



**CITY OF COLORADO SPRINGS
OFFICE OF THE CITY AUDITOR**

**08-16 – MEMORIAL HEALTH SYSTEM
UNCOMPENSATED CARE – INTERIM REPORT**

PUBLIC REPORT

SEPTEMBER 3, 2008

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Office of the City Auditor

Date: September 3, 2008

To: Honorable Mayor and Members of City Council
Members of the Memorial Health System Audit Committee
Members of the Memorial Health System Board of Trustees
Members of the Uncompensated Care Committee

Re: 08-16 – Memorial Uncompensated Care – Interim Report

The 2008 Audit Plan included an audit of the cost of Uncompensated Care at Memorial Health System (Memorial). The purpose of the audit was to review Memorial's policies and procedures regarding the accounting for and reporting of the cost of uncompensated care.

We have completed our fieldwork regarding the accounting for and reporting of the cost of uncompensated care and are issuing this interim report containing our understandings, observations, and conclusions.

We conclude that overall, Memorial staff has consistently applied their definition of the cost of Uncompensated Care in the calculations they use to support numbers reported to their Board and the City Council.

We have issued this interim report so it can be available to the Uncompensated Care Committee. While we continue our review of the policies and practices related to the cost of Uncompensated Care, we are making our services available to the Committee.

As always, feel free to contact me if you have any questions.

Sincerely,

A handwritten signature in purple ink that reads "Jeff Litchfield".

Jeff Litchfield
City Auditor

cc: Dr. Larry McEvoy II, Chief Executive Officer
Tracy Narvet, Interim Chief Financial Officer
John Wyckoff, Compliance Officer

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Findings, Recommendations, and Responses

There were no findings or recommendations for this part of the audit.

Abbreviations and Acronyms used in this Report

Memorial Memorial Health System

Introduction

AUTHORIZATION

We performed an audit of the amount of Uncompensated Care as calculated and reported by Memorial Health System (Memorial). We conducted this audit under the authority of Chapter 1, Article 2, Part 7 of the City Code, and more specifically parts 703, 705, and 706, and Part 709 (B) and (C) of the Code, which state:

1.2.703: ENSURE PUBLIC ACCOUNTABILITY:

The City Auditor shall ensure that administrative officials are held publicly accountable for their use of public funds and the other resources at their disposal. The City Auditor shall investigate whether or not laws are being administered in the public interest, determine if there have been abuses of discretion, arbitrary actions or errors of judgment, and shall encourage diligence on the part of administrative officials.

1.2.705: DETERMINE EFFECTIVENESS AND EFFICIENCY OF PROGRAMS:

The City Auditor shall determine the extent to which legislative policies are being efficiently and effectively implemented by administrative officials. The City Auditor shall determine whether City programs are achieving desired objectives. The City Auditor shall review the administrative control systems established by the enterprises, department or group managers and by the City Manager, Utilities Executive Director and Memorial Hospital Executive Director and determine whether these control systems are adequate and effective in accomplishing their objectives.

1.2.706: EXAMINE BOOKS, RECORDS:

The City Auditor shall examine and inspect all books, records, files, papers, documents and information stored on computer records or in other files or records relating to all financial affairs of every office, department, group, enterprise, political subdivision and organization which receives funds from the City or under the direct or indirect control of the City Council. The Auditor may require any person to appear at any time upon proper notice and to produce any accounts, books, records, files and other papers pertaining to the receipt or expenditure of City funds, whether general or special. If that person fails to produce the papers, then the Auditor may request Council approval to search for and take any book, paper or record in the custody of that person or public official.

1.2.709: MAKE PERIODIC REPORTS TO COUNCIL:

- B. Information of proposals deemed expedient in support of the City's credit, and recommendations for lessening expenditures, for promoting frugality and economy in City affairs and for an improved level of fiscal management;
- C. Matters concerning the effectiveness and efficiency of the programs and operation of the City;

Introduction

ORGANIZATIONAL PLACEMENT

The Office of the City Auditor is structured in a manner to provide organizational independence from the entities it audits. This independence is accomplished by the City Auditor being appointed by and reporting directly to the City Council. The audited entity in this audit was Memorial Health System, which is an enterprise of the City of Colorado Springs under the direction of its Chief Executive Officer. The Chief Executive Officer reports to the Memorial Health System Board of Trustees, who are appointed by the City Council.

SCOPE AND METHODOLOGY

The purpose of this audit was to review Memorial's policies and procedures regarding the accounting for and reporting of Uncompensated Care. Our audit period was to review the transactions for the five-year period 2003 through 2007.

