hospital is authorized under section 20, chapter 48, RLH 1955, to receive, manage, and invest these funds. Disbursements are made for purchases of equipment, improvements to the hospital, and other purposes specified by the donors.

Other Funds: Balance Sheet

The balance sheet of the above funds, as of June 30, 1967, is shown on Table III below. A brief discussion follows this table.

TABLE III. BALANCE SHEET
Other Funds
June 30, 1967

Assets	
Cash:	
In bank	\$18,567
On hand	<u>727</u>
Total assets	<u>19,294</u>
Fund Balances	
Trust funds:	
Patients	13,907
Occupational therapy activities	<u>1,484</u>
Total trust funds balance	15,391
Donation funds:	
General division donation fund . \$3,190	
Extended care division donation fund	145
Tuberculosis patients' welfare donation fund	<u>568</u>
Total trust and donation funds balance	<u>\$19,294</u>

The total assets of \$19,294 represent cash in bank and on hand in the amounts of \$18,567 and \$727, respectively. Of the total cash balance of \$19,294, \$15,391 belongs to the trust funds and \$3,903 belongs to the donation funds.

Donation Funds: Changes in Balances

The nature of the changes which occurred in the donation fund balances during the fiscal year is detailed in Table IV.

The total fund balances of the general, extended care, and tuberculosis divisions increased by \$3,109 in fiscal year July 1, 1966 to June 30, 1967—total additions (\$10,594) minus total deductions (\$7,485). The following is a brief discussion on some of the items of receipts and disbursements.

1. Receipts. Receipts during the fiscal year came not only from donations, but also from interest on savings in the amount of \$3,374. This interest, however, was not on savings of the donation funds, but on patients' money held in trust by the hospital and invested in bank savings accounts. Due to the varying, and often small, amounts of money owned by individual patients, the hospital used to pool together the patients' money and invested the money in common savings accounts. However, the frequency in turn-over of patients caused the hospital to experience difficulty in allocating the interest earned on the savings to each individual patient. Therefore, the hospital, with the approval of its managing committee, transferred the interest which had accumulated from the patients' trust account to the

hospital's donation funds. Although this transfer appears to have been a practical solution to an otherwise difficult allocation problem, we question the legality of the managing committee's action. We recommend that the hospital seek advice from the State's attorney general on this matter. Pending the advice, we take *exception* to the transfer of interest (\$3,374) to the hospital's donation funds.

Recently, to avoid future difficulties, the hospital discontinued the practice of investing patients' money in savings accounts. Patients' money is now held in a common checking account within each division. We generally concur with the hospital's present practice. We note, however, that several patients have large cash balances—far in excess of their daily dollar needs over a reasonable period of time. This means that excess money is lying idle and not being managed productively. We recommend that, in addition to the present practice of placing patients' money into common checking accounts, the hospital consider investing excess money into individual passbook savings accounts. "Excess money" is all amounts, over and above that amount which the hospital considers to be sufficient to meet the average daily dollar needs of patients for a month or any other reasonable period. This recommendation, we believe, will permit the hospital to properly discharge its duties as trustee of the patients' property.

2. Disbursements. The total disbursements of \$7,485 include the purchase of equipment and various other expenditures made in the fiscal year. Among the equipment purchased are a cardiac monitor and a video recorder and camera, both of which are used to provide clinical services to patients. Other expenditures include minor repairs and improvements to hospital facilities.

Opinion on Financial Statements

Except as otherwise noted in this chapter, in our opinion the balance sheet (Table III) fairly presents the assets of the trust and donation funds, and the statement of changes in donation fund balances (Table IV) fairly represents the equity of each fund at June 30, 1967.

Inventory of Property

In addition to the funds previously described, Hilo Hospital maintains an inventory of its property. A summary inventory of the items under the control and responsibility of Hilo Hospital at June 30, 1967, is as follows.

Land improvements	\$ 8,654	
Building	4,199,044	
Fixed equipment	114,957	
Major movable equipment	808,167	
Total property	\$5,130,822	
Less depreciation accumulated:		
Prior to July 1, 1966	\$1,683,543	
During the year ended		
June 30, 1967	176,948	1,860,491
Total property (Net)		<u>\$3,270,331</u>

All property is valued at cost, except for donated items which are valued at an estimated market value at the time of the donation.

As of July 1, 1966, the hospital adopted the practice of recording depreciation of property in the accounting records, because depreciation is an allowable expense in the computation of cost reimbursable by the federal government under the medicare program. Ordinarily, the recording of depreciation is not a common practice for government units; all costs of acquiring property are considered sunk, and are not recognized for funding and budgeting purposes.

TABLE IV. STATEMENT OF CHANGES IN FUND BALANCES
Donation Funds
Year Ended June 30, 1967

	<i>General Division Donation Fund</i>	<i>Extended Care Division Donation Fund</i>	<i>T. B. Patients' Welfare Fund</i>	<i>Total</i>
Balance, July 1, 1966	\$ --	\$ 577	\$217	\$ 794
Add Receipts:				
Donations:				
Hilo Women's Carousel Group	2,939			2,939
American Cancer Society	1,000			1,000
Other organizations	450	583	463	1,496
Physicians	1,485			1,485
Individuals	200		100	300
Interest on savings	3,222		152	3,374
Total additions	<u>9,296</u>	<u>583</u>	<u>715</u>	<u>10,594</u>
Deduct Disbursements:				
Purchase of equipment	4,954	1,015		5,969
Various expenditures	1,152		364	1,516
Total deductions	<u>6,106</u>	<u>1,015</u>	<u>364</u>	<u>7,485</u>
Balance, June 30, 1967	<u>\$3,190</u>	<u>\$ 145</u>	<u>\$568</u>	<u>\$ 3,903</u>

SELECTED PROBLEMS

This chapter contains our findings and recommendations on specific problems and issues reflected by the practices of Hilo Hospital. Some of the problems and issues existing at Hilo Hospital are similar to those we found existing at Kula Sanatorium when we made an audit of that institution. Our recommendations with respect to Hilo Hospital are, in these cases, generally similar to those which we made in our report on our audit of Kula Sanatorium.¹

Utilization of Generic Versus Brand Name Drugs

There has been continued controversy on both local and national levels concerning the preference of utilizing or prescribing drugs by their generic or non-proprietary names rather than their brand names because of the higher cost generally associated with brand name drugs. The hospital follows the practice of purchasing primarily brand name drugs. We were informed by the management of the hospital that the movement towards an increased use of generic drugs is gradual, due to the mixed reactions of doctors on this matter. We recommend that the hospital, in conjunction with the pharmacy committee of the hospital's medical staff, continue its efforts to the extent possible towards increased utilization of generic drugs.

