

AUDIT REPORT NO. 69-5  
JUNE 1969

# FINANCIAL AUDIT OF THE SAMUEL MAHELONA MEMORIAL HOSPITAL

FOR THE FISCAL YEAR ENDED JUNE 30, 1968

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**

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.



LEGISLATIVE AUDITOR  
IOLANI PALACE  
HONOLULU, HAWAII 96813

## Foreword

This audit report is the result of an examination of the financial statements and records of the Samuel Mahelona Memorial Hospital and the transactions noted therein for the fiscal year ended June 30, 1968. Our examination was strictly a financial one and did not include a review of the efficiency and effectiveness with which the hospital is carrying out its programs.

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

It is our practice to request agencies affected by our examination to submit in writing their comments on our findings and recommendations and to indicate what action they have taken or intend to take thereof. Such requests were made to the hospital and the State department of health. Their responses, together with our comments, are appended to this report as *Part IV, A Memorandum on the Comments Made by the Affected Agencies*.

We are deeply grateful for the excellent cooperation and assistance extended to us by the management and staff of the hospital and the State department of health.

Clinton T. Tanimura  
Legislative Auditor

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**PART I  
INTRODUCTION AND SOME BACKGROUND**

**Chapter 1**

**INTRODUCTION**

This is a report on our post-audit of the financial transactions, books and accounts of the Samuel Mahelona Memorial Hospital. The audit was conducted pursuant to section 23-4, Hawaii Revised Statutes which requires the office of the auditor to conduct post-audits of all transactions and of all books and accounts kept by departments, offices and agencies which are supported by or handle State or public funds.

**Purpose of the Audit**

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

**Scope of Audit**

The audit examined the hospital's financial records for, and the transactions had during the fiscal year from July 1, 1967 to June 30, 1968. It was conducted 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 Samuel Mahelona Memorial Hospital (chapter 2).

Part II (chapters 3 through 6) 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.

**Chapter 2**

**SOME BACKGROUND**

The Samuel Mahelona Memorial Hospital is a government-operated, long-term care institution

located at Kapaa in the county of Kauai. The hospital was initially established in 1917, under the authority of Act 55, SLH 1915, as a sanatorium for the care and treatment of persons afflicted with tuberculosis. It operated exclusively as a tuberculosis sanatorium through 1960. The hospital today provides diagnostic, treatment, and rehabilitation services not only to tubercular patients but also to psychiatric and chronic disease patients. The present facility, containing 110 beds, was built in 1950.

## Hospital Programs

**Tuberculosis program.** Since the 1950's, improved case findings and treatment of tuberculosis have resulted in fewer admissions of and shorter hospital stays for tubercular patients. For example, in fiscal year 1959-60, admissions totaled 100; the average, daily patient census was 73; and the average length of stay was 240 days. However, in fiscal year 1967-68, admissions totaled 24; the average, daily patient census was 10; and the average length of stay was 155 days. Treatment for tuberculosis is rendered free of charge under section 325-78, HRS.

**Psychiatric program.** In July 1960, the hospital began to admit selected mental cases

from the Hawaii State Hospital and other mental patients referred by the Kauai Mental Health Service and private physicians. In October 1966, the first mentally retarded (transferred from the Waimano Training School and Hospital) was admitted. In the year ended June 30, 1968, the hospital's psychiatric program (including both the mentally ill and the mentally retarded) had 67 admissions and an average daily census of 58. Professional psychiatric services are provided the patients in this program by a psychiatrist, and other patient care services are furnished by the hospital.

**Chronic (skilled nursing care) program.** In 1959, the legislature authorized the hospital to admit indigent and medically indigent persons suffering from chronic diseases, provided that sufficient beds are available to tubercular patients (Act 69, SLH 1959). The hospital admitted its first chronic indigent patient in need of long-term care in December 1967. Today, eligible persons are usually referred for admission by agencies involved in rehabilitation and by physicians in the community. In fiscal year 1967-1968, there were 20 admissions and an average daily census of 17 patients in the chronic program.

Exhibit I at the end of this chapter summarizes the statistical data of the hospital.

## Recent Legislation on Hospital Administration

In recent years, the State legislature has enacted several pieces of legislation affecting the administration of all public hospitals, including the Samuel Mahelona Memorial Hospital. Act 97, SLH 1965, transferred the functions of planning, construction, improvement, maintenance and operation of all public hospitals from the counties to the State, effective July 1, 1965. However, to insure an uninterrupted continuation of services, the act authorized the State to contract with the several counties for the counties to perform the above functions (with certain restrictions) during the period July 1, 1965 to June 30, 1966. Pursuant to such authorization, the State contracted with the county of Kauai for the latter to operate and maintain the Samuel Mahelona Memorial Hospital.

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

Finally, Act 203, SLH 1967, affirmed that all matters pertaining to the operation and maintenance of public hospitals and related public health and medical facilities are the responsibilities of the State, but provided that "each county shall, on behalf of the State, operate and maintain" such public hospitals and other public health and medical facilities, with

all costs to be paid for by the State. This act also provided for the establishment in each county of a ten-member county hospital advisory council to serve without compensation and to advise the State director of health on matters concerning the planning, construction, improvement, maintenance and operation of public hospitals and other public health and medical facilities within the county.<sup>1</sup>

Pursuant to Act 203, a county hospital advisory council was organized for the county of Kauai in February 1968. In addition, the county of Kauai, by its resolution No. 83, dated December 6, 1967, created a county advisory committee on hospital management to advise the county council on all aspects of hospital management and operations in the county of Kauai.<sup>2</sup>

<sup>1</sup>At the 1969 session, the legislature completed the State "take-over" of all public hospital and health facilities operations by enacting H.B. No. 740, H.D. 1, S.D. 1. This bill, upon the governor's approval, requires that effective January 1, 1970, all functions pertaining to the operation and maintenance of all public hospitals and all other public health and medical facilities (which are currently being performed by the various counties in behalf of the State under Act 203, SLH 1967), together with all personnel, personal property and real property employed therein, be completely transferred from the counties to the State.

<sup>2</sup>For a general discussion on the various county hospital advisory councils and boards, see our reports to the State legislature entitled, *Status Report on the Implementation of Act 203, Session Laws of Hawaii 1967*, dated February 1968, and *Second Annual Status Report on the Implementation of Act 203, Session Laws of Hawaii 1967*, dated February 1969.

## Funding

The day-to-day operations of the Samuel Mahelona Memorial Hospital are financed by hospital receipts and funds from the State

general fund which are appropriated annually by the legislature. The State general fund is the primary source of funds since hospital receipts constitute a very small portion of the monetary resources required to operate and maintain the hospital.

### EXHIBIT I STATISTICAL DATA Years Ended June 30, 1967 and 1968

	1967	1968
Number of beds . . . . .	105	105
Average number of employees . . .	94.5	93.2
Nursing personnel:		
Registered nurses . . . . .	9 <sup>a</sup>	9 <sup>a</sup>
Practical nurses . . . . .	17	17
Meals served . . . . .	94,332	99,858
Pounds laundered . . . . .	96,554	97,385
Out-patient visits . . . . .	5,251	4,531
Patients admitted . . . . .	122	110
Patient-days of care . . . . .	28,071	30,097
Average length of stay . . . . .	244	298
Daily average number of patients .	76.8	82.5
X-ray examinations –		
occasions of service . . . . .	4,576 <sup>b</sup>	3,425
Laboratory examinations . . . . .	-- <sup>b</sup>	9,465
Total physical therapy treatments	-- <sup>b</sup>	153

<sup>a</sup>Includes nurses in administration.

<sup>b</sup>Information not available for comparison with 1968 data.

