

MANAGEMENT LETTER

Nassau Health Care Corporation and Subsidiaries

Year ended December 31, 2012



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## Management and the Board of Directors Nassau Health Care Corporation and Subsidiaries

In planning and performing our audit of the basic financial statements of Nassau Health Care Corporation and Subsidiaries (component unit of Nassau County) (the “Corporation”) as of and for the year ended December 31, 2012, in accordance with auditing standards generally accepted in the United States, we considered its internal control over financial reporting (“internal control”) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Corporation’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

During our audit, we noted the following deficiencies in internal control (as described above) and other matters. Items denoted by an asterisk (\*) indicate that similar comments were made in the prior year. The Corporation’s written response to the deficiencies identified in our audit was not subject to auditing procedures.

### ***Patient Accounts Receivable Collection Cycle\****

For health care providers, the patient accounts receivable billing and collection cycle is a critical finance and operations process that requires a robust internal control framework and a detailed and focused execution plan. Particularly, for the Corporation, which serves a high indigent population, it is critical that management continue to focus on all aspects of this process, which is a significant driver of the operating cash flow. Therefore, it is critically important that management continue its focus on this process, with the goal of ensuring full collection of all services provided.

Management continues to reevaluate its revenue cycle processes in order to identify improvement opportunities. In connection with the operational improvements, it is also critical that management continues to evaluate the financial reporting implications of revenue cycle results, especially as such results impact the valuation of net accounts receivable and net patient service revenue.

As part of management's ongoing improvement initiatives, we recommend management continue to consider the following areas of focus:

- Management should continue to review accounts at the financial class level, with particular attention on significant balances (for example, Medicaid, Medicaid pending and self pay financial classes) to determine whether collection monitoring procedures can be strengthened and improved, thereby improving collection results and shortening the collections cycle.
- In connection therewith, management should also continue to consider the net collectability of accounts receivable in the aggregate, with such analyses updated timely to reflect the latest collection trends, particularly in hard to collect financial classes, to assist in management's estimation of valuation allowances for contractual adjustments and bad debts. We recommend that a hindsight review of the collection status of accounts receivable, or a similar analysis, be performed at periodic intervals, e.g., quarterly, to provide management with the ability to monitor reserve levels throughout the year on a more timely basis.
- Specifically for accounts pending Medicaid approval, management should continue to evaluate operational improvements in order to minimize to the extent possible administrative delays in the Medicaid approval process. For example, issues which have created delays in the past should continue to be evaluated to determine if the Corporation can modify its processes to avoid similar delays in the future. Additionally, for purposes of valuation of accounts receivable and revenue in the Corporation's financial reporting, management should consider developing additional financial classes (or an alternate internal stratification) of the pending Medicaid accounts based on a periodic assessment of the likelihood of Medicaid approval. For example, after 60 to 90 days from the date of service, certain accounts may exhibit attributes which make Medicaid approval appear less likely and such accounts should be identified and reserved as early as possible.
- At December 31, 2012, a significant number of accounts remain unbilled. Higher levels of unbilled accounts may impact collection timing and also impact financial reporting as collection estimates for such accounts require a higher degree of judgment. The Corporation should consider assessing its procedures and review mechanisms to ensure that billings are processed in a timely manner throughout the course of the year.

#### Management's Response

Management concurs and is continuing to review and improve the accounts receivable processes. Management has implemented revenue cycle initiatives to improve the revenue cycle processes and reduce days in account receivable.

***Designation of Party Responsible for External Financial Reporting and Consolidation Considerations***

The preparation of external financial statements which include all components comprising the Corporation in a format that is in accordance with US GAAP for governmental entities is a significant process separate from the monthly internal financial statement preparation.

Management should designate a specific individual responsible for external financial reporting and consolidation considerations related to the multiple entities included within the Corporation's financial statements.

The Corporation's external financial reporting will become increasingly complex as Government Accounting Standards Board ("GASB") Statement No. 61, *The Financial Reporting Entity: Omnibus an amendment of GASB Statements No. 14 and No. 34*, becomes effective for the 2013 financial statements. This Statement modifies certain requirements for inclusion of component units in the financial reporting entity and amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. As a result of the adoption of this Statement, the Corporation's financial reporting on the face of the financial statements and within the footnote disclosures will be disaggregated by reporting entity and require additional opinion units to be referred to within the Report of Independent Auditors.