Vending Machines

Vending machines are stationed at various locations throughout the hospital. The revenue

¹Legislative Auditor, *Management Audit of Kula Sanatorium: A Report to the Governor and the Legislature of the State of Hawaii*, audit report no. 67-2, February, 1967.

from these vending machines are disposed of variously as follows:

Source	Approximate Annual Revenue	Disposition
Revenue from three softdrink vending machines	\$ 437	Puumaile Patients' Association
Revenue from all other vending machines	\$1180	Hui Haukapila (hospital employees' assn.)

The use of revenue from vending machine in the above manner is not unique to Hilo Hospital. Other public institutions and agencies throughout the State do from time to time install vending machines in public buildings and utilize the revenue for the benefit of patients and employees.² It appears that revenues from vending machines are public funds, since they are generated from the use of space in public buildings.

We do not question the benefits derived from the use of the above funds for patients' and employees' activities, but there is neither a statute nor governmental policy which permits such non-operational uses of what otherwise are public funds. Until some statutory authority is found and governmental policy formulated to permit earmarking of the income for use by patients and employees, we recommend that all revenues from vending machines be treated and deposited as hospital revenue and included in the estimated hospital revenue for budget purposes.

²*Ibid.*, pp. 82-83.

Laundry Services

The hospital maintains and operates its own laundry facilities. For the year ended June 30, 1967, the cost of maintaining and operating these laundry facilities amounted to approximately \$100,500 or 10 cents per pound of laundry serviced. In order to make a comparison of the above cost with the cost of possibly contracting laundry services to private concerns, we secured an unofficial quotation from a local laundry firm in Hilo. It quoted a price of 11 cents to 14 cents per pound, the exact rate depending upon negotiation. It would thus appear that the maintenance and operation by the hospital of its own laundry services is economical. We recommend, however, that the hospital conduct a cost analysis of the different possible alternative ways of securing efficient and economical laundry services.

We believe that a detail cost analysis is imperative in the light of the hospital's proposed planning and construction of new laundry facilities, at the cost of \$274,000, programmed for fiscal years 1970 and 1971.³ Since the Hawaii county hospitals are now consolidated, pursuant to Hawaii county resolution no. 282, dated November 22, 1967, the alternatives to insure efficient and economical laundry services should include the following.

- . Hilo hospital provide laundry services to all county hospitals on Hawaii.

³The *Executive Budget for the Fiscal Year 1968-1969: Part II, The Capital Improvements Program 1968-1974*, p. 124. This proposed planning and construction of new laundry facilities is a portion of the total recommendations for the renovation and modernization of Hilo Hospital made by Lawrence Conway and Associates, hospital consultants, based on its study completed in September, 1967.

- . Contract laundry services for all county hospitals on Hawaii to private concerns.
- . Hilo Hospital provide its own laundry service and contract laundry services of all other county hospitals to private concerns.
- . Hilo Hospital provide laundry services to itself and to some of the other county hospitals, and contract laundry services for the remaining county hospitals to private concerns.

Free Coffee for Employees

The hospital has a long established practice of providing free coffee in the morning to hospital employees. There is no justifiable reason for this gratuity. It constitutes an unwarranted preferential treatment of Hilo Hospital employees over other governmental employees. We recommend that this practice be discontinued immediately.

Employee Housing

As we noted in chapter 4, during fiscal year 1966-1967, the hospital collected \$18,530 in rentals from individuals occupying living quarters owned by the hospital. Some of these individuals are employees of the hospital (nurses and single males), and others are former employees who are now retired. Two observations are pertinent.

1. **Reasonableness of rental charges.** We find that the rentals now being charged for the living quarters are insufficient to recover the cost to the hospital in maintaining and operating them. A cost analysis study was recently conducted by the assistant superintendent. In his memorandum, dated April 10, 1967, the assistant superintendent noted that the per room costs being incurred by the hospital as compared with the rentals being charged are as follows:

	Estimated Monthly Cost	Monthly Rent Charged by Hospital
Nurses' Quarters:		
Bathroom shared by two	\$39.82 *	\$35
Private bathroom	39.82 *	40
Men's Quarters	31.95	25

*No consideration given to living comfort in cost analysis.

In computing the above costs, the assistant superintendent took into account the janitorial services, linen, electricity, water, refrigerator, range, cleaning supplies and other services, supplies and equipment furnished or made available to the tenants, but excluded the cost of repairs to and depreciation of the buildings and appurtenant equipment. It is evident that the actual cost in every case would be greater if the costs of repairs and depreciation are taken into account. We are in accord with the recommendation made by the assistant superintendent in his memorandum that the rentals for the living quarters be raised to at least the costs being incurred by the hospital.

2. **Need to maintain living quarters.** The assistant superintendent in his memorandum of April 10, 1967, noted our report on the audit of Kula Sanatorium,⁴ wherein we noted that the State policy provides that government-owned living quarters may be made available to government employees:

when it is necessary because of geographic isolation and extreme inadequacy or absence of private housing facilities; or

⁴Legislative Auditor, *Management Audit of Kula Sanatorium* p. 42, *Et seq.*

when it is necessary to acquire actual additional service, which, due to the character of the employment, may be required at any hour of the day or night; or

when it is necessary to meet emergencies involving the care and preservation of government property and the safeguarding of human life.

We recommend that the hospital review its housing policy in the light of our report on the Kula Sanatorium and, except for those living quarters set aside for the quartering of employees required to perform stand-by duties on a regular basis, the hospital give serious consideration to the possibility of phasing out the employee living quarters or converting them to program-oriented uses. We further recommend that the living quarters being furnished former employees (who are now retired) be terminated as quickly as possible. There is clearly no obligation and no justification for the hospital to make living quarters available to retired employees.