Source: Data compiled by the Samuel Mahelona Memorial Hospital from its records and reports.

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

**Chapter 3**

**INTERNAL CONTROL**

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

The term, *system of internal control*, means the plan of organization and all of the methods and measures adopted by the hospital to check the accuracy and reliability of its accounting data, to promote operational efficiency, and to encourage adherence to the applicable laws, policies, and rules and regulations of the State of Hawaii, the State department of health, the county of Kauai, and the hospital. 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, revenue and expenditures in accordance with generally accepted accounting principles and with the laws, policies, and rules and regulations of the State, the department of

health, the county and the hospital. 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.

**Depositing and Transporting of Cash Receipts**

Hospital deposits are made by a clerk in the business office by hand-carrying the cash receipts from the hospital to the county treasury office. The distance between the hospital and the treasury office is approximately nine miles. Because of this long distance, deposits are not made on a daily basis but are made generally once every week.

Two aspects of the above practice are contrary to a sound system of internal control. First, the once-a-week (rather than daily) deposits of cash receipts increase the risk of theft, misappropriation and "temporary use" of the cash. Second, the hand-carrying of hospital receipts over a long distance constitutes an open invitation to possible foul play.

*We recommend that the hospital, in conjunction with the State department of health, make necessary arrangements with the director of finance, county of Kauai, to open an account with a bank located near the hospital (i.e. a bank located in the town of Kapaa) and that the hospital thereafter deposit all cash receipts into this bank account on a daily basis. We believe that this arrangement will make daily deposits practical and also minimize the possibility of foul play to the clerk and loss of cash because the distance required for travel will be greatly reduced.*

### **Inventory Control of Drugs**

The director of nursing is the custodian of drugs and is also the keeper of the perpetual drug inventory record.<sup>1</sup> Since the perpetual inventory record serves as the primary tool to control the drug inventory, the record should be maintained by someone other than the person dispensing the drugs. Therefore, *we recommend that the director of nursing be relieved of maintaining the perpetual, drug inventory record.* It should be noted here that the duty of maintaining perpetual inventory records is normally assigned to a clerk rather than to an administrator like the director of nursing.

<sup>1</sup>A perpetual inventory is a detail record containing a running count of inventory items on hand.

### **Non-Compliance with Perquisite Policies**

Our audit revealed that the hospital has not complied with the State's procedures in granting perquisites.<sup>2</sup>

Prior to April 2, 1968, perquisites at public hospitals were governed by county policies and procedures. On April 2, 1968, the State department of health, with the approval of the governor, issued certain policies and instructions to be followed by all public hospitals. Included among the instructions was one stating that "all hospitals will follow the department of health perquisite policy." The State department of health's policy on perquisites requires all executive officers of divisions to submit to the State director of health reports on all employees to whom perquisites are granted. Also, the perquisite policy specifically requires all permits authorizing the personal use of government vehicles to be validated by the director of health.

Certain employees of the hospital receive perquisites, and the hospital's superintendent and medical director has the personal use of a hospital vehicle. However, the hospital has not submitted to the director of health any report on these employees receiving perquisites, and

<sup>2</sup>The State department of health, in its *Policies and Procedures on Perquisites*, dated October 27, 1964, defines perquisites as, "Those things furnished or services rendered to an employee by the State government which have value to the employee by reducing his personal expenses."

the permit authorizing the superintendent the personal use of the hospital vehicle has not been validated by the director of health.

*We recommend that the hospital adhere to the State policy and immediately submit the required perquisite reports and request for motor vehicle permit to the director of health. A review of the perquisites will give the director a chance to determine whether the perquisites are properly allowable under the State policy.*

## Chapter 4

### SPECIAL FUND

The operation and maintenance of the Samuel Mahelona Memorial Hospital are financed through a special fund.<sup>1</sup> The fund derives its resources from State general fund appropriation and non-general fund hospital receipts. The non-general fund revenue constitutes only a small part of the special fund. The bulk of the fund consists of a State general fund appropriation. The State legislature appropriates for each fiscal year a sum equal to the excess of expenditures over non-general fund receipts estimated for the year. The amount of the appropriation is reduced, however, to the extent

<sup>1</sup>See section 147-24, RLH 1955. This section was superseded by Act 97, SLH 1965, Act 14, SLH 1966, and Act 203, SLH 1967, and is therefore omitted in the newly issued Hawaii Revised Statutes. The use of the special fund, however, has continued since Act 97.

that the actual excess is less than the estimate.<sup>2</sup> However, if it appears that the actual requirement will exceed the estimated expenditures and that the actual non-general fund receipts will exceed the estimated receipts, the hospital may, with the prior approval of the State department of budget and finance, utilize any such excess receipts to pay for such additional requirement.

This chapter displays the special fund financial statements. It contains a discussion of the major 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, the 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.

<sup>2</sup>Provided that this requirement of a reduction in the appropriated amount does not apply if the excess receipt is to be expended for a purpose or purposes approved by the governor or the director of the State department of budget and finance. (See general appropriation acts of 1961 *et seq*; for example, section 15, Act 54, SLH 1967.)

On the other hand, the financial statements on the *accrual* basis of accounting reflect the special fund's total proprietary rights.<sup>3</sup> They display the rights acquired and the rights given away by the hospital 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.

### Opinion on Financial Statements

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 at June 30, 1968 and the results of the hospital's operations for the year July 1, 1967 to June 30, 1968.

As to the figures presented on the *modified cash* basis of accounting, it is our opinion that the financial statements fairly present the cash balance, liabilities, and commitments of the fund at June 30, 1968 and the results of revenue collected and expenditures made and obligated on account of the fund for the fiscal year July 1, 1967 to June 30, 1968.

<sup>3</sup> Except that *fixed assets* such as land and buildings (if purchased with special fund monies) are not reflected even on the accrual basis. 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, 1968 is shown in Table I.

TABLE I  
BALANCE SHEET  
SPECIAL FUND  
June 30, 1968

ASSETS	Accrual	Modified Cash
Cash:		
In treasury, county of Kauai . . .	\$ 40,192	\$ 40,192
On hand . . . . .	100	100
Total cash . . . . .	<u>\$ 40,292</u>	<u>\$ 40,292</u>
Accounts receivable . . . . .	44,461	-
Inventories of drugs and supplies, at cost . . . . .	21,878	-
Total assets . . . . .	<u>\$106,631</u>	<u>\$ 40,292</u>
<b>LIABILITIES, RESERVE AND FUND BALANCE</b>		
Unrequired balance of appropriation due to State general fund, Section 1, Act 54, SLH 1967 . . .	\$ 29,436	\$ 29,436
Reserve for encumbrances . . . . .		10,756
Fund balance:		
Balance, July 1, 1967 . . . . .	43,426	100
Add:		
Appropriation from State general fund, Section 1, Act 54, SLH 1967 . . . . .	654,281	654,281
Transfer of funds from the Maui Memorial Hospital . . .	4,450	4,450
Deduct excess of expenditures over revenue (Table II) . . . . .	[624,962]	[658,731]
Balance, June 30, 1968 . . . . .	<u>77,195</u>	<u>100</u>
Total liabilities, reserve and fund balance . . . . .	<u>\$106,631</u>	<u>\$ 40,292</u>

As noted in the balance sheet, the accrual basis 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.

Liabilities under both methods of accounting are similar. Encumbrances,<sup>4</sup> however, 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.

<sup>4</sup> *Encumbrances* are 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 encumbrances when they are paid or become actually due and payable.

