



LOUISIANA LEGISLATIVE AUDITOR
STEVE J. THERIOT, CPA

December 19, 2008

Dr. Michael Butler, Acting Chief Executive Officer
Louisiana State University Health System –
Health Care Services Divison
P.O. Box 91308
Baton Rouge, Louisiana 70821

Dear Dr. Butler:

As an integral part of the Single Audit of Louisiana, we are requesting that you provide our office with an official response relating to the enclosed reportable audit findings for your department. We have discussed these finding with management of the department. Please provide responses no later than January 16, 2009. The official response should be on agency letterhead, addressed to Steve J. Theriot, CPA, Legislative Auditor, signed by an appropriate agency official, and should contain the following:

- ◆ A response for each finding in a separate letter.
- ◆ A reference to the finding by title, but please do not repeat the entire finding in your response.
- ◆ A statement as to whether you concur, concur in part, or do not concur with the individual finding and recommendation, and the reasons you concur in part or do not concur.
- ◆ A corrective action plan, including the status of action taken or action planned to correct the internal control weakness and/or finding of noncompliance, or a statement why corrective action is not necessary. Office of Management and Budget Circular A-133 requires the corrective action plan to include at a minimum the following:
 - the name(s) of the contact person(s) responsible for corrective action
 - the corrective action planned
 - and the anticipated completion date.

Dr. Michael Butler, Acting Chief Executive Officer
Louisiana State University Health System –
Health Care Services Division
December 19, 2008
Page Two

If you do not agree with the audit findings or you believe corrective action is not required, then your corrective action plan should include an explanation and specific reasons.

Also, please do not fold or staple the responses as your responses may be included in the Single Audit Report of the State of Louisiana.

Please note that the enclosed findings are considered a draft and will not become a matter of public record until the audit is complete. Likewise, your responses to these findings are considered to be a part of our working papers and will not become a matter of public record until the audit is complete. We consider our draft findings and your responses to be a confidential record comprising a part of our working papers, until the audit is complete, at which time both items of information will become a matter of public record in accordance with Louisiana Revised Statutes 44:4(6) and 44:6.

Thank you for your cooperation in this matter. If you have any questions, please contact me at (225) 339-3916.

Sincerely,



Barrett Hunter, CPA
Audit Manager

BH:CP

The following findings are enclosed:

- Energy Efficiency Contract Contrary to Law
- Inadequate Controls Over Consumable Inventory
- Unlocated Moveable Property
- Misappropriation of Funds

**LSU HEALTH SYSTEM –
HEALTH CARE SERVICES DIVISION**

Energy Efficiency Contract Contrary to Law

University Medical Center (UMC) and Lallie Kemp Regional Medical Center (LKRMC) entered into performance-based energy efficiency contracts with Johnson Controls, Inc. (JCI) in October 1999 and November 2002, respectively, that included stipulated savings and, therefore, does not comply with state law. Louisiana Revised Statute (R.S.) 39:1496.1(A) provides that a state agency may enter into a performance-based energy efficiency contract for services and equipment. R.S. 39:1484(A)(14), requires the payment obligation to be either a percentage of the annual energy cost savings attributable to the services or equipment under the contract; or guaranteed under contract to be less than the annual energy cost savings attributable to the services or equipment under the contract. R.S. 39:1496.1(D) requires the contract to contain a guarantee of energy savings to the entity. The statute further provides that the annual calculation of the energy savings must include maintenance savings that result from operation expenses eliminated and future capital replacement expenditures avoided as a result of equipment installed or services performed by the contractor.

Attorney General Opinion 07-0002 provides, "...for the stipulated operational savings to be included in the total guaranteed savings, those savings must actually be guaranteed. In order for the operational savings to be guaranteed, the Contract would have to provide for some type of measurement and/or verification of the operational savings....". Although the Attorney General Opinion was directed to local government, the same guarantee is required in state law, therefore the conclusion is the same.

A review of the energy efficiency contract, which is for 20 years and \$4.7 million between UMC and JCI, disclosed the following deficiencies:

- JCI guaranteed a total of \$4,762,185 in savings during the term of the contract, consisting of measurable savings of \$1,943,165 and operational savings of \$2,819,020. Per the contract: "Operational Savings are mutually agreed by the Customer and JCI ...and shall not be measured or monitored during the Term." The contract also stipulates that operational savings are repair and maintenance costs avoided by the customer through the implementation of the Performance Contracting Agreement. The operational savings are not guaranteed because the contract does not provide for measurement and/or verification of the operational savings. Therefore, excluding the operational savings, the guaranteed savings over the life of the contract are only the measurable savings of \$1,943,165. The total payments due to JCI over the life of the contract are \$4,746,367. The payment obligation exceeds the adjusted guaranteed annual energy cost savings by \$2.8 million.
- The contract states that JCI may credit any excess savings, in whole or in part, toward the annual guaranteed savings in any future year of the term. R.S. 39:1496.1 requires the payment obligation for each year of the contract to be less than the annual energy cost savings. It is not appropriate to carryforward excess savings to future years.

