

TEXAS HEALTH AND HUMAN SERVICES COMMISSION
INSPECTOR GENERAL

**AUDIT OF PROVIDENCE MEMORIAL
HOSPITAL COST REPORT**

Fiscal Year 2014



October 31, 2017



HHSC IG

TEXAS HEALTH AND HUMAN
SERVICES COMMISSION
INSPECTOR GENERAL

WHY THE IG CONDUCTED THIS AUDIT

The Texas Health and Human Services Commission (HHSC) Inspector General (IG) is responsible for enforcing state law relating to the provision of Medicaid and other Health and Human Services programs. HHSC has the authority to conduct desk reviews and field audits of provider cost reports in order to evaluate whether financial and statistical information reported in the cost reports conforms to applicable rules and instructions.

Providers participating in the Medicare program are required by federal and state law to submit information to report costs relating to health care services rendered to Medicare and Medicaid beneficiaries. Cost reports are submitted annually to the Centers for Medicare and Medicaid Services (CMS). Cost report information is used by HHSC as a basis for setting certain Medicaid payment rates.

This report details results of the audit of Providence Memorial Hospital (Providence) in El Paso, Texas.

WHAT THE IG RECOMMENDS

Providence should follow the American Hospital Association (AHA) guide as required when determining the useful lives of assets for cost reporting purposes.

For more information, contact:
IG.AuditDivision@hhsc.state.tx.us

October 31, 2017

AUDIT OF PROVIDENCE MEMORIAL HOSPITAL COST REPORT

Fiscal Year 2014

WHAT THE IG FOUND

The audit objective was to determine whether the amounts in the capitalization and moveable equipment cost centers reported on the Providence Medicare cost report for fiscal year 2014 were accurate, allowable, and adequately supported, according to CMS and state requirements. The scope of the audit included the cost report period from June 1, 2013, to May 31, 2014, which is Providence's fiscal year.

The IG Audit Division reviewed the two cost centers associated with capitalized assets and movable equipment. Total depreciation expense claimed on the 2014 cost report for these cost centers was \$13.2 million, which represented approximately 6 percent of total Providence expenses reported. The IG Audit Division also reviewed square footage changes throughout the hospital. This review helped to determine whether square footage statistics used to allocate overhead and administrative expenses to inpatient and ancillary cost centers were accurate.

The IG Audit Division assessed whether Providence was in compliance with requirements in the following areas: physical asset verification, square footage statistics, and information technology (IT) general controls over S2K, the system Providence used to record depreciation and capitalized asset information.

Based on the results of audit test work, the IG Audit Division determined that the sample of assets selected for physical verification were accounted for, disposals tested were disposed according to policy and had sufficient supporting documentation, square footage statistics were accurate, and user access and passwords were in compliance with Providence internal policies. The IG Audit Division reviewed Ernst and Young's Service Organization Controls Type 1 (SOC 1) report dated November 7, 2014, which included tests of the S2K system change management process.

Test results showed that Providence's capitalization and useful life policy did not always comply with the AHA guide and, for four of ten assets tested, depreciation calculations were not in compliance with federal requirements. The IG Audit Division will submit an adjustment to increase the reported expense in the amount of \$6,031.43 to the Texas Medicaid and Healthcare Partnership, the Texas Medicaid fiscal intermediary.

LESSONS LEARNED

The CMS Manual states, "For assets acquired on or after January 1, 1981, only the AHA guidelines (for depreciation) may be used." Using the AHA guidelines ensures consistency in depreciation cost reporting for hospitals, which makes cost reports comparable. When cost reports are used to set Medicaid payment rates, comparable information stabilizes the payment rates set.

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INTRODUCTION

The Texas Health and Human Services Commission (HHSC) Inspector General (IG) Audit Division has conducted an audit of the fiscal year 2014 cost report for Providence Memorial Hospital (Providence). This audit report is one in a series of IG Audit Division audits of hospital cost reports. The focus of this audit is on the capitalization and moveable equipment cost centers¹ and square footage statistics reported on Providence's Medicare cost report. The cost report includes adjustments for Medicaid for fiscal year June 1, 2013, through May 31, 2014. General information technology (IT) controls were tested for compliance with Providence's internal policies. Unless otherwise described, any year referenced is Providence's fiscal year.

