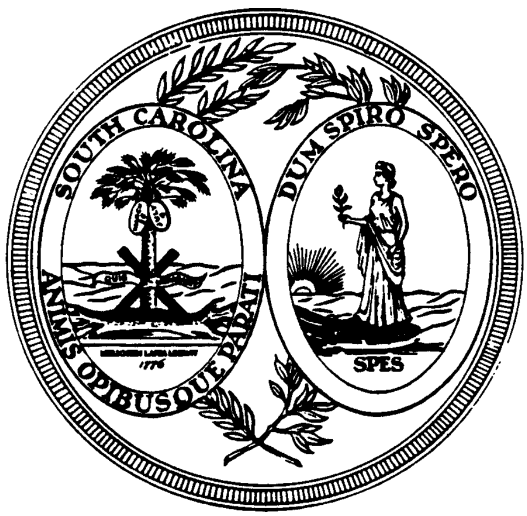
South Carolina Legislative Audit Council

LAC

Report to the General Assembly

May 1999

A Review of the Medical University of South Carolina and University Medical Associates



www.state.sc.us/sclac

Legislative Audit Council

400 Gervais Street
Columbia, SC 29201
(803) 253-7612 VOICE
(803) 253-7639 FAX

Authorized by §2-15-10 *et seq.* of the South Carolina Code of Laws, the Legislative Audit Council, created in 1975, reviews the operations of state agencies, investigates fiscal matters as required, and provides information to assist the General Assembly. Some audits are conducted at the request of groups of legislators who have questions about potential problems in state agencies or programs; other audits are performed as a result of statutory mandate.

The Legislative Audit Council is composed of five public members, one of whom must be a practicing certified or licensed public accountant and one of whom must be an attorney. In addition, four members of the General Assembly serve ex officio.

Audits by the Legislative Audit Council conform to generally accepted government auditing standards as set forth by the Comptroller General of the United States.

Copies of all LAC audits are available to the public at no charge.

A Review of the Medical University of South Carolina and University Medical Associates was conducted by the following audit team.

Audit Team

Audit Manager
Jane I. Thesing

Senior Auditor
Lynn U. Ballentine, CPA

Associate Auditor
Andrea Derrick Truitt
John B. Wack

Typography
Candice H. Pou
Maribeth Rollings Werts

Staff Counsel
Andrea Derrick Truitt

South Carolina Legislative Audit Council

LAC

Report to the General Assembly

A Review of the Medical University of South Carolina and University Medical Associates

LAC/98-2

Contents

Appendices

Synopsis

As requested by members of the General Assembly, we conducted an audit of the Medical University of South Carolina (MUSC) and University Medical Associates (UMA), the practice plan for faculty in the College of Medicine. Our findings raise questions about the degree of independence of UMA and address issues relating to MUSC's accountability for the expenditure of public funds.

- We reviewed the relationship between MUSC and UMA and found that it is not clear whether UMA could legally be considered as acting separately from MUSC. The two organizations have a blended relationship which allows MUSC to use UMA to advance its mission. However, it also allows MUSC to avoid accountability for the use of public funds. If UMA acts for the state, it would be subject to some state restrictions on spending and limitations on its corporate structure.

- Even though a 1997 MUSC internal audit questioned whether many MUSC discretionary fund expenditures were appropriate, we found no evidence that MUSC changed its spending practices in response to this review. Our sample of over $262,000 in expenditures from January to June 1998 showed many expenditures that may be in violation of state law. For example, MUSC regularly buys meals and funds social events for small groups of employees, students, and alumni. Many of these expenditures may not be perceived by taxpayers as a prudent use of resources. They are an inappropriate use of public funds.

- Our review of MUSC's and UMA's contributions to outside organizations revealed that both organizations made contributions. Some of MUSC's contributions were not appropriate expenditures of public funds because they were made to organizations that are religious or sectarian in nature, or to civic organizations whose benefits extend only to members. Also, some contributions did not appear to relate directly to MUSC's mission. We also found that MUSC and UMA officials requested political contributions to be made through one of UMA's subsidiary companies. These political contributions present the appearance of impropriety.

- We found that UMA's major source of revenue (85%) is services provided to patients, and the majority of its expenditures are for salaries. We also sampled some of UMA's expenditures for meetings, conferences, dinners, travel, recruitment, and gifts. According to a UMA official, MUSC increasingly channels its expenditures through UMA in these categories. If UMA acts for the state, many of these expenditures would be an inappropriate use of public funds.

- The compensation of most MUSC faculty is composed of a state salary and an incentive amount from UMA. We found that MUSC uses national norms to set salaries for faculty. MUSC was generally in compliance with state requirements and its own policies. However, only half of MUSC employees reported their salary supplements to the Budget and Control Board, as required by law. The General Assembly now requires MUSC, rather than the employees, to report supplements.

- MUSC owns one aircraft (MedAir) that is used to provide transportation to outreach clinics and for administrative travel. We did not find evidence of improper use of MedAir. However, we noted that MedAir is expensive for MUSC to operate and recommended that the university consider using less expensive alternatives to meet its transportation needs.

- As required by appropriations act provisos, MUSC has offered discounts on hospital services to all state employees. MUSC and UMA also provide discounts to other groups of employees and students. For FY 96-97 and FY 97-98, these discounts were more than $3 million. We found that the discounts that MUSC offers to all state employees are used primarily by employees who reside in the Charleston area. Also, MUSC needs to improve controls to ensure that members of the General Assembly do not receive discounts that are prohibited by law.

- We did not find evidence of a significant nepotism problem at MUSC. However, the blended nature of MUSC and UMA can result in situations that violate the intent of state nepotism guidelines.

Introduction and Background

Audit Objectives

As requested by members of the General Assembly, we conducted an audit of the Medical University of South Carolina (MUSC) and University Medical Associates (UMA), the practice plan for faculty in the College of Medicine. The requesters were primarily interested in the relationship between MUSC and UMA, UMA's organization, and financial issues relating to MUSC and UMA. The objectives of this audit are listed below.

- Review the relationship between MUSC and UMA and determine whether it complies with statutory provisions (see p. 7).
- Review the relationships between UMA and its affiliated organizations and determine whether these relationships are in accord with statutory provisions (see p. 7).
- Review current and former ambulatory care agreements between MUSC and UMA to determine whether the state's interests have been protected (see p. 16).
- Review MUSC's expenditures of discretionary funds to determine whether they have been in compliance with state law (see p. 17).
- Review gifts and contributions made by MUSC and UMA to determine whether they have been appropriate (see p. 24).
- Review UMA's expenditures to determine what criteria govern these expenditures and whether these requirements have been followed (see p. 29).
- Review UMA's income to determine sources (see p. 33).
- Review compensation of MUSC employees who receive supplements from UMA to determine compliance with policy and legal requirements (see p. 37).
- Determine whether MUSC's expenditures for air transportation have been appropriate (see p. 45).
- Review MUSC's and UMA's compliance with requirements in providing free or reduced fee medical care to state employees and determine the costs (see p. 48).

- ❑ Determine whether MUSC and UMA have adequate controls to ensure compliance with applicable nepotism requirements (see p. 52).

- ❑ Review the results of MUSC's grant from the U.S. Department of Energy and determine whether appropriate controls are in place to ensure that grant funds are used appropriately (see p. 54).

For further discussion of the audit scope and methodology, see Appendix A. This audit was conducted in compliance with generally accepted government auditing standards.

Background

The Medical College of South Carolina was incorporated in December 1823 as a private institution of the Medical Society of South Carolina. In 1913 the state assumed ownership of the college. Its name was changed to the Medical University of South Carolina (MUSC) in 1969.

MUSC is governed by a 14-member board of trustees that includes the Governor or his designee (ex officio), 12 members elected by the General Assembly, and 1 member appointed by the Governor. Board members serve four-year terms.

The medical university is an academic health sciences center. It provides professional education, clinical (patient care) services, and biomedical research. The MUSC campus, located in Charleston, occupies more than 61 acres and contains 84 buildings. Academically, MUSC is organized into six colleges:

- College of Medicine
- College of Pharmacy
- College of Nursing
- College of Graduate Studies
- College of Dental Medicine
- College of Health Professions

Baccalaureate, master's, and doctoral degrees are awarded in 30 fields of study. Over 2,200 students are enrolled at MUSC and more than 700 degrees are awarded each year.

Patient care is provided within the MUSC medical center, founded in 1955. The medical center is the 600-bed referral and teaching facility which includes the Medical University Hospital, the Storm Eye Institute, the Children's Hospital, the Rutledge Tower (primarily outpatient services), the Hollings Cancer Center, and the Institute of Psychiatry.

MUSC has a staff of more than 8,000 employees. According to a human resources official, approximately 4,000 work at the medical center and 4,400 are academic/research employees.

MUSC's Affiliated Organizations

In addition to its academic division and medical center, MUSC has several affiliated organizations. This review focuses on MUSC's relationship with University Medical Associates (UMA) and its affiliated for-profit corporations. We did not review MUSC's other affiliated organizations. These entities are shown in the organizational chart (see Chart 1.1) and are described briefly below.

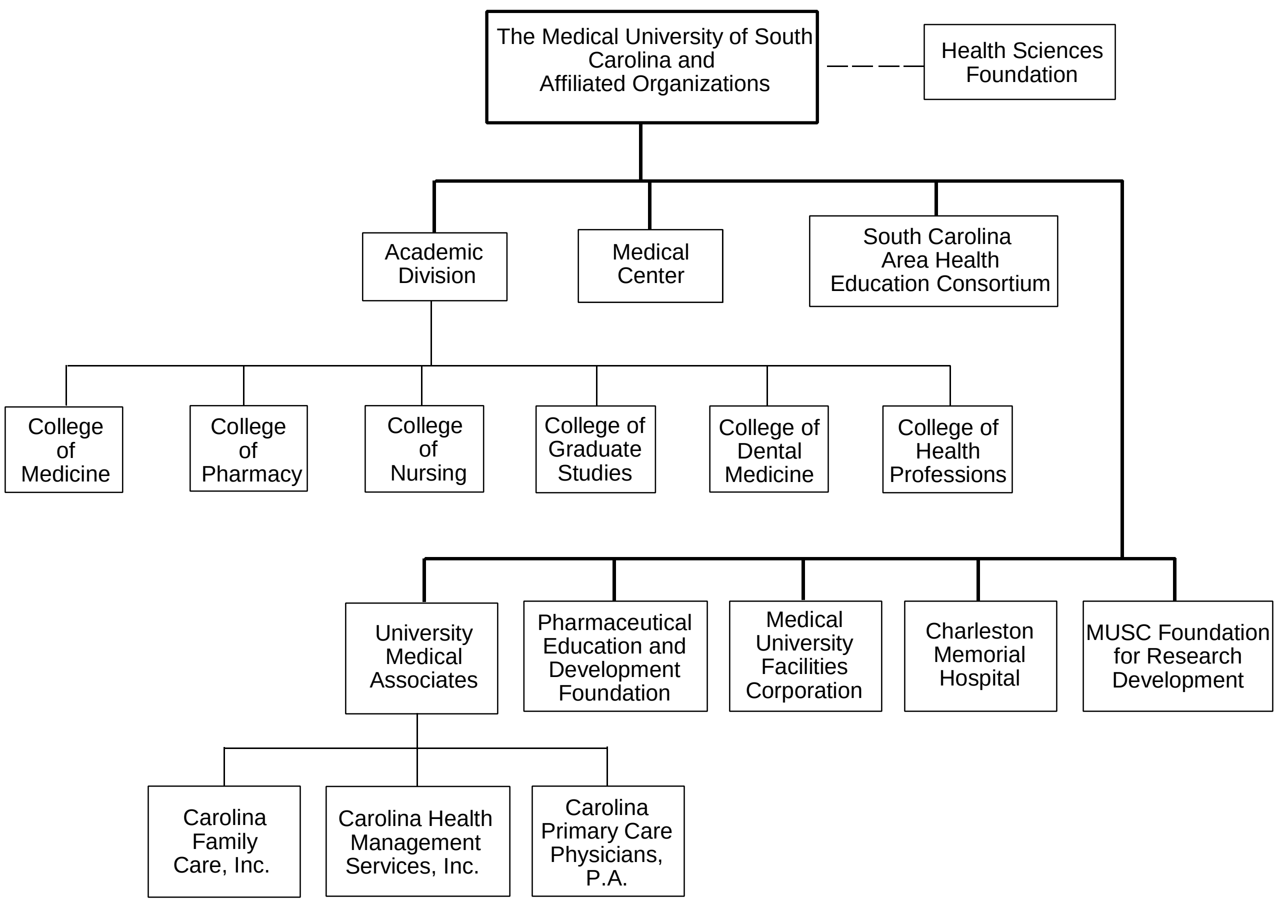
- Health Sciences Foundation (HSF) — a non-profit corporation that is an educational and charitable foundation established to promote education, research, and the clinical facilities and programs of MUSC.
- South Carolina Area Health Education Consortium (AHEC) — a state entity that provides a system of community-academic partnerships whose central purpose is the recruitment, education, and retention of primary health care providers.
- University Medical Associates (UMA) — a non-profit corporation established as the clinical practice plan for qualified faculty physicians and to support and promote the educational, medical, scientific, and research purposes of the university. UMA controls three for-profit corporations.
- Pharmaceutical Education and Development Foundation (PEDF) — a non-profit corporation established to provide pharmaceutical students with practical education and experience in the field of industrial pharmaceutics.

- Medical University Facilities Corporation — a non-profit corporation established to obtain financing for the university's acquisitions of real property.

- Charleston Memorial Hospital (CMH) — a 172-bed teaching hospital owned by Charleston County and managed by MUSC.

- MUSC Foundation for Research Development (MFRD) — a non-profit corporation established to develop and administer sponsored research projects conducted by MUSC faculty.

Chart 1.1: MUSC Organization



Source: MUSC.

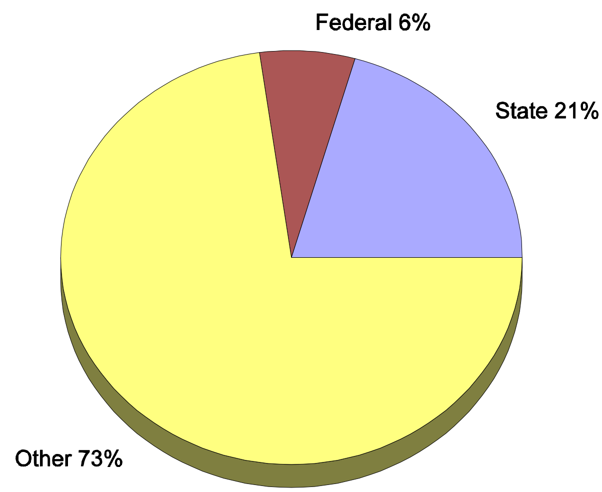
MUSC's Funding

MUSC's annual budget is more than $600 million, with the primary source of revenue coming from patient fees at the medical center. State and federal sources of income comprised 27% of MUSC's revenues for FY 97-98 (see Graph 1.1). In contrast, ten years ago about 45% of MUSC's revenues were from state and federal sources.

The state portion of MUSC's revenues (21%) is, however, greater than the average at other medical schools. The 74 U.S. public medical schools reported in a published survey that they received an average of 16% of their revenues from state and local government appropriations in FY 96-97.

MUSC's expenditures by function (see Graph 1.2) demonstrate that the majority of funds spent were for the medical center. See Appendix B for a five-year summary of MUSC's revenues and expenditures.