The energy efficiency contract, which is for 17 years and \$3.4 million between LKRMC and JCI, stipulates the value of the operational savings in the contract. Under Schedule E of the contract, JCI guaranteed a total of \$3,489,692 in savings during the term of the contract. The savings consists of measurable savings of \$1,550,162 and operational savings of \$1,939,530. Per the contract, "Operational Savings" are agreed by the parties to be achieved and "will not be additionally measured or monitored during the term of the Agreement". Exhibit 5 of Schedule E defines operational savings to include avoided repair, maintenance, and other costs, and also states that the operational costs will not be additionally measured or monitored during the contract term. The operational savings are not guaranteed because the contract does not provide for measurement and/or verification of the operational savings. Therefore, excluding the operational savings, the guaranteed savings over the life of the contract are only the measurable savings of \$1,550,162. The total rental and service payments due to JCI over the life of the contract are \$3,414,894. Therefore, the payment obligation exceeds the adjusted guaranteed annual energy cost savings by approximately \$1.9 million during the term of the contract.

At the signing date, management felt that the contracts complied with state law. However, because the operational savings are stipulated and are not measurable and verifiable, the contracts are not in compliance with the law.

Management should revise its energy efficiency contracts to comply with state law to ensure that each savings component is verifiable and that the guaranteed savings have been realized.

**LSU HEALTH SYSTEM –
HEALTH CARE SERVICES DIVISION**

Inadequate Controls Over Consumable Inventory

For the third consecutive audit, the Medical Center of Louisiana at New Orleans (MCLNO) has failed to maintain adequate control over its consumable inventories valued at \$8,875,982 at June 30, 2008. Also, for the third consecutive audit, University Medical Center (UMC) has weaknesses in its controls over consumable inventory. A proper system of internal control over inventory should include procedures to ensure that inventories are safeguarded and that inventory losses, should they occur, are detected in a short period of time by normal business procedures. A perpetual inventory system is generally regarded as an acceptable method of controlling inventory and safeguarding assets. Use of a perpetual inventory system allows an entity to record the receipt of goods at the time of purchase and the issuance of goods as they are withdrawn for use. At any point in time, a count of goods on hand should agree to the balance in the inventory system and discrepancies should be investigated to determine if losses are due to theft or fraud.

MCLNO's Warehouse Department, with a total inventory of \$5,280,907 at June 30, 2008, is the only department that is on a perpetual inventory system (PeopleSoft) at MCLNO. MCLNO has a high volume of inventory transactions, yet management did not perform periodic physical counts throughout the fiscal year to ensure the perpetual inventory system was working properly. Of the 62 Warehouse inventory items tested totaling \$160,398, 49 items (79%) totaling \$41,831 did not match the inventory amounts recorded in the PeopleSoft system.

Procedures performed on UMC's inventory system disclosed the following deficiencies:

- Although the Supplies Processing Distribution (SPD) Department converted to a perpetual inventory system in September 2007, a physical count of 25 items disclosed that 7 items (28%) did not agree to the amounts shown in the perpetual inventory system.
- A physical count of 20 items disclosed that 6 items (30%) did not agree to the amounts shown in the perpetual inventory system for the Warehouse Department.

Failure to implement adequate procedures over consumable inventories increases the risk of inaccurate accounting and reporting of consumable inventory, as well as the risk of fraud and the losses remaining undetected.

Management should perform periodic physical test counts and reconcile them to the perpetual inventory system to ensure that the system is functioning properly. Management should establish control procedures to ensure that inventory is adequately safeguarded, valued, and recorded.

**LSU HEALTH SYSTEM –
HEALTH CARE SERVICES DIVISION**

Unlocated Movable Property

University Medical Center (UMC), Earl K. Long Medical Center (EKLMC) for the second consecutive audit, and Medical Center of Louisiana at New Orleans (MCLNO) for the third consecutive audit, are not properly accounting for and safeguarding their movable property. Louisiana Administrative Code Title 34 Part VII Section 313 (A) states, in part, that efforts must be made to locate all movable property items for which there are no explanations available for their disappearance. Property unlocated after three years is permanently removed from the movable property records. Louisiana Revised Statute 39:325 requires entities to conduct an annual inventory of movable property and identify amounts of unlocated property in an annual certification submitted to the Louisiana Property Assistance Agency (LPAA). Good internal control requires that adequate procedures be in place to ensure that the locations of all movable property items are monitored and updated frequently and that thorough periodic physical counts of property inventory be conducted. In addition, good internal control should ensure that movable property is properly safeguarded against loss or theft arising from unauthorized use and misappropriation.