*Assets. 1. Cash.* On June 30, 1968, the total cash of the special fund was \$40,292, including \$40,192 held in the county of Kauai treasury and \$100 held in the business office as petty cash. The petty cash fund is used to facilitate the payment of minor expenses of the hospital, such as postage and sundry supplies.

*2. Accounts receivable.* On the accrual basis, accounts receivable totaled \$44,461 on June 30, 1968. This sum represents the uncollected balance of hospital revenue due from the following sources:

Medicare <sup>5</sup> .....	\$ 8,143
Medicaid <sup>6</sup> .....	21,133
Contractual reimbursements .	13,496
Others .....	<u>1,689</u>
	<u>\$44,461</u>

Receivables from medicare (\$8143) and medicaid (\$21,133) are the amounts collectible by the hospital as provisional payments for services rendered to medicare and medicaid patients during the fiscal year.

<sup>5</sup> Medicare is a federal health insurance program for the aged authorized under the Social Security Act.

<sup>6</sup> Medicaid is a federal grant-in-aid program under the Social Security Act which provides funds on a matching basis with the states to persons eligible to receive public assistance for medical care.

Contractual reimbursements (\$8131 from medicare and \$5365 from medicaid) are claims for the difference between the reasonable cost of providing services to medicare and medicaid patients during the fiscal year and the amount of provisional payments received and receivable by the hospital for these services. These claims are subject to audits by representatives of medicare and medicaid.

3. *Inventories of drugs and supplies.* Inventories on hand as of June 30, 1968 (\$21,878) are valued at cost and include primarily drugs and pharmaceuticals. Other items included are groceries, linen, hospital and office supplies, and livestock.

**Liabilities, reserve and fund balance.** 1. *Unrequired balance of appropriation due the State general fund.* As of June 30, 1968, the hospital had an unrequired balance of \$29,436. This balance represents that portion of State general fund money that was appropriated and allotted (\$683,717) to the hospital but was not required for the operation and maintenance of the hospital for the fiscal year ended June 30, 1968. This unrequired amount (\$29,436) was returned to the State general fund subsequent to June 30, 1968.

2. *Reserve for encumbrances.* The reserve for encumbrances of \$10,756 represents the estimated cost of equipment, material and supplies ordered but not yet received as of June 30, 1968.

3. *Fund balance.* During the fiscal year 1967-68, the fund balance on both the accrual and the modified cash bases increased (a) by \$654,281, which represents the allotted and expended portion of the State general fund appropriation, authorized by section 1, Act 54, SLH 1967, and (b) by \$4450, which represents a transfer of funds from the Maui Memorial Hospital.<sup>7</sup> The fund balance decreased by the amount of the excess of expenditures over revenue, which is discussed later in this chapter.

As a result of this increase and decrease, the fund balance, as of June 30, 1968, amounted to \$100 under the modified cash basis and \$77,195 under the accrual basis. The difference of \$77,095 is due to the non-recognition of inventories and accounts receivable on the modified cash basis and the non-recognition of encumbrances on the accrual basis. A reconciliation of the accrual fund balance with the modified cash fund balance follows.

<sup>7</sup>The Maui Memorial Hospital ended the 1965-66 fiscal year with a surplus of \$35,960. The governor recommended that this surplus be used to purchase equipment for all Act 97 hospitals and that the allocation of this surplus among the hospitals be based on a review of equipment requirements and priorities by a committee created by the State department of health. An equipment review committee was formed in early 1967. By October 1967, this committee agreed on certain allocations of the surplus funds among the Act 97 hospitals. The Samuel Mahelona Memorial Hospital's allocation amounted to \$4,450. The use of excess receipts of special fund hospitals for any purpose approved by the governor or the State director of budget and finance has traditionally been authorized by the legislature in the general appropriation acts enacted since 1961. See footnote 2, chapter 4, *supra*.

Fund balance, accrual basis . . . . .		\$77,195	
Deduct items not recognized as assets under the modified cash basis of accounting:			
Accounts receivable . . . . .	\$44,461		
Inventories, at cost . . . . .	<u>21,878</u>		
	66,339		
Deduct encumbered items not recognized as a liability under the accrual basis of accounting . . . . .	<u>10,756</u>	<u>77,095</u>	
Fund balance, modified cash basis . . . . .		<u>\$ 100</u>	

The accumulated fund surplus of \$77,195, on the accrual basis, essentially represents the difference between all assets owned (whether in cash, accounts receivable, or inventory) and the liabilities incurred and outstanding on June 30, 1968.

On the other hand, the accumulated fund surplus of \$100, on the modified cash basis, represents the excess of cash (\$40,292) required to meet liabilities and commitments (\$40,192) at June 30, 1968. This excess of \$100 actually represents the amount of money that was set aside years ago in order to establish a petty cash fund, 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 1968 is in Table II. "Revenue" as used here means non-general fund hospital receipts.

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 actually received 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*<sup>9</sup>—that is, became *legally payable*—by the hospital during the fiscal year. The statement on the *modified cash*

<sup>9</sup>Under the accrual method of accounting, supplies and inventorial items for which expenditures are incurred are recorded and carried as assets 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.

**TABLE II**  
**STATEMENT OF REVENUE AND EXPENDITURES**  
**SPECIAL FUND**  
**Year Ended June 30, 1968**

	Actual Amount <sup>8</sup>			Modified Cash Over [Under] Budget
	Accrual	Modified Cash	Budget	
Revenue:				
Patient services .....	\$ 73,912	\$ 48,808	\$ -	\$48,808
Other revenue .....	21,436	20,927	18,500	2,427
Total revenue .....	<u>95,348</u>	<u>69,735</u>	<u>18,500</u>	<u>51,235</u>
Expenditures:				
Personal services .....	575,343	575,343	566,616	8,727
Other current expenditures (see schedule)	129,200	130,455	124,929	5,526
Equipment .....	15,767	22,668	24,377	[1,709]
Total expenditures .....	<u>720,310</u>	<u>728,466</u>	<u>715,922</u>	<u>12,544</u>
Excess of total expenditures over revenue (Table I) .....	<u>\$624,962</u>	<u>\$658,731</u>	<u>\$697,422</u>	<u>[\$38,691]</u>

<sup>8</sup>The 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.

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 during the fiscal year. On the modified cash basis, the statement enables one to compare the cash transactions had and obligations made by the hospital during the fiscal year with that anticipated in the budget. The modified 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.

The following discusses the 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.

**Revenue. 1. Patient services revenue.** Patient services revenue means receipts from non-general fund sources for various nursing and clinical services rendered to certain patients. These non-general fund sources include voluntary payments from mental and chronic indigent patients, and payments from medicare and medicaid.

During fiscal year 1967-68, patient services revenue totaled \$73,912 on the accrual basis and \$48,808 on the modified cash basis. The difference in the two figures is that the transactions reflected in the \$73,912 are not the same as those transactions reflected in the \$48,808. The accrual-based \$73,912 represents the total net amount which the hospital acquired the right to collect from medicare and medicaid for services rendered to certain patients during the fiscal year; regardless of whether or not payment was actually received, plus the amount actually collected during the fiscal year in voluntary payments, regardless of when services were rendered. The modified cash-based \$48,808 represents the total net amount which the hospital actually collected during the fiscal year in voluntary payments and from medicare and medicaid, regardless of when services were provided to patients (some of the services may have been provided in prior fiscal years).

Table II reflects no amount for patient services revenue in the "budget" column because the receipt of voluntary and medicare and medicaid payments was not anticipated or estimated either by the hospital when it prepared its 1967-68 budget in September 1966 or by the legislature when it appropriated funds to the hospital in spring 1967. The reasons why the receipt was not anticipated or estimated are as follows.