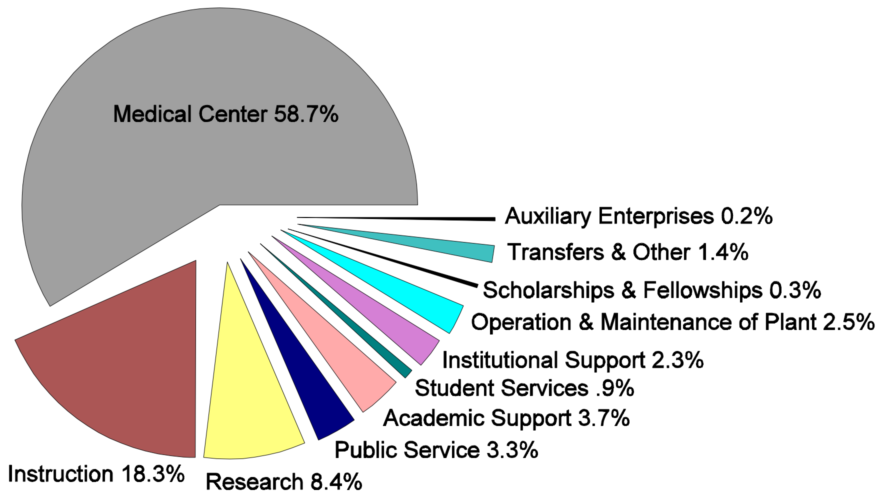
Graph 1.1: MUSC Revenues By Source – FY 97-98



'Other' is primarily revenue from patient services, but also includes medicaid disproportionate share, private grants and contracts, and student tuition and fees.

Source: MUSC.

Graph 1.2: MUSC Expenditures By Function – FY 97-98



Source: MUSC.

For state budgeting purposes, MUSC is divided into three divisions — academic, the medical center, and the Area Health Education Consortium (AHEC). Each division receives separate state appropriations (see Table 1.1).

Table 1.1: MUSC State Appropriations for FY 97-98

MUSC Division	Amount
Academic	$92,477,156
Medical Center	$20,580,819
Area Health Education Consortium	$17,025,296
TOTAL	**$130,083,271**

Source: MUSC.

MUSC's Relationship With UMA

MUSC, UMA, and Affiliated For-Profit Corporations

We reviewed the relationship between MUSC and its private practice plan, University Medical Associates (UMA). We also reviewed the relationship between UMA and its affiliated for-profit subsidiary corporations. It is not clear whether UMA could legally be considered as acting separately from MUSC. The two organizations have a blended relationship. This allows MUSC to use UMA to advance its mission. It also allows MUSC to avoid accountability for the use of public funds. If UMA acts for the state, it would be subject to some state restrictions on spending and limitations on its corporate structure.

Background

MUSC is authorized by law to establish a private practice plan. A private practice plan uses revenue from patients treated within the teaching facilities of a medical school to compensate faculty who treat patients and support the activities of the university. Provisos in appropriations acts since FY 82-83 have allowed universities to retain and spend funds from approved private practice plans in accordance with policies established by the board. The MUSC board has approved UMA as a private practice plan. Of the 125 U.S. medical schools, 120 have some type of private practice plan for their physicians.

The first private practice plan established for MUSC physicians was the Professional Staff Office (PSO). The PSO was established in October 1965 as a partnership with 63 physicians. MUSC was not involved with the operations of the PSO. According to a UMA official, there were problems with communication between the PSO and MUSC, and the MUSC board felt that there were inadequate controls to ensure that medical departments operated in an accountable manner. In an effort to exercise more control over the private practice plan, the faculty dissolved the PSO in 1991, and UMA was incorporated.

UMA was established to deliver inpatient and outpatient health care services for the University. It bills patients and collects and distributes all income generated by its participating physicians. UMA provides MUSC faculty and other health professionals with group practice arrangements. In a group practice, several physicians with various medical specialties provide patient care, and their business and administrative functions are centralized. UMA is separately incorporated with an independent governing board but has contracting, funding, and academic/teaching relationships with other parts of MUSC. UMA also employs the clinical faculty and its support staff and offers its own compensation and benefits plan.

Structure of UMA

UMA is a non-profit corporation granted exemption from state and federal taxation under section 501(c)(3) of the Internal Revenue Code. The approximately 500 faculty of the MUSC College of Medicine who are physicians are also members of UMA. In addition, UMA employs approximately 1,095 people to provide clinical and administrative support for physicians. UMA is governed by a board primarily made up of MUSC College of Medicine faculty members and MUSC administrators. In FY 97-98, UMA received patient care revenues of $119 million. During that period, UMA paid $44.7 million in salaries to MUSC faculty, transferred $2.4 million to MUSC and donated equipment and supplies valued at $2.4 million.

In addition to operating the practices of MUSC's physicians, UMA has established three for-profit corporations. According to UMA officials, these corporations were set up to expand MUSC's primary care and specialty care network by employing physicians other than MUSC faculty members. The officials stated that the trend toward managed care mandates that MUSC have relationships with primary care doctors in order to effectively compete for business. On July 1, 1995, UMA formed three for-profit subsidiaries for the purpose of creating a primary care network. This network was created by establishing new medical practices, buying and investing in existing medical practices, and contracting with area physicians. Table 2.1 describes these subsidiaries.

Table 2.1: UMA's Primary Care Subsidiaries

Corporation	Ownership	Purpose
Carolina Family Care, Inc.	UMA	Operates satellite and affiliate offices
Carolina Primary Care Physicians, P.A.	Physician who has assigned all stock rights to UMA	Employs network physicians and clinical staff
Carolina Health Management Services, Inc.	UMA	Employs management, administrative, and non-medical personnel

Source: UMA.

For the last two fiscal years, UMA's primary care subsidiaries have suffered substantial financial losses (see Table 2.2). According to a UMA official, these losses are occurring nationwide and are caused by the trend toward managed care in the health care environment. It is expensive to acquire and operate the primary care practices that are needed to obtain contracts with managed care companies.

Table 2.2: Profit/(Loss) of UMA's Primary Care Subsidiaries

Corporation	FY 96-97	FY 97-98
Carolina Family Care, Inc.	($7,927,518)	($9,085,993)
Carolina Primary Care Physicians, P.A.	$71,219	($169,249)
Carolina Health Management Services, Inc.	($270,104)	($191,648)

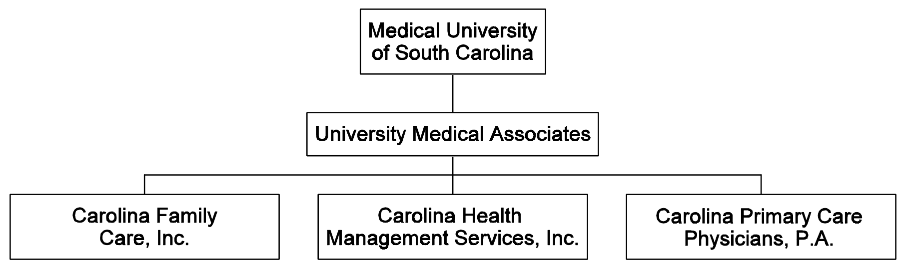
Source: UMA.

In 1997, UMA formed two additional for-profit corporations to create a specialty care network.

- Carolina Specialty Care, Inc. was created to provide specialty care services to patients in surrounding areas. It was owned 100% by UMA.
- Carolina Specialty Care Physicians, P.A. was created to employ the specialty care physicians. It was owned 100% by a physician who assigned all rights in the stock to UMA.

As of April 1999, the specialty care corporations were merged into Carolina Family Care, Inc. and Carolina Primary Care Physicians, P.A.

Chart 2.1. Organizational Chart of MUSC, UMA and UMA Subsidiaries



Source: UMA.

MUSC Governance of UMA

According to a survey conducted by the Association of American Medical Colleges for FY 96-97, 47% of the responding practice plans were part of the related university or medical school, and 38% were separate not-for-profit corporations. UMA's response to the survey indicated that it was a separate not-for-profit corporation and described its institutional relationship with MUSC as independent. However, it is questionable whether UMA is indeed separate and independent from MUSC.

We were asked to determine whether UMA is a public entity expending public funds. The answer to this question may largely depend on the nature of the relationship between UMA and MUSC. We concluded that, due to the complicated nature of this relationship, UMA's actions are not clearly separate from those of MUSC. Therefore, UMA's actions could be found to be state actions that are subject to requirements regarding the use of public funds.

One important factor in defining their relationship is the level of control MUSC exercises over UMA. MUSC authorized UMA as its private practice plan. When UMA was incorporated, two MUSC employees were listed as initial managers. UMA lists seven purposes for which it is established and operated, all of which specifically relate to MUSC. In addition to establishing

UMA's corporate purpose, the MUSC board has numerous ways of exercising control over UMA:

1. The MUSC board approves UMA's bylaws.
2. Two members of the MUSC board serve on the UMA board.
3. Four of MUSC's vice presidents serve on the UMA board.
4. Two community members on the UMA board are selected by the MUSC president.
5. All UMA voting members are MUSC faculty whose appointments are approved by the MUSC board.
6. The UMA board chairman and UMA's CEO report to the MUSC vice president for medical affairs.
7. UMA cannot own property without the approval of the MUSC board.
8. All faculty salaries including the UMA portion are approved by the dean of the MUSC College of Medicine and the MUSC president.
9. All UMA assets are transferred to MUSC if UMA is dissolved.

Blended Nature of MUSC and UMA

UMA's employees and funds are often not separated from those of MUSC. Many UMA employees work in MUSC departments and have MUSC job titles. For example, the MUSC College of Medicine's associate dean for finance and administration is actually employed by UMA. In one MUSC division, 46% of its staff are UMA employees. MUSC employees are sometimes supervised by UMA employees and vice versa. In addition, UMA often expends funds at the request of MUSC employees. For example, in FY 97-98 UMA made gifts and contributions requested by MUSC employees (see p. 26).

For financial reporting purposes MUSC must include UMA as a part of its financial statements as a "blended component unit." This means that even though UMA is a legally separate entity, since the university is financially accountable for UMA, UMA's financial information must be reported with that of MUSC. According to MUSC's audited financial statements:

> UMA is considered a component unit because the University has appointment authority over a majority of the UMA board. [Furthermore,] since the purpose of UMA is to provide services almost entirely to the University, it is considered a blended component unit.

According to a statement issued by the Governmental Accounting Standards Board, blended component units " . . . are so intertwined with the primary government [in this case, MUSC] that they are, in substance, the same as the primary government."

This blended relationship gives MUSC flexibility to use UMA to advance its mission. For example, UMA operates MUSC's outpatient clinics and can directly assist MUSC with salaries and other needs. However, by channeling the expenditure of its funds through UMA and its subsidiaries, MUSC can also avoid accountability for the use of public funds. It can spend funds for entertainment and make political contributions that are prohibited by the state.

Use of UMA Funds for MUSC's Purposes

Evidence indicates that UMA is becoming more blended with MUSC. We noted that UMA's direct funding support of MUSC has decreased in recent years. From FY 92-93 through FY 94-95, UMA transferred $10 to $13 million annually to MUSC, but in FY 97-98, UMA transferred only $2 million directly. Instead, according to a UMA official, UMA now pays for more items that formerly would have been paid for by MUSC (see p. 31). UMA also pays for services provided by some MUSC staff. For the services provided by MUSC's attorney and internal audit staff, UMA paid $85,999 in FY 97-98 and $94,000 in FY 96-97.

When employees and services are merged between the two organizations, it is difficult to separate the use of funds. MUSC's internal audit department has regularly pointed out problems relating to payment for services. For example, internal audit reports have questioned UMA's and its subsidiaries' use of MUSC's contract for computer services and Carolina Family Care's use of MUSC's contract for telephone services. Other internal audits have questioned whether employees paid by MUSC and UMA were in fact working for those organizations, and whether UMA was paying for equipment actually located at the MUSC hospital. MUSC could use UMA as a means to circumvent state controls over discretionary fund expenditures (see p. 17), contributions (see p. 24), and nepotism (see p. 53).

The MUSC board has been warned about the effects of exercising too much control over UMA's use of funds. An MUSC internal audit suggested that if MUSC exercises too much control over UMA, UMA could be deemed part of state government. The audit states that if the MUSC board wants UMA to be absolutely separate and independent of state restrictions, MUSC should not exert excessive control over the expenditure of UMA funds.

Legal Considerations in UMA's Actions

Courts have examined the circumstances under which a private entity could be considered acting for the state. The courts reviewed specific actions, such as the firing of an employee. The U.S. Supreme Court has stated that, for due process purposes, an evaluation of the extent of state involvement is needed to determine whether state action is involved. The court indicated that each case must be looked at individually for a sufficiently close association between the state and the action. In Modaber v. Culpeper Memorial Hosp., Inc., the U.S. 4th Circuit Court of Appeals explained the U.S. Supreme Court's decision in Jackson v. Metropolitan Edison Co. The court's finding is summarized below.

A state becomes responsible for a private party's act if the private party acts:

1. In an exclusively state capacity by exercising powers reserved for the state;
2. For the state's direct benefit when it shares the rewards and responsibilities of a private venture with the state; or
3. At the state's specific behest when it does a particular act which the state has directed or encouraged.

This illustrates the type of analysis that could be applied to UMA's actions on behalf of MUSC. Factors that could be considered when analyzing whether UMA acts for the state include UMA's board, by-laws, funding, and statutory authority. Factors that could indicate that UMA acts for the state include:

- MUSC employees or board appointees serve on UMA's board.
- The MUSC board approves all changes to UMA's bylaws.
- UMA's assets revert to MUSC upon UMA's dissolution.

Factors that might indicate that UMA does not act for the state include:

- UMA does not receive state appropriations.
- UMA was not created by statute but by the MUSC board pursuant to a proviso in the appropriations act.
- The provision of medical services has been determined by the courts not to be an exclusive power of the state.

All of these factors could be considered when determining if UMA is acting for the state.

In 1998, legal consultants hired by MUSC evaluated the relationship between MUSC and one of its other affiliated foundations. The consultants recommended that the foundation board be restructured to give a clear majority to members not affiliated with MUSC. Existing legal precedents strongly support the position that a corporation governed by non-MUSC members would not be found to be controlled by MUSC. The consultants also recommended that MUSC's control over the foundation's bylaws be eliminated. This gives MUSC an extremely high level of control over the foundation and would weigh strongly in favor of a determination that the foundation is an "alter ego" of MUSC.

If UMA were considered to be acting for the state, it may have to follow additional requirements and restrictions as appropriate, including the following:

- The Freedom of Information Act would apply to UMA documents.
- UMA's expenditures would have to meet the public purpose test.
- UMA could not make political contributions.
- UMA could not own for-profit subsidiaries.

There would be more state control over UMA's expenditures and therefore more accountability to the state.

UMA is currently structured as a non-profit corporation with three for-profit subsidiaries. As a corporation separate from MUSC, this organizational structure is permitted under state law. However, if UMA acts for the state, it could be prohibited from acting through the for-profit corporations. Article X, §11 of the South Carolina Constitution prevents the state from being a stockholder in any corporation. The for-profit corporations could be restructured into non-profit organizations, or UMA could establish contractual relationships with outside providers.

Conclusion

As UMA currently operates, it is unclear whether UMA would be considered as acting for the state. UMA could be vulnerable to a challenge to the validity of some of its actions. For example, its expenditures of funds could be questioned (see p. 29).

MUSC should evaluate how it interacts with UMA to better define the relationship. Such an evaluation should be integrated with its ongoing strategic planning process. In 1998, two different consultant groups provided advice about a strategic plan for MUSC's organizational structure. A key part of organizational planning includes the nature of MUSC's hospital. MUSC could try to affiliate its hospital with a for-profit corporation. Other strategies could involve the hospital (now a state agency) becoming a state authority or a non-profit organization. Both consultant groups identified the need for better integration between UMA and the MUSC Medical Center. As part of its strategic planning process, MUSC officials should evaluate its relationship with UMA.

Recommendation

1. The MUSC board of trustees should clearly define UMA's role with regard to its actions for the state. If the board wants UMA to act as a private corporation, it should make changes to ensure that UMA's actions are independent from those of MUSC. These changes could include:

    - Restructuring UMA's board of directors so that a majority of the board is not affiliated with MUSC.
    - Eliminating MUSC's control over UMA's bylaws.
    - Defining separate authority and accountability for spending for the two organizations.