We conducted our audit in accordance with the *International Standards for the Professional Practice of Internal Auditing*, a part of the Professional Practices Framework promulgated by the Institute of Internal Auditors. Our audit included such tests of records and other supporting documentation as we deemed necessary in the circumstances. We reviewed the internal control structure and compliance tests were performed. Sufficient competent evidential matter was gathered to support our conclusions.

BACKGROUND

Memorial provides healthcare services to Colorado Springs and the surrounding area. The assets they use to provide this service includes three hospitals – Memorial Hospital Central, Memorial Hospital North, and Memorial Hospital for Children (in partnership with The Children's Hospital) – and several clinical facilities. For the year ended December 31, 2007, Memorial's charges for services were \$507.7 million and expenses were \$500.2 million. The expense number included \$65.6 million in Uncompensated Care.

Memorial has reported the cost to provide Uncompensated Care has increased over the last 10 years from \$10.3 million to \$65.6 million. This increase has been the topic of much discussion. The Mayor has appointed a committee to study the state of Uncompensated Care. The committee is comprised of City Council members, Memorial Board members, and community leaders.

Over the last few years, we have heard many questions about Uncompensated Care. Several of those questions involved the makeup of Uncompensated Care and how it was calculated. Later in this section, we have provided a definition of Uncompensated Care as well as several observations based on financial information.

During our review, we noticed two other numbers being publicly reported which contained measurements similar to Uncompensated Care. They were Community Benefit and Indigent Care. We will provide a comparison between these three measures.

Introduction

DEFINITION

There does not appear to be a universal definition of the components of the costs of Uncompensated Care as used in the healthcare industry. The following slide was prepared by Memorial and contains their definition of the costs of Uncompensated Care.

How Uncompensated Care* is Calculated

1. Calculate overall ratio of costs to charges (A)
2. Multiply all “uncompensated care” patient charges x (A) =
Cost of care provided to “uncompensated care” patients (B)
3. (B) – reimbursement from “uncompensated care” patients
= Cost of Uncompensated Care (C)

* MHS defines uncompensated care as charity care, CICP, Medicaid and bad debt.

To help the reader understand how the numbers flow, we have taken Memorial’s definition and expanded it to arrive at:

- the sum of the Gross Patient Charges for:
 - Medicaid,
 - the Colorado Indigent Care Program,
 - Charity Care,plus
 - the Provision for Bad Debt Expense,
- all of which are discounted by a factor (Ratio of Costs to Charges) that represents the actual cost of providing the services,
- it is then reduced by the revenue received by each program, and
- further reduced by the Disproportionate Share Payment received from Medicare,
- to arrive at the cost of Uncompensated Care.

This definition was consistently used by Memorial during the five-year period we reviewed.

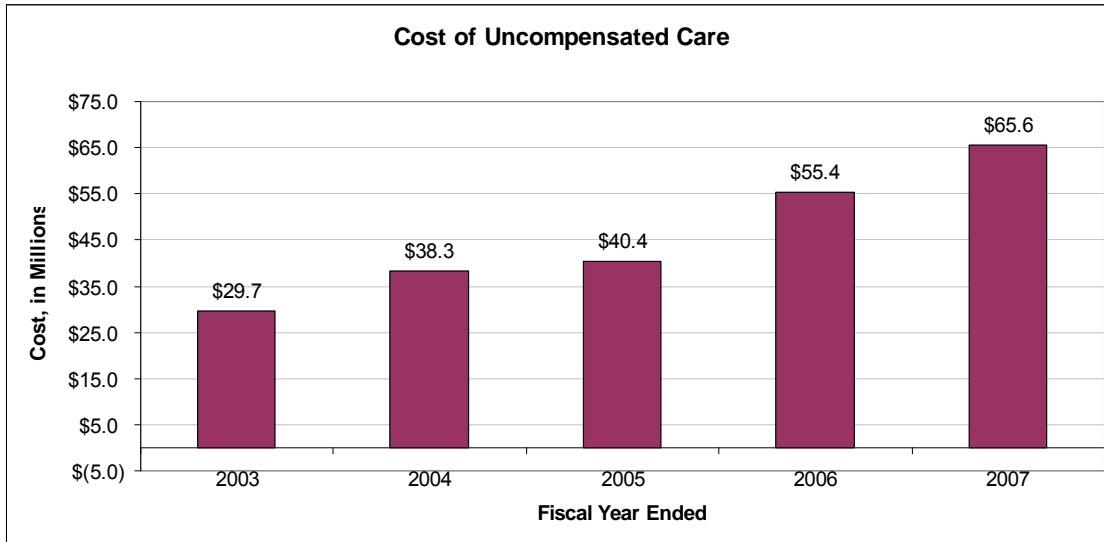
OBSERVATIONS

This section contains a series of observations based on the financial data we reviewed.