During our tests of movable property, we noted that UMC's certification of annual property inventory dated June 15, 2007, identified unlocated movable property items totaling \$1,308,683. Of that amount, items totaling \$23,230 were removed from the property records because they were not located after three consecutive years. Of the unlocated property reported on UMC's physical inventory certification, the amount of unlocated computers and computer-related equipment totaled \$554,114. The certification disclosed \$22,045,472 in total movable property administered by UMC. Due to the high number of discrepancies, LPAA did not approve the 2007 certification of annual property inventory.

Louisiana State University Health System - Health Care Services Division requires hospitals to submit an Asset Management Monthly Checklist. The monthly checklist requires a reconciliation of the American Appraisal Associates worksheet to the PeopleSoft accounting software and to Protégé, the statewide inventory system. UMC did not perform the monthly reconciliation from July 2007 to January 2008. The reconciliations are a key control to ensure that property is recorded timely and accurately in the statewide inventory system and assets are properly included in the financial statements.

EKLMC identified unlocated movable property items totaling \$682,925 as a result of physical inventory procedures. Of that amount, items totaling \$28,632 were removed from the property records because they had not been located for three consecutive years. Of the unlocated property reported on EKLMC's physical inventory certification, the amount of unlocated computers and computer related equipment totaled \$184,585. The certification of property inventory disclosed \$20,353,670 in total movable property administered by EKLMC. EKLMC submitted its annual certification of property inventory to LPAA on May 30, 2008.

On May 30, 2008, MCLNO reported unlocated movable property items with an original cost of \$4,876,324 as a result of its physical inventory procedures. Of that amount,

items totaling \$1,277,262 were removed from the property records because they had not been located for three consecutive years. Of the unlocated property reported on MCLNO's physical inventory certification, the amount of unlocated computers and computer-related equipment totaled \$681,217. The certification of property inventory disclosed \$76,070,432 in total movable property administered by MCLNO.

Although MCLNO is making improvements in locating previously unlocated assets, the amount of unlocated assets still represents a significant amount mainly because of the impact of Hurricane Katrina. The extensive flood damage particularly to the main campus created hazardous environmental conditions and the lack of electrical power hampered efforts to locate movable property items. The efforts to re-establish healthcare services after the hurricane resulted in many items being transferred to other hospitals and clinics where these items could be used to provide healthcare. This movement posed additional problems in accurately locating and reporting movable property as cost center managers were not available to prepare the necessary transfer or delete forms. In addition, MCLNO continues to have high turnover in its Property Manager position.

Failure to establish adequate controls over movable property increases the risk of loss arising from unauthorized use of property and subjects the hospitals to noncompliance with state laws and regulations. Because of the nature of the services provided by the hospitals, the risk exists that sensitive information could be improperly recovered from the missing computers and/or computer-related equipment.

Management should strengthen its controls over movable property to ensure compliance with internal policies and state laws and regulations; adequately secure and monitor movable property; and conduct timely, accurate physical inventories. Management should devote additional efforts to locating movable property items reported as unlocated in previous years. In addition, management should ensure that monthly reconciliations between property systems are performed timely and accurately.

**LSU HEALTH SYSTEM –
HEALTH CARE SERVICES DIVISION**

Misappropriation of Funds

Lallie Kemp Regional Medical Center (LKRMC) identified a misappropriation of processing fees of the Medicine Procurement Program (MPP). Louisiana Revised Statute 14:67 defines theft as the misappropriation or taking of anything of value which belongs to another, either without the consent of the other to the misappropriation or taking, or by means of fraudulent conduct, practices or representations. The medical center immediately requested an internal audit by LSU Health System - Health Care Services Division (HCSD) Internal Audit.

HCSD Internal Audit determined that between March 1, 2006 and January 16, 2007, MPP processing fees totaling \$35,436 were allegedly stolen by an employee. LKRMC notified the Louisiana Legislative Auditor of the misappropriation on February 8, 2007, turned over its investigation of the stolen funds to the Tangipahoa Parish District Attorney's Office, and is seeking restitution. The employee was terminated, arrested by the Tangipahoa Parish Sheriff's Department, and arraigned in the District Court for Tangipahoa Parish on November 17, 2007. LKRMC Staff dedicated significant time and effort to the extraction of data from the pharmacy logs and their actions kept critical original documents from being destroyed. LKRMC Management, in coordination with HCSD Internal Audit, has developed comprehensive policies and procedures to strengthen controls to prevent future thefts.

LKRMC should continue to seek improvements in its controls over MPP processing fees and should seek full restitution from the former employee.