(a) Under existing statutes, neither mental nor chronic, indigent patients are required to pay from their own pockets the cost of their

hospitalization. However, in December 1966 (after it had already prepared its 1967-68 budget), the hospital initiated the practice of requesting voluntary payments from mental and chronic patients. (b) Medicare became effective on July 1, 1966; however, since medicare was a relatively new federal program, the hospital had no prior experience on which an estimate of the revenue to be received under this program could be formulated. (c) Medicaid became a source of revenue to the hospital in December 1967 when the hospital admitted its first chronic indigent patient under Act 69, SLH 1959; the program to admit chronic indigent patients had not been fully developed at the time the hospital prepared its 1967-68 budget.

2. *Other revenue.* Other revenue totaled \$21,436 under the accrual basis, and \$20,927 under the modified cash basis for fiscal year 1967-68. The reasons for the difference in amounts between the two methods of accounting are similar to those given for "patient services revenue." Included in other revenue are receipts from non-patients for rentals of facilities owned by the hospital (\$10,147) and for meals (\$4740). Included also are the amounts of vacation time transferred from the county for county employees who became hospital employees (\$3845).<sup>10</sup> The modified cash-based \$20,927 of other revenue

<sup>10</sup>Whenever an employee transfers from the county to the hospital, his accumulated vacation time is also transferred.

exceeded the budget by \$2427. This excess is due to the transfers of vacation time which were not anticipated.

**Expenditures.** The expenditures of the special fund (for personal services, other current expenditures, and equipment) totaled \$720,310 under the accrual basis, and \$728,466 under the modified cash basis. A detailed listing of other current expenditures (accrual basis) is presented in the schedule of Table II.

The difference of \$8156 between the two methods of accounting (\$728,466 minus \$720,310) occurred as a result of the differing treatment accorded certain transactions under the two methods 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 1967-68. These items thus show up in the statement of revenue and expenditures for fiscal year 1967-68 on the *accrual* basis (but not on the modified cash basis). In addition, the *encumbrances in fiscal year 1967-68* totaled more than the amount of the *prior year's encumbrances* which became legally due and payable by the hospital in fiscal year 1967-68.

The total expenditure of \$728,466, under the modified cash basis, exceeded the budgeted amount of \$715,922 by \$12,544. This excess was financed primarily from increased hospital receipts. The major variances between the actual and budgeted expenditures are as follows.

1. *Personal services.* Payments to approximately 93 employees totaled \$575,343, representing approximately 79% of the hospital's total expenditure. The \$575,343 exceeded the budgeted amount of \$566,616 by \$8727. The excess was caused primarily by salary increases resulting from a reclassification of the hospital nursing and support positions. The State department of personnel services (DPS) reclassified the nursing and support positions as a part of the revision of the State classification system that it is presently conducting. The DPS announced the commencement of its study of the nursing and hospital support positions in November 1966 and completed it in July 1967. The reclassification actions taken were made retroactive to December 1, 1966.<sup>11</sup> Consequently, the fiscal impact of the reclassification actions was beyond the control of the hospital.

<sup>11</sup>The action taken by the DPS was apparently made without prior consideration of the State's ability to finance the increased cost of salaries. This is made evident in a memorandum dated September 1967 (which was *after* the reclassification was completed) from the State director of finance to the State director of the department of health in which he stated (in part), "While the means of financing this additional cost has not been fully ascertained, it is our hope that through the use of excess receipts, possible deferment of non-essential purchases of equipment, and transfers, the greater part or all of the costs can be met." This kind of reclassification action taken by the DPS without involving the State director of finance to ascertain the cost implications of the intended action is reviewed in our audit report no. 69-4, entitled, *General Audit of the Department of Personnel Services*, dated February 1969. See particularly part II, chapters 2 and 3 of that report.

2. *Other current expenditures.* Other current services expenditures were primarily for materials and supplies used in the operation and maintenance of the hospital. The \$130,455 of other current expenditures exceeded the budgeted amount of \$124,929 by \$5526. This excess was primarily caused by the costs incurred by the hospital in its chronic program. This program started in December 1967 and its fund requirement was not budgeted for fiscal year 1967-68.

SCHEDULE OF TABLE II  
SCHEDULE OF OTHER CURRENT EXPENDITURES  
Year Ended June 30, 1968

		Accrual
Nursing Services:		
Medical and surgical . . . . .	\$26,102	
Patient care . . . . .	<u>2,819</u>	\$ 28,921
Clinical Services:		
Laboratory . . . . .	4,005	
Radiology . . . . .	3,562	
Outpatient clinic . . . . .	2,689	
Occupational therapy . . . . .	2,452	
Physical therapy . . . . .	1,920	
Others . . . . .	<u>544</u>	15,172
House Services:		
Dietary . . . . .	30,997	
Plant operation . . . . .	17,764	
Plant and equipment maintenance . . . . .	11,507	
Personnel quarters . . . . .	5,963	
Housekeeping . . . . .	3,220	
Laundry and linen . . . . .	2,283	
Automotive . . . . .	2,015	
Ground maintenance . . . . .	<u>1,908</u>	75,657
General and Administrative:		
Administration . . . . .	8,251	
Fiscal service . . . . .	<u>1,199</u>	
Total other current expenditures . . . . .		<u>\$129,200</u>

**Excess of total expenditures over revenue.** As shown on Table II, total expenditures exceeded total revenue by \$624,962 on the *accrual* basis, and \$658,731 on the *modified cash* basis. It should be noted, however, that the expenditure total is exclusive of the following cost items:

a. Fringe benefits for hospital employees, which include State's portion of FICA taxes and retirement system contributions	\$61,649
b. County administrative cost, which is cost of staff services provided by the county of Kauai to the hospital . . . . .	17,000
c. Interest on bonds issued by the county of Kauai to finance the construction of the hospital building . . . . .	<u>1,020</u>
	<u>\$79,669</u>

The addition of these items results in total expenditures exceeding total revenue by \$704,631, rather than \$624,962, on the accrual basis. These items, however, are not included in the hospital's financial statements because monies for these items are not appropriated to the hospital's special fund and the hospital has neither control over nor responsibility for the expenditures applicable to these items. Monies for fringe benefits and county administrative cost are budgeted and allotted to and expended by the State department of budget and finance; monies for bond interests are budgeted and allotted to and expended by the county of Kauai.

The excess of total expenditures over total revenue of \$658,731, on the *modified cash*

basis, represents the amount of money needed by and paid to the hospital by the State as a supplement to hospital receipts. This amount was \$38,691 less than the \$697,422 appropriated by the State legislature under Act 54, SLH 1967.

## Chapter 5

### OTHER FUNDS AND PROPERTY INVENTORY

This chapter contains our findings on those funds (other than the special fund) which the hospital administers and on the property which the hospital controls.

#### Other Funds

The hospital controls a patients' trust fund, an occupational therapy fund, and a donation fund.

**Balance sheet.** The balance sheet for these funds is shown on Table III.

The assets of \$23,014 consist entirely of cash. Of this total, \$19,646 belongs to the patients' trust fund, \$796 to the occupational therapy fund, and \$2572 to the donation fund.

**TABLE III  
BALANCE SHEET  
TRUST AND DONATION FUNDS  
June 30, 1968**

<b>ASSETS</b>	
Cash:	
In bank .....	\$22,914
On hand .....	<u>100</u>
Total assets .....	<u>\$23,014</u>
<b>FUND BALANCES</b>	
Trust funds:	
Patients .....	\$19,646
Occupational therapy activities .....	<u>796</u>
Total trust funds balance .....	20,442
Donation fund:	
Balance, July 1, 1967 .....	\$1,851
Add:	
Donations received .....	984
Interest on savings .....	<u>55</u>
Balance of donation fund ..	2,890
Deduct various expenditures . . . .	<u>318</u> 2,572
Total trust and donation fund balances . . .	<u>\$23,014</u>

**Opinion on balance sheet.** In our opinion, the balance sheet (Table III) fairly presents the assets of the trust and donation funds of the hospital at June 30, 1968.