    If the board wants UMA to act for the state, it should make changes to ensure that UMA's actions comply with all state requirements. These changes could include:

    - Restructuring UMA's for-profit corporations to prevent the state from being a stockholder in a corporation or prohibiting MUSC from requesting any actions through the for-profit corporations.
    - Requiring all UMA expenditures to meet guidelines for the use of public funds.

Ambulatory Care Agreements

We reviewed the ambulatory care agreements between MUSC and UMA to determine whether the state's interests have been protected. These agreements govern the operation of MUSC medical center's outpatient clinics and their use to provide clinical education to MUSC students and residents. We found no evidence that the state's interests have not been protected.

On July 1, 1994, MUSC, through its medical center, and UMA entered into an agreement for UMA to manage MUSC's ambulatory care activities (outpatient clinics). According to a UMA official, this agreement was written to get the MUSC physicians involved in the clinics and increase their use. Under this agreement, MUSC was responsible for providing the facilities and UMA was responsible for providing the staff to operate the clinics and for billing for most services to patients. As its fee for these services, UMA kept 10% of the net income from these billings and remitted the remaining revenue to MUSC.

On January 1, 1998, a new agreement was signed under which MUSC will do the billing for ambulatory care activities, and UMA will provide the facilities. Under this agreement, MUSC handles the billing and reimburses UMA for its actual expenses, estimated to be $30 million for FY 97-98, for the cost of operating the clinics. Any equipment acquired by UMA under this agreement is donated to MUSC. This agreement has a five-year term through December 31, 2002, but MUSC has the right to immediately terminate the agreement at will.

Financial Issues

In this chapter we discuss MUSC's discretionary fund expenditures. Our review of this area raised some questions about prudent use of resources. MUSC and its consultants have stated that MUSC, particularly its hospital, may be unable to compete in today's health care environment unless it has more flexibility and freedom from state restrictions such as those on procurement and personnel. However, we noted many instances where MUSC spent resources freely and in a manner that appeared to contradict its need to operate efficiently to compete with other institutions. These spending practices can be seen in MUSC's discretionary fund expenditures and its contributions, as discussed below.

We also noted that MUSC has made an increasing number of expenditures through UMA (see p. 31). UMA and its subsidiaries also spend freely for items such as entertainment, gifts, and contributions, including political contributions. If UMA is considered to be acting for the state, some of these expenditures may not comply with state law regarding the expenditure of public funds. In our opinion, UMA's funds could be used to more directly further the mission of MUSC.

MUSC's Discretionary Spending

In recent audits, we have reviewed the expenditure of discretionary funds, primarily auxiliary enterprise revenues such as vending machine profits, at Winthrop University and Francis Marion University. We found that Winthrop and Francis Marion may have violated state law by improperly spending public funds on meals, receptions, and entertainment. MUSC has a large amount of discretionary funds available, including funds generated by its private practice plan with UMA. For example, between January and June of 1998, MUSC spent $6,267,776 in discretionary funds.

Even though a 1997 MUSC internal audit questioned whether many of the discretionary fund expenditures were an appropriate use of public funds, we found no evidence that MUSC changed its spending practices in response to this review. While a significant portion of MUSC's discretionary fund expenditures from January through June 1998 were for purposes such as personnel costs, operations, and staff recruiting, we identified many expenditures that did not serve a public purpose and may be in violation of state law.

State Spending Guidelines

Under South Carolina law, public funds must be expended for a public purpose. Public funds are not limited to tax revenues but include funds from any source in the hands of a public official. A May 21, 1993, attorney general's opinion states:

> . . . every expenditure of public funds must directly promote a public purpose . . . . As related to a university, it might be said that an expenditure would be required to promote the public health, safety, morals, general welfare, etc. of *all of the inhabitants of the university, or at least a substantial part thereof.* [Emphasis added.]

In addition, this same attorney general's opinion cited prior attorney general's opinions, which prohibit public funding of social activities and the use of public funds for individuals, as follows:

- Public funding of picnics and social events for governing body members and employees of a local government would be improper (May 22, 1989).
- Using public funds for a retirement reception for a state employee would not be proper. The public benefit of such an event, according to the opinion, would be remote or indirect (March 29, 1984).
- Profits from a county jail canteen should not be used for selected individuals. However, using " . . . such profits for the entire inmate population could probably be authorized" (June 1, 1992).

Generally, state employees are authorized publicly funded meals when traveling on official state business.

MUSC's Additional Spending Guidelines

Appropriations act proviso 72.8 in FY 97-98 and similar previous provisos state:

> . . . funds at State Institutions of Higher Learning derived wholly from . . . approved Private Practice plans at institutions and affiliated agencies may be retained at the institution and expended by the respective institutions only in accord with policies established by the institution's Board of Trustees.

The proviso states that travel and procurement regulations do not apply to the use of these funds.

In October 1997, MUSC's board of trustees approved a policy on discretionary funds which mandates that "all such expenditures shall comply with State law and be expended for only public purposes directly benefitting the University." The policy also states that all expenditures are to be judged by a prudent person standard, where a "reasonable, independent and objective person . . . would agree that good skill and good judgement were exercised in the use of resources." Further, each expenditure "must be documented on the requisition as reasonable, appropriate, and beneficial to the University."

In October 1998, the board of trustees approved an amended policy on discretionary spending. The new policy is substantially the same as the 1997 policy, but adds per-person meal limits for recruitment and special activities of $15 for breakfast, $25 for lunch, and $75 for dinner.

Review of Specific Discretionary Expenditures

MUSC's internal audit department reviewed the university's discretionary spending in a report presented to the board of trustees in May 1997. This report noted that MUSC's spending policy from 1982 was not adequate, and questioned whether many of MUSC's expenditures of public funds were appropriate. Despite the approval of a new discretionary funds policy in October 1997, our review of more recent expenditures demonstrated that many of the same types of questionable transactions noted in the internal audit were still being made on a consistent basis.

We reviewed a subjective sample of 138 expenditures from January through June 1998 that totaled $262,100, primarily from refreshment costs and special activities accounts. We examined the available invoices and supporting documentation for each transaction.

Expenditures Not Serving a Public Purpose or the Majority of MUSC

The May 1997 internal audit described one category of discretionary expenditures that appeared to benefit a select group of employees or students instead of the majority of the university or the community it serves. Some expenditures were for events that seemed to be social or perquisites for select individuals. During our review of comparable expenditures from early 1998, we noted many examples which show that this spending pattern has continued, including those listed in Table 3.1.

Table 3.1: Discretionary Fund Expenditures Not Serving a Public Purpose, January – June 1998

Date[1]	Purpose	Amount
01/16/98	Reception for the freshman class at the Gibbes Museum of Art	$1,500.00
02/25/98	Cash prizes for art contest winners	$4,000.00
04/01/98	Food, equipment, and room charges for retreat for 12 members of MUSC's finance and administration senior management team	$849.40
04/01/98	Food, refreshments, and room charges for weekday retreat for quality improvement steering committee	$1,233.76
04/09/98	Cookies, fruit, and beverages for MUSC physicians to encourage completion of paperwork — March1998	$7,002.45
04/15/98	Catering services for weekday retreat at Alhambra Hall for Medical Center management	$8,815.47
05/29/98	Reception for 38 faculty members, residents, and outside surgeons at the Charleston Harbor Hilton Resort	$1,756.56
06/03/98	Farewell dinner for the CEO of the Pharmacy Research Center (includes $916 in alcoholic beverages)	$3,686.87
06/12/98	Tobacco jar given as a gift to a visiting professor	$143.10
06/16/98	Dinner for departing fellows	$1,209.60
06/17/98	Flower arrangements for a commencement dinner	$954.00
06/20/98	Balance due for meeting of 17 College of Medicine managers at the Seabrook Island Conference Resort (doesn't include a $2,000 deposit)	$5,618.15
06/20/98	Dinner for graduating residents at the Dunes West Golf Club	$1,079.50

1 The date the expenditure was entered into MUSC's accounting system.

Source: MUSC.

Expenditures Unlikely to be Perceived as Appropriate by the General Public

The May 1997 internal audit described another category of discretionary expenditures that an average taxpayer might not view as necessary or beneficial to the overall operation of the university. As noted above, MUSC's October 1997 discretionary funds policy stated that all expenditures are to be judged by a prudent person standard. During our current review, we observed transactions which seemed excessive and/or unnecessary, including those shown in Table 3.2.

Table 3.2: Excessive and/or Unnecessary Discretionary Fund Expenditures, January – June 1998

Date[1]	Purpose	Amount
01/21/98	Banquet dinner for MUSC's board of visitors and board of trustees at the Embassy Suites Hotel (includes over $1,250 for 56 bottles of wine and $519 in liquor)	$9,389.46
02/09/98	Reimbursement that primarily included drinks, flowers, candles, etc., for donor receptions, as well as candy for the spouses of the board of trustees	$355.89
03/09/98	Dinner for MUSC's board of trustees and guests (doesn't include $945 gratuity)	$4,760.01
04/13/98	Dinner for MUSC's board of visitors (includes $1,091 for alcoholic beverages)	$4,633.32
04/15/98	Caribbean cruise (8 days/7 nights) for a resident to learn about Attention Deficit and Hyperactivity Disorder	$1,500.00
05/21/98	Dinner at the Middleton Place Landmark for MUSC's board of trustees (includes $646 in liquor and $525 gratuity)	$4,094.02
06/05/98	Luncheon and dinner banquets for "Golden Grads" and trustees on May 14, 1998	$12,748.30
06/18/98	Catering and lodging for diversity workshop for residents at the Wild Dunes Resort, April 3-4, 1998	$6,877.92
06/29/98	Two banquets at the Harbour Club: $10,150 for commencement dinner (includes over $2,900 for alcoholic beverages) and $550 for breakfast fund-raiser	$10,699.37
07/06/98	Breakfast for Doctor's Day	$4,710.68

1 The date the expenditure was entered into MUSC's accounting system.

Source: MUSC.

Expenditures Without Adequate Documentation

The May 1997 internal audit also noted that many of the discretionary expenditures reviewed were lacking adequate documentation, including a clear description of the event and its purpose, a list of attendees (specifying whether MUSC employee or guest), and a justification for the expense. MUSC's October 1997 discretionary funds policy requires that each expenditure "must be documented on the requisition as reasonable, appropriate, and beneficial to the University," while reimbursements "must include a clear and detailed description of the purpose of the expenditure and the names of those in attendance." In our review of 1998 expenditures, we found that many payments lacked adequate documentation, including those listed in Table 3.3.

Table 3.3: Discretionary Fund Expenditures Lacking Adequate Documentation, January – June 1998

Date[1]	Purpose	Amount
01/06/98	Catering charges for a risk forum in Columbia[2]	$1,222.00
02/19/98	Staff retreat at a Holiday Inn	$1,581.98
03/03/98	Banquet lunch at a Holiday Inn	$962.00
04/20/98	Food and other charges for a meeting at the Harbour Club	$655.31
04/23/98	Reimbursement for items for a faculty retreat	$448.19
05/12/98	Catered faculty and staff educational conference	$2,456.76
05/26/98	Food and beverages for diversity workshop at the Kiawah Island Golf & Tennis Resort	$272.75
06/02/98	Banquet at the Charleston Place Hotel	$1,183.80
06/10/98	Catered reception	$498.83
06/28/98	Banquet lunch for a teaching workshop at a Holiday Inn	$1,664,95
07/02/98	Strategic planning retreat for MUSC staff, Board members, and consultants (includes two banquets)	$6,733.41

1 The date the expenditure was entered into MUSC's accounting system.
2 We noted a duplicate $1,222 payment was made for the same catering services on February 9, 1998. After we inquired about the second payment, MUSC contacted the vendor for a refund.

NOTE: In April 1999, after reviewing the draft audit, MUSC furnished additional documentation for some of these expenditures.

Source: MUSC.

Conclusion

According to MUSC officials, the October 1997 discretionary funds policy was approved by the board of trustees in response to an internal audit report that was critical of MUSC's spending of discretionary funds. Even though this policy was supposed to tighten internal spending controls, we found that the same inappropriate use of public funds has continued with 1998 expenditures. MUSC officials stated that these types of expenditures are regularly made at other institutions and in the private sector, and have significant benefits for the university. However, many of MUSC's expenditures do not represent a prudent use of public resources and may not comply with state law.

Recommendations

2. MUSC should ensure that private practice plan revenues and other public funds are spent in compliance with state law.

3. The General Assembly may wish to provide more specific legislative guidelines for the spending of discretionary funds at state institutions of higher learning.

Internal Audit

We observed that MUSC has a strong internal audit function that is structured to provide independent assessments of agency operations. However, it is not clear to what extent management has implemented the recommendations in internal audits.

In previous reviews of other agencies, we have identified problems with the resources devoted to internal audit and the independence of the internal audit function. Internal audits are an important control that agencies can use to ensure that resources are being used appropriately. Internal auditors should be organizationally located outside the agency's staff or line management and should regularly report to the appropriate government oversight body. MUSC's internal audit department reports directly to the board of trustees, and its staffing and funding are determined by the board. This structure allows the internal audit department independence in reviewing MUSC's operations.

In the course of our audit, we reviewed several of MUSC's internal audits, including reports about discretionary spending, MedAir operations, and a federal energy grant (see pp. 17, 45, 54). The audits focused on performance issues, identified significant problems, and made recommendations for improvement. We noted, however, that MUSC has not implemented appropriate changes in its practices for discretionary funds spending even though its internal audit identified several relevant issues concerning the expenditure of public funds. Careful consideration of issues identified and implementation of corrective action will increase the benefits MUSC can realize from its internal audit process.

Recommendation

4. MUSC should ensure that issues raised in internal audits are carefully considered and action is taken to correct identified problems.

MUSC and UMA Contributions

One of our audit objectives was to review contributions made by MUSC and UMA to outside organizations, and to determine if these gifts were made in compliance with state law. We examined financial records from MUSC, UMA, and UMA's for-profit subsidiary corporations to identify contributions made during FY 96-97 and FY 97-98. We found that while the total amount of contributions made by MUSC significantly decreased from FY 96-97 to FY 97-98, contributions made from UMA accounts during the same period increased by an even greater amount (see Table 3.4).

Table 3.4: Contributions Made by MUSC and UMA

Contributing Organization	FY 96-97	FY 97-98
MUSC	$133,592	$6,103
UMA	$378,401	$809,750
UMA's Subsidiaries	$9,100	$35,925
TOTAL	**$521,093**	**$851,778**

Source: MUSC and UMA.

We have reviewed state guidelines on contributions in previous audits. Article XI, §4 of the S.C. Constitution prohibits the expenditure of public funds for "... the direct benefit of any religious or other private educational institution." In addition, state law requires that funds from any source in the hands of a public official be expended for a public purpose. S.C. Supreme Court cases and attorney general's opinions have further indicated that it is unlawful to contribute public funds to a nonprofit corporation that is sectarian or religious, or to civic organizations whose benefits extend only to members. Additionally, expenditures of public funds must be in accord with the mission of the agency.

MUSC's Contributions

All contributions made by MUSC during the period reviewed were not from state appropriations, but from discretionary funds, such as those generated by MUSC's private practice plan. In addition to complying with criteria for the expenditure of public funds described above, MUSC's contributions must also follow board policy. MUSC's October 1997 discretionary fund policy states that all donations and sponsorships must receive prior written approval of MUSC's president, and be paid out of an MUSC affiliate (such as UMA or the Health Sciences Foundation).

Most of MUSC's contributions from FY 96-97 and FY 97-98, such as donations to the American Heart Association, the American Cancer Society, and the American Red Cross, appeared to meet a public purpose and were in accord with MUSC's mission. However, a number of expenditures did not appear to meet state criteria for the use of public funds. Some of these transactions are listed below:

- MUSC donated $1,000 to a private high school.
- MUSC donated $100 to a local YWCA, and made a $50 memorial contribution directly to a church.
- Among contributions to organizations whose benefits appeared to be limited to members, MUSC gave $1,000 to sponsor a women's softball team, $400 to support an adult basketball team, $1,000 to a high school JROTC program, and $100 to pay an individual's membership dues in a library society.

