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October 31, 2006

Mr. Arthur A. Gianelli, President / Chief Executive Officer
Nassau Health Care Corporation
Nassau University Medical Center
2201 Hempstead Turnpike
East Meadow, New York 11554

Dear Mr. Gianelli:

A limited review of Nassau Healthcare Corporation's (NHCC) non-patient care revenues and expenses and the financial records of the Meadowbrook Medical Education and Research Foundation, Inc. (MMERF) was performed for the period January 2002 through September 2004. The review was performed in accordance with the authority granted to the Comptroller's Office by the *Stabilization Agreement Amendment* dated September 29, 2004. The objectives of the review were to (1) examine NHCC's non-patient care revenue and non-patient care expense transactions to determine the adequacy of NHCC's internal controls, compliance with NHCC policies, expense disbursement justification, and reasonableness of revenue recognition; and (2) examine the nature and propriety of the transactions between NHCC and MMERF. The limited review of MMERF included a review of the accounting for and usage of donations, and the use of funds received from the Faculty Practice Plan.

At the time this office was commencing the non-patient care revenue and expense review, the State Comptroller's Office was completing its review of NHCC's procurement practices. The State Comptroller's report "Nassau Health Care Corporation – Review of Procurement Procedures" was issued in October 2005 and is available on the State Comptroller's web site at <http://nysosc3.osc.state.ny.us/localgov/audits/2005/counties/nassau.pdf>. To prevent a duplication of efforts, this office did not test or evaluate procurement controls, nor did we perform an extensive review of financial services expense transactions or legal services expense transactions because these were included in the State's review.

Audit Scope

To accomplish our objectives with regard to NHCC's non-patient care revenue and non-patient care expenses, we reviewed existing policies and procedures, detailed transaction accounting records, and we tested the processing of transactions for:

- proper supervisory review and authorization;
- adequacy of documentation;
- adherence to policies and procedures; and
- adherence to contractual arrangements and purchase orders.

With regard to our objective to examine the nature and propriety of the transactions between NHCC and MMERF, we reviewed MMERF's charter, and other related documentation. We also interviewed NHCC's management regarding the transactions between MMERF and NHCC. We did not perform internal control evaluations of MMERF and instead relied on the work performed by the external auditors, Marks, Paneth & Shron, LLP.

Audit Findings and NHCC's Response

The matters covered in this letter have been discussed with NHCC officials during this audit. On February 6, 2006 we submitted a draft to NHCC with a request for comments. After extensive discussion, NHCC's comments were received on October 12, 2006. Those comments, and our response to those comments, are included within the body of this letter.

Audit Findings on NHCC's Non-patient Care Revenue and Non-patient Care Expenses

Audit Finding #1

Written Procedures and Segregation of Duties

While NHCC does have written policies and procedures covering various topics, it does not have adequate written policies and procedures controlling the billing, monitoring and collection of nonpatient revenues, or the processing and payment of most nonpatient expenses. Receipt of some revenues and the payment of some expenses are not properly monitored. In addition, the system of internal controls did not adequately segregate duties to provide checks and balances over non-patient expense transactions.

The only written policy that exists for non-patient revenue and expenses is one for miscellaneous expenses, and we found that it was outdated and there was noncompliance with that policy for 47% of the hospital's miscellaneous expenses tested. Those expenses, totaling \$1.8 million of the \$3.7 million characterized as miscellaneous, were missing the required levels of authorization by senior management. In addition, recurring purchases from 10 vendors totaling \$2.8 million were primarily characterized as miscellaneous claims and therefore required only senior management approval instead of a written contract. While this is a prudent control for the

occasional miscellaneous claim, senior management approval should not take the place of executed contracts.

