STATE OF
NORTH CAROLINA

SPECIAL REVIEW

ONSLOW COUNTY
HOSPITAL AUTHORITY

JACKSONVILLE, NORTH CAROLINA

JULY 2000

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

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LETTER OF TRANSMITTAL

July 31, 2000

The Honorable James B. Hunt, Jr., Governor
Mr. James W. Hudler, Chairman
Onslow County Hospital Authority
The Honorable Anthony M. Padgett, Chairman
Onslow County Board of Commissioners
Dr. L. Edward Piper, Interim Chief Executive Officer
Onslow County Hospital Authority
Members of the North Carolina General Assembly

Ladies and Gentlemen:

Pursuant to General Statute §147-64.6(c)(16), we have completed the special review into allegations concerning Onslow County Hospital Authority. The results of the review, along with recommendations for corrective actions, are contained in this report.

General Statute §147-64.6(c)(12) requires the State Auditor to provide the Governor, the Attorney General, and other appropriate officials with written notice of apparent instances of violations of penal statutes or apparent instances of malfeasance, misfeasance, or nonfeasance by an officer or employee. In accordance with that mandate, and our standard operating practice, we are providing copies of this special review to the Governor, the Attorney General and other appropriate officials.

Respectfully submitted,

Ralph Campbell, Jr.

Ralph Campbell, Jr., CFE
State Auditor

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ORGANIZATIONAL OVERVIEW

On November 27, 1972, the Onslow County Board of Commissioners formed the Onslow County Hospital Authority (the "Authority") for the purpose of administering a not-for-profit community hospital. Onslow Memorial Hospital (the Hospital) became operational on August 14, 1974.

The Onslow County Board of Commissioners appoints the Authority's twenty-one Commissioners, who in turn employ a Chief Executive Officer (CEO) to manage the Hospital and its affiliated organizations. The CEO's managerial oversight includes the Hospital, Physician Services of Onslow County (community clinics and specialized medical practices), Onslow Ambulatory Services (an outpatient surgery center) and Onslow Health Services (a provider of home health care). Administrative support functions include Financial Services and Human Resources.

The Hospital treats more than 10,000 in-patients every year in its 133-bed acute-care facility in Jacksonville, North Carolina. The Hospital also serves over 50,000 outpatients every year in Onslow County through its network of community clinics, a surgery center, and home health services.

Onslow County Hospital Authority employs more than 700 people and has annual revenue exceeding $75 million.

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INTRODUCTION

On February 3, 2000 the Onslow County Board of Commissioners called a special meeting to address concerns regarding the Onslow County Hospital Authority. Specifically, the meeting was held to discuss the former Chief Executive Officer's (CEO) actions in hiring a Vice President for Planning at $90,000 per year, and then, prior to his assuming office, negotiating a $360,000 settlement for his resignation.

During the February 3, 2000 special meeting, the Onslow County Board of Commissioners approved a motion for the State Auditor to conduct an audit of Onslow Memorial Hospital. The State Auditor was asked to conduct an audit because of the presence of Medicaid and Medicare funding and the independence of the office. A letter to the State Auditor dated February 4, 2000 requested that his office "conduct a thorough investigation of all aspects of Onslow Memorial Hospital's financial and other records between January 1, 1997 and the present date." (Exhibit A)

The State Auditor responded to the Onslow County Board of Commissioners by letter (Exhibit B) agreeing to conduct a special review of the specific transactions which gave rise to the request. The results of the review of these specific transactions are included in Findings 1 through 4. During the course of the special review, other activities and transactions related to the conduct of the former CEO were also reviewed. The Onslow County Hospital Authority terminated the employment of the former CEO on March 29, 2000.

The following procedures were used to conduct the special review:

- Examination of Onslow Memorial Hospital records and contracts.
- Examination of Onslow County records.
- Examination of records external to either of the above organizations.
- Review of Onslow Memorial Hospital policies and procedures.
- Interviews with employees of Onslow Memorial Hospital.
- Interviews with employees of Onslow County.
- Interviews with others external to either of the above organizations.

This report presents the results of the special review conducted pursuant to G.S. §147-64.b(c)(16) rather than a financial audit. Onslow County Hospital Authority contracts with an independent accounting firm to perform its annual financial audit.

FINDINGS AND RECOMMENDATIONS

1. THE FORMER CHIEF EXECUTIVE OFFICER DEVIATED FROM STANDARD PRACTICE, VIOLATED HOSPITAL POLICIES AND BREACHED HIS FIDUCIARY DUTY IN THE HIRING AND SEPARATION OF THE VICE PRESIDENT FOR PLANNING.

During 1998, Onslow Memorial Hospital (the Hospital) conducted a nationwide search for a Vice President in charge of Marketing and Strategic Planning. In a March 1998 advertisement in *Modern Healthcare*, the Hospital clearly wanted an individual with hospital experience, particularly in the areas of managed care negotiations and hospital fund-raising. The Senior Vice President in charge of Human Resources for the Hospital stated that at least 75 resumes and applications were received in response to the advertisement, but no interviews were conducted.

In December of 1998, the President of the Onslow County Chamber of Commerce introduced a man from Texas to the Hospital's former Chief Executive Officer as a candidate for the marketing and planning position. Following a series of three interviews in the spring of 1999, the Texas man signed an employment contract on June 15, 1999 to become the Hospital's Vice President for Planning at an annual salary of $90,000 per year.

The former Chief Executive Officer drafted the employment contract signed on June 15, 1999. It was never presented to the Hospital's legal counsel for review. Likewise, the Hospital's Human Resources Department was never informed of the Texas man's employment status as Hospital Policy 102-17 requires. As a result, a background check was never conducted and there is no personnel file for the man.

The employment contract indicated that the Hospital agreed to pay up to $10,000 in moving expenses based on the lower of three estimates. Only one estimate, prepared by a local moving company, was provided as support for two “relocation expense” disbursements. The first “relocation expense” payment of $4,435.31, authorized by the former Chief Executive Officer, occurred on July 21, 1999.

The Texas man endorsed the first “relocation expense” check with his signature and the notation: “no recourse or legal liability assumed by endorsee.” The Texas man stated in an interview that he occasionally signed checks this way “as a matter of habit” from his background in real estate.

The former Chief Executive Officer authorized a second “relocation expense” check for $5,395.00 in payment of an invoice from the Texas man dated August 4, 1999, with the notation “Final Relocation Expenses inclusive of Travel, Lodging, Meals and Interview Expenses”. The Texas man stated in an interview that he only moved a limited amount of his personal possessions to North Carolina.

Internal Revenue Service (IRS) regulations state that if an employee is reimbursed for moving expenses under a non-accountable plan, (i.e., a plan that does not require supporting documentation such as receipts) the payments must be included in income and reported on IRS Form W-2. A W-2 was not issued to the Texas man. IRS Form 1099 was issued to the Texas man for 1999, but it did not include the moving expense “reimbursements.”

The former Chairman of the Onslow County Hospital Authority (the former Chairman) stated in an interview with us, that in June or July of 1999, he became aware that the Vice President for Planning position had been offered to a man from Texas. He also stated that he asked the former Chief Executive Officer if it was "too late to stop it." In contrast to the former Chairman's recollection of events, the former Chief Executive Officer asserted that he was directed by the former Chairman to rescind or terminate the offer of employment to the Texas man.

On August 10, 1999, the former Chief Executive Officer entered into an agreement with the Texas man to pay $360,000 in return for his resignation from the Hospital position of Senior Vice President for Planning. In an interview with us, the former Chief Executive Officer stated that he entered into this agreement primarily to avoid potential litigation over the withdrawal of the employment contract. The amount of the settlement allegedly represented two years of compensation combined with a variety of fringe benefits. The agreement specified that payments would be made in the amount of $20,000 per month over a period of 18 months. From August 16, 1999 to January 4, 2000, a series of wire transfers and checks to the Texas man totaled $120,000. Upon the Hospital Authority's discovery of the settlement agreement in February 2000, the payments were suspended.

There are a number of inconsistencies with respect to the Hospital's severance policy, the severance clause in the employment contract and the amount of the settlement agreement. Specifically, the Hospital's severance policy provides administrative officers and department heads with 20 working days severance pay. Under this formula, an annual salary of $90,000 equates to $6,923. The employment contract drafted by the former Chief Executive Officer provided six months of severance pay or $45,000. The settlement agreement provided for $360,000 in return for voluntary resignation.