Objective

The objective of the audit was to determine whether amounts for selected cost centers reported on the Medicare cost report were accurate, allowable, and adequately supported, in accordance with applicable Centers for Medicare and Medicaid Services (CMS) and state requirements.

Background

The IG is responsible for enforcing state law relating to the provision of Medicaid and other Health and Human Services (HHS) programs.² As a provider of services in the Medicare program, Providence is required by federal law to report costs relating to health care services provided to Medicare beneficiaries.³ The cost reports include information such as facility characteristics (which include square footage statistics), utilization data, cost, and charges by cost center. Square footage statistics are used to allocate overhead and administrative expenses to inpatient and ancillary cost centers in the cost report. Included in the cost report are adjustments to report Medicaid costs relating to health care services provided to Medicaid beneficiaries as required by state law.⁴ Cost reports are required from providers annually,⁵ and information included in the cost reports is used by HHSC as a basis for setting certain Medicaid payment rates. HHSC has the authority to conduct desk reviews and field audits of provider cost reports in order to determine whether financial and statistical information reported in the cost reports conforms to

¹ A "cost center" is an organizational unit, generally a department or its subunit, having a common function or purpose for which direct and indirect costs are accumulated, allocated, and apportioned.

² 1 Tex. Admin. Code § 371.3(a) (May 1, 2016).

³ 42 C.F.R. § 413.20(a) and (b) (Dec. 2, 1996).

⁴ 1 Tex. Admin. Code § 355.105(b) (Nov. 25, 2012) and (Aug. 1, 2013).

⁵ 42 C.F.R. § 413.20 (b) (Dec. 2, 1996).

applicable rules and instructions, and if not, require adjustments to the cost report.⁶ The IG submits the adjusted cost report to the Texas Medicaid and Healthcare Partnership (TMHP),⁷ the Texas Medicaid fiscal intermediary, for processing. TMHP processes the adjusted cost report and sends the provider a settlement letter within six months from the date TMHP received the adjusted cost report from the IG.

Providence, now known as The Hospitals of Providence, has been a provider in El Paso, Texas since 1952. Tenet Healthcare Corporation acquired Providence on December 31, 2016. During the audit period, Providence was a 480-bed hospital providing clinical, pharmacy, oncology, physical therapy, intensive, critical, and coronary care, as well as outpatient services. Auditors reviewed the two cost centers associated with capitalized assets and moveable equipment. Total depreciation expense claimed on Providence's 2014 cost report for these cost centers was \$13.2 million, or approximately 6 percent of total Providence expenses reported.

In addition, the IG Audit Division reviewed square footage changes throughout the hospital. This review helped to determine whether square footage statistics used to allocate overhead and administrative expenses to inpatient and ancillary cost centers were accurate.

The IG Audit Division presented preliminary audit results, issues, and recommendations to Providence in a draft report dated October 16, 2017. Providence's management response is included in this report, following Recommendation 1.

⁶ 1 Tex. Admin. Code §355.106(a) (Sep. 1, 2011).

⁷ The Texas Medicaid and Healthcare Partnership (TMHP) is a group of contractors under the leadership of Accenture. Accenture administers Texas Medicaid and other state health-care programs on behalf of the Texas Health and Human Services Commission.

AUDIT RESULTS

Providence is required by federal and state requirements to follow straight line depreciation methods⁸ and maintain supporting documentation⁹ of depreciation expenses. The IG Audit Division reviewed Providence's compliance with these requirements related to physical asset verification, depreciation calculation, and square footage statistics. This report details the results in those areas, as well as the results of limited IT testing.

PHYSICAL ASSET VERIFICATION

Auditors tested a haphazard sample¹⁰ of 12 assets for physical verification from the listing of 25,833 capitalized assets included in the 2014 cost report. Auditors tested these assets to determine whether the assets existed and were (a) identifiable, (b) able to be physically located, (c) in working condition, (d) currently in use, and (e) related to the provision of patient care.

Audit results showed that the assets tested did exist and Providence was in compliance with state requirements for Medicaid costs.