Weaknesses in NHCC's internal control system resulted in a loosely controlled expense payment and recognition process. When we reviewed a test sample of non-patient care expenses, other than miscellaneous, we found the following for the audit period January 2002 to September 2004:

- Authorization and/or supporting documentation was missing for 73 paid invoices totaling nearly \$664,000.
- The lack of oversight and proper segregation of duties over the approval of temporary staffing claim vouchers resulted in unnecessary temporary staffing costs. Temporary staff was paid for overtime and holidays, contrary to the vendor contracts.
- Twelve claims totaling \$316,000 were approved by two individuals who were not employees of NHCC. Eight of these claims were approved by a temporary employee for payment to his own temporary staffing firm.
- NHCC generates manual checks to pay invoices that require quick payment, but they were not being properly reviewed and accounted for.
 - Manual checks were not entered into the system on a timely basis, which could result in a misstatement of expenses.
 - Manual checks were generated without adequate supporting documentation and proper review of existing documentation.
- NHCC uses a signature stamp to authorize the payment of vendor invoices, and we found no evidence of proper controls over its use. The use of a signature stamp, without proper controls does not provide assurance that the department head authorized the transaction.
- There is insufficient documentation to support accrual calculations.
- There is no assurance that all monthly expense accruals are accurate. A comparison of accruals to actual expenses identified several accounts where monthly accruals consistently exceeded actual expenses.
- During our review, we noted \$750,000 in expenses that were miscoded and charged to the wrong expense accounts.

NHCC Response

To facilitate audit reviews and oversight, NHCC is improving the manner in which control policies regarding non-patient-care revenues and expenses are documented and monitored, including segregation of duties. In addition, temporary staffing claims are now subjected to a more comprehensive review, recommendations regarding use of a signature stamp have been adopted, and any miscoded transactions have been corrected.

Auditor's Follow-Up Response

We concur with the corrective actions taken by NHCC.

Audit Finding #2

Non-Patient Revenue

We reviewed NHCC's revenues from resident apartment rentals, blood sales to other hospitals, rentals to patients of telephone and television, rooftop antennae rentals, and non-resident parking revenue. We identified the following revenue procedures that should be improved.

Contracts

The hospital uses outside vendors to collect revenue generated from rooftop antennae rental, telephone and television rental, and parking lot fees. These contracts are not monitored, and as of the end of our field work in February 2005, we found that:

- the hospital's contracts with the telephone and television rental revenue collection company and the parking revenue collection company had expired. The hospital had not renegotiated these contracts even though both companies had continued to collect revenue on the hospital's behalf;
- the contract for the collection of revenue from the rooftop antennae rental was unilaterally terminated by the contractor, although it continued to collect revenue on the hospital's behalf without remitting the revenue to the hospital. In January of 2005 the hospital contracted with a new vendor; and
- the rates charged in expired television, telephone and parking fee contracts were not current industry rates and the hospital is foregoing significant revenue by not renegotiating the terms of its contracts when they expire.

Internal Controls

The hospital does not have an adequate process in place to ensure the collection of non-patient care revenues.

- We reconciled all shipments, invoices and collection records of blood sales for 2002, 2003 and the first nine months of 2004 and found that revenues from blood sales to other hospitals totaling \$76,000 were not invoiced to the recipient hospitals.
- The hospital did not monitor remittances on those sales that are invoiced. Neither the blood lab or accounts receivable department aged outstanding unpaid invoices or follow-up unpaid invoices for collection.
- The vendor who collects revenue from rooftop antennae rental collected \$19,000 from the period June 2003 to September 2004, but did not remit it to NHCC.
- Periodic reconciliations between actual payroll deductions and rent rolls for resident

apartment rentals were not performed in 2004. We performed reconciliations as of October 19, 2004 and determined that rent had not been collected for nine units. Gone undetected for a full year, this would amount to \$80,600 in uncollected rent.

- Periodic reconciliations were not performed for television rental commissions. Our reconciliation found that \$86,300 in commissions was outstanding for 2003 and 2004. As of the end of our field work in February 2005 the TV rental company still owed NHCC \$19,000 of the \$86,300 in outstanding commissions.
- As part of its contract with the parking fee revenue collection company, the hospital has the right to audit the gross receipts that are used to determine NHCC's commission. As of the end of our fieldwork, the hospital had not exercised that right and therefore, could not be sure that its commission revenue is correct.