Individuals in a position of trust or fiduciary relationship, such as officers, directors, and other high-level employees of an organization owe certain duties to their employers. These fiduciary duties include loyalty and due care. The former Chief Executive Officer acted without the advice of legal counsel in negotiating a settlement agreement that was $315,000 greater than the severance amount stated in the original employment contract. Moreover, the Hospital Authority was never advised of the settlement agreement or the payments to the Texas man. The former Chief Executive Officer's conduct represents a breach of fiduciary duty.

RECOMMENDATION

The Hospital Authority should investigate legal remedies in response to the former Chief Executive Officer's conduct, including the recovery of all related funds.

2. THE FORMER CHIEF EXECUTIVE OFFICER RECOMMENDED THE ACQUISTION OF AN ADMINISTRATIVE OFFICE BUILDING WITHOUT HAVING THE BUILDING APPRAISED.

In 1997, the need for additional administrative office space became apparent to Hospital management. To meet this need, the Hospital acquired a property near its primary facility as a potential site for an office building and rehabilitation center. A local land surveyor and developer surveyed the property for the Hospital.

In another section of Jacksonville, a few miles from the Hospital, the local surveyor and developer surveyed a commercial complex known as the New River Shopping Center for a Raleigh, NC real estate investor. This survey was performed in association with the investor's acquisition of the shopping center.

During the same period of time in 1997, the Onslow County Board of Commissioners completed an extensive effort to consider the viability of acquiring and renovating an old bank building in the New River Shopping Center to use as administrative offices. The Onslow County Board of Commissioners concluded it was not cost effective for the county to acquire and renovate the building primarily because of its condition. An architectural firm engaged by Onslow County estimated the building and land acquisition cost at $350,000 before renovations could even begin. The same firm's preliminary estimate of repairs and renovation for the building exceeded $1,000,000.

The following series of transactions is presented to illustrate the old bank building's progression of ownership in 1997 and the price the Hospital ultimately paid for the building.

- ♦ On August 12, 1997, the local surveyor acquired an option to purchase a parcel of the New River Shopping Center where the old bank building is located.
- ♦ On September 8, 1997 PF Properties, LLC, a Raleigh, NC real estate holding company, sold the old bank building property to the spouse of the Raleigh real estate investor for $320,000.
- ♦ On November 10, 1997, the surveyor and the Hospital Authority signed an Agreement of Purchase and Sale in which the local surveyor agreed to sell the old bank building to the Hospital Authority for $544,000.
- ♦ On December 1, 1997, the Raleigh real estate investor's spouse sold the old bank building to Carbone Investments, Inc., a corporation established by the local surveyor through his attorney, for $350,000.
- ♦ On December 19, 1997, Carbone Investments, Inc., transferred the old bank building back to the surveyor for $500,000.
- ♦ On December 19, 1997, the surveyor sold the old bank building to the Hospital Authority for $544,000.

In effect, the surveyor acquired the old bank building (through his corporation) for $350,000 and sold it to the Hospital in less than 20 days for $544,000, an increase of $194,000.

There is no evidence that the former Chief Executive Officer obtained an independent appraisal of the old bank building before recommending its acquisition. In addition, the Hospital's Plant Manager stated the former Chief Executive Officer instructed him in mid-September 1997, to provide a cost analysis for the renovation of the old bank building within seven to ten days. The Plant Manager provided an estimate of the cost to renovate the building but cautioned that the true cost could run 50 to 100 percent higher. Moreover, the Plant Manager stated that an accurate survey performed by an architectural firm would require six to eight weeks.

RECOMMENDATION

In meeting the future infrastructure needs of the Hospital, independent appraisals should be obtained for all potential property acquisitions.

3. THE FORMER CHIEF EXECUTIVE OFFICER ACQUIRED REAL PROPERTY WITHOUT AUTHORIZATION FROM THE HOSPITAL AUTHORITY.

A board member of the Onslow Health Foundation & Charitable Trust (the board member) is a general partner in a North Carolina general partnership entitled Perimeter Properties. During an October 1999 board meeting of the Onslow Health Foundation & Charitable Trust, the board member broached the subject of donating a 23.5-acre parcel of land from Perimeter Properties to the Foundation. The land was appraised for $822,000 in May 1999.

In connection with the development of the Jacksonville, North Carolina area near the 23.5-acre parcel of land, a road known as Williamsburg Parkway was under construction. Perimeter Properties was responsible for the completion of Williamsburg Parkway and obtained a proposal to complete the construction for $72,172.

In November of 1999, the board member modified his donation proposal. The modification required the Hospital to purchase a 2 acre subdivided parcel from the 23.5-acre tract from Perimeter Properties for $72,000.

At the November 22, 1999 meeting of the Onslow County Hospital Authority, the land donation from Perimeter Properties was discussed at length. The board minutes from the meeting indicate there was significant opposition to the proposal of purchasing the 2-acre tract for $72,000 as a condition of the donation. Some authority members expressed concern about acquiring a property, even through donation, that the Hospital did not need. Other authority members expressed concern about being associated with a transaction that provided a $750,000 income tax deduction for Perimeter Properties. The former Chief Executive Officer stated that neither the Hospital nor the Foundation could accept the property if it was contingent on acquiring the 2-acre tract for $72,000. The Hospital Authority's general counsel advised them to obtain an environmental assessment of the property before proceeding.

After considerable deliberation, the Hospital Authority voted in favor of a motion to explore any property tax consequences associated with the properties and address any environmental concerns. The motion included a provision that the Authority not be liable for constructing a road for Perimeter Properties by acquiring the 2-acre tract of land for $72,000.

Despite advice from legal counsel to obtain an environmental assessment and the Hospital Authority's position on the 2-acre tract of property, the former Chief Executive Officer signed an agreement on December 22, 1999 to purchase the 2-acre tract of land from Perimeter Properties for $72,000. A local attorney signed the purchase agreement on behalf of Perimeter Properties. On December 28, 1999, at the direction of the former Chief Executive Officer, the Chief Fiscal Officer had two checks drawn to an attorney in trust to settle the land acquisition. The checks included $3,296.50 in settlement charges. The first check for $37,648.25 was drawn on an Onslow Memorial Hospital bank account. The second check for $37,648.25 was drawn on an Onslow Health Foundation bank account.

The former Chief Executive Officer stated in an interview that the opportunity to obtain the larger tract of land through donation justified the acquisition of the 2-acre tract. Yet, the fact remains, the former Chief Executive Officer disregarded direction from the Hospital Authority to refrain from acquiring the 2-acre parcel of land as a condition of the donation from Perimeter Properties.

RECOMMENDATION

The Hospital Authority should amend its operating policies and procedures such that real property transactions require the Authority's explicit, and possibly written authorization. If a Hospital employee acts without this explicit authorization, the Authority should investigate legal remedies to invalidate applicable transactions.

4. AN OVERPAYMENT ASSOCIATED WITH THE ACQUISITION OF A SURGERY CENTER EFFECTIVELY BECAME A LOAN TO AN ONSLOW COUNTY PHYSICIAN.

At its May 27, 1998 meeting, the Onslow County Hospital Authority approved a financing proposal to purchase an outpatient surgery center adjacent to the Hospital from a local physician. According to Hospital Administrators, the acquisition of the local physician's surgery center improved the Hospital's position in a lucrative outpatient surgery market in Onslow County. The Hospital had created its own outpatient surgery center within its primary facility, but it was apparently not competitive with the local physician's surgery center.

The surgery center was acquired for $9,961,107 through the issuance of $8,500,000 in bonds and $1,461,107 in cash. In conducting its audit of the Onslow County Hospital Authority financial statements for the year ended September 30, 1998, an independent accounting firm identified an additional $575,000 paid to the local physician as "advances" toward the purchase. The accounting firm allocated the grand total of $10,536,107 to seven asset categories including Land, Buildings, Equipment, Licenses, Certificate of Need, Covenants not to Compete, and Goodwill.

The accounting firm assigned a value to each asset category presumably based on documentation available to them during the financial statement audit. The allocation of the $10,536,107 purchase price included an assignment of $2,990,000 to "Goodwill". Goodwill is an accounting term that is generally associated with the future earnings potential of a business operation. It generally represents the difference between the purchase price of an organization and the book value of the acquired assets. Thus, the Hospital Authority paid the local physician a substantial amount of money to acquire the potential future earnings of the surgery center. Ultimately, only the future profitability of the Hospital's surgery center can justify the amount paid for "goodwill."