Physician's Employment Contract

1. **Contract renewal.** During the course of our examination, we noted that the employment contract of the tuberculosis physician-surgeon expired on October 1, 1962, and was not renewed until August 29, 1967. During the period not covered by a contract, the doctor continued to provide medical services to the hospital and was compensated for his services in accordance with the expired contract. Although no legal complication arose during this period, that it could have occurred cannot be ignored. We recommend that the hospital take such steps, as the maintenance of proper files and records, to

insure the timely renewal of contracts to avoid possible legal complications in the future.

2. **Allowances.** The above mentioned doctor receives a monthly car and telephone allowance in addition to his fee. These allowances are not stipulated in the contract document, dated August 29, 1967. Being a contractual agreement, the hospital can expect only those services, and the doctor can expect only that remuneration which are specifically set forth in the contract. (Moreover, as we point out in the next section, the allowance for telephone is wholly unjustified, and the automobile allowance, even if justified, is unreasonable.) We recommend that the payment of the telephone and monthly car allowances be discontinued, and, if the granting of any of these allowances can be justified, that it be specifically provided for in the contract.

3. **Sick leave.** The tuberculosis physician-surgeon's contract is based on the provisions of section 3-61(1), RLH 1955, as amended, which exempts from the county civil service, positions filled by persons employed on a contract basis who may lawfully perform their duties concurrently with their private business or profession, and whose duties require only a portion of their time. A contract employee is actually a private, self-employed, business operator, who performs government service concurrently with his private business. As such, he generally makes his own arrangements as necessary in the event of his illness. Yet, the tuberculosis physician-surgeon's contract provides that the doctor shall be entitled to sick leave benefits as set forth in chapter 5, RLH 1955, as amended.

In our audit report on the management of Kula Sanatorium,⁵ we acknowledged the right

⁵*Ibid.*, p. 64, *et seq.*

of management to enter into contracts with independent contractors, where the conditions enumerated in section 3-61(1), RLH 1955, as amended, exists, and the general authority of management to negotiate the terms and conditions of the contract. We questioned, however, the reasonableness and propriety of granting to contractual employees those benefits generally applicable to regular government employees, such as sick leave. We pointed out in that report on Kula Sanatorium, that we did not believe that a person hired by fee contracts should be allowed sick leave privileges. We further pointed out that even if granting sick leave privileges is proper, that we did not believe that the granting of the privileges in full is justified, since a contract physician performs only part-time services, and thus to grant him full benefits discriminates against regular, full-time, government employees.⁶

We again iterate the recommendation which we made in our report on the management of Kula Sanatorium that the State department of health seek immediate legal clarification from the State attorney general as to whether or not contract employees may be granted any of the benefits accorded by law to regular government employees, and if so, to what extent. We further recommend that Hilo Hospital amend the existing employment contract with the tuberculosis physician-surgeon or re-enter into a new one if

⁶In this connection, it is noted that section 5-30, RLH 1955, as amended, expressly excludes contract employees from entitlement to vacation benefits. However, section 5-39, RLH 1955, as amended, relating to sick leaves, does not expressly exclude contract employees from entitlement to sick leave benefits; it states that with the exception of teachers, educational officers, cafeteria workers and the university of Hawaii instructional staff, "all officers and employees in the service of the State or of the several counties" shall be entitled to sick leave pay. The State's rules and regulations on vacation and sick leaves (revised June 12, 1967) is not clear on the entitlement of employees, hired on a contract basis, to sick leave benefits.

such amendment or new contract is needed to conform to the attorney general's opinion.

Automobile and Telephone Allowances

The medical director and the tuberculosis physician-surgeon receive monthly automobile allowances of \$25 and monthly, residential, telephone allowances of seven dollars.

1. **Telephone allowance.** We were informed by the hospital that the policy of paying the doctors' private telephone bills was established years ago when housing was provided them on hospital property. Somehow this policy was continued when the doctors moved to private residences. We find no justification and the hospital could give none of these telephone allowances.⁷ We recommend that the telephone allowances be discontinued immediately.

2. **Automobile allowance.** The flat, monthly automobile allowances paid to the doctors are intended to defray the cost of the doctors' use of their own automobiles in traveling to and from the various chest clinics in the county of Hawaii. Again, as we pointed out in our report on the audit of the management of Kula Sanatorium,⁸ transportation expenses incurred on official business of the hospital are legitimate expenses of the hospital, and the employee incurring such expenses should be reimbursed. However, in our opinion, the granting of the flat, monthly automobile allowances to the doctors is not justified, and the amount paid is excessive and unreasonable.

⁷The State department of health's *Policies and Procedures on Perquisites*, dated October 23, 1964, for example, states, "Residential telephone service may be provided to an employee without charge only when the employee is residing in government quarters and when the telephone is necessitated by the duties and responsibilities of the employee."

⁸Legislative Auditor, *Management Audit of Kula Sanatorium*, pp. 78-81.

Generally, under State policies, the allowance of flat monthly amounts for automobile expenses is granted only in exceptional cases; it is granted generally only to department heads and their first deputies or first assistants who use their private automobiles so extensively on official business that it is administratively impracticable to separate the public use from the non-public use of their personal vehicles. All other employees are reimbursed on a mileage basis or have the use of government vehicle when local travel is required.

The duties of the physicians are generally confined to the hospital. Their trips outside the hospital premises are predictable and the mileage easily determinable. They do not, therefore, qualify as exceptional cases. Moreover, our examination revealed that the \$25 allowance is excessive in the light of the mileage actually traveled by the physicians on hospital business. Our estimate of the miles actually traveled by the physicians and the per mileage reimbursement being received by them at the rate of \$25 per month are as follows:

Doctor	A Annual Reimbursement Received by Doctors	B Annual Estimated Miles Traveled for Chest Clinics	A ÷ B Reimbursement per Mile
Medical Director	\$300	1428	21¢
Tuberculosis Physician-Surgeon	\$300	1212	25¢

The reimbursement per mile as shown above is far in excess of the 11 cents per mile paid to county employees. We recommend that the flat monthly automobile allowances be discontinued and that reimbursements of expenses for use of private automobiles on hospital business be made on a mileage basis.

PART III. SUMMARY

Section 32, chapter 2, Revised Laws of Hawaii 1955, as amended, requires the office of the auditor to conduct post-audits of all transactions and of all books and accounts kept by State departments and its political subdivisions. Pursuant to this requirement, the office of the auditor examined the books and accounts of Hilo Hospital and the transactions noted therein for the fiscal period July 1, 1966 to June 30, 1967.