Some other contributions that appeared not to benefit MUSC or have any direct relationship to its public mission included:

- $5,000 donated to a symphony group.
- $1,500 to support an English teachers' conference.
- $1,000 given in support of an arts festival.

We noted that nearly all of MUSC's contributions made during FY 97-98 were in violation of the agency's October 1997 discretionary funds policy described above; we found no documentation of prior written approval of these contributions by the president, and they were paid directly by MUSC rather than through an affiliate organization.

UMA's Contributions

One of UMA's corporate purposes is to engage in charitable programs related to patient care, education, and the research mission of MUSC. Consistent with this purpose, we noted that approximately $109,160 (29%) of UMA's contributions in FY 96-97 and $322,435 (40%) of UMA's contributions in FY 97-98 went to the Health Sciences Foundation, a nonprofit affiliate of MUSC (see p. 3).

According to UMA officials, UMA has two written policies that are applicable to gifts and contributions — its accounts payable (AP) guidelines, and a matching policy for employees' donations. The AP guidelines only disallow contributions to political action committees or for charity events that do not benefit UMA or MUSC. The matching policy provides that UMA will match its employees' charitable contributions of up to $500 per year.

MUSC officials often request that contributions be made through UMA.

During the period reviewed MUSC officials often requested that UMA make contributions from funds that were due MUSC. For example, UMA's faculty practice plan provides that 1% of plan revenues be allocated to the MUSC president's fund. We found that the president frequently requested that contributions be made from the president's fund through UMA. The amount of these contributions was then deducted from the amount available. In fact, MUSC's 1997 policy on the use of discretionary funds requires not only that the president give written approval of donations and sponsorships, but that they be made by an MUSC *affiliated* organization *on behalf of* MUSC. Since the funds used for the contributions were MUSC's, they could be considered public funds.

Because UMA's revenues are from a private practice plan and we were unable to conclusively determine whether UMA should be considered as acting for the state (see p. 7), it is unclear what criteria should apply to contributions made through UMA accounts. Most of UMA's contributions were requested by MUSC officials who were responsible for both MUSC and UMA accounts. Some of the expenditures made through UMA were from funds controlled by public officials, and the contributions were deducted from the revenue that was available for the respective MUSC office or department according to the practice plan. Further, 118 (85%) of the 139 contributions made by UMA in accordance with its matching policy were paid at the request of UMA members who are also MUSC faculty.

If a UMA expenditure requested by a public official is considered the use of public funds, a number of UMA transactions would be inappropriate according to state guidelines, including the following:

- 47 matching contributions totaling $20,250 to religious and/or private high schools.
- Donations to three churches totaling $200, $2,800 to a local YWCA, and $1,250 in matching contributions to a religious foundation.
- $10,000 donated to a local arts festival.

Political Contributions

Nearly all contributions made by UMA's subsidiary corporations during FY 96-97 and FY 97-98 were of a political nature. According to financial records, only two subsidiaries made any contributions during the period reviewed — Carolina Health Management Services, Inc. (CHMS) made 59 contributions, while Carolina Specialty Care, Inc. made one. Fifty-seven (95%) of these 60 contributions were made to political campaigns. As discussed on page 9, these subsidiaries suffered financial losses in FY 96-97 and FY 97-98.

The political contributions paid out of UMA's subsidiary accounts were typically requested by UMA's CEO. Documentation maintained by UMA concerning these contributions indicates that many requests originated from MUSC officials, such as the executive assistant to the president and the legislative liaison, and that MUSC and/or UMA sought recognition for these contributions. These circumstances present the appearance of impropriety, as South Carolina Code §8-13-1346 states that no public resources are to be used to influence the outcome of elections. The total amount of political contributions made through UMA's subsidiaries increased over 400% between FY 96-97 and FY 97-98 (see Table 3.5). According to UMA's CEO, prior to the creation of UMA's for-profit subsidiaries, MUSC and UMA officials used their personal funds to make contributions.

Table 3.5: Contributions Made Through UMA's Subsidiary Corporations

Type of Contribution	FY 96-97	FY 97-98	TOTAL
Political Campaigns	$7,100	$35,550	$42,650
Non-political	$2,000	$375	$2,375
TOTAL	**$9,100**	**$35,925**	**$45,025**

Source: UMA.

We observed that the political contributions were made within the state limits for campaign contributions for each election cycle. In no case did a statewide candidate receive more than $3,500 per cycle, nor did any regional candidates receive more than $1,000 per cycle from the subsidiary corporations. The largest amount contributed to a single official was $7,000 contributed to a gubernatorial candidate, $3,500 in FY 97-98 during the primary election cycle, and $3,500 in October 1998 during the general election cycle.

We noted another area of concern regarding a series of donations to one statewide political candidate. Between September 1997 and October 1998, three contributions totaling $2,250 were made to the incumbent South Carolina Attorney General (AG). In 1996, the AG had conducted a review of the legality of UMA's operations in response to a request from members of the General Assembly. Since the AG may periodically be asked to review legal issues relating to UMA and its subsidiaries, these contributions present the appearance of a conflict of interest. Because government auditing standards mandate that we be assured of the independence of any outside experts whose work we rely on, we did not request any new opinions regarding MUSC or UMA from the AG during this audit.

Recommendations

5. MUSC should discontinue its practice of contributing funds for the direct benefit of religious or other private educational institutions, to nonprofit corporations that are sectarian or religious, or to civic organizations whose benefits extend only to members. This applies to contributions made through MUSC or UMA accounts controlled by MUSC officials, regardless of the revenue source.

6. MUSC and UMA officials should not request that political contributions be made through UMA's subsidiary corporations.

UMA's Expenditures

We reviewed UMA's expenditures to determine what criteria govern these expenditures and whether these requirements were followed. As discussed on page 7, due to the blended nature of MUSC and UMA, we were unable to determine whether UMA acts separately from MUSC. If UMA were subject to requirements regarding the use of public funds, we found that some expenditures would appear to violate these requirements.

We reviewed total expenditures made by UMA for FY 96-97 and FY 97-98 (see Table 3.6). The majority of the expenditures in each major category (i.e. departmental and corporate) were for faculty and staff salaries.

Table 3.6: UMA's Expenditures for FY 96-97 Through FY 97-98

Description	FY 96-97	FY 97-98	2-Year TOTAL	Percent[2]
Departmental Expenses	$83,017,077	$94,297,228	$177,314,305	64.6%
Provision for Bad Debts	$15,059,105	$17,808,485	$32,867,590	12.0%
Corporate Operating Expenses	$12,436,766	$16,850,216	$29,286,982	10.7%
Ambulatory Care Agreement Expenses[1]	-0-	$18,570,561	$18,570,561	6.8%
Interest Expense	$2,338,412	$2,915,854	$5,254,266	1.9%
Rent Expense	$871,171	$252,761	$1,123,932	0.4%
Interest Expense on Rental Property	$1,045,476	$687,017	$1,732,493	0.6%
Loss on Disposition of Assets	$1,903	$4,865	$6,768	0.0%
Nonmandatory Contributions to Health Sciences Foundation	$108,380	$903,725	$1,012,105	0.4%
Nonmandatory transfers to MUSC	$4,667,677	$2,678,488	$7,346,165	2.6%
TOTAL	**$119,545,967**	**$154,969,200**	**$274,515,167**	**100.0%**

1 The accounting methods used for the Ambulatory Care Agreement were changed on 1/1/98. See page 34 for further discussion.
2 Percentage of total expenditures.

Source: UMA.

UMA has established accounts payable guidelines for internal use by employees. These guidelines give instructions for submitting expenses for reimbursement and list the types of eligible expenses. For example, UMA's internal guidelines limit reimbursement for meals to $75 per person, per meal. This far exceeds the state's limits of $6 for breakfast, $7 for lunch, and $12 for dinner for in-state meals. However, according to appropriations act proviso 72.8 in FY 97-98 and provisos in earlier years, there are no limits on the cost of meals if they are paid for with revenues generated from a private practice plan.

UMA Could be Considered to be Acting for the State

As stated previously, UMA's transfer of funds to MUSC has decreased in recent years. According to a UMA official, one reason for this is that UMA now pays for more items that normally would have been paid for by MUSC. Specifically, UMA has increased its expenditures for MUSC salaries, meetings, conferences, and travel. UMA officials stated it was sometimes more efficient for MUSC to purchase through UMA. We noted that UMA, as a private corporation, does not have to follow state requirements for public funds when it makes purchases for MUSC. However, it is not clear whether UMA is acting separately from MUSC. If UMA acts for the state, its expenditures would have to serve a public purpose (see p. 7).

Expenditures Related to MUSC's College of Medicine

We reviewed listings of detailed expenditures made by UMA on behalf of MUSC's College of Medicine for FY 96-97 and FY 97-98. The total amounts spent for this period in the categories we reviewed are presented in Table 3.7.

Table 3.7: UMA Expenditures Relating to the College of Medicine for FY 96-97 and FY 97-98 for Four Expense Accounts

Category of Expense	FY 96-97	FY 97-98	2-Year TOTAL
Meetings, Conferences, and Dinners	$1,228,545	$1,223,758	$2,452,303
Travel	$433,393	$449,859	$883,252
Recruitment	$229,605	$295,445	$525,050
Gifts	$35,756	$16,215	$51,971
TOTAL	**$1,927,299**	**$1,985,277**	**$3,912,576**

Source: UMA.

Examples of expenditures from these accounts that would not directly promote a public purpose are listed in Table 3.8.

Table 3.8: Descriptions of Expenditures Made by UMA During FY 97-98

Date[1]	Description of Expenditure	Amount
6/10/98	Catering fee for residents' graduation dinner	$4,004.00
7/16/97	Catering fee for residents' year-end gathering	$1,767.80
10/22/97	Alcohol (and bartending fee) for alumni cultivation reception	$1,324.79
7/01/98	Retirement ceremony at the Harbour Club for two doctors	$3,158.79
6/01/98	Retirement reception for one doctor	$7,419.11
7/09/97	Chief residents' banquet at the Country Club of Charleston	$4,939.50
1/14/98	Catering fee for one department's holiday party	$7,281.00
12/05/97 & 1/21/98	Department Christmas party at the Harbour Club	$14,825.69
9/17/97	Farewell dinner for hospital CEO (costing over $93 per person)	$7,282.13
5/27/98	Dean's reception for 1998 graduating class and their parents	$6,095.00
8/13/97	Hospital CEO's trip to Washington, D.C., for sitting for a painted portrait	$1,214.40
5/06/98	Payment for babysitting service for new faculty member	$100.00
7/16/97	Two bracelets — gifts for chief residents' wives	$328.60
8/27/97	Christmas gifts for one department's staff	$853.87
12/03/97	Christmas bonus for 42 employees of one department	$1,050.00
1/28/98	Special-ordered MUSC trays for the MUSC board of trustees	$1,532.00
6/03/98	Reimbursement for 1997 Christmas gifts for residents	$308.91
12/11/97	Payment for 30 fruit boxes to be given to referring physicians	$660.00

1 The transaction date from UMA's accounting system.

Source: UMA.

The expenditures listed in Table 3.8 appear to benefit selected members of MUSC's / UMA's faculty, staff, residents, and students. Although it is unclear whether UMA acts for the state, its funds are used to support a state entity. These funds may be better used if they are spent more directly in support of MUSC's mission.

Recommendation

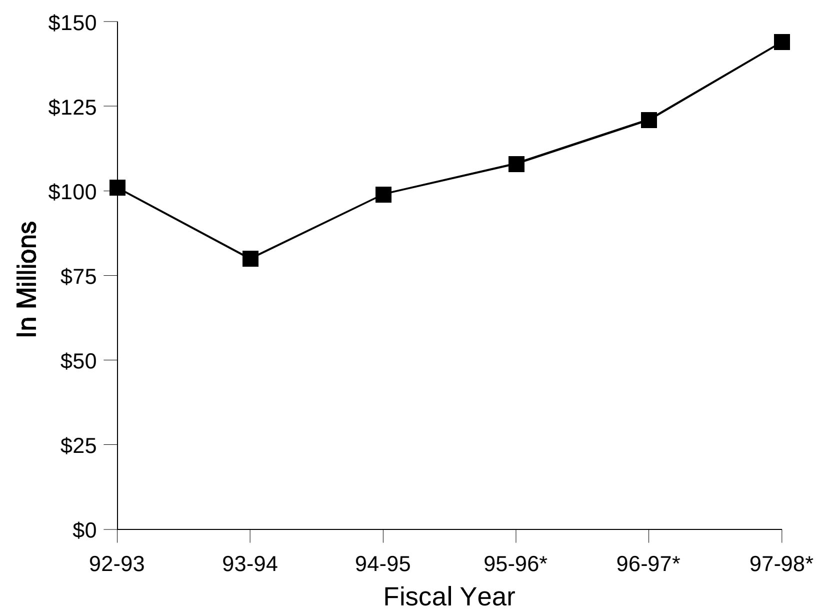
7. UMA should reevaluate its spending guidelines to ensure they reflect a prudent use of resources.

UMA's Income

Our audit request asked us to determine whether UMA had income from sources other than physicians' fees. We found that while most (85%) of UMA's income is from physicians' fees, a portion is from other sources. A description of UMA's sources of income follows.

As shown in Graph 3.1, UMA's total revenues have been generally increasing since FY 92-93.

Graph 3.1: University Medical Associates Revenues



* Since FY 95-96, UMA's revenues include revenues of its for-profit subsidiaries.

Source: UMA.

We reviewed the sources of UMA's income for FY 96-97 and FY 97-98 (see Table 3.9). Most of UMA's revenues are payments for services performed by its member physicians and other health professionals. In addition to patient care, these services include ancillary services, such as x-rays and lab work. UMA also receives income when its doctors serve as expert witnesses or participate in drug studies.

Table 3.9: University Medical Associates Income

Source of Income	FY 96-97	FY 97-98	Two-Year TOTAL	Percent
Net Clinical Service Revenue	$106,844,476	$119,279,796	$226,124,272	85.0%
Other Operating Revenue	$1,953,870	$3,480,145	$5,434,015	2.0%
Ambulatory Care Management Fee Income	$723,484	$(645,055)	$78,429	0.0%
Ambulatory Care Agreement Support		$15,900,000	$15,900,000	6.0%
Primary Care Development Support From Medicaid	$7,000,000	$3,500,000	$10,500,000	4.0%
Rental Income	$2,155,445	$1,074,729	$3,230,174	1.2%
Investment Income	$1,938,142	$1,819,286	$3,757,428	1.4%
Other Income	$630,620	$403,473	$1,034,093	0.4%
TOTAL	**$121,246,037**	**$144,812,374**	**$266,058,411**	**100.0%**

Source: UMA.

UMA has several sources of revenue that do not directly involve physician services. UMA receives income from operating clinics in which MUSC furnishes ambulatory (outpatient) care to patients and clinical education to students. Since 1992, UMA has staffed and operated MUSC's ambulatory care clinics. Through 1997, UMA's income for providing these services (recorded in Table 3.9 as management fee income) was 10% of the profits of the clinics. Beginning in 1998, UMA and MUSC implemented a new ambulatory care agreement wherein MUSC reimburses UMA's expenses for operating the clinics (see p. 16). The apparent increase in UMA's revenues under the new agreement, $15.9 million for the period January – June 1998, is offset by its expenses in operating the clinics (see p. 30).

UMA also receives income for performing other services. For example, over the two-year period, it received $10.5 million in state medicaid funds to develop primary care services (including facilities) that will benefit patients whose medical expenses are paid by medicaid. Another source of revenue for UMA (included in other operating revenue in Table 3.9) was payment for providing payroll and personnel functions to MUSC's Pharmaceutical Education and Development Foundation (PEDF). UMA's rental income was primarily from subleasing property it leases from MUSC's Health Sciences Foundation to MUSC and to St. Francis hospital. UMA has also received income from its investments, which have included mutual funds, repurchase agreements, government securities, and money market funds.