As noted above, the accounting firm identified $575,000 in advances paid toward the purchase of the surgery center. The accounting firm subsequently discovered that the local physician was overpaid $361,500. To rectify the "overpayment", the physician signed a promissory note for $361,500 dated June 1, 1999. The physician agreed to pay off the note in two installments of $180,750. A payment of $180,000 was made on June 1, 1999. The second payment on the note was due on August 31, 1999. A payment in the amount of $90,000 was made on November 8, 1999. On that date, the former Chief Executive Officer modified the original note to allow for a final payment of $90,000 plus accrued interest without consulting legal counsel. As of March 2000, the final payment on the note had not been made and the balance due to the Hospital was $99,646.

RECOMMENDATION

We originally recommended that the Hospital Authority take appropriate action to pursue collection of the unpaid principal and accrued interest associated with the promissory note from the local physician. On July 17, 2000, the Hospital Authority received a check from a law firm on behalf of the local physician for $100,616.07.

5. THE FORMER CHIEF EXECUTIVE OFFICER DID NOT SUBSTANTIATE THE BUSINESS PURPOSE OF EXPENSES CHARGED TO CREDIT CARDS.

The Hospital issued five credit cards to three senior level employees to pay for expenses incurred in the performance of their duties. Three of the five credit cards were issued to the former Chief Executive Officer. The other two credit cards were issued to the Chief Fiscal Officer and the current Chief Operating Officer. We reviewed and classified charges to all five credit cards from September 1998 to January 2000. The following table summarizes the results of our analysis:

Total credit card charges for the period	$ 28,308.74
Credit card charges supported by receipts	3,905.65
Credit card charges incurred on weekends	7,830.21
Credit card charges incurred outside Jacksonville, NC	13,789.46

As illustrated in the summary, more than 25% of the credit card charges occurred on weekends and more than 85% of the charges were unsupported by receipts to substantiate the business purpose of the charges.

A majority of the charges were incurred at hotels and restaurants. Charges at gift stores, a spa and other retail establishments were also incurred. The former Chief Executive Officer acknowledged that he used Hospital credit cards for personal expenses occasionally.

There is no evidence that the former Chief Executive Officer prepared expense reports for travel expenses as required by Hospital Policy 102-82. Credit card statements were submitted directly to the accounting department and approved for payment by the Chief Fiscal Officer.

Without expense reports, receipts, or other evidence, we could not determine if the former Chief Executive Officer used the Hospital credit cards for business or personal expenses. For example, there are numerous weekend charges at a restaurant on North Topsail Island adjacent to the St. Regis Resort. There is no evidence to substantiate the business purpose of these weekend charges. The business purpose was substantiated for the credit card charges of the Chief Fiscal Officer and the current Chief Operating Officer.

The Hospital's interim Chief Executive Officer suspended the use of corporate credit cards in February 2000.

RECOMMEDATION

A greater degree of management control can be achieved through reimbursement of business related travel expenses rather than unrestricted use of corporate credit cards. Management should continue its moratorium on corporate credit cards and ensure that expense reports are completed for all business expenses incurred by employees. In addition, management should pursue recovery of all expenses charged to corporate credit cards for which the business purpose is unsubstantiated.

6. INVOICES FROM AN INDEPENDENT CONTRACTOR FOR PHYSICIAN SERVICES WERE NOT VERIFIED AGAINST CONTRACTUAL AGREEMENTS AND HOSPITAL RECORDS BEFORE PAYMENT.

Over the past several years, the Hospital contracted with an individual from Wilmington, NC to provide physician services primarily in the areas of radiology and anesthesiology. These physician services were provided to the Hospital under the names of JK Consulting and Southeast Healthcare Systems, Inc.

The Hospital's contractual agreement with JK Consulting included the following compensation schedule:

- ♦ A physician search fee of $20,000.00 per physician,
- ♦ A "consulting fee" of $80,000.00 payable monthly at the rate of $6,666.66,
- ♦ Reimbursement for all interview and advertising expenses related to physician recruitment, and
- ♦ An additional consulting fee based on an hourly rate of $65.00 per hour.

The Hospital's contractual agreement with Southeast Healthcare Systems, Inc. included the following compensation schedule:

- ♦ $65 per hour for coordinating the activities and schedules of all physician departments as assigned by the Hospital,
- ♦ $80 per hour as a base fee for physician services provided to the Hospital, and
- ♦ $80 per hour for physician night call; $80 per hour for physician weekend call.

In 1999, the Hospital paid JK Consulting $241,198.80 and Southeast Healthcare Systems, Inc. $740,154.42. The following schedule represents a classification of these payments.

	JK CONSULTING	SOUTHEAST HEALTHCARE SYSTEMS, INC.	TOTALS
Anesthesia Services	$ 45,140.00	$ 41,000.00	$ 86,140.00
Radiology Services	25,285.00	659,429.90	684,714.90
Placement Fees	100,000.00		100,000.00
Physicians' Airfare	3,969.00	396.00	4,365.00
Malpractice Insurance		3,677.00	3,677.00
Classified Ads	3,870.00		3,870.00
Contract Services	8,976.00		8,976.00
Consulting Services	52,700.00	24,115.00	76,815.00
Travel and Meals	407.83	10,693.74	11,101.57
Phone Charges	850.97	842.78	1,693.75
Totals	$ 241,198.80	$ 740,154.42	$ 981,353.22

The terms of the Southeast Healthcare Systems, Inc. contract specified hourly rates of pay for physician and scheduling services. However, the invoiced amounts were computed from daily service rates. The daily rates appeared to be a combination of hourly physician rates and a margin for "scheduling" and "providing" the physicians. There is no evidence that an attempt was made to reconcile the daily "combination rates" with the rates in the contractual agreements. Moreover, the Hospital did not maintain records of physician attendance, consequently, the dates listed on the invoices could not be verified. As a result, payments were made for physician and scheduling services without any substantiation of the invoiced amounts. The former Chief Executive Officer authorized all payments to JK Consulting and Southeast Healthcare Systems, Inc.

As previously noted, the daily billing rates of JK Consulting and Southeast Healthcare Systems, Inc. appeared to include a margin for "scheduling" and "providing" physicians. Yet, many invoices included a separate billing for physician scheduling identified as "consulting" services. We could not associate the amounts billed for "consulting services" with a specific project or additional work product provided to the Hospital.

As of February 2000, Hospital personnel implemented a procedure to verify the attendance of physicians provided through Southeast Healthcare Systems, Inc. Hospital management stated that all invoices from Southeast Healthcare Systems, Inc. are now verified against physician records in advance of payment authorization.

RECOMMENDATION

Authorization for payment of physician service invoices should include comparison against contractual agreements as well as confirmation of time worked. Consulting service agreements should be specific enough to facilitate a comparison of periodic billings to a promised service. The authority to approve payments for consulting services should be restricted to personnel who can confirm that services were provided.

7. CONDOMINDIUMS LEASED ON NORTH TOPSAIL ISLAND WERE AN IMPRUDENT USE OF HOSPITAL RESOURCES.

During the past several years, the Hospital leased a variety of real estate to provide housing for personnel employed on a temporary basis. Radiologists, anesthesiologists, certified nurse anesthetists and consultants were among the temporary personnel for whom housing was provided.

The Hospital leased six residential properties in Jacksonville, NC. Four of the properties were in the Bluff Ridge Apartment complex very close to the Hospital. The other two properties were single-family homes in neighborhoods relatively close to the Hospital. The cumulative monthly rent for these properties was $3,550. In addition to monthly rent, the Hospital incurred expenses for utilities, cleaning, repairs and maintenance, and occasional replacement of home furnishings.

The Hospital also leased residential properties on North Topsail Island, NC. For most of the past year, the Hospital leased 3 condominium units at the St. Regis Resort on North Topsail Island. The cumulative monthly rent for these properties was $2,450. As with the properties in Jacksonville, the Hospital also incurred expenses for utilities, cleaning, maintenance and home furnishings for these units.

Hospital management did not maintain comprehensive records of occupancy related to any of the leased properties. In response to our request for records of occupancy specifically for the St. Regis Resort properties, the Hospital's Director of Hotel Services and Community Relations (the Director) provided two documents from consultants who occupied the properties during 1999. One consultant stated that he occupied unit number 2308 in the St. Regis Resort for 36 days in 1999. The other consultant stated that he stayed at the St. Regis Resort for 12 days during the months of January and September 1999 but could not confirm the unit numbers at the complex. These statements from consultants represent the only documented evidence of occupancy for the St. Regis Resort properties.

The Director's administrative assistant stated that temporary physicians and nurses also occupied the units at the St. Regis Resort despite its barrier island location and the forty-minute drive to the Hospital. Again, without records of occupancy, the frequency and duration of use cannot be substantiated for the units.

The Director's administrative assistant also stated that the St. Regis Resort units were occasionally occupied without her knowledge, and the former Chief Executive Officer maintained exclusive possession of the key to unit number 1506.