**Patients' trust fund.** The patients' trust fund consists of monies belonging to individual patients. The monies are held by the hospital for safekeeping during the patients' stay in the hospital.

**Occupational therapy fund.** The occupational therapy fund is maintained by the occupational therapy department. The fund is used to purchase various materials and supplies with which patients manufacture and then sell handicraft products. Revenue from this activity is placed in this fund.

In recent years, the volume of activity in the manufacture and sale of handicraft products has been relatively small. In future years it will become even smaller, due to a planned reduction of handicraft product sales. This small volume of transactions does not appear to justify the need to maintain a separate fund. In addition, the record-keeping functions of this fund appears to be an unnecessary burden on the occupational therapy department. We feel that the activities for which this fund is used could be easily funded by the hospital's regular special fund. Therefore, *we recommend that the occupational therapy fund be eliminated.* Thereafter, all revenue from the sale of handicraft products should be treated as hospital receipts and all expenditures for material and supplies necessary for handicraft products should be treated as ordinary, operation cost of the hospital. The implementation of this recommendation will not only eliminate the record-keeping functions which are necessary when funds are separately maintained but will subject the above-mentioned expenditures to the same controls applied to any other hospital expenditure. Control of these expenditures is entirely vested in the occupational therapy department at the present time.

**Donation fund.** The donation fund is called the "Mahelona Patients' Association Fund." Monies received as gifts by the hospital from ex-patients, individuals and organizations are placed in this fund. Section 323-3, HRS authorizes the hospital to receive, manage and invest these monies. The fund is used to purchase various items for the patients' welfare and for other purposes specified by the donors.

The hospital's director of nursing maintains all records and controls all cash of this donation fund. While an administrator, such as the director of nursing, could be assigned some control functions, such as giving approval for expenditures or payments, other clerical duties as custodianship of cash and record-keeping should be delegated to a clerk or an accountant who normally performs such duties. The assignment of such clerical duties to the director of nursing is a poor utilization of her time and talent. *We recommend that the director of nursing be relieved of the record-keeping and custodial functions connected with the donation fund and that such duties be performed by a clerk or an accountant in the business office.* This recommendation was adopted by the hospital prior to the writing of this report.

### Inventory of Property

The superintendent of the Samuel Mahelona Memorial Hospital has custodial responsibility over the property used in the operations of the hospital. A summary inventory of the existing properties at June 30, 1968 is as follows.

Buildings	.....	\$1,173,112	
Equipment and furnishings	.....	346,949	
Motor vehicles	.....	<u>13,849</u>	
Total property	.....		1,533,910
Less depreciation accumulated:			
Prior to July 1, 1967	.....	\$704,152	
During the year ended			
June 30, 1968	.....	<u>43,887</u>	<u>748,039</u>
Total property (net)	.....		<u>\$ 785,871</u>

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

Governmental units do not normally record depreciation. In governmental funding and budgeting, all costs of acquiring property are considered sunk once they are expended. However, on July 1, 1966, the hospital adopted the practice of recording depreciation. It did so, because depreciation is an allowable expense in the computation of cost reimbursable by the federal government under the medicare program.

## Chapter 6

### SELECTED PROBLEMS

This chapter contains our findings and recommendations on specific problems and issues reflected by the practices of the Samuel Mahelona Memorial Hospital. Some of the issues

noted here are similar to those we found at the Kula Sanatorium and Hilo Hospital when we conducted audits of those institutions. Our recommendations with respect to the Samuel Mahelona Memorial Hospital are, in these cases, generally similar to those which we made in our Kula Sanatorium<sup>1</sup> and Hilo Hospital<sup>2</sup> audit reports.

### Vending Machine

The hospital has a vending machine which is stationed in the hospital building. The revenue from this vending machine is used by the hospital employees' association. This situation is not unique to the Samuel Mahelona Memorial 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 employees or, in some cases, patients.<sup>3</sup> It appears that revenue from these vending machines constitutes public funds, since it is generated from the use of space in public buildings.

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

<sup>2</sup> Legislative Auditor, *Financial Audit of the Hilo Hospital: A Report to the Governor and the Legislature of the State of Hawaii*, report no. 68-8, April 1968.

<sup>3</sup> Legislative Auditor, *Management Audit of Kula Sanatorium*, pp. 82-83, and *Financial Audit of the Hilo Hospital*, p. 22.

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

In August 1968, the State department of health requested an opinion from the State attorney general as to the legality of using revenue from vending machines in public hospitals for the benefit of hospital employees and patients. The attorney general has not as yet issued an opinion.

### Free Coffee or Milk for Employees

At the time of our audit, the hospital had a long established practice of providing free coffee or milk in the morning to hospital employees. There was no justifiable reason for this gratuity. It constituted an unwarranted preferential treatment of the Samuel Mahelona Memorial Hospital employees over other governmental employees.<sup>4</sup> We recommended to the hospital

<sup>4</sup> Legislative Auditor, *Financial Audit of the Hilo Hospital*, p. 23.

that this practice be discontinued immediately. We are pleased to report that prior to the writing of this report, this recommendation was adopted by the hospital. Hospital employees are now required to pay for coffee or milk.

### **Rental Charges for Housing Facilities**

As we noted in chapter 4, during fiscal year 1967-68, the hospital collected \$10,147 in rentals from individuals occupying living quarters owned by the hospital. These individuals consist of employees of the hospital, the State department of education (teachers of Kapaa High School), and an employee of the State department of social services. The rentals being charged range from \$15 to \$55 per month, depending on the type of accommodation. We understand that a cost analysis has not been made in recent years to determine whether or not these charges for living quarters are sufficient to recover the cost to the hospital in maintaining and operating them. We believe that such an analysis is now overdue. *We recommend that the hospital conduct a cost analysis to determine the adequacy of the rates now being charged the renters of living quarters owned by the hospital.*

### **Cattle Operation**

The hospital operates a cattle farm on its grounds. This operation dates back to the early

days of the hospital. We understand that the sole purpose of this operation is to supply the hospital's beef consumption requirements. No claim is made that the operation serves any therapeutic purpose.

We find that this means of meeting the beef requirements of the hospital is very uneconomical. For example, in fiscal year 1966-67, the hospital slaughtered and consumed 11 heads of cattle; in 1967-68, it slaughtered and consumed 15 heads of cattle. (In neither year did the hospital purchase any beef from private sources.) Eleven heads of cattle, if purchased from private sources in fiscal year 1966-67, would have cost about \$3000 and 15 heads of cattle, if purchased from private sources in fiscal year 1967-68, would have cost about \$3800. Yet, the salaries alone paid to the two range hands employed in the cattle operation exceeded these costs. In fiscal year 1966-67, the salaries paid to the two range hands totaled \$9012 and in fiscal year 1967-68, \$9228. If the costs of other items such as feed, spray, and slaughtering are added to the salaries, the diseconomy of the cattle operation would become even more evident. We find no justification for the continuation of the cattle operation, and *we recommend that the hospital, in conjunction with the State department of health, take immediate steps to phase-out the cattle operation.*

### PART III SUMMARY

Section 23-4, Hawaii Revised Statutes 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, we examined the books and accounts of the Samuel Mahelona Memorial Hospital and the transactions noted therein for the fiscal year July 1, 1967 to June 30, 1968.

