Office of Missouri State Auditor

Nicole Galloway, CPA

FOLLOW-UP REPORT ON AUDIT FINDINGS

Putnam County Memorial Hospital

Report No. 2018-045

July 2018

auditor.mo.gov

Putnam County Memorial Hospital
Follow-Up Report on Audit Findings
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*Includes selected findings

NICOLE GALLOWAY, CPA
Missouri State Auditor

Honorable Michael L. Parson, Governor
and
Putnam County Memorial Hospital Board
and
Putnam County Commission
Unionville, Missouri

We have conducted follow-up work on certain audit report findings contained in Report No. 2017-074, *Putnam County Memorial Hospital* (rated as Poor), issued in August 2017, pursuant to the Auditor's Follow-Up Team to Effect Recommendations (AFTER) program. The objectives of the AFTER program are to:

1. Identify audit report findings that require immediate management attention and any other findings for which follow up is considered necessary at this time, and inform the hospital's management about the follow-up review on those findings.

2. Identify and provide status information for each recommendation reviewed. The status of each recommendation reviewed will be one of the following:

    - Implemented: Auditee fully implemented the recommendation, either as described in the report or in a manner that resolved the underlying issue.
    - In Progress: Auditee has specific plans to begin, or has begun, to implement and intends to fully implement the recommendation.
    - Partially Implemented: Auditee implemented the recommendation in part, but is not making efforts to fully implement it.
    - Not Implemented: Auditee has not implemented the recommendation and has no specific plans to implement the recommendation.

As part of the AFTER work conducted, we reviewed documentation and held discussions with hospital personnel and board members to verify the status of implementation for the recommendations. Documentation provided by hospital personnel and board members included minutes of meetings, financial records, written contracts and agreements, and other pertinent documents. This report is a summary of the results of this follow-up work, which was substantially completed during March, April, and May 2018.

Nicole R. Galloway, CPA
State Auditor

1.1 Lack of Board Oversight - Management contracts

The Board of Trustees did not perform sufficient due diligence over the process of awarding management contracts and did not adequately document how decisions related to the hiring of management companies were made or retain sufficient documentation to show discussions with legal counsel occurred prior to entering into the contracts.

Proposals not formally requested, procured, or analyzed

The Board entered into management services contracts in April 2012 with Practice Plus, Inc. (Practice Plus), and again in September 2016 with Hospital Partners, Inc. (Hospital Partners). The Board entered into both contracts without requesting formal bids or proposals for such services. Board minutes did not document what, if any, documents or presentations the Board received from the prospective management companies or how or what led to the decision to enter into agreements with these firms.

Lack of adequate documentation to support contract reviews

The Board could not provide adequate documentation to show discussions with legal counsel occurred prior to entering into the management contract with Hospital Partners. The Board signed the agreement without adequate legal counsel input despite the County Commission's offer to pay for legal services and despite the contract being drafted by the entity being contracted with.

As a result of inadequate legal review, the management contract included an indemnity clause. Such a clause left the Board and the hospital potentially liable for any fraudulent or negligent activity of the contractor, which was unusual for a contract of this nature. The contract also omitted basic financial terms defining how much the contractor was to be compensated.

Recommendation

The Board establish procedures to provide sufficient due diligence over the awarding of contracts. The Board should also document how and why final decisions are made in order to support the decision made was in the best interest of the hospital. In addition, the Board should ensure legal counsel perform a formal, documented review prior to entering into future contracts in order to ensure the contracts do not include broad indemnity clauses.

Status

In Progress

The Board has taken steps to improve its oversight of contracts and has obtained legal representation to help ensure any future contracts are adequately reviewed. The Board issued a request for proposals for a new management company with a deadline of May 1, 2018, but received no official responses. However, the Board has been corresponding with a potential vendor who may have an interest in managing the hospital.

In addition, in June 2017 the Board hired an attorney who specializes in healthcare law as the Board's official legal counsel to represent it in all decisions. The attorney will formally review any new contracts the Board is considering, and in the future the Board will sufficiently document how decisions made are in the best interest of the hospital. The attorney's role is to both act in and protect the hospital's best interest for any future agreements or significant operational, management, ownership, or other changes. In March 2018, he reviewed an engagement letter between the hospital and a consulting firm prior to the Board's final approval.