In a management letter from the Hospital's accounting firm for the year ended September 30, 1998, a recommendation was made to enhance the monitoring of all lease activities associated with Hospital operations. The management response to this recommendation stated that a "master list of all leases has been developed to properly monitor all lease activity."

The Hospital's Chief Fiscal Officer stated that he had no knowledge of the existence of leased properties at the St. Regis Resort.

The Hospital's interim Chief Executive Officer terminated the St. Regis Resort leases in February 2000.

RECOMMENDATION

> Management should thoroughly analyze the costs and benefits associated with future lease agreements. In addition to lease rates, other expenses such as utilities, repairs, maintenance and home furnishings should be

considered as well as projected utilization. Occupancy records should be maintained to facilitate the comparison of apartment leases to other housing alternatives such as extended-stay hotels. The Hospital should refrain from leasing residential resort properties because of the inherent potential for abuse.

8. THE MONETARY VALUE ASSOCIATED WITH THE PERSONAL USE OF A VEHICLE WAS EXCLUDED FROM THE FORMER CHIEF EXECUTIVE OFFICER'S ANNUAL WAGE AND TAX STATEMENT.

The former Chief Executive Officer's employment contract included an automobile allowance for business and personal use. To meet this contact provision, the Hospital leased a 1998 Buick Park Avenue for the former Chief Executive Officer at a monthly cost of $719.59. The lease payments for this vehicle totaled $8,635.08 per year. Additional operating costs for the vehicle included insurance, fuel, and maintenance.

Federal tax law provides that the value of an employee's personal use of an employer's vehicle must be determined by the employer and included in the employee's annual income. The former Chief Executive Officer did not submit records of the business and personal use of the leased vehicle to the Hospital's accounting department. As a result, the value of the personal use of the vehicle was excluded from the former Chief Executive Officer's annual wage and tax statement filed with the Internal Revenue Service (IRS).

The Hospital's interim Chief Executive Officer cancelled the automobile lease in February 2000.

RECOMMENDATION

Management should implement procedures to ensure compliance with IRS regulations associated with the personal use of employer provided vehicles.

9. THE FORMER CHIEF EXECUTIVE OFFICER AUTHORIZED THE LOCATION OF STORAGE BUILDINGS AT AN EMPLOYEE'S RESIDENCE.

On February 17, 1999, the Hospital purchased a 10 x 20 storage building for $2,597.00 to store various types of Hospital property. The building was placed on the private property of the Director of Hotel Services and Community Relations (the Director).

On February 23, 1999, another storage building was purchased by the Hospital. This building measured 12 X 16, cost $3,174.70, and was also placed on the private property of the Director.

We conducted a physical inventory of the two buildings on March 15, 2000. The buildings' contents included two bedroom suits, three sofas, three television sets, a stereo system, several pieces of wicker furniture, an exhibition tent, golf balls, a kitchen table and four chairs. According to an assistant to the Director, most of these items had probably been used in one or more of the Hospital's leased residential properties.

The location of these storage buildings at the residence of a Hospital employee did not violate an explicit Hospital policy. Nonetheless, locating the storage buildings at an employee's residence evoked a perception of misconduct from other Hospital employees. Moreover, the Director's contention that the buildings were located at her residence for a logistical purpose directly contradicted statements from other Hospital employees. That is, the Director's residence was actually "out of the way" with respect to Hospital clinics and leased residential properties in Jacksonville and outlying areas of Onslow County.

RECOMMENDATION

Management should evaluate the need for retaining the storage buildings. The buildings should be relocated to the Hospital's property if their continued use and ownership is justified. Otherwise, the buildings should be sold with the proceeds applied to an appropriate Hospital need.

10. HOSPITAL AUTHORITY COMMISSIONERS MAY BE IN VIOLATION OF CONFLICT OF INTEREST BYLAWS AND GENERAL STATUTE 131E-21.

The Hospital Authority's Bylaws include a section entitled Conflict of Interest. Specifically, Article IV, Section VI states that Commissioners are prohibited from entering into any contract with the Hospital if they will personally benefit from such contract or become interested in any profits therefrom. However, another part of the same section of the Bylaws implies that Commissioners are permitted to have a financial interest in an organization that conducts business with the Hospital provided they do not vote on relevant contracts or transactions and transactions are approved by a majority of disinterested Commissioners.

A Commissioner of the Onslow County Hospital Authority is the principal owner of a business that provides travel services to the Hospital. During the fiscal year ended September 30, 1999, the Commissioner's business received $32,857.92 in payment for travel services. The Commissioner signed a standard conflict of interest statement for that fiscal year stating: *I am not aware of any transaction, existing or contemplated which would constitute a conflict of interest by virtue of my serving as a commissioner on the Onslow County Hospital Authority.*

Another Hospital Authority Commissioner is the principal owner of a business that provides temporary personnel to the Hospital. During the fiscal year ended September 30, 1999, this Commissioner's business received $297,867.32 in payment for temporary personnel. There is no standard conflict of interest statement on file for this Commissioner.

The transactions between the Hospital and two of its Commissioners appear to require at least the approval of the other Commissioners. Additionally, these transactions appear to violate General Statute 131E-21 which states:

> No commissioner or employee of the hospital authority shall: Have any interest, direct or indirect in any contract or proposed contract for materials or services to be furnished or used in connection with any hospital facility, except an employment contract for an employee.

RECOMMENDATION

The Hospital Authority should comply with General Statute 131E-21 and consult with legal counsel as to bylaw agreement with the Statute. In addition, we recommend all Hospital Authority Commissioners disclose any business relationships with the Hospital Authority that represent a violation of the Statute. If violations are identified, then Hospital Authority Commissioners should take appropriate action.

11. THE FORMER CHIEF EXECUTIVE OFFICER AUTHORIZED THE ACQUISITION OF RADIOLOGY EQUIPMENT THAT NEVER BECAME OPERATIONAL.

On March 23, 1994, the former Chief Executive Officer initiated and authorized the purchase of a mammography unit from a local physician for $44,000. The Hospital's property records show the unit was "placed in service" on March 31, 1994. However, the Hospital's Administrative Director of Radiology stated the unit was never actually "placed in service". In fact, the Radiology Director stated that she had enough problems to deal with and didn't need another one by trying to use an obsolete x-ray machine.

Another Hospital Administrator corroborated the Radiology Director's assessment of the condition and utility of the mammography unit. The Administrator stated that the unit would have required extensive repairs and expensive upgrades to make it usable.

The unit was placed in storage on April 14, 1994, three weeks after it was acquired from the local physician. A note left in the Director's property records emphasized that the mammography unit was placed in storage within three weeks of its acquisition.

In January of 1998, after nearly four years of storage, the x-ray tube was removed from the unit and sent to a company in Illinois for disposal. The rest of the unit was dismantled and discarded.

In effect, the Hospital paid $44,000 for a mammography unit that never benefited the Hospital or its patients.

RECOMMENDATION

Equipment purchases for the Hospital should be a function of clinical and operational necessity. Equipment purchases should be initiated at the department level, preferably in coordination with a separate purchasing department, in advance of approval at an executive level. Additionally, any proposed purchases of used equipment should be thoroughly evaluated to avoid the acquisition of obsolete or outdated equipment.

Statement of Financial Impact

The following schedule represents a quantification of the items examined during the special review. We cannot completely quantify the tangible benefits or detriment, if any, to the public resulting from the findings of the review. We are simply noting areas where the system of internal controls was either circumvented or should be enhanced, or where, in our judgment, questionable activities or practices occurred.

1.	The former Chief Executive Officer deviated from standard practice, violated Hospital policies and breached his fiduciary duty in the hiring and separation of the Vice President for Planning.	$ 120,000.00
2.	The former Chief Executive Officer authorized the payment of relocation expenses without appropriate documentation.	9,830.31
3.	The former Chief Executive Officer recommended the acquisition of an administrative office building without having the building appraised.	194,000.00
4.	The former Chief Executive Officer acquired real property without authorization from the Hospital Authority.	75,296.50
5.	An overpayment associated with the acquisition of a surgery center effectively became a loan to an Onslow County physician.	99,646.00
6.	The former Chief Executive Officer did not substantiate the business purpose of expenses charged to credit cards. (Note 1)	24,403.09
7.	Invoices from an independent contractor for physician services were not verified against contractual agreements and Hospital records before payment. (Note 2)	76,815.00
8.	Condominiums leased on North Topsail Island were an imprudent use of Hospital resources. (Note 3)	29,400.00
9.	The former Chief Executive Officer authorized the location of storage buildings at an employee's residence. (Note 4)	5,771.70
10.	The former Chief Executive Officer authorized the acquisition of radiology equipment that never became operational.	44,000.00
		$ 679,162.60

Note 1: Total credit card charges less credit card charges supported by receipts ($28,308.74 - $3,905.65).
Note 2: Consulting service fees that were not associated with a specific project or work product.
Note 3: Annual cost of leasing three condominiums on North Topsail Island ($2,450.00 x 12 months).
Note 4: Total cost of storage buildings ($2,597.00 + $3,174.70).