The audit was conducted to determine the legality of the hospital's financial transactions, the accuracy and reliability of its financial records, the efficiency and economy of its operations, and the adequacy of the hospital's controls to safeguard its assets against loss, waste, fraud and extravagance.

The examination covered the hospital's special fund and other funds of which the hospital is authorized to receive, manage and invest. Our major findings and recommendations with respect to internal control, special fund, and the other funds are summarized below.

Internal Control

A system of internal control is required to insure accuracy and reliability of financial data, to promote operational efficiency, and to assure adherence to laws, policies, rules and regulations. Included in any system of internal control is the principle of "cross-check"—that is, the separation of duties such that no one individual handles all phases of a transaction.

1. **Handling of mail receipts.** At the time of our examination, the billing and collection clerk was sorting and the senior account clerk was opening the mail, and they were both handling

cash received through the mail. To strengthen internal control, we recommended to the hospital that a person, who does not handle or record cash, open incoming mail and prepare a list or tape of mail receipts; that the mail receipts should then be routed to the senior account clerk for recording the receipts and for depositing of the cash; and that the list or tape should be routed to the senior accountant who should compare this list or tape periodically with the record on receipts and cash deposits to insure that all cash is being properly recorded and deposited. This recommendation was adopted by the hospital prior to the writing of this report.

2. **Transporting daily cash deposits.** At the time of our audit, we noted that the senior accountant was hand-carrying the hospital's daily receipts for deposit to the county treasurer's office, which is approximately three miles from the hospital. This situation provided unnecessary opportunities for foul play. For the protection of the senior accountant and to prevent possible losses of cash, we recommended to the hospital that an armored car service be contracted for the transportation of the daily deposits. This recommendation also was adopted by the hospital prior to the writing of this report.

3. **Control of storeroom inventory.** The hospital's inventory records, which are the primary instrument of control over storeroom inventory, are currently being maintained by the custodians of the inventory items. Ideally, to insure proper internal controls, the duty of maintaining the inventory records should be separated from the duty of exercising custody over inventory items. We recognize that due to limited personnel,

it may not be possible for the hospital to completely segregate the two duties. However, to insure some control over inventory, we recommend that someone other than the custodians of the actual goods, periodically and on a test basis, check the inventory records and conduct physical counts of the inventory items, so that any difference between the records and the physical count may be immediately investigated and any deficiencies brought to the attention of proper authority.

4. Maintenance of book of accounts. The hospital maintains two sets of accounting records: (a) one set accumulates cost data by functions for the hospital as a single unit and (b) the other set accumulates cost data by functions for each of three divisions—general, tuberculosis and extended care. The maintenance of two sets of books is unnecessary and results in a poor utilization of manhours. Maintenance of the second set of books was necessary prior to Act 97, SLH 1965, when public hospitals were the counties' responsibility. Books of accounts by the three divisions were then necessary for budgeting purposes, since the divisions were differently funded by the State or county. Since Act 97, the State is solely responsible for funding all aspects of public hospitals, and the second set of books are no longer needed. We recommend that the second set of books be discontinued.

5. Destruction of accounting records and documents. Hilo Hospital has on hand, accounting records and documents which are more than 20 years old. This has created storage problems. We recommend that necessary steps be initiated for the destruction of old records and documents in accordance with section 8, chapter 138, RLH 1955, as amended.

Special Fund

Hilo Hospital and all of its programs are funded by a special fund created by section 63, chapter 146, RLH 1955, as amended. The special fund receives its resources from charges to patients for services rendered, and to the extent actual hospital receipts in a fiscal year are insufficient to pay for all operating costs, it is supplemented by State appropriations.

1. Balance sheet. The special fund balance sheet, as of June 30, 1967, shows that the assets and liabilities totaled, on the accrual basis (including cash, receivables and payables, but excluding encumbrances), \$1,856,756, and on the modified cash basis (including cash, payables and encumbrances, but excluding accounts receivable), \$63,302.

2. Accounts receivable. As of June 30, 1967, the hospital's accounts receivable for medical and hospital services rendered totaled \$1,646,299. Included in this amount is \$736,915 which, for all practical purposes, is uncollectible. This uncollectible amount includes inactive accounts, old receivables and accounts in the hands of collectors. We take *exception* to the inclusion of this \$736,915 (on the accrual basis) as assets of the hospital. Not included in the total receivable noted in the balance sheet of \$1,646,299, is an estimated \$100,000 legally receivable from the federal government for services rendered under the medicare program. We take *exception* to the exclusion of this amount from the hospital's assets on the accrual basis.

In our review of the accounts receivable, we noted that the various delinquent accounts are not accorded uniform treatment. As authorized by, section 65, chapter 146, RLH 1955, as amended, the hospital transfers to private collectors, those accounts which are delinquent. The

accounts which are transferred to the collectors, however, include only those accounts on which no payment *whatsoever* has been made within a period of 90 days. If any payment (even as little as one dollar) has been made within that period, the account is not referred to a collector for collection. We do not believe that this practice is justified. We recommend that the hospital tighten its delinquency policy and include slow-paying as well as non-paying accounts to the collection agencies after the hospital has exercised a reasonable effort to effect collection.

3. Revenue and expenditures. *a.* During fiscal year 1966-1967, the special fund net operating revenue, on the accrual basis, was \$2,315,267 (receivables *accrued* less the value of services rendered tubercular and mental patients, whose costs are assumed by the State, the excess of charges for services rendered to patients under the State welfare program over and above the per diem rate paid to the hospital by the State department of social services, and the policy discounts given to hospital employees on outpatient x-ray and laboratory fees). On the modified cash basis, the special fund net operating revenue was \$2,033,917 (cash actually collected). The \$2,033,917 was \$263,543 over the budget of \$1,770,374. Actual collection exceeded the amount anticipated in the budget because (1) the payments made under the federal medicare program, effective July 1, 1966, was not anticipated in the budget; (2) the per diem payments to the hospital by the State department of social services for services rendered to welfare patients increased, effective July 1, 1966; and (3) the hospital serviced more patients than estimated.