Introduction

Annual Cost of Uncompensated Care

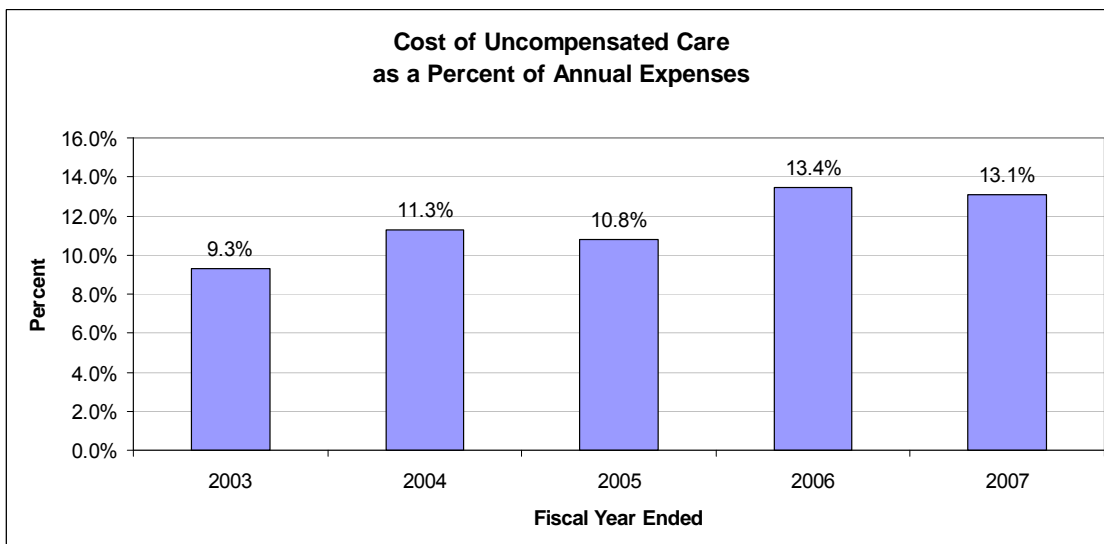
This chart shows Uncompensated Care as reported by Memorial and verified by our office.



The chart shows the cost of Uncompensated Care has increased 121% over the last five years.

Cost of Uncompensated Care, as a Percent of Annual Expenses

This chart is calculated by taking the cost of Uncompensated Care and dividing it by the annual expenses as reported in the Statement of Activities as found in the City of Colorado Springs Comprehensive Annual Financial Reports for the periods indicated.

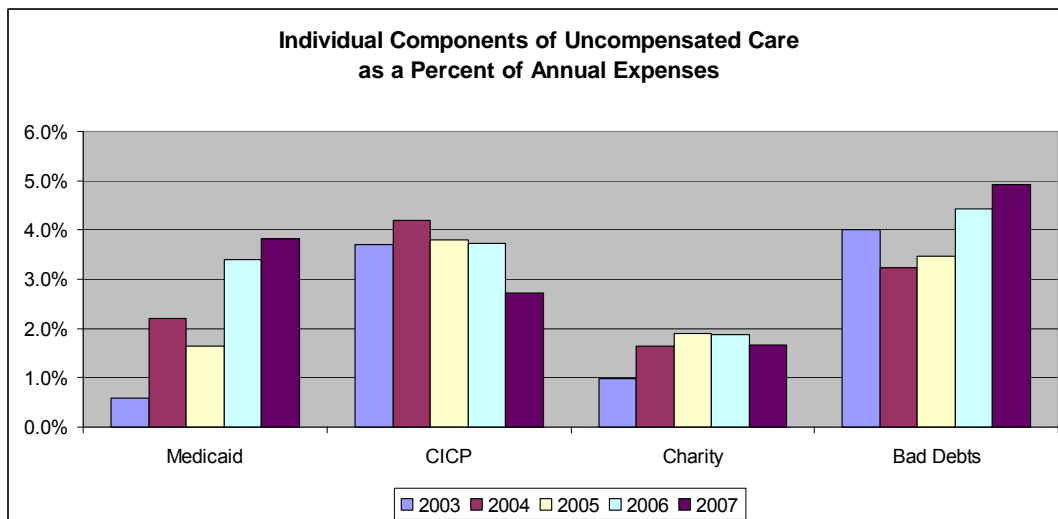


The chart shows the cost of Uncompensated Care, as a percent of annual expenses, has increased 41% over the last five years.