NHCC Response

NHCC will continue to improve monitoring activities for these programs. However, it is important to note that in each category that was reviewed, the activity was not a revenue initiative. The programs were initiated to address a significant public need by:

(1) making rooftop antennae space available to law enforcement and emergency responders such as the police and fire departments;

(2) making televisions and telephone communications available to patients;

(3) making parking available to outpatients and visitors;

(4) making unused blood products available to other facilities that were struggling with shortages;

(5) making housing available to post-graduate physicians in residency training programs and on call at the Medical Center.

Consistent with its mission, NHCC made policy decisions in each case not to exact the highest possible commercial pricing for these public services.

Auditor's Follow-up Response

We concur with NHCC's intentions to improve monitoring and encourage NHCC to ensure that new contracts are in effect upon the expiration of old contracts, and that goods and services are invoiced promptly and followed up for collection.

NHCC should follow up on all outstanding amounts owed and ensure collection.

We adhere to our view that NHCC should review the rates charged in expired television, telephone and parking fee contracts and compare them to current industry rates. The Corporation is foregoing significant revenue by not renegotiating the terms of its contracts when they expire. Even if the NHCC determines not to raise charges to a market level, it should consider whether these services can be priced to generate more support for the NHCC's medical mission.

Nature and Propriety of the Transactions between NHCC and MMERF

Background

MMERF is managed and controlled by NHCC, and NHCC's Board of Directors also acts as the Board for MMERF. NHCC's Chief Financial Officer serves as the Executive Secretary/Treasurer for MMERF. As a tax exempt organization pursuant to Section 501(c)(3) of the Internal Revenue Code, MMERF's purpose is to attract and apply funding for the advancement of medical and nursing education, medical research and to enhance healthcare services at NHCC by providing an atmosphere that encourages professional personnel to participate in activities such as innovative medical research and education.

Audit Finding #3

Fixed Assets

MMERF does not have adequate written procedures for the recording of fixed assets. Current procedures require assets costing more than \$2,000 and having a useful life of two or more years to be capitalized. The \$2,000 threshold should be periodically evaluated for reasonableness.

In addition, capitalized assets are not tagged and an internal inventory of fixed assets has not taken place since the year 2000.

NHCC Response

Written procedures are contained in policy memoranda. The \$2,000 threshold was previously established as a result of an evaluation for reasonableness. MMERF will continue periodic evaluations of the reasonableness of that threshold. Tagging has been implemented.

Auditor's Follow-up Response

Various policy memoranda are not a replacement for a policy and procedures manual accessible to employees. We believe that the \$2,000 threshold may be too high because items such as laptop computers now cost less than \$2,000 and may attract pilferage. Because they are not recorded in the fixed asset system and inventoried, their theft may be undetected.

Audit Recommendations

NHCC must document and strengthen policies and procedures in order to ensure that actual revenues and expenditures are accounted for properly. The loss of revenue and the payment of unnecessary expenses could be reduced by better oversight of revenue contracts and payment of expenses, and the implementation of a strong accounting process.

Expenditures, when in compliance with its charter, should be carefully evaluated prior to the expenditure of funds. MMERF's support of NHCC's medical research and enhancements of healthcare services should not result in unnecessary expenses. MMERF should also strengthen its policies and procedures in order to ensure that actual revenues and expenditures are accounted for properly, especially in the area of fixed assets.

NHCC Response

We concur with and will continue to implement the recommendations.

We would like to express our appreciation to you and the members of your staff who cooperated fully with this office throughout the entire audit process.

Sincerely,

Aline Khatchadourian
Deputy Comptroller for Audit and Special Projects

cc: Hon. Thomas R. Suozzi, County Executive
Hon. Judith Jacobs, County Legislature Presiding Officer
Hon. Peter Schmitt, County Legislature Minority Officer
Kathleen Rice, District Attorney
Lorna B. Goodman, County Attorney
Christopher Hahn, Chief Deputy County Executive
Thomas Stokes, Deputy County Executive
Martin Payson, Chairman of the Board, NHCC
Gary Bie, Chief Financial Officer, NHCC
Richard Perrotti, Finance Director, NHCC