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118 Old Bridge Street
Jacksonville, NC 28540
Telephone (910) 347-4717
Fax (910) 455-7878

Exhibit A

COUNTY OF ONSLOW

February 4, 2000

The Honorable Ralph Campbell, Jr.
State Auditor
Suite 201, Legislative Office Building
300 N. Salisbury Street
Raleigh, NC 27603-5903

Dear Secretary Campbell:

In a special meeting yesterday afternoon, The Onslow County Board of Commissioners approved a motion to request an independent audit of the Onslow Memorial Hospital by your office. The approved motion was in three parts:

1) That the Onslow County Board of Commissioners submit a formal request to Mr. Ralph Campbell, Jr., State Auditor for the State of North Carolina requesting that he send a team from his office to conduct an audit of Onslow Memorial Hospital.

2) That Mr. Doug Kramer be restricted from the building and grounds of Onslow Memorial Hospital from this point in time until the completion and receipt of the final response from the Sate Auditor's Office.

3) All records presently in possession of Onslow Memorial Hospital be immediately secured in their present location until the audit is complete.

The Board respectfully requests that your office conduct a thorough investigation of all aspects of Onslow Memorial Hospital's financial and other records between January 1, 1997 and the present date. The citizens of Onslow County would ask that your office perform this comprehensive audit at your earliest possible opportunity.

Please feel free to contact me if you have any questions regarding this matter. Thank you for your consideration of this very important request

Sincerely,

Anthony M. Padgett
Chairman

CC: The Honorable Board of County Commissioners
The Onslow County Hospital Authority Board

Onslow County Request for Audit
02/04/00
Page 2 of 2

118 Old Bridge Street ♦ Jacksonville, North Carolina 28540-4259 ♦ Telephone: (910) 347-4717 ♦ Fax: (910) 455-7878

STATE OF NORTH CAROLINA
Office of the State Auditor

Exhibit B

RALPH CAMPBELL, JR.
STATE AUDITOR

300 N. SALISBURY STREET
RALEIGH, N.C. 27603-5903
TELEPHONE: (919) 733-3216
FAX: (919) 733-8443

February 11, 2000

The Honorable Anthony M. Padgett, Chairman
Onslow County Commissioners
116 Old Bridge Street
Jacksonville NC 28540

Dear Commissioner Padgett:

We have received the request made by you on behalf of the Onslow County Board of Commissioners to audit Onslow Memorial Hospital.

We have carefully reviewed the request submitted by the County Commissioners. In response to that request, we will conduct a special review of Onslow Memorial Hospital. This special review will encompass the separation agreement and other transactions which gave rise to the request.

Please note that if we find evidence of apparent violations of criminal statutes we are required by North Carolina General Statute 147-64.6(c)(12) to report that to the Governor, the Attorney General, and other appropriate officials.

I have instructed our audit team to make immediate arrangements to institute this review. I want to thank you in advance for your cooperation, that of the Board of County Commissioners and the Hospital Authority Board, in assuring that the auditors have ready access to personnel and records needed to complete their work. In addition, it is my understanding that arrangements have already been made to provide them with suitable working space. This spirit of cooperation will expedite our efforts.

Please do not hesitate to contact this office if you have any questions.

Sincerely,

Ralph Campbell, Jr.

Ralph Campbell, Jr.
State Auditor

cc: Onslow County Board of County Commissioners
Mr. Ron Lewis, County Manager, Onslow County
The Onslow County Hospital Authority Board

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Auditor's Note
Onslow County Hospital Authority's Response to Special Review

The Office of the State Auditor has carefully reviewed the response to the findings and recommendations, which is included in its entirety. We have paid particular attention to those areas where the response contains assertions or conclusions contrary to the findings and recommendations or where it questions why certain areas were addressed in detail in the report. We addressed certain transactions in detail in recognition that the acute interest surrounding these matters required full disclosure of the circumstances. Based on our reexamination of the special review, the Office of the State Auditor stands behind the findings and recommendations in this report.

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RESPONSE OF ONSLOW COUNTY HOSPITAL AUTHORITY

TO

SPECIAL REVIEW OF STATE AUDITOR

Preface to Response

This response has been collectively prepared under the direction of the Governing Body of Onslow County Hospital Authority and the current administrative staff. It represents facts and circumstances surrounding the matters raised in the State Auditor's Special Review ("Special Review") of this organization. As will be explained, some of the matters and events leading up to them were unknown to us. Others were, and continue to be, public information available to all of the citizens of Onslow County. There is not now, never has been, and never will be a policy of withholding otherwise public information from those who own and rely on this institution for their medical care --- the citizens of Onslow County!

Comment on Organizational Overview

In Special Review

As stated in the Special Review, in 1972 the elected Commissioners of Onslow County, after months of study, concluded that a Hospital Authority was the best method available under North Carolina law to operate an acute care medical facility in the Onslow County community. Brief references to their resolutions adopted at that time gives some insight into their collective thought process:

> "WHEREAS, the Onslow County Board of County Commissioners has made such investigation as it deems necessary which investigation has continued during the immediately proceeding five (5) months; and

WHEREAS, from such investigation into the adequacy of hospital facilities and medical accommodations from the operations of private enterprises in Onslow County and the surrounding area as defined in North Carolina General Statutes Chapter 131, Article 12, and into the public health and welfare of inhabitants of Onslow County and said surrounding areas and has concluded that the same require the maintenance and operation of public hospital facilities for the inhabitants of Onslow County and said surrounding area;

NOW, THEREFORE, be it RESOLVED:

That the Board of County Commissioners of Onslow County pursuant to North Carolina General Statutes Chapter 131, Article 12, does hereby find and determine:

(1) That there is a lack of adequate hospital facilities and medical accommodations from the operations of private enterprises in Onslow County and said surrounding area as defined in said Article; and

(2) That the public health and welfare, including the health and welfare of persons of low income in Onslow County and said surrounding area, require the maintenance and operation of public hospital facilities for the inhabitants thereof." **(Resolution of Onslow County Board of Commissioners, November 20, 1972.)**

The County Commissioners also made a determination at their meeting of November 20, 1972 "that the population of Onslow County is constantly growing and we are now on the threshold of new medical facilities for the county and are in need of setting up a group to push forward for new doctors, new nurses, and new medically related activities, and we feel that the best way of doing this is to set up a hospital authority in Onslow County…".

Following this resolution and the accompanying findings made by the County Commissioners, the current Onslow County Hospital Authority was established and continues to this day.

The Special Review also refers to "affiliated organizations". We think it is important, not only to know what those "organizations" are, but the reason for their existence. Each of the affiliated organizations is a non-profit corporation formed by the Hospital Authority under the laws of the State of North Carolina. As required by North Carolina law, each is governed by a Board of Directors whose members are also members of the Governing Body of the Hospital Authority. Each organization is a public body and is subject to the same public oversight as the parent Authority. For example, each is subject to the North Carolina Open Meetings Law and the Public Records Law, as well as a multitude of State and Federal laws and regulations specific to public bodies who render healthcare services and are regulated by the laws of the State of North Carolina and the United States.

Just prior to the establishment of the Authority, in 1965 the United States Congress enacted the Medicare Program to provide a nationwide, federally funded health insurance program for the elderly. Most hospitals in this country, as well as other types of providers, participate in the Medicare and Medicaid Programs. Medicare payments are a significant source of revenue and failure to comply with program requirements can result in a limitation or a termination of payments.

Accreditation is another type of healthcare approval obtained by hospitals. Accreditation may satisfy the requirements for participation in the Medicare and Medicaid reimbursement programs. This is often referred to as "deemed status" because the entity is "deemed" to have met all of the applicable requirements by virtue of its accreditation. Thus, accreditation may strongly contribute to the viability of a hospital.