Introduction

Composition of the Cost of Uncompensated Care, as a Percent of Annual Expenses

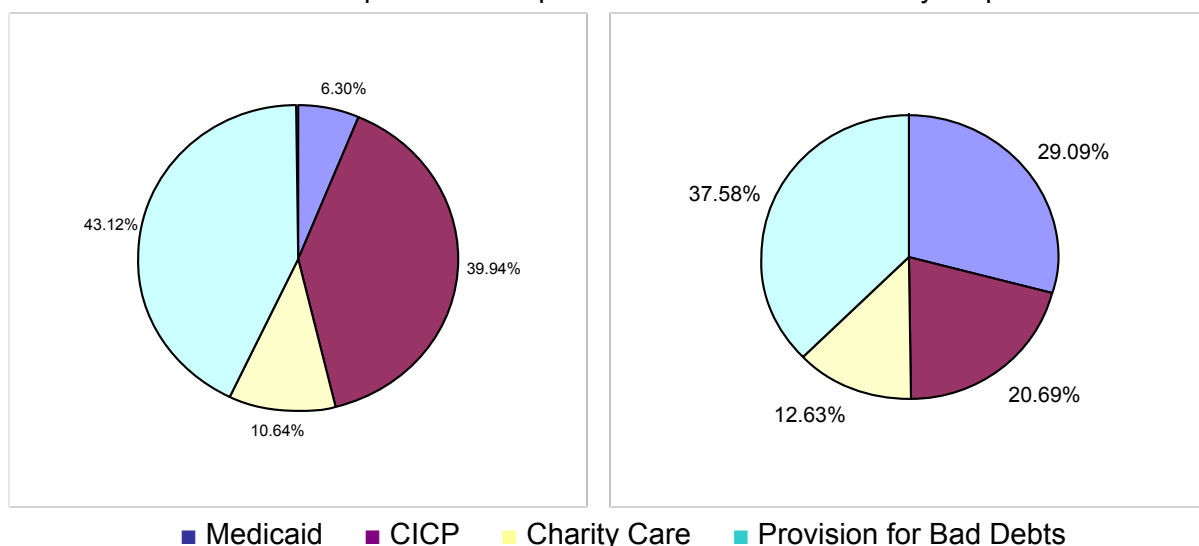
This chart shows each of the four components of Uncompensated Care and their percentage of annual expenses for the five year period.



To expand on the data in this chart, it shows that Medicaid was 0.6% of total expenses in 2003 and rose to 3.8% of total expenses in 2007, or an increase of 552.1%. The changes for the other three categories, in the order shown in the graph are -26.8%, 67.7% and 23.1%.

Composition of the total Cost of Uncompensated Care, for 2003 and 2007

These charts show how the pieces of the pie have shifted over the five year period we reviewed.



The biggest shift is that the Uncompensated Cost of Medicaid has risen from 6.3% of the total to 29.09% of the total.

Introduction

MEASUREMENTS SIMILAR TO UNCOMPENSATED CARE

Two other measurements similar to Uncompensated Care are Community Benefit and Indigent Care. Community Benefit is reported in the "Report to the Community" published by Memorial. Indigent Care is reported in Memorial's annual financial report. The following table shows the differences between the two numbers when compared to the Uncompensated Care calculation.

	Uncompensated Care	Community Benefit	Indigent Care
Gross Patient Revenue:			
Medicare	No	Yes	No
Medicaid	Yes	Yes	Yes
Colorado Indigent Care Program	Yes	Yes	Yes
Charity Care	Yes	Yes	Yes
Provision for Bad Debts	Yes	No	No
Multiplied by Ratio of Cost to Charges	Yes	Yes	No
Less Revenues Received:			
Medicare	No	Yes	No
Medicaid	Yes	Yes	Yes
Colorado Indigent Care Program	Yes	Yes	Yes
Disproportionate Share Payments	Yes	Yes	No
Plus Community Outreach	No	Yes	No

Note - in the Community Benefit number published in the 2007 Report to the Community, the information for the Colorado Indigent Care Program and the Charity Care are combined into one number titled Charity Care.

The numbers reported as of December 31, 2007 for each of the areas are:

Uncompensated Care	\$65,615,740
Community Benefit	87,860,000
Indigent Care	249,091,000

OVERALL OPINION

We conclude that overall, Memorial staff has consistently applied their definition of the cost of Uncompensated Care in the calculations they use to support numbers reported to their Board and the City Council.

Introduction

FOR THE FUTURE

We have issued this Interim Report so it can be available to the Uncompensated Care Committee. While we continue our review of the policies and practices related to the cost of Uncompensated Care, we are making our services available to the Committee in accordance with Section 1.2.707 of the City Code, which states:

- A. The City Auditor shall confer and consult with the enterprises ... on matters relating to financial practices and the implementation of programs and operations.

We anticipate our final report to be issued once the Uncompensated Care Committee has completed their tasks.