



Guam Memorial Hospital Authority FY 2006 Draft Financial Highlights

June 13, 2007

The Guam Memorial Hospital Authority's (GMHA) fiscal year 2006 audited financial statements have been completed before the June 30th deadline, the first time in GMHA's history that the audit has been completed early. Despite the improvement in timeliness, GMHA continues to face a myriad of challenges.

GMHA Receives Qualified Opinion for Fifth Consecutive Year

The hospital received a qualified opinion for the fifth consecutive year from independent auditors J. Scott Magliari and Company. The qualified opinion was due to the following:

- \$24.2 million (M) difference in accounts receivable confirmations from third-party payors as compared to GMHA's subsidiary ledger summary with no reconciliations performed to identify the differences;
- Inability to determine the reasonableness of the accounts receivable, the allowance for bad debts, and the contractual adjustments in the amount of \$100.3M and \$66.7M as of September 30, 2006 and 2005, respectively;
- Lack of reconciliation between the capital assets control register and the general ledger; movable equipment register control account was understated by \$587,708 at September 30, 2006 compared to the overstatement of \$1.7M at September 30, 2005; building and land improvement register control account was understated by \$848,374 and \$1.7M at September 30, 2006 and 2005, respectively;
- Lack of inventory controls to properly account for all inventory locations of GMHA; and the Pharmacy Department's physical count was not properly valued and was not entered in the inventory accounting system of GMHA, which is a departure from accounting principles generally accepted in the United States.

Instability In Key Management Positions Results In Questioned Cost of Over \$5M

GMHA's accounting infrastructure remains in a vulnerable position due to the lack of continuity in the hospital's management particularly with the Hospital Administrator and Chief Financial Officer (CFO). Over the last 10 years, there have been 11 Hospital Administrators, and one CFO who held the position for only two years. As a result of the instability in management, the GMHA has had significant audit qualifications and questioned cost of over \$5M from FY 2002 to FY 2006.

Current Administration's Efforts to Improve Financial Stability Results in Collections of \$6.4M

The current administration, which started in April 2005, is now in its third year and has worked diligently to address audit findings, reconcile the accounts receivable to the master control, and improve patient collections. Aggressive collection efforts for Medicare and Medicaid services have resulted in a favorable redetermination of disallowed expenses from prior years. The aggregate total of \$6.4M was received as a result of the hospital's appeal, of which \$1.5M was paid in FY 2006, and \$4.9M was subsequently received in October 2006.

Additionally, the GMHA's administration has initiated a Financial Management Improvement Plan (FMIP) with the goal of creating financial stability, and improving the effectiveness and efficiency of internal processes.

Reliance on General Fund Appropriations and Federal Grants

GMHA continues to incur operating losses and negative cash flows from operations that are insufficient to pay current expenses and liabilities. In FY 2006, total operating expenses grew to \$79.3M from \$75.8M in FY 2005. As a result GMHA recorded an operating loss of \$12.1M. From FY 2002 through FY 2006, GMHA's operating expenses have far exceeded its ability to collect revenues resulting in negative cash flows and operating losses of \$3.3M, \$11.4M, \$11M, \$18.1M, and \$12.1M respectively.

Government subsidies from General Fund appropriations and Compact impact funds have kept the hospital viable. Government of Guam appropriations and Federal Grants were \$26.2M, \$1.5M, \$9.3M, \$17.5M and \$16.6M from FY 2002 to FY 2006.

A going concern is footnoted in the report, as GMHA management expects to continue experiencing negative operating losses and cash flows, and is reliant on both government of Guam appropriations and compact impact funds to sustain operations and maintain the quality of medical services provided to the public.

Potential Impact of the Government of Guam's Liquidity Crisis

The financial stability of GMHA is further jeopardized with the government of Guam's liquidity crisis. In March 2007, Standard & Poor's placed Guam on a CreditWatch with negative implications for liquidity. "The liquidity crisis is directly attributed to Guam's long-term structural financial imbalance, with recurring deficits, a large and growing negative general fund balance, and massive long-term liabilities. The CreditWatch placement also reflects the possibility that these challenges will further diminish the government's ability to meet operational responsibilities, while addressing long-term requirements". With the liquidity crisis, there is no assurance that the government of Guam will be able to fund significant appropriations to GMHA.

GMHA Closes The Year With An Increase in Net Assets of \$5.3M

In FY 2006, GMHA recorded an increase in total operating revenues of \$9.5M from \$57.7M to \$67.2M. The increase was attributed to the \$9.5M increase in net patient service revenue. Conversely, operating expenses increased by \$3.6M from \$75.7M to \$79.3M. The major increases in expenses were due to a \$3.3M increase in nursing expense, and the \$1M increase in ancillary expenses. Although expenses increased, GMHA closed the year with an increase in net assets of \$5.3M after government subsidies of \$12M and Federal contributions of \$5.4M. Had the subsidies not been provided GMHA would have recorded a loss of \$12.1M.