Accreditation is performed by a non-governmental organization and is generally voluntary. The Joint Commission on Accreditation of Healthcare Organizations ("JCAHO") has become the foremost accrediting body for hospitals. Composed of representatives of various healthcare providers and physicians, it evaluates the quality of care provided in hospitals, nursing homes, and other healthcare facilities. Onslow Memorial Hospital is accredited by JCAHO. However, due to the non-acute care functions of some of the outreach community clinics, it is not necessary that they all be accredited by JCAHO. However, if the functions that they perform in the outlying locations such as Sneads Ferry, Richlands and Swansboro were **functionally** integrated with Onslow

Memorial Hospital, JCAHO would require these outlying clinics to be surveyed in the accrediting process. Thus, if they were **functionally** integrated with Onslow Memorial Hospital, the expense of achieving JCAHO accreditation in these outlying rural areas would be prohibitive and the 50,000 outpatients seen every year mentioned in the Special Review would have to be seen either in the main acute care facility in Jacksonville or obtain their healthcare out of county.

It is for the reasons stated above, i.e., to avoid **functional** integration with Onslow Memorial Hospital, that the outlying clinics are operated by the affiliated organizations. This method of organization and operation in no way reflects upon the quality of medical care rendered in the community clinics. The physical facilities in which they are located just do not reflect the rigorous standards of the JCAHO accredited acute care inpatient facility operated by Onslow Memorial Hospital as the operating entity of the Authority. The clinics have quality oversight by other licensing and accrediting organizations. For example, SurgiCare of Jacksonville is accredited by the Accreditation Association for Ambulatory Healthcare ("AAAHC").

Comment on Introduction

In Special Review

The Special Review accurately states that on February 3, 2000 the Onslow County Board of Commissioners approved a motion requesting the State Auditor to conduct an audit of this institution. However, lest those reading the Special Review are left with an understanding that this request was the unilateral act of the Board of County Commissioners, the hospital would like this Special Review to reflect that it was the Hospital's Governing Body who originally recommended that the Office of the State Auditor be the independent investigative body. We would also like the Special Review to show, as we are confident the Auditor will agree, that all facets of the hospital, its staff and facilities as well as all records, were made instantly available to the review team and that they received the utmost cooperation during their inquiries.

<u>Comments On</u>

<u>Findings and Recommendations</u>

<u>In Special Review</u>

1. **THE FORMER CHIEF EXECUTIVE OFFICER DEVIATED FROM STANDARD PRACTICE, VIOLATED HOSPITAL POLICIES AND BREACHED HIS FIDUCIARY DUTY IN THE HIRING AND SEPARATION OF THE VICE PRESIDENT FOR PLANNING**.

<u>The "Former Chief Executive Officer"</u>

Although this individual is not mentioned by name in the Special Review, it is certainly well known that the reference is to Douglas Kramer. As stated in the Special Review, upon discovery of what has come to be known as the "Gary Rollins matter", the Governing Body of the hospital terminated Mr. Kramer's employment on March 29, 2000. One of the reasons given for his termination for "just cause" was:

> "a. He [Kramer] agreed to and executed an Agreement and General Release of All Claims with Gary Rollins dated August 10, 1999 which purports to obligate the Authority to pay excessive funds to Gary Rollins for no consideration; and
>
> b. He agreed to and executed an Agreement and General Release of All Claims with Gary Rollins dated August 10, 1999 without this Agreement being reviewed by competent legal counsel representing his employer, the Authority; and
>
> c. In agreeing to and executing the Agreement and General Release of All Claims with Gary Rollins, he violated the Onslow County Hospital Authority Personnel Policy No. 102-16 which specifies employment severance policy; and
>
> d. In agreeing to and executing the Agreement and General Release of All Claims with Gary Rollins, he exceeded the stated severance provisions of the Rollins employment agreement dated June 15, 1999, wherein it was provided that Rollins had 'a guaranteed severance package of six months'."

In essence, the hospital agrees with the facts as stated in finding number 1 in the Special Review. Neither the employment agreement nor the settlement agreement were made known to or approved by the Hospital Board or administration, other than Mr. Kramer. He alone directed and approved the payments to Gary Rollins. As stated in the Special Review, upon discovery of this agreement, further payments were suspended. The hospital anticipates that some form of legal action based on the "settlement agreement" executed by Mr. Kramer will be filed by Mr. Rollins' attorneys.

The hospital also anticipates that Mr. Kramer will file some form of legal action in an attempt to enforce his employment contract on the basis that the Governing Body lacked "just cause" for his termination. For this reason, we feel it inadvisable to speculate on Mr. Kramer's reasoning or thought processes in hiring and terminating Mr. Rollins.

As to the recommendation concerning finding number 1 in the Special Review, the hospital has investigated, and continues to investigate, all legal remedies available. As stated above, it is anticipated that separate legal actions will be filed by both Mr. Rollins and Mr. Kramer following the public release of the Special Review. In such event, appropriate counterclaims will be asserted in each action. In the event that no action is filed by either of these individuals, a determination will then be made as to the advisability of filing independent actions on behalf of the Authority.

2. THE FORMER CHIEF EXECUTIVE OFFICER RECOMMENDED THE ACQUISTION OF AN ADMINISTRATIVE OFFICE BUILDING WITHOUT HAVING THE BUILDING APPRAISED.

It is with this finding in the Special Review that the hospital has the most significant disagreement. The building which was purchased is now known as the New River Annex. The Special Review states that in 1997 the need for administrative office space became apparent to hospital management and that, in order to meet this need, "the hospital acquired a property near its primary facility as a potential site for an **office building and** rehabilitation center". The actual chronology of events is that the hospital purchased a three acre tract of land on Huff Drive in Jacksonville for a **physical rehabilitation center only**. John Worrell, Plant Engineer at the hospital and a civil engineering graduate of North Carolina State University, designed preliminary plans for the rehabilitation facility only.

Mr. Worrell is highly qualified in construction cost estimates. Following his graduation in 1970 from North Carolina State as a civil engineer, he was employed in private industry and responsible for purchase, in-house maintenance, contracted maintenance, design, and construction costs for facilities. In 1988, he was employed by Onslow Memorial Hospital as plant engineer and responsible for all construction, engineering and maintenance at the hospital. He acts as the liaison between hospital administration and all architects and engineers and has been responsible for the design and construction of over 15 hospital facilities. In his position, he routinely interacts with architects, engineers, the North Carolina Department of Facility Services, North Carolina Department of Insurance, City of Jacksonville Inspections Department, the Joint Commission on Accreditation of Healthcare Organizations ("JCAHO"), the United States Occupational Safety and Health Administration ("OSHA"), the Federal Environmental Protection Agency ("EPA") and other state and federal inspection and certification agencies. His position also requires the design and installation of fire alarms, security and various communication systems for hospital facilities. He maintains over 5,000 architectural and engineering prints and files and insures that JCAHO, as well as state and local building codes are strictly enforced.

As stated in the Special Review, in 1997 the need for additional space for the business office of the hospital reached crisis proportions. At that time, the business office was divided into two separate off campus leased locations. Due to normal business staff increases, both offices were extremely overcrowded. The roof on one needed replacing to the point of having to be removed, the air conditioning in the leased building needed to be replaced and additional phone lines to accommodate increased business needs were unavailable.

Faced with the urgent situation to accommodate business office operations, Mr. Worrell, at the direction of hospital administration, reviewed available space on the property previously purchased on Huff Drive. He determined that a 20,000 square foot building could be placed on the Huff Drive property. However, at an estimated construction cost of $100 per square foot for the building without parking, required sedimentation ponds, paving and other related costs, the total construction costs of a new building on the Huff Drive property was estimated to be $2,000,000.00. With the necessary related costs, the total estimated construction cost for new construction was estimated at $2,500,000.00.

Following this evaluation, the hospital was made aware of the possible availability of the old bank building in the New River Shopping Center. Mr. Worrell was then asked to evaluate the renovation of this building to accommodate the business office and administration. He did an extensive evaluation of the estimated renovation costs of the building. He also contacted the officials at Onslow County and asked for any information that they had concerning a review that the County previously had performed and their cost estimates for renovation and use for County purposes. The County official who spoke with Mr. Worrell advised him that they did not know where this information was or even if it was available in any written form. They suggested that he contact an architect in New Bern who had done the review for the County. Mr. Worrell did contact the New Bern architect, who was reluctant to give him copies of his written work product but was willing to freely discuss the matter. The architect advised Mr. Worrell that in his approach to renovation costs for the County, he assumed that the building would be "entirely gutted" inside. Using this approach, the architect was of the opinion that it would be more cost effective to demolish the entire building and start over. Thus, the cost estimate to the County was prohibitive. However, the architect advised Mr. Worrell that if the interior of the building was not "gutted" and the interior layout essentially remained, his estimate would be considerably lower.