Administrative Issues at MUSC

Compensation Issues

Our audit requesters asked that we provide information concerning the compensation structure for physicians employed by both MUSC and UMA, as well as the supplements paid by UMA to MUSC's administrators. In this section we provide an overview of the procedures for determining compensation levels for MUSC College of Medicine faculty. Also discussed are the following:

- Methods used for setting faculty compensation by USC's School of Medicine.
- Benefits provided by UMA to MUSC faculty.
- Supplements paid to MUSC administrators.
- Reporting of salary supplements to the Budget and Control Board (B&CB).
- Methods used by MUSC and UMA for withholding and matching payroll taxes.

With one exception, we found that MUSC was in compliance with state requirements and its own policies concerning compensation of employees.

Procedures for Setting Faculty Compensation

MUSC College of Medicine faculty teach, practice medicine, and conduct research. Often, the teaching is done while they are seeing patients. For the majority of MUSC faculty, compensation is composed of a state salary and an incentive amount from UMA. Each faculty member signs an annual employment contract showing MUSC salary and incentive amounts. Although the contracts specify what percentage of the faculty member's efforts will be devoted to MUSC for educational purposes and what percentage will be dedicated to patient care, it is difficult to separate these activities.

Each faculty department (such as family medicine, pediatrics, and surgery) has a departmental plan that specifies how faculty practice plan revenues are allocated to faculty members. UMA, the corporation that provides MUSC's faculty with group practice arrangements, developed an overall revenue distribution plan which outlines what must be contained in each departmental plan. According to UMA's revenue distribution plan, each department shall provide for the "development and application of an incentive system which recognizes clinical and academic productivity."

We reviewed the plans for 18 departments and found that departments use a wide variety of systems to distribute revenues. Many departments use a point system to rate faculty members' performance on factors such as research grants awarded and books or articles published. Other departments separate funds into various pools that are divided among faculty, equally or based on productivity. Clearly, however, the intent of UMA is to have faculty salaries be determined according to productivity.

MUSC uses national norms to evaluate the compensation levels of medical school faculty. Each year the Association of American Medical Colleges (AAMC) publishes a national statistical summary of medical school faculty salaries showing salary ranges for each rank in each department. MUSC compares its faculty salaries to those of all medical schools (both public and private) and all regions of the United States. According to an MUSC official, they use these benchmarks in order to compete for faculty and grants on a national basis.

MUSC faculty salaries generally range from $30,000 to more than $600,000.

At MUSC, salaries generally range from $30,000 for instructor-level appointments to more than $600,000. The AAMC statistics provide relevant salary comparisons. For example, one MUSC professor who earns $303,383 is not above the 80^{th} percentile nationally for his department and rank, while an associate professor in a different department who earns $159,931 is above the 80^{th} percentile. Faculty salaries within a department vary widely based on faculty rank or other factors such as productivity or administrative responsibilities.

It is MUSC's policy that faculty salaries should generally fall between the AAMC's 20^{th} and 80^{th} percentiles. For salaries outside of these parameters, the dean requires a written justification from the department chairman. For FY 96-97 we found that 104 (13.42%) faculty members' salaries were above the AAMC's 80^{th} percentile. Of these 104, 7 faculty members' salaries were set by the Veterans' Administration and MUSC had no control over the amounts. We reviewed the justifications for faculty and department chairmen and found them to be adequate. Many justifications cited faculty members' ability to generate research grants and significant patient care revenues.

Faculty Salary Approvals

Section 59-101-195 of the South Carolina Code of Laws states:

> The maximum compensation of any physician or other employee of a medical school of the State of South Carolina shall be approved in advance annually by the President or the Board of Trustees of that medical school. All compensation must be approved by someone other than the recipient thereof.

In order to comply with this law, the dean's staff prepares a report each year for approval by the dean showing the total salary, by source, for each faculty member. This report is prepared late in the year, and, according to the dean, is presented to the president for his approval in late spring. Although MUSC's procedures do not provide for the compensation of physicians to be approved in advance as the law mandates, they appear to comply with the spirit of this law.

University of South Carolina School of Medicine's Faculty Compensation

As a comparison to MUSC, we interviewed officials at the USC School of Medicine and reviewed relevant documentation concerning faculty compensation. Both schools use similar methods. USC requires its faculty to sign an annual compensation agreement which outlines both the member's base salary provided by the university and the maximum allowed income provided through the clinical faculty practice plan. Department chairmen are responsible for developing policies for distributing the practice plan income. USC also uses the AAMC's guidelines for evaluating faculty salaries. However, USC uses the southern region salaries as a benchmark instead of those averaged for all schools and all regions that MUSC uses.

Benefits Provided by UMA to MUSC Faculty

It is common among medical universities that both the university and the practice plan provide faculty benefits. MUSC faculty receive state benefits on the state portion of their compensation and benefits from UMA on their compensation from the practice plan. The benefits provided by UMA include a retirement plan, disability insurance, and group life insurance. The UMA benefits are based on UMA's portion of a faculty member's compensation. UMA's total costs for these benefits for faculty are shown in Table 4.1.

Table 4.1: UMA's Costs for Faculty Benefits

Benefit	FY 96-97	FY 97-98
Retirement	$4,375,230	$5,189,581
Disability Insurance	$387,389	$551,003
Group Life Insurance	$402,442	$377,875
TOTAL	**$5,165,061**	**$6,118,459**

Source: UMA.

Although the cost of an employee's benefits depends on the salary paid to a particular employee, "benefit rates" were calculated by UMA. The benefit rates for FY 96-97 and FY 97-98 were 17.16% and 18.57%, respectively.

Salary Supplements Paid to MUSC Administrators

Our audit requesters asked us to identify salary supplements paid by UMA to MUSC administrators who are not part of the faculty practice plan. We identified 19 MUSC administrators who received a salary supplement from UMA for FY 96-97 and/or FY 97-98. According to an attorney representing UMA, these supplements provide a method of compensating administrative staff members for additional work and expertise given to UMA as a support organization of MUSC. In addition, several of these administrators hold positions on UMA's governing board. The position titles and supplement amounts for these employees are shown in Table 4.2.

Table 4.2: Salary Supplements Paid to MUSC Administrators

Job Title	Supplement for	
	FY 96-97	FY 97-98
President	$140,076	$140,893
Executive Assistant to the President	$29,904	$35,696
VP of Academic Affairs and Provost	$112,254	$119,746
VP for Finance and Administration	$28,719	$31,155
Interim VP for Clinical Operations and CEO - Medical Center	$30,328	$30,466
VP for Clinical Operations and CEO - Medical Center	$51,038	Not employed in FY 97-98
VP, Frederick Research Center	$13,526	$13,656
Executive Director, MUSC Foundation for Research Development	Not employed in FY 96-97	$125,631
Dean, College of Medicine	$169,818	$166,386
Dean, College of Graduate Studies	$52,206	$57,863
Dean and Professor, College of Pharmacy	$14,710	$14,742
Professor, Department of Medicine	$117,955	$118,082
Instructor, Department of Psychiatry	$10,254	$965
Administrator, Children's Health Care Systems	Not in this position in FY 96-97	$1,571
Associate Dean for Operations, College of Medicine	$11,938	$13,450
Manager, Adult CV Diagnostic Services - Heart Center / Business Manager	$36,058	$36,038
Department Administrator / Business Manager III / Assistant Chairman, Family Medicine	$19,963	$16,430
Business Manager II, Cell Biology and Anatomy	$7,000	$7,000
Business Manager, Radiology	$25,271	$33,241
TOTAL	**$871,018**	**$963,011**

Source: MUSC.

State law governing the payment of salary supplements to state employees is unclear. Section 72.29 of the FY 98-99 appropriations act and similar provisions in previous acts state that:

> . . . salaries paid to officers and employees of the State, including its several boards, commissions, and institutions shall be in full for all services rendered, and no perquisites of office or of employment shall be allowed in addition thereto . . . .

Although this proviso appears to prohibit the payment of salary supplements, another proviso with more specific language requires that supplements, including those from faculty practice plans, be reported. Section 63C.3 of the FY 98-99 appropriations act requires that supplements be reported. According to a B&CB office of human resources official, the more specific language in the proviso that requires the reporting of supplements, in effect, gives the General Assembly's approval of such supplements.

Reporting of Salary Supplements

Only half of MUSC employees have reported their salary supplements as required by law. Proviso 17C.3 of the FY 96-97 appropriations act and similar provisions in previous acts require state employees to report any supplemental salaries, including compensation received from faculty practice plans, to the Budget and Control Board. We obtained a B&CB report of all supplements reported by MUSC employees from July 1, 1996, through October 10, 1998. We compared this listing to an MUSC report listing employees who received a salary supplement from UMA for FY 96-97. We found that only 294 of 582 (51%) employees reported the UMA supplement as required.

The General Assembly has changed the reporting provision in section 63C.3 of the FY 98-99 appropriations act. Now the employing agency rather than each employee will be responsible for reporting salary supplements. Reports of supplements will now be due from MUSC before August 31 of each year for salary supplements received during the preceding fiscal year.

Recommendation

As mandated by section 63C.3 of the FY 98-99 appropriations act, MUSC should ensure that appropriate procedures are in place to properly report salary supplements to the Budget and Control Board for all affected employees before August 31, 1999.

Vice President Compensated While on Leave

One MUSC administrator receiving a salary supplement was granted a leave of absence from his duties at MUSC in 1995 but continues to retain his appointments as a full professor and a vice president. In 1998, MUSC changed his title from vice president for research development to vice president, Frederick Research Center, to more appropriately reflect his position. In addition, he continues to receive his MUSC salary and UMA salary supplement totaling over $125,000, as well as most benefits offered by both organizations.

This individual is currently employed by a global technology company now operating the Frederick Cancer Research and Development Center (FCRDC) in Maryland. His contractual duties for MUSC include seeking opportunities for collaboration by MUSC with other research universities and centers, providing guidance in strategic planning, assisting in establishing and conducting seminars, and encouraging potential sources of grants and funding for MUSC. However, he cannot use any information obtained as a result of his position at FCRDC to benefit MUSC during competition for federal grants or contracts.

Payroll Tax Subsidy

Our audit request asked us to "ascertain whether MUSC subsidized UMA in the area of payroll taxes." We found that MUSC did subsidize UMA by paying most of the payroll taxes for faculty from 1992 through 1996. However, this situation has been corrected since January 1997.

The payroll tax issue relates to a common paymaster system used by MUSC and UMA for the payment of social security or "FICA" (Federal Insurance Contribution Act) taxes. FICA taxes are withheld and paid by employees on wages received up to a wage limit ($68,400 for 1998) and are matched dollar for dollar by the employer. A common paymaster system helps related organizations avoid multiple payments of FICA taxes for commonly employed workers. If MUSC and UMA did not have a common paymaster system, each would have to pay FICA taxes on the first $68,400 of their portion of a faculty member's salary. With this system, FICA taxes are only paid once. MUSC and UMA have used a common paymaster system since 1992.

Prior to January 1997, MUSC paid the entire employer's FICA match for all concurrent employees whose MUSC salaries were above the FICA wage limit. If an employee's MUSC salary was less than the wage limit, then UMA would withhold and match the appropriate amount on UMA's portion of the salary. However, in January 1997, MUSC and UMA changed the system for withholding and matching of FICA taxes in order to ensure that each organization pays its appropriate share of FICA taxes. Each organization now withholds and matches FICA taxes on wages as they are paid until the employee's total compensation reaches the wage limit. Therefore, MUSC no longer subsidizes the wages paid by UMA.

The amount of subsidy MUSC provided to UMA by paying its share of FICA taxes from 1992 through 1996 cannot be easily determined. We noted that payroll tax expense for UMA increased for 1997, the year the system was corrected, as shown in Table 4.3.

Table 4.3: UMA Payroll Tax Expense for 1996 and 1997

Tax Expense	Amount
1996 Payroll Taxes	$1,045,636
1997 Payroll Taxes	$1,761,715
Increase	$716,079

Source: UMA.

However, it would probably not be valid to estimate the total MUSC subsidy at $3,580,395 (5 years at $716,079 per year). Other factors such as compensation levels, employee turnover, and the level of the FICA wage limit would also affect these figures. The procedures used by MUSC and UMA since January 1997 to administer the common paymaster system appear appropriate.

Airplane Operations

MUSC owns one aircraft (MedAir), a King Air C90-1 purchased in 1983 for $1.035 million, that can accommodate up to seven passengers. This plane was originally acquired to provide transportation to outreach clinics, and is currently used for that purpose and MUSC administrative travel. We did not include MUSC's Meducare air ambulance service in our review.

In December 1998, MUSC completed an internal audit of MedAir operations for FY 96-97. We reviewed this audit and all MedAir flight records for FY 97-98. We did not find improper use of MedAir. However, we noted that MedAir is expensive for MUSC to operate and recommend that the university consider using less expensive alternatives to meet its transportation needs.

Use of MedAir

We found that most of MedAir's flights during FY 97-98 were associated with the university's outreach clinics, where MUSC physicians met with patients for follow-up or specialized care that, according to an MUSC official, might not otherwise be available in their area. MUSC administrators also regularly used the airplane to attend meetings and other events throughout the state. MedAir passengers who were not MUSC employees included the president's wife and UMA officials. A summary of some of the non-clinical MedAir travel is shown in Table 4.4.

Table 4.4: MedAir Administrative Travel, FY 97-98

Passenger	Times Flown
MUSC's President	27
Wife of MUSC's President	4
Dean of MUSC's College of Medicine	15
Members of MUSC's Board of Trustees (6)	26*
UMA's Chief Executive Officer	10

* Combined total for six trustees.

Source: MUSC.

MedAir passengers are required to sign a statement verifying that their travel is official business for the State of South Carolina and to provide the purpose of their trips. Records indicated that administrative travel was primarily for meetings, fund raising, and recruiting students. Although some records were vague (with the stated purpose simply listed as “meeting”), we did not find evidence of travel that was inappropriate.

As discussed on page 7, it is not clear whether UMA should be considered as acting for the state. When UMA’s CEO flew on MedAir, UMA reimbursed MUSC for the cost of his flights. We could not determine from the stated purpose of his trips that he was flying for the state’s (MUSC’s) business. If UMA is not acting for the state, it would be inappropriate for UMA officials to fly on MedAir.

Costs of MedAir Operations

MUSC’s internal audit of MedAir estimated that the total cost of operating MedAir averaged $322,644 per year between FY 91-92 and FY 96-97. MUSC internally bills the departments of MedAir passengers for some of the operating costs. The internal audit noted that these reimbursements are insufficient, because such basic costs as the pilots’ salaries, depreciation of the aircraft, and major maintenance were not being recovered through the fees charged to the passengers. The audit report indicated that MUSC was not recouping an average of more than $125,000 per year. According to MUSC’s controller, the operating costs of MedAir are subsidized with MUSC general administration and medical center funds. In our review of MedAir operations for FY 97-98, we estimated that MUSC did not recoup more than $214,000 of its overall costs of $361,359.

MUSC should reassess the costs and benefits of owning its own aircraft.

We noted that even the subsidized bills can be costly compared to alternative means of transportation. For example, in August 1997, a member of MUSC’s board of trustees was flown from Florence to Charleston to attend a board meeting at a cost of $680 for only 90 miles.

Because the use of MedAir is so costly, the university should reassess the costs and benefits of owning and operating its own aircraft. MUSC could obtain bids on the costs of chartering planes for the regularly scheduled clinical travel. Administrative travel needs could often be met with commercial flights or auto travel that would be less costly. In addition, selling the aircraft would provide MUSC with significant revenues.