Management should begin the process of preparing for the adoption of GASB Statement No. 61 by evaluating the criteria for presenting component units and assessing any required presentation changes which may result.

In addition, management should consider whether internal financial statements should be prepared on a periodic basis in a manner that is consistent with the external financial statements.

**Management's Response**

Management concurs.

### ***Financial Statement Close Process and Significant Disclosures\****

The financial statement close process includes, among other things, the monthly process used by the Corporation's finance department to update and maintain the general ledger, reconcile Corporation activity to the general ledger, perform detailed account analysis for management's review, and produce financial statements.

The Corporation should continue to strengthen the financial statement close process and underlying controls by:

- Enhancing formal policies, procedures, roles, responsibilities, time-frames, and financial statement closing goals into the monthly close process.
- Enhancing formal policies regarding the posting of journal entries. Specifically, written documentation should include the parameters for initiating journal entries and a matrix for approving and authorizing journal entries. Further, written policies should establish standard guidelines for the written approval of all journal entries by someone senior to the preparer, in addition to written documentation by the preparer.
- Enhancing formal procedures into the financial statement close process so that all appropriate account reconciliations are completed timely and evidence of their review is maintained.
- Codifying the formal procedures in the accounting policies and procedures manual.

Additionally, the Corporation's controls over significant financial statement disclosures and the related sources of information that influence these disclosures should be evaluated by management. Controls related to the preparation, review and approval of the significant financial statement disclosures should be considered. Additionally, narratives or other explanatory information that document the flow of information from the Corporation's accounting records (including source inputs and required summarizations) to the disclosures in the financial statements should be enhanced.

#### **Management's Response**

Management concurs. A large part of the aforementioned is already in place and management will continue to strengthen controls and enhance disclosures.

### ***Unclaimed Property***

Increasingly, federal and state governments are pursuing refunds through unclaimed property filing requirements. The complexity of health care billing arrangements, inconsistent patient information and the level of sophistication of payers are a few of the sources of credit balances within the patient accounts receivable balance which are required to be evaluated for unclaimed property amounts. Additionally, payments made to employees and vendors are subject to unclaimed property requirements. Management should continue to review patient account ledgers, cash disbursement and payroll records, and other sources of potential unclaimed property to determine the cause of these amounts and document whether the items should be adjusted or reclassified within the financial statements, paid as refunds to the appropriate parties, or escheated to the State. We recommend that management consider formally documenting the process necessary to review unclaimed property.

#### Management's Response

Management concurs and will review the patient accounts receivable processes to determine if refunds or escheating to the State is required. The Corporation is current with all unclaimed funds reporting as it relates to accounts payable and payroll.

### **Information Technology General Controls**

#### ***Logical Access***

Lack of supporting evidence and formal review of user access

*(Systems affected: Lawson (general ledger, payroll and accounts payable system) and Eagle (patient billing))*

There is no periodic re-certification process in place for the Lawson or Eagle applications to validate and confirm that application access remains valid and appropriate over time.

A formal process for re-certification of user access rights on a periodic basis is integral to verifying the continued appropriateness of access at the application levels. Without a formal framework for the review process, there is no reasonable assurance that inappropriate or unauthorized access are detected and properly corrected. Proper accountability for the execution of the review process, including timeliness, may not be established.

#### Lawson:

Management should consider on a periodic basis (at least annually) for respective process owners to review user access rights to determine if access is appropriate in Lawson based on the individuals current function and responsibilities. Supporting documentation of the review and follow up action items should be retained as evidence.

Typically to remediate this observation, users are reviewed on a departmental basis. Department managers review the access granted to each of the employees within that department. The department manager denotes any changes required and IT performs the necessary access modifications. Evidence of the review by the department manager is retained along with support that the access modifications were completed.

Eagle:

Management should consider developing a process to require supervisors to provide a formal acknowledgement (i.e. email) that they have completed their review. Evidence of review should be retained along with support for any access modifications requested by supervisors.

Management's Response

*Lawson:* Management concurs and will implement a periodic review of all users.

Responsibility for user access to the Lawson application is controlled by the Finance Department. We have centralized security whereby only two Finance Department personnel can make changes and our system is maintained such that:

- 1) People who are no longer with the Corporation are made non-active through notification within the Corporation (i.e. the ITWeb notifications), or
- 2) Most of the Lawson users have a security role of "USER" with the same rights so that movement within a department would not mean another type of access is needed since "Users" have the same access.
- 3) Departmental users in Payroll, HR, Finance, IT and Purchasing are limited and user access is tightly controlled. All other users are departmental users and are limited to ordering supplies from the store room or through existing purchase orders. These users are also limited to access to their respective departments only. A departmental user review was conducted last year when the Lawson system was upgraded.