Mr. Worrell also contacted NBBJ, an international architectural firm that does architectural work for Onslow Memorial Hospital. He discussed his analysis with them and they suggested that he walk through the building with contractors in order to receive their comments. He then contacted several contractors and subcontractors and inspected the building with them to receive their opinions and cost estimates.

Following discussions with the County and the New Bern architect, Mr. Worrell estimated the projected costs of renovations to be $529,500.00. As mentioned in the Special Review, he stated that his estimate, due to the inability to inspect for some things in covered areas, could be as much as 100% low. In other words, the renovation costs, if doubled, could be $1,059,000.00. Added to the offered purchase price of $544,000.00, the total cost to renovate and occupy the building could be $1,603,000.00. This worst case scenario was still $897,000.00 lower than the cost of new construction on Huff Drive.

This approach to value obviously uses what is known as "use value". Such an approach is commonly and routinely accepted by the real estate appraisal industry as the value a specific property has for a specific use. Use value focuses on the value the real estate contributes to the enterprise to which it is a part, without regard to the property's highest and best use or the monetary amount that might be realized upon its sale.

The County and the New Bern architect used the use value approach in making their decision not to purchase the building if total demolition of the interior was necessary.

The lower and worst case cost of acquiring and renovating the New River Building was considered by both the hospital administration, Hospital Executive Committee and the full Hospital Authority Board prior to acquisition by the hospital. All of Mr. Worrell's working papers, as well as his extensive educational and work experience, were made available to the audit team. Because of the urgent needs of the hospital business office, the significant time difference between renovation versus design and construction of a new facility and the lease costs of the two inadequate facilities, the hospital elected to acquire and renovate the New River Building.

The Special Review places some emphasis on the "progression of ownership" of the building, previous financial transactions between private individuals and time spans between property transfers. The Special Review states that the surveyor (seller) acquired the bank building and sold it to the hospital in "less than 20 days". However, they also state that the surveyor (seller) acquired an option on August 12, 1997 and sold the property, which was presumably the subject of the option, on December 19, 1997, a period of time somewhat greater than 20 days. Admittedly, the hospital did not inquire into what previous owners had paid for the property. Whether the $194,000.00 differential figure stated in the Special Review was a gross profit, net profit, or otherwise, to the surveyor (seller) is merely a matter of speculation. It certainly has no relationship to traditional concepts of market or use value.

The undeniable fact remains that the hospital had an urgent need, examined available alternatives and concluded that the purchase of the New River Building would constitute, at worst, a savings of almost a million dollars. In fact, Mr. Worrell's estimate of construction costs was not 100% low. Upon completion of the construction and occupancy of the building by the business office and administration, his estimate proved to be 80% low, an even greater savings.

We think it is important to note that this evaluation process was used. Mr. Worrell's credentials show that he is imminently qualified to make a professional appraisal of renovation costs. As a matter of fact, if a third party appraiser were to estimate the cost of renovation of any existing structure, it is from people such as John Worrell and the contractors he consulted that he would seek advice. We suggest that the approach to value used by the audit review team, namely time progression of ownership and previous purchase price differential, is not relevant to this situation. On a comparative basis, the cost of relieving the urgent situation that the hospital faced would have been worth it even if the property's previous owner had donated it to the seller.

A copy of Mr. Worrell's education and work experience and his working papers on this project are available for review by anyone wishing to inspect them.

3. THE FORMER CHIEF EXECUTIVE OFFICER ACQUIRED REAL PROPERTY WITHOUT AUTHORIZATION FROM THE HOSPITAL AUTHORITY.

In addition to the reasons stated in the comments to finding number 1, this matter was given as another reason for the "just cause" dismissal of Mr. Kramer. His notice states:

> "Without authority, he purchased from Perimeter Properties a 2.06 acre track of land for $72,000.00 in violation and disregard of the directives of the Governing Body of the Authority."

The comments referenced above in response to finding number 1 are equally applicable to this finding. The hospital has re-emphasized in its operating policies and procedures that real property transactions require specific approval of the Authority's Governing Body, following legal review.

4. AN OVERPAYMENT ASSOCIATED WITH THE ACQUISITION OF A SURGERY CENTER EFFECTIVELY BECAME A LOAN TO AN ONSLOW COUNTY PHYSICIAN.

We do not understand why this finding, particularly as the text is written, was the subject of the Special Review, other than the fact that someone possibly raised some allegation of impropriety. All of the matters concerning the purchase of the Surgery Center were meticulously reviewed by multiple public agencies and professionals, including Brown and Wood, one of the leading law firms in the United States with highly specialized tax and healthcare specialists. The transaction was also reviewed and approved by the nationally respected North Carolina Local Government Commission following review and study by their professional staff.

The Special Review leaves the impression that the Outpatient Surgery Center was purchased "from a local physician". As a matter of fact, the sellers comprised several business organizations owned by at least 11 physicians and the estranged wife of one of them.

The Special Review then addresses a "goodwill" accounting term and the allocation made to goodwill by the hospital's independent accounting firm, Pricewaterhouse Coopers, L.L.P.. The Special Review then concludes that "Thus, the Hospital Authority paid **the local physician** a **substantial amount of money** to acquire the potential future earnings of the surgery center. Ultimately, only the future profitably of the hospital's surgery center can justify the amount paid for 'goodwill'." This portion of the text leaves the erroneous impression that a speculative amount of money was paid as goodwill for "the local physician's surgery center". First of all, as stated above, there were multiple individuals involved as sellers in this transaction. It was not "the local physician's surgery center". Secondly, goodwill was an amount unilaterally assigned by the accounting firm during preparation of the annual audit.

In the closing process, an overpayment was inadvertently and erroneously made. Due to the inability of the physician to repay the overpayment immediately, in the exercise of business judgment, the Authority accepted a short term secured promissory note, with interest. Presumably due to continued inability to pay the note in full on its stated due date, as stated in the Special Review, Mr. Kramer extended the time of payment.

The Authority was aggressively pursuing full payment of this note and it has now been paid in full, with interest.

5. THE FORMER CHIEF EXECUTIVE OFFICER DID NOT SUBSTANTIATE THE BUSINESS PURPOSE OF EXPENSES CHARGED TO CREDIT CARDS.

As with findings number 1 and 3, discussed above, credit card charges are another reason given as just cause for Mr. Kramer's termination of employment:

> "Without authority, he used Authority credit cards for his own personal benefit and gain."

The Special Review states that Mr. Kramer's credit card statements were submitted directly to the accounting department and approved for payment by the Chief Fiscal Officer. Actually, the credit card statements were submitted by Mr. Kramer as Chief Executive Officer and approved by him in that capacity.

As stated, use of corporate credit cards has now been suspended and reimbursement of business expenses, as it did before under existing hospital policy, requires adequate documentation. The hospital will pursue recovery of any inappropriate expenses charged by Mr. Kramer.

6. INVOICES FROM AN INDEPENDENT CONTRACTOR FOR PHYSICIAN SERVICES WERE NOT VERIFIED AGAINST CONTRACTUAL AGREEMENTS AND HOSPITAL RECORDS BEFORE PAYMENT.

This is another finding which is a possible source of litigation. Mr. Kramer's notice of termination states:

> "He continued business relationships with Janna Williams and/or JK Consulting and/or other entities controlled and directed by Janna Williams in violation of specific directives of Physician Services of Onslow County, a wholly controlled subsidiary of the Authority."

The hospital will need to continue to use other outside organizations to acquire the services of contracted physicians. All payments pursuant to such service agreements will be actually verified against the agreement.

7. CONDOMINIUMS LEASED ON NORTH TOPSAIL ISLAND WERE AN IMPRUDENT USE OF HOSPITAL RESOURCES.

As previously stated, the hospital has several outlying clinics and uses temporary facilities for contracted physicians and for physicians they are recruiting. Jacksonville is a difficult area to recruit physicians to relocate to due to a larger hospital less than an hour away to the north in New Bern, an even larger hospital less than an hour away to the south in Wilmington and a large multi-specialty internal medicine practice approximately 20 minutes away to the north in Pollocksville. The hospital's Director of Hotel Services and Community Relations often placed temporary healthcare providers and persons being recruited in leased facilities. However, unfortunately, we cannot dispute the fact that record keeping for these facilities was inadequate. This area of operation has now received increased analysis and oversight and all occupancy and payment records are now fully substantiated. All condominium leases have now been terminated and properties are used on an as needed basis. The Director of Hotel Services and Community Relations referred to in the Special Review is no longer employed by the hospital.