1.2 Lack of Board Oversight - Oversight of management compensation

The Board did not ensure personnel were in place to provide oversight of management company activities, and did not provide sufficient direct oversight of the compensation paid to the companies, including salaries paid to executive administration personnel.

Hospital Partners compensation and fees

The new CEO, who was also the President of the management company, approved his own salary, and paid his own management company management and accounting fees not specified in the management contract. The contract with Hospital Partners did not contain any compensation terms for the CEO or contain a specific management fee structure for work performed. In addition, the Board did not ensure other hospital officials not associated with the contractor monitored the activity of the management company.

The new CEO initially approved an annual salary for himself of $160,000 and, over the next 5 months, directed the hospital's human resources personnel to increase his annual salary to $180,000, and eventually to $200,000. Board members indicated they were aware the CEO may be included in the hospital's payroll and thus receive a salary; however, the Board Chairman indicated a salary amount for the CEO was not discussed and approved by the Board prior to March 2017, when we discussed this issue with the Board.

The CEO also directed hospital staff to pay management and accounting fees totaling $360,000 from September 2016 through February 2017 to Hospital Partners, none of which were outlined and defined in the management services contract or discussed in Board meeting minutes. Board members indicated they were not aware the hospital was making these payments although they approved the check register, which includes these expenditures, at each monthly Board meeting.

Recommendation

The Board establish procedures to ensure sufficient oversight of contracts is performed and provide direct oversight of the compensation paid to management companies and executive administration personnel.

Status

Partially Implemented

In September 2017, former CEO David Byrns informed the Board that he was retiring and selling his interest in the business to his business partner Jorge Perez, and subsequently resigned as the hospital's CEO. Prior to that, he appointed an administrator to assist with overseeing operations temporarily. In October 2017, the Board appointed long-time hospital employee and former Director of Nursing Gayle Pickens as CEO. If a new management company takes control of hospital operations, the Board intends to retain the CEO in her current position or a similar alternate position so there is proper oversight of the activities of the management company and the Board does not fully relinquish control of day to day operations.

The hospital discontinued paying the monthly management fee to Hospital Partners effective September 12, 2017. However after that date, hospital management continued to approve large wire transfers to Empower HIS LLC for billing fees, and approved wire transfers directly to the accounts of certain laboratories or other vendors associated with Empower HIS LLC without adequate documentation to support the amounts billed. For example, emails from January and February 2018 indicate the Controller of Empower HIS LLC routinely requested up to $170,000 be wired immediately to his company and two other unknown vendors, without always providing sufficient supporting documentation as to the purpose of the transfer or how the transfer amount was determined. The current CEO indicated she and other personnel with accounting duties were repeatedly instructed by Byrns and his colleagues to follow instructions and directives of management and billing companies and not to ask any questions about the laboratory billings. As a result of the lack of documentation provided to the Board, the Board had little assurance the hospital was retaining the 14 percent of lab revenues allowed after paying approximately 80 percent of lab revenues for laboratory management fees and 6 percent of lab revenues to the billing company per the signed agreements. The hospital terminated the billing agreement with Empower HIS LLC as of April 20, 2018.

The Board's attorney and a consulting firm are currently working to determine if the hospital is owed any additional monies from the management company, laboratory management companies, or billing company. Board members indicated they will ensure any future contracts the hospital enters into include clear and definite terms for fees, expenses, reimbursements, and other forms of compensation.

1.3 Lack of Board Oversight - Laboratory contracts and questionable laboratory billings

The Board did not provide appropriate oversight of laboratory contracts entered into by the CEO/management company President. As a result, the hospital incurred unnecessary payroll costs, and was involved in questionable laboratory billing practices.

Laboratory contract and payroll costs

In October 2016, the hospital contracted with Hospital Laboratory Partners, LLC[1] (Hospital Lab Partners) to operate all clinical and operational aspects of a clinical laboratory on behalf of the hospital. The Board did not formally approve the contract, did not provide any oversight of the terms of the contract, and was not aware of any of the contract's terms or the hospital's obligations to the contractor. Due to this lack of oversight, beginning in November 2016, the former CEO added payroll expenses of approximately $68,000 per month for 33 phlebotomists to facilitate laboratory activity, in violation of the contract's terms.