b. Expenditures during the fiscal year, on the accrual basis, totaled \$2,944,103, and on the

modified cash basis, \$2,940,159. The difference of \$3,944 is due to the inclusion, under the accrual method, and exclusion, under the modified cash basis, of prior years' encumbrances which became legally due and payable in the fiscal year, and the inclusion, under the modified cash basis, and exclusion, under the accrual basis, of encumbrances made during the fiscal year 1966-1967. The \$2,940,159, on the modified cash basis, is \$227,343 more than the amount budgeted for the fiscal year. The increase in actual expenditures over the amount budgeted was due to the payment of overtime in cash, rather than by compensatory time off, job rating reclassifications which took effect on December 1, 1966, the use of three temporary positions, the lack of turnover savings, an increase in daily patient census over that estimated, payment of workmen's compensation and health plan benefits not initially considered, and the payment of insurance premiums not included in the budget.

c. A part of the expenditures was offset by recoveries made by the hospital through the collection of rentals, sale of non-patient meals, etc. The hospital recovered \$32,930 in total. The net operating expenditure, thus, was \$2,911,173 under the accrual method, and \$2,907,229 under the modified cash method of accounting.

d. With the inclusion of equipment purchases and improvements to property, the total expenditures exceeded revenue by \$666,382 under the accrual method, and \$92,050 under the modified cash method. Equipment purchases and improvements to property was \$70,476 on the accrual basis, and \$47,738 on the modified cash basis. The difference between \$70,476 and \$47,738 is accounted for by the fact that on the accrual method, what was an encumbrance prior

to the fiscal year became legally payable during fiscal 1966-1967, and the \$47,738 on the modified cash basis includes new encumbrances made during the fiscal year (which is not included on the accrual basis).

The \$921,050 (on the modified cash basis) is the amount which the State is required to make up. This is \$3,462 less than the \$924,512 anticipated and appropriated to the hospital for the fiscal year.

4. Opinion on financial statements. Except as otherwise noted with respect to the inclusion of uncollectible accounts in, and the exclusion of \$100,000 receivable from the federal government from accounts receivable, in our opinion, the financial statements of the special fund, presented on the *accrual* basis of accounting, fairly present the assets and liabilities of the fund as of June 30, 1967, and the results of the hospital's operations during the fiscal year July 1, 1966 to June 30, 1967. With respect to the figures presented on the *modified cash* basis, in our opinion, the financial statements fairly present the cash balance and the liabilities of the special fund as of June 30, 1967, and the results of the revenue collected and expenditures made and obligated by the special fund during the fiscal year July 1, 1966 to June 30, 1967.

Other Funds and Property Inventory

In addition to the special fund, the hospital maintains and administers certain trust funds and donation funds. It also maintains an inventory of all property held by the hospital.

1. Balance sheet. As of June 30, 1967, the hospital held in trust, the principal amount of \$13,907 which belongs to patients; \$1,484 for occupational therapy activities; and \$3,903 in unexpended monies donated to the hospital by

private individuals and organizations.

2. Changes in fund balance. During the fiscal year, new donations to the hospital totaled \$10,594, and equipment purchases and other expenditures from the donation funds totaled \$7,485. Also during the fiscal year, \$3,374 in interests was received by the donation fund. This interest came from the savings accounts into which the hospital had deposited monies belonging to patients. Due to the turnover of patients, the hospital experienced difficulty in allocating the accumulated savings to the individual patients. The hospital's managing committee thus voted to transfer the interests to the donation funds. We recommend that the hospital secure the State attorney general's opinion on the legality of the action taken. Pending this opinion, we take *exception* to the inclusion of the interests in the donation funds.

3. Current handling of patients' trust fund. Recently, to avoid future difficulties, the hospital terminated the patients' savings accounts, and transferred all patients' money to a common checking account. We generally concur with this action. However, where the amount of a patient's money exceeds the patient's daily requirements over a reasonable period of time, we believe that the hospital should deposit such excess into the patient's individual passbook savings account, and we so recommend.

4. Opinion on financial statements. Except as otherwise noted with respect to the transfer of interest on patients' savings to the donation funds, in our opinion, the balance sheet of the trust and donation funds fairly presents the assets of the funds as of June 30, 1967, and the statement of changes in fund balance of the donation funds fairly represents the equity of the funds as of June 30, 1967.

Selected Problems

There are several specific problems and issues reflected by the practices of Hilo Hospital that deserve some comments. Some of these problems are similar to those which existed at Kula Sanatorium when we made an audit of that institution (see our audit report entitled, *Management Audit of Kula Sanatorium*, audit report no. 67-2, February 1967).

1. Utilization of generic versus brand drugs. The hospital generally purchases drugs by their brand name rather than by their generic or non-proprietary name. Movement towards the use of the more economical, generic drugs is gradual, due to the mixed reactions of doctors on this highly controversial matter. We recommend that the hospital continue its efforts to the extent possible to increase its use of generic drugs.

2. Vending machines. Vending machine revenues are collected and used by the hospital patients' and employees' associations. Since the vending machines are in public buildings, these revenues are generated in effect from the use of public buildings and thus constitute public funds. Being public funds, there must be some earmarking under legal authority to enable the use of the revenues for a special purpose. We find neither a statute nor governmental policy which permits the use of the revenues for patients' or employees' associations. Until some statutory authority is found and governmental policy formulated, permitting the use of vending machine revenues by the patients and employees, we recommend that all revenues from the vending machines be treated and deposited as hospital revenue and included as estimated revenue in the hospital's annual budget.

3. Laundry services. The hospital's cost of maintaining and operating its own laundry facilities

is approximately 10 cents per pound of laundry serviced. Although this cost appears competitive with the cost of contracting with a private concern for laundry services, we recommend that the hospital conduct a cost analysis of the different possible alternative ways of securing efficient and economical laundry services. We believe that such a study is imperative, in the light of the proposed planning and construction of new laundry facilities, programmed for fiscal year 1970 and 1971, and the consolidation of all public hospitals on the island of Hawaii under one authority.

4. Free coffee for employees. The hospital provides free coffee to its employees in the morning. We see no justification for this practice, which was established many years ago. We recommend that the hospital immediately discontinue this practice of providing free coffee at government expense.

5. Rental of personnel quarters. The hospital is currently renting living quarters on the hospital premises to individuals. Some of these individuals are employees of the hospital (nurses and single males) and others are former employees, now retired. A cost analysis study of the employees' living quarters was recently conducted by the assistant superintendent. His memorandum, dated April 10, 1967, notes that the rentals now being charged are not enough to recover the actual costs being incurred by the hospital in providing these accommodations. We recommend that the rents be raised to at least cover the cost to the hospital in providing the living quarters. We further recommend that the hospital review its housing policy, and, except to the extent necessary to house those required to perform stand-by duties on a regular basis, the hospital give serious consideration to phasing

out the employees' living quarters or converting them to program-oriented uses. We also recommend that the living quarters being furnished former employees (who are now retired) be terminated as quickly as possible. There is clearly no justification for the hospital making living quarters available to retired employees.