MUSC could potentially reduce costs if they decide to continue operating MedAir. Alternative staffing options could be considered. MedAir flights are almost always made with one pilot, although MUSC currently employs two full-time pilots who have administrative support. The plane was only used for a total of 209 days in FY 97-98. MUSC could also modify current passenger rates to allow for the recovery of all costs, including related salaries, aircraft depreciation, and major maintenance. Management could better evaluate the cost-effectiveness of the operation if all the costs were considered and equitably distributed.

Policies and Procedures Need Revision

The internal audit review of MedAir operations found that current MedAir policies and procedures had not been properly approved or distributed to personnel involved with or using the aircraft. The charges billed to passengers often did not follow the rates described in MUSC's written guidelines. Upon further review, we discovered that MedAir's chief pilot regularly bills passengers for "dead head" (empty) and charter flights according to a procedure that is not in the written policy. We also observed that MedAir's policies do not provide for non-MUSC personnel to use the aircraft, even though UMA staff, the president's and board members' wives, and representatives of The Citadel and the College of Charleston have been passengers on MedAir flights during recent years.

Recommendations

8. MUSC should reconsider the costs and benefits of owning and operating its own aircraft. If the university continues to operate MedAir, administrators should ensure that the total operating costs are accounted for and equitably distributed among those using the plane.

9. MUSC should revise its MedAir policies and procedures to ensure they accurately reflect authorized usage and billing procedures.

Employee Discounts

MUSC offers discounts on hospital services provided to all state employees. We reviewed the use and cost of these discounts and found:

- ❑ The discounts that MUSC offers to all state employees are used primarily by employees who reside in the Charleston area.

- ❑ MUSC needs to improve controls to ensure that members of the General Assembly do not receive discounts that are prohibited by law.

Section 72.30 of the FY 98-99 appropriations act and similar provisos in previous appropriations acts state that MUSC "shall provide hospital services to state employees and officials of state government at a rate not to exceed the payment rates to hospitals provided by the employee's insurance program(s)." MUSC has interpreted this proviso to mean that state employees should receive MUSC hospital services for the amount that insurance will pay for authorized services. Therefore, state employees do not have to pay co-payments or deductibles for hospitalizations at MUSC. [1]

MUSC provides the same discount for hospital services to other groups in addition to state employees. These include:

- UMA employees.
- Charleston Memorial Hospital employees.
- MUSC students.
- Retired state employees and UMA employees.
- Dependents of eligible groups.

In addition, UMA gives discounts on physician services to all of the groups listed above. According to MUSC and UMA records, the total cost of these discounts for FY 96-97 and FY 97-98 was more than $3 million (see Table 4.5).

1 MUSC offers smaller discounts for psychiatric services and for state employees who are not insured by the state health plan.

Table 4.5: Cost of Employee Discounts

Year	Hospital Services (MUSC)		Physician Services (UMA)	
	#Admissions/ Patients[1]	Amount	# Patients	Amount
FY 96-97	5,106	$946,177	5,384	$419,844
FY 97-98	10,534	$1,382,483	6,200	$473,412
Two-Year TOTAL	**15,640**	**$2,328,660**	**11,584**	**$893,256**

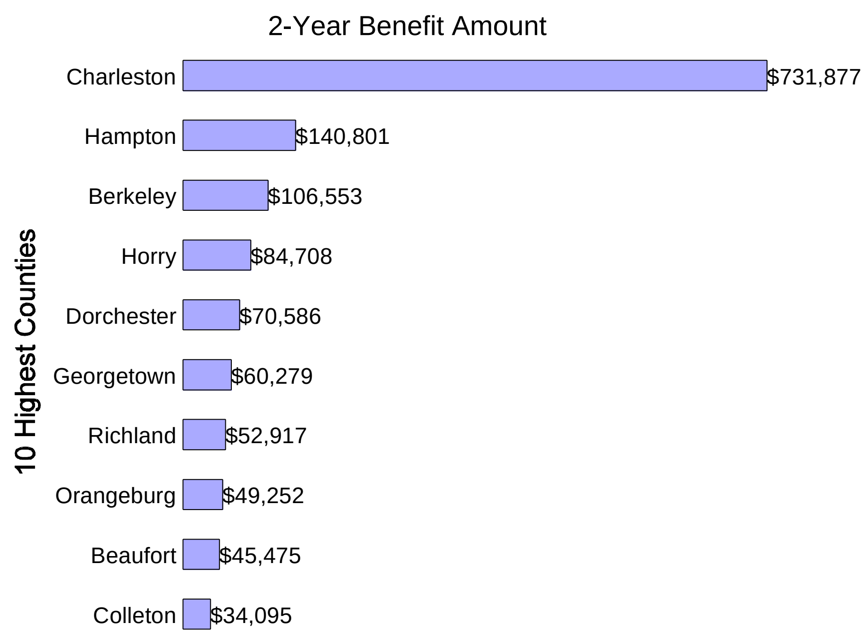
1 For July 1996 through December 1997, UMA billed MUSC's patients for outpatient hospital services. UMA's data is for number of patients. MUSC's data is for number of admissions (a patient could be admitted more than once).

Source: MUSC and UMA.

Statewide Use of MUSC's Employee Discounts

Even though all state employees can receive discounts on hospital services from MUSC, these discounts are used primarily by state workers in the Charleston area. We reviewed the distribution of discounts for state employees (excluding staff directly employed by MUSC and UMA) by the employee's county of residence. We found that 46% of the discount benefits were received by state employees who live in Charleston county, an amount more than 500% greater than benefits received by employees in the next highest county (see Graph 4.1). State employees in the upstate made little use of the benefit.

Graph 4.1: State Employee Discounts for MUSC Hospital Services by Employee's County of Residence for the Ten Highest Counties, FY 96-97 through FY 97-98



Source: MUSC and UMA.

Both the cost and distribution of the discount benefit raise questions about its value. All the state's taxpayers are subsidizing hospital costs for a group of state employees who are primarily from a particular geographic area. Also, MUSC could use revenues lost because of the discount for other financial needs.

According to a UMA official, UMA gives discounts to its employees and state employees in order to be competitive. The discounts are an incentive to employees to use MUSC/UMA for their healthcare needs.

Controls Over Discounts for Members of the General Assembly

MUSC should improve its controls over eligibility determination to ensure that members of the General Assembly do not receive discounts that are prohibited by law. South Carolina Code §44-7-3210, effective in June 1996, requires members of the General Assembly to pay ". . . any co-payment or deductible as may be applicable for receiving services at a hospital facility in this State. . . ." We found that MUSC gave discounts to six members of the General Assembly in FY 96-97 and FY 97-98 who should not have received discounts. Though the amounts of these discounts ($580 total) were not material, MUSC has no system to prevent these prohibited discounts in any amount.

According to MUSC officials, one way they identify employees who are eligible for discounts is through their health insurance. They assume that patients who are insured by the state health plan are eligible for a discount. However, members of the General Assembly may be insured by the state health plan but are not eligible for hospital discounts. MUSC does not have a process to identify patients covered by the state health plan who are also members of the General Assembly.

Recommendations

10. The General Assembly may wish to reevaluate the proviso requiring MUSC to provide discounted hospital services to all state employees. If the proviso remains in effect, MUSC should ensure that all state employees are aware of the discounted services.

11. MUSC and UMA should reevaluate the costs and benefits of employee discounts for physician and hospital services.

12. MUSC should institute controls to ensure that members of the General Assembly pay deductibles and copayments as required by South Carolina Code §44-7-3210.

Employment of Relatives

One of our audit objectives was to determine whether MUSC and UMA have adequate controls to ensure compliance with applicable nepotism requirements. We did not find evidence of a significant nepotism problem at the university. However, the blended nature of MUSC and UMA can result in situations that violate the intent of state nepotism guidelines.

The State Ethics Act limits the employment of relatives at state agencies, such as MUSC. Section 8-13-750 (A) of the South Carolina Code of Laws states that, “No public official . . . may cause the employment, appointment, promotion, transfer, or advancement of a family member to a . . . position in which the public official . . . supervises or manages.” We reviewed written policies on the hiring and employment of relatives at MUSC and UMA, and found that both had guidelines that appeared to be at least as strict as those set by state law.

Few Cases of Possible Nepotism Found at MUSC

We were alerted to several potential instances of nepotism at MUSC through various sources. Some of these examples involved persons hired as part of a federal grant that is currently being investigated by a federal inspector general’s office (see p. 54). Most of the additional allegations involved persons who no longer work for the university. During our review, MUSC human resources (HR) officials acted to remedy three employment situations that appeared to violate nepotism provisions. They also strengthened controls over the hiring process to make detection of nepotism problems more likely. Because approximately 8,400 people are employed by MUSC, the small number of instances we reviewed was not significant. Also, university officials took appropriate action to remedy questionable situations and improve controls.

In addition to reviewing allegations of nepotism, we contacted 53 high-ranking individuals associated with MUSC to see if they had relatives currently employed by MUSC and/or UMA. This sample included members of the board of trustees, the president, many senior administrators, and the chairs of all MUSC clinical departments. We received 51 responses, and 41 (80%) of these stated that the individual didn’t have a relative currently employed by either organization. MUSC’s HR director verified that nine of the ten officials reporting relatives were not in positions where they could influence the employment of their relatives; the MUSC officials could not directly impact the compensation or performance evaluations of their relatives. In one case, the son of an MUSC dean was found to be working within the same college. MUSC officials stated that the son has been transferred to a different position in order to prevent him from being under the chain of command of his father.

Improved Controls Needed

As noted on page 11, we observed that MUSC and UMA employees work together in the same departments, where some MUSC employees supervise UMA employees and vice versa. However, since UMA is legally a separate non-profit corporation, MUSC and UMA have independent human resources departments. This situation can contribute to the appearance of nepotism at MUSC.

We observed one example in which an MUSC employee, a personnel manager, directly participated in the hiring of her own sister to work as a UMA accounting technician in the same department where she worked. Both sisters currently report to the same supervisor. When we brought this situation to the attention of MUSC's HR director, the university responded that the accounting technician "is not an MUSC employee, but is employed by UMA," and thus was not in MUSC's files. The UMA job application filled out by the accounting technician listed the name of the personnel manager under the relatives section, but did not acknowledge her relationship, position, or department as requested by the form.

As illustrated by this situation, it appears that an MUSC employee could hire or promote a relative to work directly under her chain of command for UMA. We believe this situation is inconsistent with the spirit of the State Ethics Act. When we brought this concern to the attention of MUSC officials, they responded that future job application forms would include a section where applicants must indicate whether they have relatives employed by UMA that work at MUSC.

Recommendation

13. MUSC should modify its policies and procedures to ensure that state employees do not hire or otherwise influence the employment status of their relatives who might work for UMA.

Department of Energy Agreement

One of our audit objectives was to examine the results of a January 1995 cooperative agreement between MUSC and the U.S. Department of Energy (DOE). MUSC agreed to conduct a study to determine how the state, in cooperation with the DOE, could best manage the ever-increasing quantities of spent nuclear fuel and high level nuclear waste in South Carolina. MUSC used its own employees, outside consultants, and subcontractors in attempting to meet the stated objectives.

Much of the work done on this study involved surveying state residents concerning their opinions about foreign spent fuel being shipped to South Carolina. MUSC initiated six community forums around the state, which were attended by 250 persons. In September 1995, the DOE directed MUSC to close out work on the program and shift its focus to the environmental education of college, high school, and middle school students. The term of the agreement ended on March 31, 1996, and MUSC claimed and was reimbursed $4,883,198 for its costs over the 14-month period. The agreement was funded entirely with federal funds and required no state match.

Administrative Problems Found

A May 1996 MUSC internal audit cited a number of deficiencies in the handling of the cooperative agreement:

- Costs claimed by MUSC included some consulting work done on other projects.

- There were several relationships between MUSC employees and subcontractor employees that could be perceived as inappropriate. Those hired through the program included the MUSC president’s niece, the mother of MUSC’s controller, and others directly related to MUSC officials.

- An MUSC subcontractor used program funds to pay two registered lobbyists, including MUSC’s legislative liaison, for consulting work, even though federal funds cannot be used for lobbying. MUSC did not reimburse the subcontractor for these fees.

In response to possible irregularities occurring under the agreement, the DOE's Savannah River operations office conducted a separate review of the spent fuel program. Their August 1997 report identified $776,303 in questioned costs, $536,316 in unsupported costs, and $352 in unallowable costs.

Ongoing Federal Review

Our objective was to review problems identified with MUSC's conduct of the cooperative agreement and determine whether appropriate controls are now in place. However, in August 1998, the DOE's inspector general (IG) for investigations subpoenaed from MUSC extensive documentation pertinent to the agreement and began an ongoing investigation of issues related to the spent fuel project. An official at the IG's office informed the LAC that the U.S. Attorney's office was also involved in this investigation.

Therefore, in order to prevent duplication of effort or interference with an ongoing legal investigation, we deferred further review of the DOE cooperative agreement during this audit.

Appendices

Audit Scope and Methodology

Our review was generally limited to the issues discussed in the audit requests. These issues focused on MUSC's College of Medicine, UMA, and UMA's subsidiaries. They also involved specific management concerns relating to MUSC. We did not review other issues or divisions of MUSC or its affiliated organizations. The period of review was FY 96-97 and FY 97-98, with more extended or limited periods for some areas. We did not review issues in litigation at the time of our review. We also limited the scope of our review to avoid duplication with MUSC's contracted strategic planning reviews and the work of MUSC's internal audit department.

The following types of records from both MUSC and UMA were sources of evidence for our review:

- Financial reports and accounting records.
- Legal records, including contracts and agreements.
- Flight records.
- Personnel records.
- Policies and procedures.
- Meeting records.

We also reviewed laws and regulations, attorney general's opinions, records of court decisions, consultant reports, surveys, and other studies. We interviewed MUSC and UMA officials, officials from other state agencies, and officials from other medical schools. We performed limited verification of computer-generated information that we used. However, the reliability of computer-generated data was not central to our audit objectives, and, when all evidence is viewed in context, we believe the opinions, conclusions, and recommendations in this report are valid.

We used state laws, attorney general's opinions, court decisions, and commonly recognized standards of good management and business practice to evaluate MUSC's performance. We performed limited nonstatistical sampling, as discussed in the report. We evaluated management controls over expenditures of discretionary funds, expenditures for air transportation and contributions, identification of employees eligible for discounts, and hiring.

MUSC's Revenues and Expenditures

	FY 97-98	FY 96-97	FY 95-96	FY 94-95	FY 93-94
Revenues (in thousands)					
Student tuition and fees	$11,402	$10,220	$9,093	$9,952	$9,005
State appropriations	$130,205	$124,137	$117,920	$138,030	$132,662
Federal grants and contracts	$40,594	$41,129	$44,126	$40,749	$31,455
State and private gifts, grants and contracts	$21,886	$22,764	$17,421	$16,585	$14,632
Sales and services of educational departments	$7,557	$7,195	$8,517	$7,966	$6,751
Sales and services of hospitals	$388,189	$379,583	$361,527	$398,924	$436,074
Sales and services of auxiliary enterprises	$2,829	$2,534	$2,086	$1,830	$1,816
Other academic division revenues	$19,274	$16,658	$7,874	$6,896	$8,021
Other hospital revenues	$12,894	$14,678	$19,736	$42,977	$9,973
TOTAL	**$634,830**	**$618,898**	**$588,300**	**$663,909**	**$650,389**
Expenditures (in thousands)					
Instruction	$120,932	$106,754	$100,692	$97,959	$91,939
Research	$55,256	$52,830	$54,064	$48,882	$41,754
Public service	$21,927	$15,469	$11,978	$12,024	$9,812
Academic support	$24,254	$18,169	$11,950	$11,168	$10,740
Student services	$5,766	$4,981	$4,319	$4,053	$3,518
Institutional support	$15,513	$12,127	$14,221	$9,553	$12,333
Operation and maintenance of plant	$16,316	$13,525	$13,692	$12,483	$12,763
Scholarships and fellowships	$1,766	$1,296	$1,056	$1,044	$1,092
Hospitals	$386,912	$347,644	$329,854	$304,351	$330,070
Auxiliary enterprises	$1,169	$974	$953	$779	$803
Mandatory transfers:					
Principal and interest	$13,485	$13,501	$13,435	$14,701	$13,628
Loan funds matching grant	$118	$74	$124	$118	$125
Endowment income transferred to principal	$18	$16	$15	$14	
Nonmandatory transfers	($3,633)	$12,422	($3,650)	($3,266)	($12,257)
Other	$347	$129	$142	$80,147	$112,604
(Excess) deficiency of restricted receipts over revenue	($953)	($17,640)	($405)	($300)	($1,135)
TOTAL Expenditures and Transfers	**$659,193**	**$582,271**	**$552,440**	**$593,710**	**$627,789**

Source: MUSC Comprehensive Annual Financial Report, FY 97-98.