*Eagle:* Management concurs and a process is being developed.

***Change Management***

Approval to migrate changes to production is not formally documented or retained

(Systems affected: Eagle)

During review of the change management process for the Eagle application, we were not able to obtain evidence to support that changes are approved prior to migrating the change to the production environment. Management should consider formalizing the approval process to migrate changes to production. Evidence of approval should be retained.

Management's Response

Management concurs and a formal process has been instituted.

### ***Change Management***

#### **Inappropriate Segregation of Duties for Change Management and Monitoring of Changes (Systems affected: Eagle)**

The Eagle application is a third-party application hosted and maintained by Siemens. Siemens owns the source code to the application and performs both development and migration of changes to production environment. There is no Service Organization Control (“SOC”) report that exists for Eagle. As such, we are unable to gain assurance that appropriate segregation of duties exists. There is currently no monitoring control in place to mitigate the risk of unauthorized changes being implemented in the production environment.

Failure to restrict programmer and developer access to the production environments increases the risk that unauthorized program changes or program changes that have not undergone proper testing may be transferred to production. This may pose a risk over systems and financial data integrity.

We recommend that the Corporation implement monitoring controls (either prevent or detect) to mitigate the risk of vendors having access to develop and migrate changes to the production environment.

#### **Management’s Response**

This problem has been forwarded to Siemens’ management. A solution will be developed once their reply is received.

#### **Health care industry matter:**

##### ***International Classification of Diseases, 10th Revision (“ICD 10”)***

In the coming years, the US will move from the ICD-9 system of disease classification to ICD-10 (currently scheduled for an October 2014 transition date). The ICD-10 system will expand the number of available codes from 24,000 to 155,000. Although the new coding system will enable better documentation of specific diagnostic information, the changes will significantly impact people, processes, resources and technology across the entire health care spectrum.

In relation to the Corporation, there are several systems, databases, interfaces, reports and processes that utilize ICD-9 codes that must be remediated by October 1, 2014. To some degree, the Corporation will be dependent on external vendors to remediate vendor-supported systems and databases. Beyond this external dependency, the Corporation will be required to remediate internal systems and test interfaces between all systems once they have been converted to be able to process ICD-10 codes.



Because ICD-9 (and, soon, ICD-10) codes are the foundation for payment, particularly with payers that pay the Hospital based on clinical diagnosis, it will be important to carefully implement the transition to ICD-10 codes. As a provider of psychiatric services, the degree of impact of the conversion to ICD-10 is less severe than at an acute care hospital, however, management and the Board should maintain focus on this important transition. We have provided example action steps which are for consideration as the implementation of ICD-10 progresses.

A summary of example action steps include:

- Establish a steering committee to oversee the project. Steering committee members consist of personnel from various departments, including finance, medical records, medical staff and human resources.
- Identify and appoint a project manager for the transition.
- Decided on a target date that the Corporation will begin coding of claims in both ICD-9 and ICD-10. Some organizations are planning to start this nine to twelve months prior to October 1, 2014.
- Complete a software systems inventory
- Conduct an assessment of case diagnoses (i.e. DRG's) to assess where the current clinical documentation practices might not be adequate to support ICD-10 coding requirements
- Critically analyze the denials management process to develop an action plan to address the potential for increased payment denials after ICD-10 becomes effective.
- Prepare employees and physicians for the implementation of ICD-10 by identifying, selecting and utilizing a workforce training strategy and supporting tools.
- Establish a process for maintaining regular contact with the Corporation's software vendors and payers. Gather detailed information about their ICD-10 readiness plans and how they plan to interface with the Corporation.
- Determine an approach and methodology for computing the financial impact of ICD-10 on the organization. For example, the impact of potential changes to payments under the ICD-10 codes, the cost of implementing ICD-10 and the impact of potential payment delays or denials, including related contingency liquidity plans as deemed necessary.

### Management's Response

Management concurs and has begun the processes and training required in preparation of the ICD-10 coding requirements.

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This communication is intended solely for the information and use of management, the Board of Directors and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

*Ernst + Young LLP*

June 27, 2013