6. **Physician's employment contract.** *a. Contract renewal.* The employment contract of the tuberculosis physician-surgeon expired on October 1, 1962, and was not renewed until August 29, 1967. In order to avoid any recurrence of the above incident which may lead to possible legal complications, we recommend that the hospital take such steps, as the maintenance of proper files and records, to insure the timely renewal of contracts.

b. Allowances. The above mentioned doctor receives monthly car and telephone allowances which are not provided for in his contract. We recommend that these allowances be discontinued, and if the granting of any of these allowances can be justified, that it be specifically provided for in the contract.

c. Sick leave. The doctor's contract provides for sick leave benefits. Being a contract employee performing government service concurrently with his private business, the doctor is an independent contractor. As such, it is expected that he would make his own arrangements in the event of his illness. We thus question the reasonableness and propriety of granting the doctor, a contractual employee, that benefit generally applicable to regular government employees.

Even if such benefit can properly be granted, we do not believe that the doctor should be allowed the full benefit for part-time services. We recommend that the State health department secure immediate clarification on this matter from the State attorney general. We further recommend that the hospital amend the physician's contract or re-enter into a new one if such amendment or new contract is needed to conform to the attorney general's opinion.

7. **Automobile and telephone allowances.** The hospital pays a flat monthly automobile allowance of \$25 and a monthly telephone allowance of seven dollars to the medical director and the tuberculosis physician-surgeon.

The practice of paying for the doctors' residential telephone bills was established years ago when housing was provided the doctors on hospital property. The practice continued when the doctors moved to private residences. There is no justification for these allowances. We recommend that the allowances be discontinued immediately.

The granting of flat, monthly automobile allowances is not justified. Travel by the doctors on hospital business is predictable and the mileage easily determinable. Moreover the \$25, when converted to allowance per mile, based on our estimate of the miles actually traveled by the doctors in a year, is far in excess of the 11 cents per mile paid to county employees. We recommend that the above flat automobile allowance be discontinued and that reimbursements of expenses for use of private automobiles on hospital business be made on a mileage basis.

PART IV. A MEMORANDUM ON THE COMMENTS MADE BY THE AFFECTED AGENCY

This financial report of Hilo Hospital was completed in April, 1968. On April 26, 1968, we distributed a copy of the report to Hilo Hospital, via a transmittal letter, a copy of which is attached as Attachment No. 1. The hospital was requested to submit to us its comments, if any, no later than May 10, 1968.

Hilo Hospital submitted its response on May 15, 1968 (see Attachment No. 2). Hilo Hospital agrees with the recommendations contained in our report and has indicated that it is implementing or will implement the changes recommended, except the following.

Accounts Receivable

In reference to the inactive accounts receivable, the hospital responded thus:

"We concur with your view that the inclusion of accounts receivables, classified as inactive under assets does not reflect a correct picture of the balance sheet of the hospital. These accounts receivables have been kept in the books in view of an opinion rendered by the County Attorney's office in May 1962 when the question was posed by a previous Superintendent. This opinion held that they can be removed from our books only by specific Legislative authority. We would be very pleased to discontinue these inactive accounts receivable if specific legal authority is received."

Our comments. By its response, it appears that the hospital may not have fully understood the point made in our report. We took an *exception* to the inclusion of the inactive accounts receivable as an asset of the special fund. In the terminology and by the audit standard of financial auditors, an *exception* means that the auditor has disagreed with the reasonable accuracy of the financial statements he has audited because of the inclusion or exclusion of certain items on the financial statements. We do not believe that the amount of the inactive accounts receivable should have been shown as an asset on the financial statement because it is doubtful that it can be collected.

We made no reference to the removal of inactive accounts from the hospital's books nor the discontinuance of maintaining inactive accounts. However, since the hospital has expressed its willingness to remove the inactive accounts from its books if specific legal authority is received, we recommend that the hospital secure legal interpretation

by requesting the department of health to seek legal counsel from the State attorney general.

Other funds

1. Interest on patients' savings accounts. In our report we noted that \$3,374 of interest earned on patients' money held in trust by the hospital was transferred to the hospital's donation funds. We recommended that the hospital seek advice from the State's attorney general as to whether the above transfer was legal. Hilo Hospital's response to this recommendation was (in part) as follows:

"Since this service [of managing patients' funds] requires manpower and expenditure of hospital funds, the interest earned on these accounts should accrue to the hospital.

"In the particular instance cited in the report, we proposed to the State Deputy Comptroller during the course of their audit of 1966, that it was impossible to segregate and credit interest earnings to specific patients accounts. We had concluded after many years of experience, that Hilo Hospital was the custodian of these accounts and that the interest properly belonged to the hospital. The Deputy Comptroller concurred in a letter dated February 13, 1967."

Our comments. The hospital has apparently acted on the advice of the State deputy comptroller. We believe that the State attorney general, as the legal counsel of the State, and not the hospital or the State deputy comptroller, should be the agency making a determination of this nature.

We do not agree with the hospital that the interest earned on the patients' savings accounts should accrue to the hospital as compensation for maintaining the accounts. The providing of the services does not automatically give the hospital the right to the income.

2. Investment. We recommended in our report that the hospital consider investing certain of the patients' excess funds into individual passbook savings accounts thereby properly discharging its duties as trustee of the patients' property. The hospital responded as follows:

"In view of the added burden and responsibility of maintaining separate savings accounts, we are now depositing these funds in a checking account

where no interest is earned. You have recommended that individual patient's passbook savings accounts be maintained. We do not believe this is a hospital responsibility. We are not in the business of managing private funds, and cannot absorb this additional workload with our staff as presently budgeted."

Our comments. The patients in question are primarily long-term patients of the hospital's extended care and tuberculosis divisions. Due to the nature of their illnesses, their care and welfare have been almost entirely assumed by the State. As part of its responsibilities, the hospital acts as the trustee of the patients' money. Although there is no policy relating to the investment of patients' funds, we believe that prudent financial management dictates that, in the patients' best interest, the funds be deposited in interest-bearing accounts.