As a result of our inquiries about these payroll expenses, the former CEO stated Hospital Lab Partners had reimbursed the hospital for the costs. However, in verifying this information the former CEO was only able to provide documentation of a journal entry on the hospital's financial system, but could not provide evidence that a check was deposited or monies wired into the hospital's bank account.

Questionable laboratory billing practices

The hospital's laboratory contract with Hospital Lab Partners resulted in a significant increase of questionable revenues from laboratory billings of health insurance companies.

From November 2016 through February 2017 the hospital paid Hospital Lab Partners $19.8 million for laboratory billings received. However, as of January 23, 2017, the hospital's Unionville, Missouri lab had not begun processing tests, according to discussions with the former CEO, but billings for the lab had begun immediately upon Hospital Partners signing the management agreement with the Board. Our review of lab billings received by the hospital indicated the originating activity was for out-of-state patients for lab work not conducted in Putnam County.

During the audit, the State Auditor's Office was contacted by the fraud examiner of a private insurance company in Florida that had recently denied claims of approximately $700,000 from the hospital due to the excessive cost of the claims, a lack of documentation to support the claims, and indications the billings may be fraudulent. This individual referred us to a fraud

[1] Hospital Lab Partners was incorporated in Florida on October 13, 2016, and entered into the Putnam County Hospital laboratory contract on October 20, 2016.

investigator for a second, much larger, private insurance company who stated payments of up to $4.3 million in what the company considered fraudulent claims had been paid to the hospital in recent months. Based on this information, the second insurance company was no longer paying any claims from the hospital because the billings submitted were pass-through billings, which were indicative of a fraud scheme. Continued use of such questionable laboratory billings could leave the hospital at risk.

Laboratory subcontractors

In addition to the lab management fees paid to Hospital Lab Partners, the hospital also paid approximately $10.6 million in lab management fees without adequate supporting documentation to other subcontracted laboratories from November 2016 through February 2017. Without adequate documentation to support the expenditures there was no assurance the payments were for legitimate hospital business.

Questionable use of phlebotomy services

The employment of 33 primarily out-of-state phlebotomists to perform pre-laboratory services throughout the country was a questionable practice, and could put the hospital at risk. Based on documentation provided by hospital personnel, the phlebotomists on the payroll work out of various medical practices throughout the country.

It was unclear why the CEO placed staff from 33 different medical practices on the hospital's payroll, however, such practices may not be legitimate, and could put the hospital at risk if questioned.

Recommendation

The Board recover payments made to laboratory-related staff and ensure laboratory contract terms are followed going forward, and provide additional oversight of laboratory activity to ensure activity being billed is appropriate.

Status

In Progress

The questionable laboratory billings are no longer occurring at the hospital. The Board terminated the management agreement with Hospital Partners, Inc. as of February 28, 2018, and terminated the billing agreement with Empower HIS LLC as of April 20, 2018. The hospital is currently performing billing duties in house with plans to issue a request for proposal for a new billing company in the near future. According to the Board, the hospital's legal counsel is continuing to research all agreements, contracts, and other correspondence established during the time Hospital Partners, Inc. managed operations and will take appropriate measures to recover any monies due to the hospital if there are any.

The Board removed all out-of-state phlebotomists from the hospital's payroll effective October 31, 2017. We found no indication the management company had reimbursed the hospital for the cost of these personnel, though the Board's attorney is considering this issue as part of his ongoing investigation. According to the hospital's accounting records, the hospital paid approximately $2.3 million to Empower HIS LLC, $2.2 million to Hospital Laboratory Partners, LLC, and $18.4 million to at least 10 other labs for billing and lab management fees from July 1, 2017 through April 30, 2018.

Similar laboratory billing practices to those discussed in the audit report have resulted in ongoing litigation between major private insurers and entities and individuals related to Hospital Partners. In a complaint filed in the U.S. District Court for the Northern District of Georgia, insurers allege Jorge Perez, Vice President of Hospital Partners, assisted "in the management of [a] pass-through billing scheme" at Chestatee Regional Hospital[2] located in Georgia causing plans to reimburse improper laboratory claims totaling approximately $111 million. The complaint also states had the claims been billed to the plans directly by the laboratory or the other non-participating laboratories where the testing was performed, many of the claims would not have been paid, and those that were would have been paid at substantially lower rates. A similar practice at the former Campbellton-Graceville hospital in Florida resulted in one lab receiving about $25 million in improper reimbursements. In 2015, a former laboratory company agreed to pay $256 million to the U.S. Department of Justice to resolve allegations that it billed Medicare "many millions of dollars' worth" of urine drug testing claims that were "not reasonable and necessary or that were furnished pursuant to prohibited referrals" in violation of the Anti-Kickback Statute, 42 U.S.C. § 1320a-7b(b), and other statutes.