The audit was conducted to determine the propriety of the hospital's financial transactions, the accuracy and reliability of its financial records, 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 which the hospital maintained during the fiscal year.

Our major findings and recommendations are summarized below.

#### **Internal Control**

A system of internal control is required to insure the 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. Depositing and transporting of cash receipts.** Cash deposits are made generally once every week by a clerk in the business office by hand-carrying the cash receipts to the county treasury office, a distance of approximately nine miles. Once-a-week (rather than daily) deposits of cash increase the risk of theft or misappropriation, and hand-carrying cash over a long distance is an open invitation to foul play. *We recommend that the hospital, in conjunction with the State department of health, make necessary arrangements to open an account with a bank located near the hospital and that the hospital thereafter deposit all cash receipts into this bank account on a daily basis.*

**2. Inventory control of drugs.** The director of nursing is the designated custodian and dispenser of inventoried drugs. She is also the keeper of the perpetual drug inventory record. Proper internal control requires the separation of the duties of custodianship of inventory property and maintenance of inventory records. *We recommend that the director of nursing be relieved of maintaining the perpetual inventory record.*

**3. Non-compliance with perquisite policies.** Certain employees of the hospital receive perquisites and the superintendent and medical director of the hospital has the personal use of a hospital vehicle. The State department of health's policy on perquisites requires the submission to the health department of reports on all employees to whom perquisites have been authorized. The policy also requires the validation by the director of health of all permits authorizing the personal use of government vehicles. The hospital has not adhered to these requirements. *We recommend that the hospital adhere to the State policy and immediately submit the required perquisite reports and request for motor vehicle permit to the director of health.*

### Special Fund

The Samuel Mahelona Memorial Hospital and all of its programs are funded by a special fund. The special fund consists of State general fund appropriations and hospital non-general fund receipts. Each year's general fund appropriation is intended to cover the difference between the hospital's anticipated expenditures and non-general fund receipts during the fiscal year.

**1. Opinion on financial statements.** 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 at June 30, 1968, and the results of the hospital's operations for the year July 1, 1967 to June 30, 1968. With respect to the

financial statements presented on the *modified cash* basis, in our opinion they fairly present the cash balance, liabilities and commitments of the fund at June 30, 1968, and the results of revenue collected and expenditures made and obligated on account of the fund for the fiscal year July 1, 1967 to June 30, 1968.

**2. Balance sheet.** On the accrual basis, the balance sheet shows that on June 30, 1968, the hospital had assets of \$106,631 and liabilities of \$29,436, for a fund balance of \$77,195. On the modified cash basis, the balance sheet shows that on June 30, 1968, the hospital had assets of \$40,292, liabilities of \$29,436 and encumbrances of \$10,756, for a fund balance of \$100. The difference of \$77,095 in the fund balances between the two methods of accounting, is that the accrual method includes non-liquid assets (accounts receivable and inventories) totaling \$66,339 and excludes encumbrances totaling \$10,756.

**3. Statement of revenue and expenditures.**  
*a.* During the fiscal year, non-general fund hospital receipts totaled \$95,348 on the accrual basis, and \$69,735 on the modified cash basis. The accrual-based figure reflects generally the amount of receipts the hospital acquired the right to collect, and the modified cash-based figure represents the amount of cash the hospital actually collected. The modified cash-based \$69,735 was \$51,235 over the budgeted amount of \$18,500. Actual collection exceeded the amount anticipated in the budget because revenue from voluntary payments by mental and chronic patients and from medicare and

medicaid was not considered when the budget was formulated.

b. Expenditures during the fiscal year totaled \$720,310 on the accrual basis, and \$728,466 on the modified cash basis. The difference of \$8156 is due to the inclusion, under the accrual method, and exclusion, under the modified cash basis, of the prior year's encumbrances which became legally due and payable in fiscal year 1967-68, and the inclusion, under the modified cash basis, and exclusion, under the accrual basis, of encumbrances made during the fiscal year. The total expenditure of \$728,466, on the modified cash basis, is \$12,544 more than the amount budgeted for the fiscal year. The increase in actual expenditures over the amount budgeted was due to (1) the job rating reclassification action taken by the State department of personnel services which raised the salaries of nurses and those in the hospital support positions, and (2) the initiation of the chronic program in December 1967. The costs of neither of these actions were taken into account when the budget was prepared.

c. Total expenditures for operations and equipment exceeded revenue by \$624,962 under the accrual method, and \$658,731 under the modified cash method. The \$658,731 (on the modified cash basis) is the actual amount of State funds required to supplement actual hospital receipts collected in the fiscal year. This is \$38,691 less than the \$697,422 anticipated and appropriated to the hospital.

## Other Funds and Property Inventory

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

1. **Balance sheet: trust and donation funds.** The balance sheet notes that at June 30, 1968, the hospital held in trust, \$19,646 of patients' money, \$796 for occupational therapy activities, and \$2572 of donated funds.

2. **Opinion on balance sheet.** In our opinion, the balance sheet of the trust and donation funds fairly presents the assets of the trust funds and donation fund of the hospital at June 30, 1968.

3. **Occupational therapy fund.** The occupational therapy activities trust fund is maintained by the hospital's occupational therapy department. It is used to purchase supplies and materials with which patients manufacture and sell handicraft products. Maintenance of this fund, separate and apart from the hospital's special fund, appears to be an unnecessary burden on the occupational therapy department, particularly since the fund's transactions are few in number. *We recommend that the occupational therapy fund be eliminated and subsequent financial transactions of this activity be treated as transactions of the special fund.*

**4. Donation fund.** The hospital's director of nursing maintains all records and controls all cash of the donation fund. An employee in an administrative position should not be burdened with such clerical and fund maintenance duties as record-keeping and custodianship of cash. *We recommend that the director of nursing be relieved of the record-keeping and custodial functions connected with the donation fund and that such duties be performed by a clerk or an accountant in the business office.* This recommendation was adopted by the hospital prior to the writing of this report.

**5. Property inventory.** The total value of property under the control and responsibility of the Samuel Mahelona Memorial Hospital as of June 30, 1968 was \$1,533,910. Property is valued at cost, except that donated items are valued at estimated market value at the time of donation.

#### **Selected Problems**

Several specific problems and issues arising from the operational practices of the Samuel Mahelona Memorial Hospital deserve comment. Some of these problems are similar to those which existed at the Kula Sanatorium and Hilo Hospital when we conducted audits of those institutions (see our audit reports entitled, *Management Audit of Kula Sanatorium* and *Financial Audit of the Hilo Hospital*).

**1. Vending machine.** Revenue from a vending machine situated in the hospital building is used by the hospital employees' association. Since the vending machine is in a public building, the revenue generated in effect constitutes public funds. Being public funds, there must be some earmarking under legal authority to enable the use of the revenue for a special purpose. We find neither a statute nor governmental policy which permits the use of the revenue for the benefit of the hospital employees. *Until such statutory authority is found and government policy formulated to permit the earmarking of the income for use by employees, we recommend that all revenue from the vending machine be treated and deposited as hospital revenue and included in the estimated revenue for budget purposes.*

**2. Free coffee or milk for employees.** At the time of our audit, the hospital was providing free coffee and milk to its employees. We saw no justification for this practice and recommended the immediate discontinuance of this gratuity. This recommendation has already been adopted and the employees are now required to pay for coffee and milk.