The hospital contends that it cannot absorb, with its present staff, the additional workload anticipated by the adoption of our recommendation. We do not think that this contention has merit. We estimate that at the present time there would only be approximately 34 passbooks to be maintained by the hospital to account for the excess funds. All recordkeeping of deposits and interest to the individual passbooks would be done by the financial institution. There appears to be very little additional work to maintain savings accounts for the long-term care patients of the hospital.

Laundry Service

The hospital's first sentence in its response stated, "We do not concur in the recommendation concerning contracting laundry service to private firms." We did not make such a recommendation. We recommended that the hospital conduct a cost analysis of the different possible *alternative* ways of securing efficient and economical laundry services. Contracting laundry services to private firms is merely one of the alternatives which we listed. The cost study should be made in the light of the hospital's proposed planning and construction of new laundry facilities in the near future.

Physician's Employment Contract - Sick Leave Benefits

The hospital employs a physician by contract which grants him sick leave benefits. We questioned the reasonableness and propriety of granting such benefits to a contractual employee and recommended that the State department of health seek immediate legal clarification from the State attorney general as to whether or not contract employees may be granted any of the benefits accorded by law to regular

government employees, and if so, to what extent. The hospital's response stated (in part): "In 1961, (prior to Act 97) the County Civil Service and the County Attorney reviewed the contract between Hilo Hospital and the physician, which includes a provision for sick leave. The County Civil Service office has advised us that, under its interpretation, contractual employees are entitled to sick leave At the moment, we are bound by decisions made by the responsible authorities of the County of Hawaii."

Our comments. The above interpretation by the County civil service office was presumably made prior to the enactment of Act 97, Session Laws of Hawaii 1965, and may therefore not have been applicable since Act 97 and subsequent related legislation. Under such circumstances, we believe that it would be wise for the hospital to request the State department of health to seek legal advice from the State attorney general.

CLINTON T. TANIMURA
Auditor

ATTACHMENT NO. 1

COPY
THE OFFICE OF THE AUDITOR
State of Hawaii
Iolani Palace
Honolulu, Hawaii 96813
April 26, 1968

Mr. Frank E. Keifer
Superintendent, Hilo Hospital
1190 Waianuenu Avenue
Hilo, Hawaii 96720

Dear Mr. Keifer:

Enclosed is a copy of our preliminary report on the financial audit of Hilo Hospital for the fiscal year ended June 30, 1967. The term, "Preliminary," indicates that the report has not been released for general distribution. However, copies of this report have been submitted to the Chairman and Executive Officer of the County of Hawaii, the Department of Health, the Governor, the President of the State Senate, and the Speaker of the State House of Representatives.

The report contains a number of recommendations. I would appreciate receiving your written comments on them, including information as to the specific actions you have taken or intend to take with respect to each of them. Your comments must be in our hands by May 10, 1968. The report will be finalized and released shortly thereafter.

If you wish to discuss the report with us, we will be pleased to meet with you on or before May 6, 1968. We await a call from your office to fix the appointment. A "no call" will be assumed to mean that a meeting is not required.

We are deeply thankful for the help and cooperation extended by your staff to our auditors.

Sincerely yours,
/s/ Clinton T. Tanimura
Clinton T. Tanimura
Legislative Auditor

Encl.

COPY

HILO HOSPITAL
1190 Waianuenue Avenue
Hilo, Hawaii 96720

Mr. Clinton T. Tanimura
Legislative Auditor, State of Hawaii
Iolani Palace
Honolulu, Hawaii 96813

Dear Mr. Tanimura:

Thank you for the opportunity to comment on the recommendations and exceptions contained in the report on the financial audit of Hilo Hospital for the fiscal period ending June 30, 1967. Certain of the recommendations were adopted during the course of the audit and others will be implemented soon. We would like to clarify a few of the exceptions.

I. Internal Control

Your recommendation on the handling of cash and checks received in the mail was adopted while the audit was being conducted. We agree that this measure maintains better internal control.

Your recommendation on transporting daily cash deposits was adopted while the audit was in process. We agree that the use of armored car service is both a good security measure and a time saver.

We agree with your recommendation on the control of storeroom inventory. As indicated in your report, this has not been possible in the past because of limited personnel. With the recent addition of a new position in the business office, we will be able to institute periodic control checks.

II. Maintenance of Books and Accounts

We agree that maintaining two sets of accounts unnecessarily duplicated the work in the business office. During the period of transition required to conform to the provisions of Act 97 and Medicare, the business office was necessarily involved with major

changes in systems and methods. Studies were made to identify the areas where there was duplication of work or procedures. By trial and elimination, a system has now been devised which requires only one set of books. Supplementary records will be maintained to permit accounting on a modified cash basis for budgetary purposes.

III. Destruction of Accounting Records and Documents

We will proceed immediately to destroy old records and documents in accordance with Section 8, Chapter 138, RLH 1955, as amended.

IV. Accounts Receivable

We will implement your recommendation on the collection procedure for delinquent receivables and set up specific guidelines to transfer slow paying accounts to the collectors.

We concur with your view that the inclusion of accounts receivables, classified as inactive under assets, does not reflect a correct picture of the balance sheet of the hospital. These accounts receivables have been kept in the books in view of an opinion rendered by the County Attorney's office in May 1962 when the question was posed by a previous Superintendent. This opinion held that they can be removed from our books only by specific Legislative authority. We would be very pleased to discontinue these inactive accounts receivable if specific legal authority is received.

We agree that under an accrual method of accounting the Medicare receivables item is an asset. However, the \$100,000 figure was an estimate only and could not be computed with any accuracy until at least 6 months after the end of the fiscal year, the first year under Medicare. The reimbursement amount is again subject to final audit by the Medicare intermediary, and this audit is presently being conducted. During the coming fiscal year, reimbursement amounts can be foot-noted in our financial statements as an asset, as you recommended.

V. Other Funds

The practice of depositing monies belonging to patients into one savings account has posed a problem in trying to allocate interest earned to individual accounts. Aside from the task of crediting each account with interest from a joint savings account, some patients had expired and others could not be located.

The handling of patients funds has traditionally been a problem in hospital management, here and everywhere. Attempts have been made in the past to have responsible civic and service organization members assume this function. Since this service requires manpower and expenditure of hospital funds, the interest earned on these accounts should accrue to the hospital.