The hospital has made efforts to increase legitimate lab activity. In an effort to continue to provide lab services and increase revenues, the hospital is processing approximately 20 lab specimens per day for a small hospital based in Arkansas, in addition to any activity generated from the hospital or the clinic. The hospital does not bill insurers directly for the services performed for the Arkansas hospital, but generates revenue through billing that hospital for services provided.

2. Financial Condition

The hospital was in extremely poor financial condition. According to discussions with the hospital's Controller, accounting firms had been unwilling to perform a financial statement audit of the hospital in recent years due to a lack of resources for payment.

The hospital's financial condition had steadily declined since we reported similar concerns in our 2 year-end December 31, 2011, audit report of Putnam County.[3] In addition, several prior financial statement audit reports, including

[2] Complaint (Mar. 28, 2018), *Blue Cross and Blue Shield of Georgia, Inc., et at, v. DL Investment Holdings. LLC, et al.* N.D. Ga. (No. 1:18 CV 01304).
[3] Report No. 2012-058, *Putnam County*, issued in June 2012.

the audit report for the year ended June 30, 2014, identified a going concern issue with the hospital (conditions and events given rise to substantial doubt about the entity's ability to continue).

The hospital's audited and unaudited financial information indicated net position had been consistently negative and continued to worsen, and the hospital had continued to operate at a deficit since at least the year ended June 30, 2013.

For the year ended June 30, 2016, actual revenues totaled $7.5 million, or approximately 49 percent of the $15.2 million budgeted revenues. In addition, although the hospital expended only $11.1 million of the $15.4 million expenditure budget, actual expenditures exceeded actual revenues by approximately $3.6 million.

As the hospital's financial condition continued to worsen, hospital management began using tax anticipation notes and promissory notes to obtain funding to pay hospital expenses. From 2011 to 2015, hospital management financed funding of $1,410,000 through various tax anticipation notes and promissory notes.

Accounts receivable and accounts payable

The hospital had high levels of uncollectible accounts receivable, while at the same time experiencing high accounts payable balances. As of June 2016, accounts receivable totaled approximately $5.5 million, of which 76 percent, or approximately $4.2 million, remained uncollected after 120 days. According to the hospital's financial report, nearly $3.6 million of the accounts receivable were likely uncollectible.

In addition, the Board meeting minutes indicated the hospital was extremely behind in making payments to vendors. As of June 2016, the hospital calculated it took, on average, 379 days to make payments to vendors and current accounts payable totaled approximately $7.9 million.

After Hospital Partners began providing management services for the administration of the hospital in September 2016, the accounts payable were significantly reduced and the hospital entered settlement agreements.

Statewide performance comparison

We obtained statewide hospital data from the Missouri Department of Health and Senior Services to evaluate the performance of the hospital relative to statewide averages of other critical access hospitals (CAH). Our analysis determined that despite an occupancy rate of 37.5 percent, which was higher than the statewide CAH average of 32.2 percent, the hospital generates revenues per bed and governmental revenues per Medicare discharge at a significantly lower rate than other peer hospitals.

CPA audits and cost reports

The hospital did not receive an independent CPA audit for fiscal year 2015 or 2016. In addition, the hospital did not submit required annual cost reports to the Centers for Medicare and Medicaid Services during this time period.

The lack of an independent CPA audit limited the reliability of financial information available to the Board for budgeting and planning purposes. In addition, the untimely completion and submission of cost reports to CMS could present significant potential liabilities to the hospital.