DEPRECIATION CALCULATION

Auditors tested supporting documentation to determine whether depreciation expense was calculated accurately and according to Providence's policy, Texas Administrative Code (TAC), CMS regulations, and the book, *Estimated Useful Lives of Depreciable Hospital Assets* (AHA guide).¹¹

Asset Disposals

Auditors tested a haphazard sample of 12 asset disposals reported during the cost report period. Auditors tested supporting documentation to determine whether depreciation expense was calculated accurately and according to hospital policy, TAC, and CMS regulations. The disposed assets were also tested for gain or loss at disposal, and whether the gain or loss was recorded appropriately.

⁸ 1 Tex. Admin. Code §355.103(b)(10) (Sep. 1, 2011) and (Jan.1, 2015) and Centers for Medicare and Medicaid Services Provider Reimbursement Manual § 15-1.116(A) (Nov. 1972).

⁹ 1 Tex. Admin. Code §355.105(b)(2)(A) (Nov. 25, 2012) and (Aug. 1, 2013).

¹⁰ "Haphazard sampling" is a non-statistical technique used by auditors to simulate random sampling.

¹¹ *Estimated Useful Lives of Depreciable Hospital Assets* is a reference book providing health care organizations and supporting personnel with the estimated useful lives of a wide variety of commonly used depreciable assets. It is referenced in both state and federal regulations as the authority for determining depreciation schedules. American Hospital Association, *Estimated Useful Lives of Depreciable Hospital Assets* (2013).

The results of the items tested showed that Providence was in compliance with its policy and federal and state requirements for calculating and recording depreciation expenses associated with asset disposals.

Asset Additions

Providence applied its capitalization and useful life policy when preparing its cost report depreciation data. Providence's capitalization and useful life policy is appropriate for other financial reporting purposes; however, for cost reporting, Providence is required to follow the CMS Manual. The CMS Manual states, "For assets acquired on or after January 1, 1981, only the AHA guidelines may be used."¹²

Auditors tested a haphazard sample of ten assets that were purchased and capitalized during the cost report period. Four of the ten (40 percent) purchased assets were depreciated using either a more conservative or more accelerated useful life than the AHA guide dictates. As shown in Table 1, three of the four were depreciated using a useful life longer than the AHA guide dictates, and the fourth was depreciated using a useful life shorter than the AHA guide dictates for these types of assets. Using a longer useful life means less depreciation expense is recorded each year, while a more accelerated useful life means more depreciation expense is recorded each year.

Table 1: Assets Depreciated Differently than AHA Guidelines

Asset	Cost	Useful Life per Hospital Policy	Useful Life per AHA Guide	Adjusted Depreciation
Ultrasound Machine Logiq E9	\$159,603.80	7 years	5 years	(\$ 4,560.11)
HVAC for Endo Branch Rm	57,800.00	22 years, 9 months	15 years	(1,312.67)
HVAC Blower Motors & Controls	28,009.69	22 years, 4 months	15 years	(357.67)
Ventilator-Babylog	18,574.87	7 years	10 years	199.02
Total				(\$ 6,031.43)

Source: IG Audit Division and AHA Guide

Recommendation 1

Providence should follow the AHA guide as required when determining the useful lives of assets for cost reporting purposes. Providence should recalculate depreciation expense for all cost reports that have not been settled.

¹² Centers for Medicare and Medicaid Services Provider Reimbursement Manual § 15-1.104.17 (Dec. 2011).

The IG will submit to TMHP an adjustment to the cost report to increase the reported expense in the amount of \$6,031.43.

Management Response

Action Plan

Starting in the fall of 2017 the AHA Guide's depreciable lives will be utilized to depreciate the hospital's new additions. We will include this depreciation in our cost reports filings ending in 2018 and after. As for the cost reporting years that haven't been settled, we will recalculate the depreciation expense and submit amendments for those cost reporting years.

Responsible Manager

Corporate Director of Cost Reporting/Corporate Audit Reimbursement Manager

Target Implementation Date

April 2018

SQUARE FOOTAGE STATISTICS

The IG Audit Division tested all 11 changes in square footage that affected cost allocations in the cost report for the period under review. Tests included verifying that departments where changes in square footage was noted were reflected in the cost report, and that there were blueprints to support the changes.

The results of testing showed that the square footage changes were reflected in the cost report and blueprints existed to support the changes.