**3. Rental charges for housing facilities.** The hospital is currently renting living quarters on the hospital premises to employees of the hospital, the State department of education, and the State department of social services. No cost analysis has been made recently to determine whether or not the charges for the quarters are sufficient to recover the cost of providing these accommodations. *We recommend that the*

*hospital conduct a cost analysis to determine the adequacy of the rates now being charged the renters of living quarters owned by the hospital.*

**4. Cattle operation.** The hospital raises cattle on its premises to supply the beef requirements of the hospital. We find that this means of meeting the beef requirements of the hospital is

very uneconomical. The salaries alone paid to two range hands employed in the cattle operation far exceed the estimated cost of purchasing beef from private sources. We find no justification for the continuation of this operation. *We recommend that the hospital, in conjunction with the State department of health, take immediate steps to phase-out the cattle operation.*

**PART IV**  
**A MEMORANDUM ON THE COMMENTS MADE BY AFFECTED AGENCIES**

This financial audit report of the Samuel Mahelona Memorial Hospital was completed in April 1969. In accordance with our usual practice, we transmitted a copy of the preliminary draft of this report to those agencies affected by our findings and recommendations for their comments. The affected agencies included the hospital and the State department of health. (Our transmittal letters are attached as Attachment Nos. 1 and 2.) The responses of the agencies follow as Attachment Nos. 3 and 4. Both agencies agree with the findings and recommendations contained in our report and have indicated that our recommendations are being or will be implemented. However, the hospital's response in reference to our finding that it has not complied with the State perquisite policies deserves some comment.

*The hospital's response.* Our report stated that the hospital has failed to submit to the State department of health, as required by the department's policy, reports on all employees to whom perquisites have been authorized. The hospital has responded by stating that on March 28, 1969, it submitted to the department of health the required report. A copy of that perquisite report is attached as Exhibit "A" to the hospital's response.

*Our comment.* The hospital's perquisite report (Exhibit "A" to the hospital's response) is deficient in two respects. First, the report does not include all of the perquisites furnished by the hospital. The report includes only those perquisites which are furnished "free of charge," namely, (1) the personal use of a government vehicle, and (2) free living quarters. "Perquisites," however, is defined as things furnished or services rendered to an employee by the State which have value to the employee by *reducing his personal expense*.<sup>\*</sup> Certain employees at the hospital receive services or things, such as meals, housing and laundry, at costs which are less than their "fair value." The difference between the fair value and the cost of any such service or thing reduces an employee's personal expense. All employees receiving services and things at cost should thus be included in the hospital's report.

<sup>\*</sup>State department of health, *Policies and Procedures on Perquisites*, October 27, 1964.

The second deficiency is that the perquisite report lacks pertinent information. For example, no justification is given for the superintendent and medical director's personal use of a government vehicle. This omission is probably due to the hospital's failure to use the format specifically prescribed by the State department of health for reporting perquisites.

Both deficiencies (and the failure of the hospital to comply with State policies in the first place) stem in part from the lack of adequate communication between the State department of health and the hospital. For example, despite the deficiencies in the hospital's perquisite report, the State department of health has not as yet notified the hospital of these deficiencies. In our view, this lack of communication holds true with respect to all public hospitals; there is insufficient information being transmitted to the hospitals regarding State policies and procedures.

*We recommend that the State department of health establish and maintain communication with all public hospitals and furnish information, instructions and guidance to insure compliance by all hospitals with pertinent State policies and procedures.*

COPY

ATTACHMENT NO. 1

CLINTON T. TANIMURA  
Auditor

THE OFFICE OF THE AUDITOR  
State of Hawaii  
Iolani Palace  
Honolulu, Hawaii 96813

April 30, 1969

Dr. Peter Kim  
Superintendent and Medical Director  
Samuel Mahelona Memorial Hospital  
4800 Kawaihau Road  
Kapaa, Hawaii 96746

Dear Dr. Kim:

Enclosed is a copy of our preliminary report on the financial audit of the Samuel Mahelona Memorial Hospital for the fiscal year ended June 30, 1968. The term, "preliminary," indicates that the report has not been released for general distribution. However, copies of the report have been transmitted to the Mayor of the County of Kauai, the Director of the State Department of Health, the Governor, and the presiding officers of both houses of the State Legislature.

The report contains several 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. I have also asked the Director of the State Department of Health for his comments. All comments must be in our hands by May 9, 1969. 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, 1969. Please call our office to fix an appointment. A "no call" will be assumed to mean that a meeting is not required.

We sincerely appreciate the assistance and cooperation which you and members of your staff have extended to our representatives.

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

Encl.

CLINTON T. TANIMURA  
Auditor

THE OFFICE OF THE AUDITOR  
State of Hawaii  
Iolani Palace  
Honolulu, Hawaii 96813

April 30, 1969

Dr. Walter B. Quisenberry, Director  
Department of Health  
State of Hawaii  
Honolulu, Hawaii

Dear Dr. Quisenberry:

Enclosed is a copy of our preliminary report on the financial audit of the Samuel Mahelona Memorial Hospital for the fiscal year ended June 30, 1968. The term, "preliminary," indicates that the report has not been released for general distribution. However, copies of the report have been sent to the Superintendent and Medical Director of Samuel Mahelona Memorial Hospital, the Mayor of the County of Kauai, the Governor, and the presiding officers of both houses of the State legislature.

I would appreciate receiving your written comments on this report. I have also asked the hospital for its comments. All comments must be in our hands by May 9, 1969. 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, 1969. Please call our office to fix an appointment. A "no call" will be assumed to mean that a meeting is not required.

We are deeply thankful for the assistance received by our representatives from your staff.

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

Encl.

COPY

ATTACHMENT NO. 3

PETER KIM, M.D.  
Hospital Superintendent  
and Medical Director

SAMUEL MAHELONA MEMORIAL HOSPITAL

4800 Kawaihau Road  
Kapaa, Kauai, Hawaii 96746

Phone 6-4921

May 9, 1969

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

Dear Mr. Tanimura:

Thank you for the copy of your preliminary report on the financial audit of the Samuel Mahelona Memorial Hospital for the fiscal year ended June 30, 1968, and for the opportunity to review such report and comment on the recommendations contained therein.

In accordance with your request we submit the following information as to the specific actions we have taken or intend to take with respect to each recommendation:

1. DAILY DEPOSIT OF ALL CASH RECEIPTS. We are in agreement with your recommendation that all cash receipts be deposited into a bank on a daily basis to reduce the risk of theft or misappropriation and to minimize the possibility of foul play to the clerk and loss of cash because of the distance required for travel. Accordingly, with the consent of the Finance Director of the County of Kauai, an account with a bank located in Kapaa was opened on May 9, 1969.

2. MAINTENANCE OF PERPETUAL INVENTORY. We concur with your recommendation that the director of nursing should be relieved of the duties of maintaining the perpetual inventory records for drugs. We have requested authorization for a ward clerk position and we intend to have the clerk, in addition to her duties as ward clerk, assume the responsibilities of maintaining the perpetual drug inventory. We intend to effectuate this change on July 1, 1969, or soon thereafter.

3. PERQUISITE POLICIES. The perquisite report, as required by Department of Health policies on perquisites, was submitted to the Department of Health on March 28, 1969. A copy of such report, marked Exhibit No. "A", is inclosed.

4. OCCUPATIONAL THERAPY FUND. We agree that the record-keeping functions is an unnecessary burden on the occupational therapy department. The occupational therapy fund will be eliminated effective as of close of business June 30, 1969.

5. DONATED FUNDS. As noted in your report your recommendation pertaining to donated funds has already been adopted by the hospital.