Personnel Cost and Superior Courts Declaratory Judgment for Nurses Salaries

During the year, total personnel cost increased by \$6.4M from \$44.9M in FY 2005 to \$51.4M in FY 2006. The \$28.4M in nursing cost remains the highest personnel cost of the hospital, comprising 55% of total personnel cost. In October 2006, the Superior Court issued a declaratory judgment requiring GMHA to implement salary adjustments for professional nursing positions by 39% beginning April 2002, and an additional increase of 5% in October 2002. GMHA management believes the declaratory judgments by the Superior Court will have a material effect on GMHA's

financial condition. At September 30, 2006, no provision has been made on the financial statements for the liability that may arise from the declaratory judgment.

Unpaid Liabilities of \$15.6M and Untimely Payments of \$2.1M

At the close of the fiscal year GMHA was in arrears of unpaid retirement contributions to the Government of Guam Retirement Fund totaling \$15.6M. GMHA was also in arrears for payments on employee's Federal withholding taxes to the Department of Revenue and Taxation (DRT). The hospital made payments totaling \$2.1M subsequent to the close of the fiscal year and is now current with its obligations to DRT. As result of the late remittance of payments GMHA incurred \$131,344 in penalties and interest.

The independent auditors made 16 audit adjustments to correct GMHA's financial records. These adjustments had an aggregate net effect increase of \$3.7M in the statement of net assets.

Unresolved Questioned Cost Increased to \$4.4M; Audit Findings Decrease to 19

The Compliance and Internal Control Reports cited 19 findings in FY 2006, a decrease from the 22 findings in FY 2005. GMHA was also issued a separate management letter, which identified an additional 12 internal control weaknesses. Of the 19 compliance findings, four findings were considered a material weakness¹, and 15 were repeat findings from the prior year. GMHA incurred \$607,789 in questioned cost in FY 2006; the current administration has resolved approximately \$620,500 in prior years' questioned costs, leaving total unresolved questioned cost from audit findings over the last five years at \$4.4M. The 19 findings discussed in the FY 2006 report include:

Accounts Receivable Patient Affairs: Finding 06-01: At September 30, 2006, the net amount of unmatched cash receipts totaled \$182,261. The unmatched cash receipts were posted to accounts receivable-suspense account pending identification and posting to the proper patient subsidiary account. The potential for fraud exists when account balances are not reconciled timely.

Medical Billings with Unique Physician Identification Number (UPIN): Finding 06-02; GMHA did not obtain and certain doctors did not provide the required UPIN for medical services claims to be properly submitted to the Medicare Program for reimbursements. As a result, GMHA wrote-off close to \$1.7M and potentially lost revenues of \$330,258. Internal control procedures have not been fully implemented and enforced by senior management of GMHA to obtain the required UPIN information.

Allowance for Doubtful Accounts and Contractual Adjustments: Finding 06-04; GMHA does not have a formal written policy for determining its accounting estimates for provisions for bad debts, contractual allowances and adjustments. Management's failure to develop and implement policies and procedures for contractual adjustment is causing an economic burden and financial strain on both GMHA and the General Fund of the government of Guam. This finding was cited in the opinion qualification.

¹ Material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Bad Debt Receivables on Self Pay Accounts: Finding 06-05; GMHA has current receivables totaling \$7.1M for self-pay patients that represent potential write-offs in the near term resulting from the lack of monitoring by management, and the inadequate and improper evaluation.

Current Receivables on Medically Indigent Program and Medicaid: Finding 06-06; Patient accounts receivable due from the Medically Indigent Program and Medicaid are not properly reconciled, monitored, or evaluated for collectibility in a timely manner. The allowance for contractual adjustments of patient receivables from the Medically Indigent Program and Medicaid totaled \$18.3M, which negatively impacts cash flows from operations and places financial strain on GMHA's ability to meet current accounts payables.

Inventory in Pharmacy: Finding 06-09; Inventory in the Pharmacy Department is not maintained in the inventory subsidiary module of the AS400 system. There is no formal recording system over the movement of the pharmaceuticals to provide an accurate and up-to date listing of inventory on hand. The pharmaceutical inventory could be materially misstated. Potential misappropriation of assets could exist and not be detected. This finding is another area of opinion qualification.

Procurement Prepayments: Finding 06-12; Four of 60 purchase orders tested were made for the prepayment of goods and services. GMHA is not in compliance with its procurement rules and regulations. A questioned cost of \$411,846 exists as a result of this condition.

Activities Allowed or Unallowed: Finding 06-16; The drawdown for the Compact Impact grant received on March 10, 2006 for eligible vendor payables for pharmaceuticals and medical supplies as of February 9, 2006 totaling \$1.2M included certain invoices/cost already paid or reimbursed as eligible costs. A questioned cost of \$195,943 exists as a result of this condition.

For a more detailed commentary of GMHA's operations, refer to the Management Discussion and Analysis in the audit report.