In the particular instance cited in the report, we proposed to the State Deputy Comptroller during the course of their audit of 1966, that it was impossible to segregate and credit interest earnings to specific patients accounts. We had concluded after many years of experience, that Hilo Hospital was the custodian of these accounts and that the interest properly belonged to the hospital. The Deputy Comptroller concurred in a letter dated February 13, 1967.

In view of the added burden and responsibility of maintaining separate savings accounts, we are now depositing these funds in a checking account where no interest is earned. You have recommended that individual patient's passbook savings accounts be maintained. We do not believe this is a hospital responsibility. We are not in the business of managing private funds, and cannot absorb this additional workload with our staff as presently budgeted.

VI. Selected Problems

1. **Utilization of generic versus brand name drugs.** The hospital, in conjunction with the pharmacy committee of the hospital medical staff, will continue its efforts towards the increased utilization of generic drugs. This is, of course, a nationwide problem, and one which hospitals everywhere are striving to solve.

2. **Vending machines.** As recognized in your recommendations, some of the public institutions and agencies throughout the State have vending machines utilizing public space and electricity, with profits accruing to the benefit of patients and employees.

We have been attempting, without success, to interest a charitable agency to operate a snack bar and all vending concessions within the hospital. We will continue to pursue this problem, since such service is needed not only for our employees but also for hospital visitors and patients. This is a special concern because of our geographic isolation from stores and shops.

3. **Laundry service.** We do not concur in the recommendation concerning contracting laundry service to private firms. We do not believe that any of the Hilo private operations will be able to handle the large volume without materially increasing their investment in land, plant and equipment. There is no indication that prices would be lower than our present cost, especially in view of lack of competition prevalent in Hilo today. Economics aside, we have 12 employees to consider. We will continue our study of costs and other alternatives. As the number of laundry employees is decreased by normal attrition, we will not replace them without further consideration of contracting special laundry items to private firms.

We are studying the matter of Hilo Hospital providing laundry service for the other system hospitals. Honokaa and Kona Hospitals are contracting their laundry to a private

laundry firm. This is satisfactory at present, with a reasonable price per pound. We are concerned, however, about the future, since we have no control over rate increases. We are continuing to study how Hilo Hospital can provide this service at a reasonable cost, considering obvious problems in manpower and transportation.

4. **Free coffee for employees.** As we have commented before, we are hoping to attract a governmental or charitable agency to operate vending machines and also to set up a snack bar type of operation, similar to that on the fifth floor of the Department of Health. If this cannot be accomplished at an early date, we will request authority to seek bids from private food service firms to provide this service. This would include the sale of coffee. Until such time as this food service can be arranged, we will charge for coffee on a ticket or honor system, or possibly use coffee vending machines.

5. **Employee housing.** For some time, we have been in the process of reviewing the rents being charged for our living quarters. We have asked the Department of Health to comment on our recommendation that rents be adjusted to permit us to recover our operating costs. Because the State has been in the process of formulating policies and procedures for the operation of Act 97-203 hospitals, we were requested to hold rent adjustments in abeyance. On April 2, 1968, the Governor approved the prerequisite policy applicable to the Department of Health. Until officially notified to the contrary, we will proceed to implement this prerequisite policy.

VII. Physician's Employment Contract

1. **Contract renewal.** The failure to renew the contract for the tuberculosis physician-surgeon from October 1962 was a regrettable oversight and would not have occurred under our present personnel office procedures.

2. **Allowances.** We have discontinued the telephone allowance and monthly car allowances for the physicians. Mileage is now based on actual mileage incurred, at the County of Hawaii rate of 11 cents a mile.

3. **Sick leave.** In 1961, (prior to Act 97) the County Civil Service and the County Attorney reviewed the contract between Hilo Hospital and the physician, which includes a provision for sick leave. The County Civil Service office has advised us that, under its interpretation, contractual employees are entitled to sick leave. This is one of many areas where County and State interpretations and policies differ. This relationship has created numerous complexities for Act 97 hospitals and until this relationship is clarified by the Legislature, we will continue to run into sensitive situations. At the moment,

however, we are bound by decisions made by the responsible authorities of the County of Hawaii.

This particular situation, involving the tuberculosis physician-surgeon is not of primary concern since the contract with him will be terminated on June 30, 1968. We agree that clarification should be sought as to applicability of sick leave provisions for future contractual employees.

VIII. Annual Financial and Management Audits

In principle, we are in accord with having financial and management audits conducted on a periodic basis, whether by a government agency or a private firm.

The Hilo Hospital accounting records were never completely audited while under County jurisdiction, and presently only cash counts and limited audits of specific areas are made. Under Act 97, a special audit was conducted by the State in 1966 but even this could not be considered a complete audit.

We have advocated the employment of a private firm to audit our books on a regular annual basis. We have been especially concerned since the consolidation of the Hawaii County Hospital System, which added Honokaa, Kohala and Kona Hospitals to our jurisdiction. The total system budget nears \$5,000,000 with approximately 500 employees. Good business practice alone would require annual audits if the State cannot provide regular auditing and management services. No private business of this size would be without professional auditing services. With the advent of Medicare, the Department of Social Services necessarily follows the Medicare reimbursement of cost procedure. As a result, specialized and complex accounting procedures and records are required. The State Department of Health provided assistance by contracting a private audit firm to assist us for one year. We requested funds in the 1968-69 budget to hire a private firm for our entire Hospital System. This was denied. We feel strongly that regular financial and management audits have a place in our hospital system. In recognition of our size, the growing sophistication of the medical and hospital business, the tremendous rise in costs of hospitalization and the dynamic changes which are taking place everyday, an annual audit is an unquestioned necessity. The growing challenges of modern medicine must be met, and an antiquated system, not keeping pace with modern trends, will result in second rate hospital for our citizens. Hilo Hospital does not intend to be among the "second raters". We have a mission to fulfill, and a desire to do so in the best interests of the people of Hawaii.

We will continue to advise you on the progress of implementing your recommendations.

Sincerely,

/s/ Frank E. Keifer

Frank E. Keifer
Superintendent

FEK:lyu

cc: Honorable S. Kimura, Chairman & Executive Officer,
County of Hawaii
Walter B. Quisenberry, M. D., Director of Health

May 14, 1968

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