6. VENDING MACHINE. In order to seek clarification and to ascertain whether or not the continued operation of the vending machine (a coke machine) by the Mahelona Memorial Hospital Employees' Association would be possible, a request by the association, dated September 5, 1968, to operate the vending machine for the benefit of the patients and employees, was referred to the County/State Hospitals Administration Office. We were subsequently informed that the question of vending machine operation in public buildings had been referred to the Attorney General's office for clarification and guidance. It is our understanding from a recent inquiry of the Department of Health that the Attorney General has not issued an opinion on this matter. Copies of the employees association letter and County/State Hospitals Administration Office reply, marked Exhibit No. "B", are inclosed.

7. RENTAL CHARGES. We concur with your recommendation that a current cost analysis study to determine the adequacy of the rental charges should be made. Such study will be made after the close of the current fiscal year and after medicare cost reimbursement information is available to conduct such cost analysis.

8. CATTLE OPERATION. We have discussed the advisability of phasing out the cattle operation with the County/State Hospitals Administration, Department of Health. We are in accord with your recommendation that the cattle operation be phased out. We intend to phase out the operation on or before December 31, 1969. The cattle presently owned by the hospital will either be slaughtered for hospital use or sold. We have requested the assistance of the Department of Finance, County of Kauai, for the sale of the cattle.

May 9, 1969

We appreciate the assistance and suggestions offered by your staff and feel that your recommendations are well taken. We will keep you advised on our progress in implementing your recommendations.

Sincerely yours,

/s/ Peter M. Kim

PETER M. KIM, M. D.  
Hospital Superintendent, M. D.

PMK:YG:ym  
Incls.

- cc. Honorable Antone Vidinha, Jr.  
Mayor, County of Kauai
- Walter B. Quisenberry, M.D.  
Director of Health, Department of Health
- Ralph B. Berry, M.D.  
County/State Hospitals Administration Officer

EXHIBIT "A"

COPY

March 28, 1969

Ralph Berry, M. D.  
County/State Hospitals Adm. Officer  
State of Hawaii  
Department of Health  
P. O. Box 3378  
Honolulu, Hawaii 96801

Dear Dr. Berry:

In accordance with "Policies and Procedures Pertaining to County Hospitals..." dated April 2, 1968, particularly that part directing all hospitals to follow the Department of Health Perquisite Policy, we are pursuant to Section IX, of "Policies and Procedures on Perquisites" submitting the following information:

1. **Use of Government Vehicles.** C of K Vehicle No. 129, Ford Galaxie, has been assigned to and for the use of Peter M. Kim, M. D., Hospital Superintendent and Medical Director (Sec. 7-11, R.L.H. 1955).
2. **Living quarters** provided at no costs to the following named employees who render actual services on a scheduled, or constantly recurring basis after normal working hours, or who are on stand-by service, for more than one day a week:
  - a. Peter M. Kim, M. D., Hospital Superintendent, M. D.
  - b. Mary S. Daniels, R. N., Director of Nursing
  - c. Robert Kunioka, Laboratory Technologist

I am enclosing a copy each of an Agreement executed by Mrs. Daniels and Mr. Kunioka, respectively, to perform stand-by or emergency service in exchange for living accommodations.

Very truly yours,  
/s/ Yukichi Gushiken  
YUKICHI GUSHIKEN  
Business Manager

YG:Ym  
Encls.

COPY

ATTACHMENT NO. 4

STATE OF HAWAII  
DEPARTMENT OF HEALTH  
P. O. Box 3378  
Honolulu, Hawaii 96801

May 7, 1969

Mr. Clinton T. Tanimura  
Legislative Auditor  
The Office of the Auditor  
State of Hawaii  
Honolulu, Hawaii

Dear Mr. Tanimura:

Re: Financial Audit of the Samuel Mahelona Memorial Hospital

In our review of the financial audit report of Samuel Mahelona Memorial Hospital, we are pleased to note that the overall fiscal procedures and operations generally reflect sound financial controls and management.

A general plan of action has been formulated between this department and the hospital staff that will assure a coordinated effort toward the implementation of changes and the resolution of specific problems.

This department is cognizant that a number of recommendations have general application to several, or all hospitals, within the County/State Hospitals System, e.g. disposition of income from vending machines, perquisites, and the analysis of rental charges. Certain actions have already been initiated and a continuing followup is planned to handle the problem areas on a system-wide basis.

This financial audit together with prior reports on the various County/State Hospitals have been helpful to us in meeting our management responsibilities more effectively. We appreciate the efforts of your office and you may be assured of our continuing cooperation and assistance.

Very sincerely,

/s/ Walter B. Quisenberry

WALTER B. QUISENBERRY, M.D.

Director of Health



## PUBLISHED REPORT OF THE LEGISLATIVE AUDITOR

### Audit Reports

- 1966 1. Examination of the Office of the Revisor of Statutes, 66 pp. (out of print).
- 1967 1. Overtime in the State Government, 107 pp.  
2. Management Audit of Kula Sanatorium, 136 pp.
- 1968 1. Financial Audit of the Department of Health for the Fiscal Year Ended June 30, 1967, v.p. (out of print).  
2. Financial Audit of the Department of Planning and Economic Development for the Fiscal Year Ended June 30, 1967, v.p. (out of print).  
3. Financial Audit of the Department of Regulatory Agencies for the Fiscal Year Ended June 30, 1967, v.p. (out of print).  
4. Financial Audit of the Department of Hawaiian Home Lands for the Fiscal Year Ended June 30, 1967, 54 pp.  
5. Financial Audit of the Oahu Transportation Study for the Period July 1, 1962 to August 31, 1967, 68 pp.  
6. Financial Audit of the Hawaii Visitors Bureau for the Period July 1, 1966 to January 31, 1968, 69 pp.  
7. State Capital Improvements Planning Process, 55 pp.  
8. Financial Audit of the Hilo Hospital for the Fiscal Year Ended June 30, 1967, 43 pp.  
9. Financial Audit of the Hawaii Visitors Bureau for the Period July 1, 1967 to June 30, 1968, 42 pp.
- 1969 1. Financial Audit of the General Fund, State of Hawaii, for the Fiscal Year Ended June 30, 1968, v.p.  
2. Financial Audit of the Judicial Branch, State of Hawaii, for the Fiscal Year Ended June 30, 1968, v.p.  
3. Financial Audit of the State Department of Budget and Finance for the Fiscal Year Ended June 30, 1968, v.p.  
4. General Audit of the Department of Personnel Services, State of Hawaii, 129 pp.  
4. A Summary of the General Audit of the Department of Personnel Services, 53 pp.

### Other Reports

- 1965 1. Long and Short Range Programs of the Office of the Auditor, 48 pp. (out of print).  
2. A Preliminary Survey of the Problem of Hospital Care in Low Population Areas in the State of Hawaii, 17 pp. (out of print).
- 1966 1. Procedural Changes for Expediting Implementation of Capital Improvement Projects, 9 pp. (out of print)
- 1967 1. The Large School: A Preliminary Survey of Its Educational Feasibility for Hawaii, 15 pp.  
2. State-City Relationships in Highway Maintenance, and Traffic Control Functions, 28 pp.  
3. Manual of Guides of the Office of the Legislative Auditor, v.p.
- 1969 1. Transcript of Seminar in Planning-Programming-Budgeting for the State of Hawaii, 256 pp.  
2. Airports System Financing Through Revenue Bonds, 9 pp.  
3. Second Annual Status Report on the Implementation of Act 203, Session Laws of Hawaii 1967 (Relating to State-county Relationships), 13 pp.  
4. An Overview of the Governor's 1969-70 Capital Improvements Budget, 61 pp.  
5. A Supplementary Report on the Audit of the Hawaii Visitors Bureau, 2 pp.

LEGISLATIVE AUDITOR  
IOLANI PALACE  
HONOLULU, HAWAII 96813