Agency Comments

MEDICAL UNIVERSITY OF SOUTH CAROLINA

May 20, 1999

Mr. George Schroeder
Legislative Audit Council
400 Gervais Street
Columbia, South Carolina 29201

Dear Mr. Schroeder:

I would like to thank you and the auditors from the Legislative Audit Council for the very professional manner in which they conducted their recent review of the Medical University of South Carolina and the University Medical Associates. The auditors conducted their work in a very professional manner causing as little disruption as possible. While no serious infractions were found, we acknowledge that there are areas for improvement and will immediately address them.

In reviewing the audit report, we realize that the Medical University of South Carolina and the University Medical Associates are very unique and complicated organizations and present a challenge to anyone not familiar with the daily operations of these two organizations. Although we are pleased that the overall audit report was favorable, we disagree with many of the auditors' opinions which may have been influenced by the complexity of the University and the time restraints that they were working under.

The Medical University of South Carolina specifically disagrees with the repeated suggestion that the University Medical Associates may be acting for the State. We also disagree with many of the auditor's findings of questionable expenditure of public funds which we feel were appropriate and in keeping with our governing Board's policies.

By way of brief response, please allow me to address several general areas which gave rise to the auditors recommendations.

The auditor's recommendation Number 1 was that the MUSC Board of Trustees should clarify the UMA's role and address whether it is acting for the State. It is our position and we have been so advised by legal counsel, that the University Medical Associates meets all of the legal requirements to be a separate and private South Carolina corporation and would pass judicial scrutiny. We believe that its present operations would not be interpreted as the UMA acting as an agent of the State. We appreciate the LAC recommendations and will continue to revisit the structure and operations of the UMA to ensure its continued compliance with all State and Federal laws.

In response to the auditors recommendation's Number 2 and 3, the Medical University of South Carolina continues to be diligent, assuring that private practice revenues received by the Medical University of South Carolina from the University Medical Associates are spent for public purposes in compliance with State law and its Board of Trustees policy. I am hopeful that present legislation being considered will resolve this issue for all State colleges and universities and will eliminate this area of dispute from future LAC audits.

The auditors' fourth recommendation was that MUSC should ensure that issues raised in internal audits are carefully considered and that action is taken to correct any identified problems. I can unequivocally state that MUSC places great importance on its Internal Auditing functions and has and will continue to be diligent in responding to issues raised by that department. Contrary to the LAC auditor's opinion, we feel that MUSC has complied and has implemented our Internal Auditor's recommendations. The fact that the LAC Auditors may disagree with the expenditure policy of MUSC's Board of Trustees, does not mean that the MUSC Administration failed to implement and follow its policy. We do feel that with few exceptions, our expenditures met the prudent person test. These exceptions or mistakes have been addressed and appropriate steps taken to prevent their recurrence.

Recommendation Number 5 addresses discretionary funds. The Medical University of South Carolina believes that its expenditures are in compliance with its Board of Trustees policies but will increase its effort to diligently guard against donations perceived to be religious, private, or secular in nature. MUSC does take exception to the expenditures singled out in this report. By way of example, one of MUSC's stated missions is education. Numerous reports warn that a large number of our most talented high school students are going out of State to attend college and graduate schools. Through our partnerships and support of local high schools, both private and public, we strive to interest more students in the sciences and to encourage these students to remain in our State and our professional schools. A donation to the YWCA in Charleston, which serves primarily our minority population was for the same reason and not to promote or sponsor any religious belief or cause.

Physical fitness and general wellness is an important part of our students and faculty education. As we do not offer intercollegiate sports, we believe that sponsorship of athletic team events is appropriate in promoting physical fitness of our students and faculty.

The report also questioned certain expenditures as appearing not to benefit MUSC. MUSC has arranged with the Charleston Symphony Orchestra on numerous occasions to play for University events and to give outdoor concerts benefiting all students, faculty, and employees. The concerts are free and open to everyone. The "donation" (fee) was certainly reasonable to compensate the musicians for their efforts. Similarly, the arts festival brings nationally recognized artists to our community and campus. As an institution of higher education, we feel the expenditures were prudent and assisted in Faculty recruiting and benefited our entire University.

In response to the auditors Recommendation Number 6, the Medical University of South Carolina believes that political contributions made by the University Medical Associates met all legal requirements, and that any attempted restrictions by the Medical University of South Carolina on such expenditures would have been inappropriate and without legal basis. The Medical University of South Carolina believes that it is appropriate for it to express to the University Medical Associates or any affiliated organization causes or candidates which it feels supports the Medical University of South Carolina, its patients, and the quality of health care in this State. These affiliated organizations should continue to be free to support causes or candidates pursuant to State and Federal laws.

In response to the auditors Recommendation Number 7, the Board of Trustees of the Medical University of South Carolina and the Board of the University Medical Associates will continue to periodically reevaluate its spending guidelines. We believe that present expenditures reflect the prudent use of retained or self generated funds.

In response to Recommendation Number 8, The Medical University of South Carolina believes that owning and maintaining an aircraft is essential to the accomplishment of its mission of providing physicians for remote clinics throughout the State thereby making tertiary and specialized care available to many citizens of this State who would not otherwise have such care. MUSC constantly reviews and reevaluates this program. We have not identified a more economic or realistic means of providing these physician/specialists to remote clinics based on their time restraints and patient loads. We will continue to search for alternative transportation and will ensure that our records systems allow for a complete recovery of costs as suggested in Recommendation Number 9.

In response to Recommendation Numbers 10 and 11, the Medical University of South Carolina appreciates the General Assembly's support to continue a discount policy for the benefit of all State employees. Such discounts make available to State employees specialized and tertiary care. The Medical University of South Carolina sees no favoritism or discrimination in its Discount Policy and disputes the opinion of the auditors that because more Charleston area employees take advantage of the discounts than employees from other sections of the State, that the policy is somehow discriminatory and needs to be reevaluated. Surely, the auditors are not suggesting that other programs offered by institutions of higher learning that are utilized to a greater degree by their area citizens should also be discontinued. We will increase our efforts to assure that all State employees are made aware of this program. In this very competitive environment, it is extremely important that not only our own employees, but all State employees utilize and support our facilities should they so elect.

By way of response to Recommendation Number 12, the Medical University will increase its efforts to identify and educate members of the General Assembly that they must pay deductibles and co-payments pursuant to State law. We believe that six violations over a two year period does not appear to be a serious failing. In the future, we will implement a policy to better monitor this billing area.

In response to Recommendation Number 13, the Medical University of South Carolina believes that it has in place sufficient policies prohibiting Nepotism which are in full compliance with State law. The Medical University of South Carolina and the University Medical Associates will increase its level of sensitivity and will ask all applicants whether or not a relative is employed at either entity.

I want to again express my appreciation that the report was, for the most part, very favorable finding no major failures or violations during my tenure. As is true of any organization, there are areas that need improvement and fine tuning and we welcome this input. As the Medical University of South Carolina is the State's medical university all citizens should have a vital interest in its continued success. MUSC has accomplished much over the last twenty years, advancing from a local academic health center to a major medical university and research center. The Medical University of South Carolina is now positioned for a bright future and in my opinion its possibilities are unlimited even though the challenges of health care reform must be met. It is my sincere wish that as the Board of Trustees searches for my successor, that the Medical University of South Carolina will continue to flourish and continue its mission to preserve and optimize human life in South Carolina. We deserve no less.

Sincerely,

James B. Edwards, D.M.D.
President

JBE/cb

UNIVERSITY MEDICAL ASSOCIATES

May 18, 1999

George Schroeder
Legislative Audit Council
400 Gervais Street
Columbia, SC 29201

Dear Mr. Schroeder:

Thank you very much for the opportunity to comment on the Legislative Audit Council Review of the Medical university of South Carolina and University Medical Associates. I want to commend you and your staff for a very thorough review. You raise several issues that need to be addressed and clarified.

Included with this letter is a response to all the issues in the report that relate to UMA. Below is our response to the recommendations made in the report that are directed to UMA:

Recommendation 1: The MUSC Board of Trustees should clearly define UMA's role with regard to its actions for the state. If the Board wants UMA to act as a private corporation, it should make changes to ensure that UMA's actions are independent from those of MUSC.

Response: UMA concurs with this recommendation. We would welcome a review by MUSC and any advice the Board might have to improve the situation.

Recommendation 5: MUSC should discontinue its practice of contributing funds for the direct benefit of religious or other private educational institutions, to non-profit corporations that are sectarian or religious, or to civic organizations whose benefits extend only to members. This applies to contributions made through MUSC or UMA accounts controlled by MUSC officials, regardless of the revenue source.

Response: UMA will review its policy relative to contributions to organizations such as those cited in this recommendation and make any changes necessary as a result of the review.

Recommendation 6: MUSC and UMA officials should not request that political contributions be made through UMA's subsidiary corporations.

Response: UMA officials will not be making requests for political contributions through UMA's subsidiary corporations in the future.

Recommendation 7: UMA should reevaluate its spending guidelines to ensure they reflect a prudent use of resources.

Response: UMA will reevaluate its spending guidelines to ensure they reflect a prudent use of resources.

Recommendation 11: MUSC and UMA should reevaluate the costs and benefits of employee discounts for physician and hospital services.

Response: UMA will reevaluate the employee discount policy and make any changes that are necessary.

We thank you for the recommendations made by the Legislative Audit Council. Any corrective action that is needed will be immediately put into place. Please feel free to call us if you have questions regarding our response.

Sincerely,

Marion E. Woodbury
Chief Executive Officer

Response to the Legislative Audit Council Review of the Medical University of South Carolina (MUSC) and University Medical Associates (UMA)

MUSC'S Relationship with UMA

The structural relationship between MUSC and UMA was carefully developed to accomplish the following objectives:

- Establish a relationship between UMA and MUSC sufficiently close to gain tax exempt status from the Internal Revenue Service as a supporting organization under IRS Section 509(a)(3).

- Establish UMA as the clinical practice plan for qualified faculty physicians and to support and promote the educational, medical, scientific, and research purposes of the Medical University of south Carolina (MUSC).

- Establish a relationship that would be mutually supported by the faculty physicians as well as the Board and administration of MUSC.

- Establish a relationship that would withstand any challenge that UMA was not sufficiently independent of MUSC to avoid a charge that UMA should be treated as the state for some of its actions.

We believe that we have accomplished all these objectives during the last eight years. This relationship has helped foster tremendous growth at MUSC in the areas of education, research, and patient care. MUSC students, researchers, and patients are better off because of the way UMA is structured.

The structure we have chosen is very similar to that in place at most of the other public academic health science centers. To create more independence for UMA would, in our opinion, not be in the best interests of MUSC or UMA.

We are enclosing as an appendix a legal opinion from our attorneys stating that our structure is legal, appropriate and sufficiently independent to maintain its status as a separate legal entity.

Contributions

UMA is frequently solicited for contributions to support a variety of community organizations. The expectation of the community is that we should help these organizations that help the community in which we live and provide service. We believe our structure and status as a 501(c)(3) organization grants us the right to help support these community organizations.

The political contributions were made as a result of various solicitations. We believe it is our responsibility to support the candidacy of individuals willing to be involved in the political process and willing to work toward improving our state government. All our contributions were legal and in accordance with appropriate state laws.

UMA’s Expenditures and Revenue

We believe that all UMA’s expenditures and revenue are appropriate as a supporting organization of MUSC and as a faculty practice plan in the business of running medical practices. None of the expenditures are extraordinary when related to peer institutions or medical practices operating in this community. All the expenditures by UMA were legal and were made to advance the various missions of MUSC.

UMA purchases telephone services and some computer services from MUSC. These agreements were worked out with appropriate officials of the State Budget and Control Board. By adding the UMA volume to the state system, it was felt that the state and UMA benefited from the arrangement (see letter from Ted Lightle).

Payroll Tax Subsidy

From 1992 through 1996, the employer portion of the FICA taxes was not allocated between UMA and MUSC. We justified this on the basis that with the common paymaster rule no greater burden was placed on MUSC than it would have incurred had the UMA not been created. Prior to 1992, payments made to physicians over and above their state compensation was considered payments to an independent contractor not subject to employer FICA taxes. Changes to interpretations of the common paymaster rules by the Internal Revenue Service in 1997 made it necessary to allocate the employer portion of the FICA taxes between UMA and MUSC.

In any event, from 1992 through 1996, UMA made non-mandatory transfers to MUSC in the amount of $46.8 million. These amounts far exceed any gain to MUSC as a result of allocating the payroll taxes for those years.

Employee Discounts

During the 1980's and 1990's with the advent of managed care it became customary to provide discounts to employees and to other large groups that would increase volume to the health care system granting the discounts. By increasing volume without increasing expenses the cost of health care would be contained. This, in fact, occurred at MUSC and UMA as it did in many other organizations.

It is now time to revisit that discount policy and consider changes that may be more appropriate to the late 1990's and into the new millennium.

Appendix 1

May 20, 1999

Mr. Marion E. Woodbury
University Medical Associates
171 Ashley Avenue
Charleston, SC 29425

Re: Response to LAC Report dated May, 1999

Dear Marion:

You have asked us to review the May 1999 report of the South Carolina Legislative Audit Council (the "LAC"), in which the LAC questions whether the actions of University Medical Associates of the Medical University of South Carolina ("UMA") are "state actions" due to UMA's close relationship with the Medical University of South Carolina ("MUSC"). It is our conclusion, as explained more fully below, that UMA's actions do not qualify as actions of the State of South Carolina due to UMA's relationship with MUSC.

We have acted as UMA's and its affiliated entities' counsel for the past several years. We have examined MUSC's enabling legislation and financial statements. We have examined UMA's governing instruments, financial statements, contracts, activities and acquisitions during this time period. We have reviewed in detail the relationship between UMA and MUSC.

UMA was created in 1991 as a nonprofit corporation by filing articles of incorporation with the South Carolina Secretary of State like all other corporations. Similar to all other profit and nonprofit corporations, UMA has adopted bylaws which govern its internal operations. Similar to all other profit and nonprofit corporations, UMA has a fully independent governing board and duly appointed officers. UMA employs the clinical faculty of MUSC and its support staff and offers its own benefits plans. UMA bills patients and collects revenue independently from MUSC. UMA files its own tax returns. As a basis for its federal income tax exemption, UMA may use a portion of its excess revenues to support MUSC each year. UMA maintains separate records, separate bank accounts and makes its own separate tax filings.

The LAC Report questions whether UMA's actions could be found to be actions of the State due to UMA's relationship with MUSC, thereby rendering UMA subject to requirements regarding (I) the use of public funds, (ii) the application of the Freedom of Information Act to UMA's records and (iii) the constitutional prohibition of ownership of stock in business corporations. The LAC cites Modaber v. Culpeper Memorial Hospital, Inc., 674 F.2d 1023 (1982) and Jackson v. Metropolitan Edison Co., 419 U.S. 345 (1974), as authority for the proposition that acts of a private party will be classified as acts of the State if the private party acts: (1) in an exclusively State capacity by exercising powers reserved for the State, (2) for the State's direct benefit when it shares the rewards and responsibilities of a private venture with the State, or (3) at the State's specific behest when it does a particular act which the State has directed or encouraged.