The Special Review refers to a management letter from Pricewaterhouse Coopers, L.L.P.. Their recommendation refers to "capital and operating" leases, such as copiers, medical equipment, etc. The recommendation of the accounting firm had been implemented. The master list addressed capital and operating leases as recommended by the accountants.

The subject of this finding could also be the subject of litigation. In this regard, Mr. Kramer's notice stated:

> "He failed and refused to develop and implement property control policies and procedures for the Authority and its controlled subsidiaries."

8. THE MONETARY VALUE ASSOCIATED WITH THE PERSONAL USE OF A VEHICLE WAS EXCLUDED FROM THE FORMER CHIEF EXECUTIVE OFFICER'S ANNUAL WAGE AND TAX STATEMENT.

It should be noted that the Special Review does not state or indicate any personal use of the hospital vehicle by Mr. Kramer. Mr. Kramer owned two personal vehicles in addition to the one provided to him for hospital use. His employment agreement, which has now been terminated, provided:

> "**Automobile Allowance**: During the Initial Term and any Remaining Term of this Agreement, Hospital shall pay the cost of leasing an automobile under two year lease agreements, with maximum mileage of 15,000 miles per year, for the professional and personal use of Employee pursuant to policies agreed to between the parties. Employee shall pay the cost of any mileage exceeding 15,000 miles per year. In addition, Hospital shall pay for the cost of fuel, insurance, licenses and title fees and any other maintenance of the leased vehicle.
>
> **Severability of Benefits**: In the event that any of the provisions of this Article 5 relating to benefits are determined by the Certified Public Accountant

> retained by the Hospital to be contrary to the laws, rules, or regulations of the U.S. Internal Revenue Service, relating to tax exempt entities or otherwise, the value of the part so effected shall be determined by said Certified Public Accountant and such sum shall be added to Article 4 [Salary] of this Agreement. Thereafter, the part so effected shall be considered deleted from this Agreement."

Mr. Kramer was required to utilize transportation in order to perform multiple acts related to his employment, such as visiting outlying clinics, recruiting and other business related activities. Based on historical usage, the hospital determined that a good faith estimate of this mileage was 15,000 miles per year. Thus, the provision in his employment agreement. He never informed the Authority nor, as far as we know, has the audit review team determined, that the hospital vehicle was used for personal reasons. Certainly, Pricewaterhouse Coopers never determined nor advised the hospital of any provision relating to the automobile allowance in Mr. Kramer's employment agreement being out of compliance with IRS regulations.

If Mr. Kramer used the hospital vehicle for personal reasons, even though he owned two other passenger vehicles, it would seem that it would be his responsibility to handle this matter in accordance with his own tax return and advice from his personal tax advisors.

The hospital has discontinued the provision of hospital owned vehicles to chief executive officer. The interim chief executive officer, Dr. Ed Piper, owns and uses his own vehicle, as do other management level employees.

As with a multitude of issues occurring almost daily in the operation of a public tax-exempt entity, compliance with, not only IRS regulations, but all other regulatory bodies such as the Health Care Financing Administration ("HCFA") is constantly monitored by hospital administration and their professional support team.

9. THE FORMER CHIEF EXECUTIVE OFFICER AUTHORIZED THE LOCATION OF STORAGE BUILDINGS AT AN EMPLOYEE'S RESIDENCE.

The items in the storage buildings were used primarily for storage of hospital property associated with some of the leased facilities for contracted physicians, nurses, recruiting personnel, etc. The Special Review states that the use did not violate any hospital policy. We do not know the reasoning of either Mr. Kramer or the Director of Hotel Services and Community Relations in locating the storage buildings at this particular location, other than the statement of the Director referenced in the Special Review. As stated above, the Director is no longer employed at the hospital.

The buildings have been relocated from the former Director's property. Their continued use and ownership is being evaluated.

10. HOSPITAL AUTHORITY COMMISSIONERS MAY BE IN VIOLATION OF CONFLICT OF INTEREST BYLAWS AND GENERAL STATUTE 131E-21.

The Special Review states that the services provided by the travel service and temporary personnel company "may be" or "appear to violate General Statute 131E-21." It is far from certain that any violation occurred. Without commenting on the nuances of statutory construction, suffice it to say that if any violation did occur, it was totally unknown to either of the Hospital Commissioners.

Nevertheless, the Hospital Authority will review ongoing compliance with the referenced General Statute and applicable bylaws.

11. THE FORMER CHIEF EXECUTIVE OFFICER AUTHORIZED THE ACQUISITION OF RADIOLOGY EQUIPMENT THAT NEVER BECAME OPERATIONAL.

This property was purchased through the secondary market for a planned mobile mammography unit to service the outlying clinics. After the purchase, it was determined that the van planned to transport the unit and the technical personnel to support the diagnostic tests did not justify putting the unit in operation.

Equipment purchases for the hospital are analyzed as a function of clinical and operational necessity. The hospital constantly tries to avoid purchase of any obsolete or outdated equipment.

Statement Of Financial Impact

In Special Review

We disagree that the matters listed in this section are an accurate reflection of any "financial impact". The Special Review states that the "schedule represents a quantification of the **items examined** during the Special Review". It then goes on to state that: "we **cannot completely quantify** the tangible benefits or detriment, if any, to the public …". The lead-in paragraph does not appear to support the rather strong descriptive caption of "Statement of Financial Impact".

As to each item listed,

Nos. 1 & 2: This quantification is to the Gary Rollins incident set forth in finding number 1 and perhaps accurately reflects the result of these payments. It remains to be seen whether or not the hospital is able to recoup any or all of the payments.

No. 3: As stated in our response to finding number 2, we do not agree that $194,000.00 is a meaningful figure, much less has any financial impact to the public or the operation of the hospital. Quite the contrary, we believe that the purchase, renovation and occupancy of this building, as opposed to constructing a new building for the urgent needs of the hospital business office, resulted in a **savings** in excess of $1,000,000.00.

No. 4: Although perhaps not authorized, the hospital currently owns real estate that has been appraised by a designated member of the Appraisal Institute ("MAI") at an appraised value of $822,000.00. Certainly, its value is in excess of the $75,296.50 indicated as a "financial impact".

No. 5: As stated in the Special Review, this obligation has been paid in full in the amount of $100,616.07. We do not understand the reasoning to state that $99,646.00 has any "financial impact" on the hospital.

No. 6: The listing of $24,403.09 assumes that none of Mr. Kramer's credit card charges were proper.

No. 7: Likewise, this listing certainly leaves the impression that $76,815.00 was an improper payment. There is no indication that the payments were not for legitimate physician services not received.

No. 8: Some of the leases were probably an "imprudent use". This listing assumes that all of them were.

No. 9: Some cost has to be assigned for legitimate storage. This listing seems to assign a cost of $5,771.70 as a cost for a "perception of misconduct".

No. 10: We do not know what the residual value of the equipment is.

We feel that totaling these amounts at $679,162.60 leaves an impression that this is an amount improperly spent. As stated above, we simply do not agree that this itemization represents any valid "statement of financial impact".

CONCLUSION

We hope that the response to the items listed in the Special Review will receive as much attention as the findings. We sincerely hope that the release of this Special Review and our response will put an end to this matter that has received so much media attention and comment. Doug Kramer, and many other former employees of the hospital, are no longer associated with Onslow Memorial Hospital. There are no findings of any criminal violations by anyone.

The hospital has now hired Dr. Ed Piper as interim chief executive officer. Dr. Piper holds a Ph.D. degree, 4 Masters Degrees and a Bachelor of Science Degree. He has over 30 years experience in healthcare with 7 hospital organizations and is a former Diplomat in the American College of Healthcare Executives. His remaining support staff is unquestionably qualified in their respective fields. Dr. Piper and his staff have enacted substantial remedial measures for many matters other than those addressed in the Special Review.

There has been enough pain endured by this organization and it needs to come to an end. It is sincerely hoped that personal and political agendas will not impair the ability of the

Governing Body and/or Dr. Piper and his staff from progressing forward along the path that the County Commissioners envisioned when they established the Hospital Authority in 1972.

In the frenzy of the moment, many often overlook the fact that the reason for the existence of Onslow Memorial Hospital is to provide quality medical care to the citizens of Onslow County. Nowhere in all of these recent reviews has there been any indication or accusation of any deficiency in quality medical care rendered by this institution and its staff of physicians, nurses and other caregivers. However, if unfounded allegations and accusations continue to persist, erosion of quality of care will certainly eventually result as quality healthcare providers either leave the community or refuse to come.

As said many years ago, "A house divided cannot stand". In this case, the house is the hospital, the community and its elected officials. We urge those who read and pay attention to this review to let the healing process begin.

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July 31, 2000

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