Recommendation

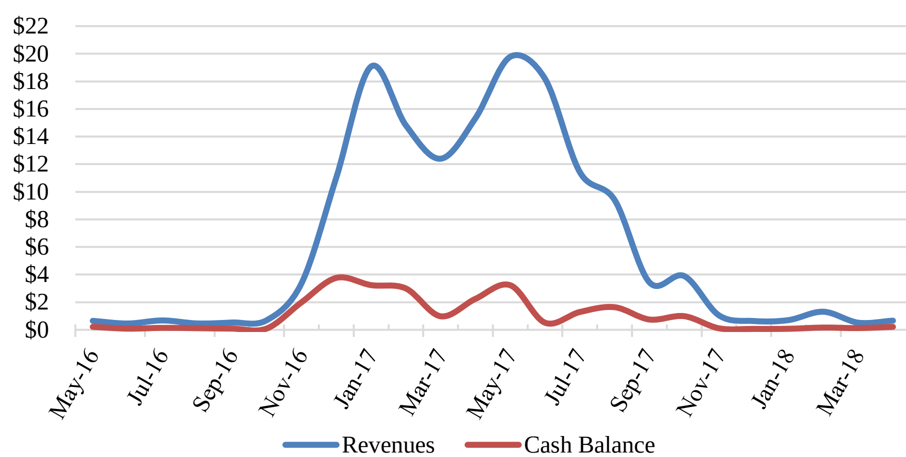
The Board better monitor the financial condition of the hospital and continue to explore all options to improve the hospital's financial condition, including a review of federal billing procedures, to ensure the healthcare needs of Putnam County citizens continue to be met.

Status

In Progress

The hospital's financial condition continues to be a concern. While the hospital's bank account balances improved while Hospital Partners was managing the hospital, balances have since returned to their original levels. See Figure 1 for a graph of hospital revenues and cash balances from May 2016 to April 2018.

Figure 1: Revenues and cash balance, May 2016 to April 2018 (in millions)



Source: Hospital bank statements

Hospital Partners took over hospital operations in September 2016. As shown in the chart, the hospital's revenues and bank balance increased significantly shortly thereafter beginning in November 2016. Monthly revenues reached a high of nearly $20 million in May 2017 before falling off sharply upon the release of our audit report in August 2017. As the chart shows the majority of the revenue coming into the hospital during this period did not remain in the hospital's bank account. As discussed previously, the majority of these revenues were transferred out to laboratory and management contractors.

Subsequent to the audit release, both revenues and the cash balance returned to similar levels as November 2016 and prior months; therefore, the laboratory billing arrangement questioned in the audit did not put the hospital in a significantly better financial position in the long term. The Board has worked to reduce the hospital's long and short term liabilities, and accounts payable were current (less than 30 days) as of February 2018. The only remaining significant long-term liability is a bond issuance that requires payments through 2033, and hospital personnel indicated the property and sales tax monies collected have generally been enough to make these annual debt service payments.

To help address the financial condition the Board signed an engagement letter with a consulting firm in March 2018 to provide various accounting and consulting services "including, but not limited to, (1) analysis of management arrangement and financial position and (2) identifying and analyzing options for an alternative management arrangement and sale and/or lease options." The Board indicated the consultant may also help determine the status of compliance with critical documentation or other requirements associated with federally funded healthcare, consult with the Board on ways to increase revenues or decrease expenses, and perform an assessment of potential or actual demands and/or claims from insurance companies and monitor the status of recoupments of overpayments due, if applicable.

To increase revenues, the Board continues to perform lab testing for another hospital at a competitive rate and is exploring the potential to market the hospital as a qualified substance abuse medical stabilization (detox) facility, which would potentially increase the number of inpatient bed days. Due to the ongoing opioid crisis at the local, state, and national level, Board members indicate they feel very strongly about the need for this service because they have noted an extreme shortage of doctors in the northern half of Missouri with credentials to prescribe the most commonly used prescription medication for treating opioid withdrawals (Suboxone). The hospital employs two doctors who have these prescribing rights. Patients would then be seen in the outpatient clinic to monitor their medical status. The Board is investigating this option as a possible pilot project and has been in discussions with the Missouri General Assembly and Missouri Department of Mental Health, as well as providers of counseling or other behavioral services.

Based on the lawsuits referred to in Section 1.3, there is more than a remote risk of the hospital facing similar types of lawsuits from insurance companies but the probability of that occurring and the timing is not determinable. This risk, coupled with the hospital being heavily reliant on federal sources of patient service revenue like Medicaid and Medicare, could quickly destabilize the hospital's financial condition if lawsuits are filed or reductions occur in these programs.