INFORMATION TECHNOLOGY GENERAL CONTROLS

Providence used a system called S2K to record asset capitalization and depreciation for the cost report period. The system was managed by an external, outsourced firm contracted by Tenet Healthcare. Auditors conducted tests to determine whether Providence had adequate controls in place to be compliant with internal policy related to S2K system user access and password requirements. The results indicated that for the S2K system, Providence's controls over user access and passwords were in compliance with policy.

The IG Audit Division reviewed Ernst and Young's SSAE 16¹³ Service Organization Controls Type 1 (SOC 1) report, and the independent service auditor's report incorporated into the SOC 1, dated November 7, 2014, which included tests of the S2K system change management process. A SOC 1 report is intended to evaluate controls at a service organization relevant to user entities'

¹³ Statement on Standards for Attestation Engagements.

internal controls over financial reporting. The SOC 1 auditor's opinion stated that (a) controls were suitably designed to provide reasonable assurance that control objectives would be achieved and (b) controls tested operated effectively. The SOC 1 auditor's tests and opinion were reviewed and determined acceptable to meet the relevant tests of the system change management process. No further work was conducted by the IG Audit Division related to change management.

CONCLUSION

The IG Audit Division completed an audit of the cost report for Providence. The audit included an evaluation of controls over capitalization, depreciation, and square footage statistics to determine whether Providence complied with applicable federal and state requirements. The IT general controls evaluation included assessment of user access and password requirements, and a review of Ernst and Young's SOC 1 report related to controls over IT system change management for the system Providence used to record capitalized assets and depreciation expenses. The IG Audit Division conducted a site visit at Providence during the week of June 26, 2017.

Based on the results of audit test work, the IG Audit Division determined:

- Assets tested for physical verification were accounted for.
- Disposal items tested were disposed of according to policy and had sufficient supporting documentation.
- Square footage changes had sufficient supporting documentation and changes were accurately reported.
- Providence was compliant with internal policies related to user access and passwords for the S2K system.

Audit results indicated that depreciation amounts reported in the Providence cost report were not in compliance with all CMS and state requirements for four of ten assets tested. Consequently, the IG Audit Division will recommend to TMHP a 2014 cost report adjustment of \$6,031.43. Since cost reports are for Medicare and Medicaid settlement purposes, the \$6,031.43 does not have a dollar-to-dollar impact on Medicaid funds. The net effect of the adjustment is \$85.00, which will be applied against future cost report settlement of Medicaid funds.

The IG Audit Division thanks management and staff at Providence and Tenet Healthcare for their cooperation and assistance during this audit.

Appendix A: Objective, Scope, and Methodology

Objective

The objective of the audit was to determine whether amounts for selected cost centers reported on the Medicare cost report were accurate, allowable, and adequately supported, in accordance with applicable CMS and state requirements.

Scope

The scope of the Providence audit included the Medicare cost report period from June 1, 2013, to May 31, 2014. The IG Audit Division focused on:

- Physical asset verification
- Depreciation calculation
- Square footage statistics
- IT general controls

Methodology

To accomplish its objectives, the IG Audit Division collected information for this audit through discussions and interviews with responsible management and staff at Providence and Tenet Healthcare and by reviewing the following information for the 2014 cost report:

- Capitalization and depreciation policy and procedure.
- Depreciation schedules.
- Crosswalk of general ledger accounts to cost centers 100 and 200 for capital-related costs.
- Chart of accounts.
- General ledger to the cost report reconciliation.
- Asset list depreciation expense to cost report reconciliation.
- Population of capitalized assets.
- List of employees with access to the information system used to record capitalized assets.
- Most recent physical inventory of capitalized assets.

- List of asset acquisitions within the period.
- List of asset disposals within the period.
- Square footage ledger used for the period.
- Listing of any changes to square footage that occurred during the period.
- Description of Service Organization Controls System for Tenet Healthcare Corporation.
- Ernst and Young Independent Service Auditor's Assurance Report.

The IG Audit Division issued an engagement letter on June 16, 2017, to Providence providing information about the upcoming audit, and conducted fieldwork at Providence in El Paso, Texas, from June 26, 2017, through June 29, 2017. While on site, the IG Audit Division interviewed responsible personnel, physically located and verified a sample of capitalized assets, reviewed documents relevant to depreciation calculations for a sample of asset acquisitions and disposals during the cost report period, and reviewed building blueprints that supported square footage changes during the cost report period.