The LAC's reliance on Jackson is misplaced. The Jackson test was created solely to determine if the Fourteenth Amendment applies to the actions of a private entity. The LAC uses Jackson to assert a much more broad proposition: that all governmental restrictions, rules and regulations (including the Freedom of Information Act, all restrictions on expenditures of the State, and the prohibition on the State from owning stock in a corporation) apply to a private entity such as UMA. The LAC offers no analysis or guidance why Jackson should be extended so broadly. Nothing in Modaber or Jackson remotely supports this proposition. In fact we have found no instances where the Jackson test has been applied outside of the Fourteenth Amendment context in finding an act of a private entity being attributed to the State.

Not only has Jackson never been applied outside of the Fourteenth Amendment context, but such an application yields far reaching results. Nonprofit organizations routinely perform state functions, and the state encourages such actions by its policies encouraging the activities of nonprofit organizations. The LAC's position leads to the following illogical conclusion: expenditures of nonprofit organizations which have a nexus to State institutions in furtherance of State purposes cause them to become an alter ego of the State, and that the funds belonging to these organizations thus convert to property of the State, simply by virtue of the organizations' acts which are encouraged by the State.

Even if we assume that the Jackson test applies to UMA outside of the Fourteenth Amendment context, UMA's actions should not be deemed to be actions of the State. The Modaber Court noted that health care is not an exclusive state function in finding that Culpeper Memorial Hospital's actions were not attributable to the State. The Modaber Court's reasoning is equally applicable to UMA. UMA's actions are not taken for the direct benefit of the State, and they are not directed by the State.

The LAC has failed to cite any relevant authority in setting forth the issue of whether UMA is separate and independent from MUSC.[1] We do not see any legal basis which support's the LAC's inclusion of this purported issue. In fact, the LAC fails to even mention the traditional analysis of "piercing the corporate veil" which is normally applied if one is seeking to disregard the corporate identity of an organization.

In our view, UMA's actions can only be found to be actions of MUSC if UMA is the "alter-ego" of MUSC through a traditional "piercing of the corporate veil" analysis. Furthermore, it is our conclusion that the well-established doctrine of "piercing the corporate veil" would not and could not be applied to disregard the separate corporate existence of UMA.

A corporation will be looked upon as a legal entity until sufficient reason to the contrary appears; but when the notion of legal entity is used to protect fraud, justify wrong, or defeat public policy, the law will disregard corporate form by "piercing the corporate veil." In concluding that the doctrine of "piercing the corporate veil" would not be successful against UMA, we applied the two-prong test for piercing the corporate veil outlined in Sturkie v. Sifly, 313 S.E.2d 316 (S.C.Ct.App.1984) and DeWitt Truck Brokers, Inc. v. W. Ray Flemming Fruit Co., 540 F.2d 681 (4th Cir. 1976).

The first prong is an eight-factor analysis of the relationship of the dominant and subservient corporations and looks to the observance of corporate formalities by the corporation in question. The eight factors are: (1) gross undercapitalization of the corporation; (2) failure of the corporation to observe corporate formalities; (3) non-payment of dividends; (4) insolvency of the corporation; (5) siphoning of funds of the corporation by the controlling party; (6) non-functioning of other officers or directors; (7) absence of corporate records; and (8) the fact that the corporation was merely a facade for the operations of the controlling party. Additionally, the conclusion to disregard the corporate entity must involve several of the eight factors, but need not involve them all.

The second prong of Sturkie requires a plaintiff to prove an element of injustice or fundamental unfairness if the acts of the corporation are not regarded as the acts of the controlling party. Sturkie, 313 S.E.2d at 318. To prove fundamental unfairness, a plaintiff must establish (1) the controlling party was aware of the plaintiff's claim against the corporation, and (2) thereafter, the controlling party acted in a self-serving manner with regard to the property of the corporation and in disregard of the plaintiff's claim in the property.

[1] The LAC notes that for financial reporting purposes MUSC must include UMA as a part of its financial statements as a "blended component unit" pursuant to standards issued by the Governmental Accounting Standards Board. This means that UMA's financial information must be reported with that of MUSC. We do not believe that any GASB statement, including the one cited by the LAC in this case, is relevant legal authority supporting the proposition that UMA's actions are actions of the State. The purposes of GASB statements as well as generally accepted accounting principles and other accounting rules have wholly separate purposes, policies and guidelines as compared to relevant South Carolina law which govern the issues raised by the LAC.

In applying the first prong of the Sturkie test, we could find none of the eight factors. UMA is fully capitalized; (2) UMA fully observes corporate formalities; (3) UMA pays over excess funds to MUSC; (4) UMA is not insolvent; (5) MUSC does not siphon funds from UMA; (6) UMA has fully functional officers and directors; (7) UMA has complete and well documented corporate records; and (8) UMA is not a facade for the operations of MUSC. Additionally, there are no facts suggesting that the second prong of Sturkie is met.

A recent South Carolina Supreme Court case is directly on point and fully supports our analysis in determining whether UMA should be considered to be a "State entity" or an "alter ego" of MUSC due to UMA's otherwise close relationship with MUSC. In Provence v. Greenville Hospital System, Memorandum Opinion Number 88-MO-163 (S.C. Sup. Ct. 1988),[2] the facts are as follows: Greenville Hospital System ("GHS") is a State entity created for the express purpose of establishing and owning a hospital system for the citizens of Greenville County. GHS created Greenville Health Corporation ("GHC") as a private, non-profit, tax exempt corporation under IRC 501(c)(3) for the purpose of allowing GHC to perform activities[3] that GHS could not legally perform due to the fact that GHS is a State entity.

In creating and controlling GHC, GHS (I) appointed the entire initial board of directors of GHC, (ii) approves the appointment of each and every additional board member of GHC, (iii) funded GHC with an initial grant of $1.2 Million Dollars; (iv) continues to fund GHC's budget shortfalls, (v) has control over GHC's annual budget and activities, and (vi) must approve any significant corporate act of GHC, including amendment of GHC's bylaws, significant asset transfers, mergers and the like.

In Provence, the plaintiff argued that since GHC was funded and controlled by GHS to perform the activities that GHS could not under State law perform, GHC should be considered to be an "alter ego" of GHS and thus have the same restrictions applicable to State entities like GHS. The court disagreed with the plaintiff. The court noted that GHC was required by federal law to be controlled by GHS in order to qualify as a tax exempt supporting organization under IRC 501(c)(3) and 509(a)(3); thus the extent of control by GHS was not relevant in determining whether GHC was an alter ego of GHS. The court examined whether GHC and GHS had maintained separate corporate identities and observed the necessary corporate formalities independent of one another in a traditional "stripping away of the corporate veil" test in determining whether GHC and GHS were alter egos of one another. The court noted that since GHC (I) had regular separate board meetings, (ii) kept accurate and complete financial records, (iii) was adequately capitalized, and (iv) generally did not act as a facade of GHS, that GHC was not an alter ego of GHS and thus GHC could enter into transactions that GHS could not because of GHS being a State entity.

In examining the relationship between UMA and MUSC, we find that it is not nearly as close a relationship as that between GHS and GHC. All GHC board members are former GHS board members; only two current UMA board members have been on the MUSC board. UMA generates its own revenue independently from MUSC, while GHC does not and requires funding from GHS. MUSC appoints two UMA board members; GHS may veto any GHC appointee. The relationship between UMA and MUSC is set forth under contracts between the two; no such contractual relationships were noted establishing the duties and rights between GHS and GHC.

Further, we have seen no evidence that UMA has not observed the necessary corporate formalities to maintain an existence separate from MUSC. UMA keeps separate records and minutes and has separate meetings. Although some persons (faculty members) are employed by both MUSC and UMA, meticulous records are kept defining the source of funds of payment of

[2] Provence is an unpublished opinion. Although unpublished opinions are not considered to be binding precedent, they are useful for the persuasiveness of their reasoning to the degree of their factual similarity. Since the facts and issues in Provence and are so similar to the facts and issues raised by the LAC, we believe Provence to be strong persuasive authority.

[3] Such activities included the participation in joint ventures and the ownership of stock in private corporations.

these salaries, separate retirement plans and benefit plans are maintained, separate W-2's and tax filings are issued, separate financial statements are prepared, and all bank accounts and funds of both corporations are clearly segregated and not commingled. Although UMA and MUSC have a general common purpose and mission, the Provence case specifically noted that GHC was created to carry out the stated purpose of GHS; thus MUSC and UMA having a common purpose is not relevant in determining whether there is a separate corporate existence.

We note that, like GHC, UMA is a tax exempt organization under IRC 501(c)(3). Like GHC's relationship with its parent organization, UMA is closely aligned with MUSC.[4] Like GHC, UMA would not have qualified as a tax exempt entity without its nexus to MUSC. However, UMA's nexus with MUSC is not relevant to the issue of whether UMA is an alter-ego of the MUSC. The court in Provence explicitly stated that the level of control by a State entity necessary to maintain tax exempt status of a tax exempt entity was not relevant in determining whether the tax exempt entity was an "alter ego" of the State.

The LAC pays a great deal of attention to the fact that MUSC may be in a position to exert some influence on UMA due to the fact that some MUSC employees serve on the Board of UMA, the MUSC Board must approve UMA bylaw changes and the assets of UMA will be distributed to MUSC upon the dissolution of UMA.[5] We know of no authority supporting the proposition that too much control by a shareholder or another organization will by itself result in a piercing of the corporate veil. Indeed, if this were the case, the separate identity of all corporations owned by a single shareholder (commonly known as "subsidiary corporations"), as well as all supporting organizations under 509(a)(3) of the Internal Revenue Code, would be disregarded under the doctrine of piercing the corporate veil.

Also, we see no significance in the decrease in UMA's direct funding support for MUSC. UMA's funds are not generated from the State. UMA's revenues are produced by the personal services of UMA physicians from its patients and their insurance companies and other third party payors.[6] Furthermore, the LAC's concern that MUSC could use UMA as a means to circumvent State controls over discretionary spending is unfounded. UMA is not spending State money; thus it should not be limited by any State spending guideline in the way UMA spends its funds. Nor would MUSC be circumventing any such restrictions simply by accepting funds from UMA. If UMA determines that its funds should be used to pay for MUSC expenses, or if it decides to donate the money to MUSC, it has the authority to do so. We see no logical reason to conclude that UMA's use of its own funds would violate South Carolina law absent a direct piercing of the corporate veil.

Thus, based on the facts and authority set forth above, it is our conclusion that UMA is not an alter-ego of MUSC, and UMA's actions are not actions of the State or MUSC due to its close nexus with MUSC.

Very truly yours,

NELSON, MULLINS, RILEY & SCARBOROUGH
By Thomas F. Moran, Its Partner
TFM:eb

---

[4] Like GHC, the basis of UMA's tax exemption under 501(c)(3)is its close alignment with MUSC. "The nexus between the teaching hospital faculty organization and the university and hospital enables the [faculty organization] to qualify for exemption." Thomas K. Hyatt and Bruce R. Hopkins, The Law of Tax exempt Organizations, Section 12.2 (1995). See generally University of Massachusetts Medical School Group Practice v. CIR, 74 T.C.1299 (1980).

[5] As a tax exempt 501(c)(3) corporation, UMA is required by the Internal Revenue Code to distribute its assets to the government, or to another 501(c)(3) corporation, upon its dissolution. It is natural, given its nexus with MUSC, that UMA should choose to benefit MUSC upon its dissolution since it otherwise must distribute its assets to the government or to a charity upon its dissolution.

[6] It is compelling to note that UMA generates its revenues by billing and collecting for services rendered to patients from third parties such as health insurance companies, HMO's, Medicare, Medicaid and the patients to whom such services are rendered. Thus, UMA's fees for services rendered are billed and collected and earned in the same manner and in the same amounts as other physicians who perform similar services at other hospitals (both nonprofit and for profit).

Appendix 2

April 21, 1999

Mr. Marion Woodbury
Medical University of South Carolina
171 Ashley Ave.
Room 420 QCSB
Charleston, SC 29425

Dear Marion,

This will confirm our earlier discussion regarding the State Telephone System established in Charleston in the mid-1980's in accordance with the legislative mandate following divestiture of the telephone industry. The Legislation in Section 1-11-430 of the South Carolina Code provided for the Budget and Control Board to secure all telecommunication equipment and services for state government enterprise under its terms and conditions and coordinate supply of equipment services for state government use. In this regard, the Budget and Control Board's Office of Information Resources (OIR) solicited and established modern telephone systems in Columbia and Charleston on a shared - integrated system basis to provide for maximum economies of scale, as well as technology standardization, and interoperability.

When UMA was established and became an integral part of the support function for MUSC, OIR determined it was in the state's best interest technically, financially, and operationally to incorporate UMA into the state's system in Charleston. Therefore, OIR initially established the telephone system at Poston Road to make UMA an integral part of the Charleston telephone system, providing 5-digit dialing and transparent intercommunications capability between the rest of MUSC in order to facilitate the operational functions between UMA and MUSC.

Over the years, OIR has continued to maintain and evolve the Charleston state government telephone system on a shared -integrated basis to achieve maximum financial, technical, operational, and functional benefits for all the users on the telephone system in Charleston, including UMA, who is a major participant of the telephone system. It is OIR's opinion that is clearly advantageous to the state financially, functionally and operationally for UMA to be an integral part of the Charleston State Government Telephone System. Because of the widespread distribution of UMA operations throughout MUSC facilities, it would be technically difficult and more costly to serve UMA with another telephone service.

The Charleston state government telephone system provides service to MUSC, The Citadel, College of Charleston and other state agencies in Charleston, as well as UMA. The Switching System and Communications Cable System were designed and are maintained on a shared-integrated systems basis.

Should you need any further information in this regard, please advise.

Sincerely,

Ted L. Lightle
Director

cc: Bob Gallager
Rick Kelly

OFFICE OF THE ATTORNEY GENERAL

May 18, 1999

Mr. George L. Schroeder
Director, Legislative Audit Council
400 Gervais Street
Columbia, South Carolina 29201

Re: MUSC/UMA Final Draft Audit

Dear Mr. Schroeder:

Concerning page 27 - 29 of your draft audit, I would like to offer the following comments:

Your audit points out that University Medical Associates (UMA) made campaign contributions to numerous “statewide” and “regional” elected officials, the largest of which was made at the “gubernatorial” level. As you know, UMA’s political contributions are taken from private funds, and, therefore, such contributions are both legal and ethical under current South Carolina law.

However, since UMA itself is quasi public in nature, your audit seeks to make the point that such contributions may “create the appearance of a conflict of interest.” That is a point worthy of debate and should be forwarded to the General Assembly for possible corrective consideration.

However, it is very unfair for you to single out the Attorney General as the only campaign you specifically mention as having received contributions from UMA. Every statewide elected official and every member of the General Assembly is responsible for either the enactment or the enforcement of all the laws of South Carolina. Therefore the potential for the appearance of a conflict would apply to all elected officials including the legislative members of the board of the Legislative Audit Council.

Your citation of the legal review authorities of the Attorney General’s office does not create a special case. To use your language, “the Attorney General may periodically be asked to review legal issues relating to UMA.” That is true. What you fail to point out is that the Attorney General is also asked to review legal concerns and to issue opinions on an unlimited number of subjects relating to everyone who lives, works, and does business in the State of South Carolina. Therefore, no campaign contributions whatsoever could meet the standard you imply.

In summary, there may be merit to your recommendation that quasi public entities like UMA should not engage in the practice of making political contributions. However, pointing a specific finger at the Attorney General among the many, many candidates who have received such contributions over the years is inappropriate and undeserved, especially in view of the fact that UMA contributed much more heavily to many other candidates. Thank you for allowing me to express my views on this issue.

Yours very truly,

John W. McIntosh
Deputy Attorney General

This report was published for a total cost of $653.10; 200 bound copies were printed at a cost of $3.26 per unit.