Criteria

The IG Audit Division used the following criteria to evaluate the information provided:

- 42 C.F.R. 413.20(a) (Dec. 2, 1996)
- 42 C.F.R. 413.20(b) (Dec. 2, 1996)
- CMS Provider Reimbursement Manual § 15-1.104.9 (May 2000)
- CMS Provider Reimbursement Manual § 15-1.104.17 (Dec. 2011)
- CMS Provider Reimbursement Manual § 15-1.116(A) (Nov. 1972)
- CMS Provider Reimbursement Manual § 15-1.2931.1 (Sept. 1993)
- 1 Tex. Admin. Code § 355.103(b)(10) (Sept. 1, 2011) and (Jan. 1, 2015)
- 1 Tex. Admin. Code § 355.105(b) (Nov. 25, 2012) and (Aug. 1, 2013)
- 1 Tex. Admin. Code § 355.106(a) (Sep. 1, 2011)

- 1 Tex. Admin. Code § 371.3(a) (May 1, 2016).
- *Estimated Useful Lives of Depreciable Hospital Assets* (2013)
- Tenet HealthSystem Capitalization and Depreciation Policy
- Tenet HealthSystem Information Technology Policies and Procedures

Auditing Standards

The IG Audit Division conducted this audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the issues and conclusions based on our audit objectives. The IG Audit Division believes the evidence obtained provides a reasonable basis for our issues and conclusions based on our audit objectives.

Appendix B: Sampling Methodology

The IG Audit Division examined the 2014 cost report, which covered the period from June 1, 2013, through May 31, 2014. After an initial assessment of cost report risk areas, the IG Audit Division performed testing of the capitalized assets and depreciation cost centers.

Auditors selected three haphazard samples:

- Physical verification: 12 of 25,833 current assets
- Asset additions: 10 of 1,169 acquired during the report period
- Asset disposals: 12 of 118 reported as disposed of during the report period

Appendix C: Report Team and Distribution

Report Team

The IG staff members who contributed to this audit report include:

- Kacy VerColen, CPA, Audit Director
- Lisa Kanette Blomberg, CPA, CIGA, Audit Manager
- Karen Mullen, CGAP, Audit Project Manager
- Sarah Corinne Warfel, IT Staff Auditor
- Albert Alberto, CIGA, Staff Auditor
- Inette Brown, MBA, MHRM, Staff Auditor
- Mo Brantley, Senior Audit Operations Specialist

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- Karen Ray, Chief Counsel
- Karin Hill, Director of Internal Audit
- Greta Rymal, Deputy Executive Commissioner Financial Services
- Ray Wilson, Director of Rate Analysis (Acting)
- Selvadas Govind, Director of Rate Analysis for Hospitals

Providence Memorial Hospital

- Charles Handley, Chief Financial Officer, The Hospitals of Providence
- Faustino Flores, Market Director of Accounting and Finance, The Hospitals of Providence

- Robert Krejci, Senior Director of Audit Support and Appeals, Government Programs, Tenet Healthcare
- Mark Jones, Manager, Government Programs, Tenet Healthcare

Appendix D: IG Mission and Contact Information

The mission of the IG is to prevent, detect, and deter fraud, waste, and abuse through the audit, investigation, and inspection of federal and state taxpayer dollars used in the provision and delivery of health and human services in Texas. The senior leadership guiding the fulfillment of IG's mission and statutory responsibility includes:

- Sylvia Hernandez Kauffman, Principal Deputy Inspector General
- Christine Maldonado, Chief of Staff and Deputy IG for Operations
- Olga Rodriguez, Senior Advisor and Director of Policy and Publications
- Roland Luna, Deputy IG for Investigations
- David Griffith, Deputy IG for Audit
- Quinton Arnold, Deputy IG for Inspections
- Alan Scantlen, Deputy IG for Data and Technology
- Judy Hoffman-Knobloch, Interim Deputy IG for Medical Services
- Anita D'Souza, Chief Counsel

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- Mail: Texas Health and Human Services Commission
Inspector General
P.O. Box 85200
Austin, Texas 78708-5200
- Phone: 512-491-2000