



GOVERNANCE AND INTERNAL CONTROLS: Turning the "Compliance Tax" into Process Improvement Treasure

The Landscape

Sound governance and internal controls will not only facilitate opportunities for growth and cost-savings by critically analyzing hospital practices, but also serve as an early warning in situations that may expose the hospital to unnecessary litigation.

In the second half of 2004 alone, examples of governance and internal control breakdowns related to hospitals abounded. For instance, at least 45 class action lawsuits have been filed by uninsured patients against nonprofit hospitals for alleged profiteering in violation of obligations to provide charity care in exchange for tax exemptions. Additionally, many hospitals do not have the internal control coverage they should, or, in some cases, do not have the ability to assess the effectiveness of the coverage they do have. According to the Department of Health and Human Services website, at least seven categories of fraud occurred from July - October in 2004; some of these frauds included the use of purchasing cards to acquire personal assets, submitting fraudulent bills to Medicare and Medicaid, misuse of physician identities in certain DME-related cases, and falsification of prescriptions for narcotic drugs.

New legislation has been proposed that may expose these same hospitals - and all not-for-profits - to additional lawsuits, as this legislation requires extensive reforms related to:

- Governance
- Disclosures
- Best practices

Also included in the pending reforms are several proposals that will subject not-for-profits to greater enforcement powers at the federal and state levels. Overall, the industry is facing well-intentioned reforms that will likely identify a surprising number of remediation opportunities and could mirror the cost-multiples experienced in the public sector for similar reform movements. This effort, not unlike that required by the Sarbanes-Oxley Act, should begin early to allow the organization to address issues at a sustainable pace.

By looking at the nuances within the proposed structural changes, certain challenges and process improvement opportunities should become apparent:

[continued >](#)



Structural Change and Expected Implications**

Information from the Senate Finance Committee discussion draft published on June 22, 2004 (unless cited otherwise) - List not meant to be exhaustive

Reform Subject	Description (Proposed / Finalized)	Implications
Governance	<ul style="list-style-type: none"> - Board defined goals and approach to measuring success in meeting stated goals. (Sen. Fin. Co. E.8) - Board must establish organizational and management policies and procedures and review any proposed deviations. (Sen. Fin. Co. G.1) - Board must review and approve significant transactions (Sen. Fin. Co. G.1) - Board must review and approve the auditing and accounting principles and practices. (Sen. Fin. Co. G.1) - Board must review summaries of conflicts determinations and oversee a compliance program to address regulatory and liability concerns. (Sen. Fin. Co. G.1) 	<ul style="list-style-type: none"> - Board defined goals and approach to measuring success in meeting stated goals. (Sen. Fin. Co. E.8) - Board must establish organizational and management policies and procedures and review any proposed deviations. (Sen. Fin. Co. G.1) - Board must review and approve significant transactions (Sen. Fin. Co. G.1) - Board must review and approve the auditing and accounting principles and practices. (Sen. Fin. Co. G.1) - Board must review summaries of conflicts determinations and oversee a compliance program to address regulatory and liability concerns. (Sen. Fin. Co. G.1)
Disclosure	<ul style="list-style-type: none"> - Mechanisms must be established to permit disclosure of material changes in activities, operations, or structure. (Sen. Fin. Co. E.8) - Confirmation of adherence to board requirements must be made on the Form 990. (Sen. Fin. Co. G.1) - Compensation arrangement must be explained and justified and made available to the public (Sen. Fin. Co. G.1) - Attachments to Form 990 must show affiliated entities and explanations of transactions between such parties, including tax and conflicts of interest opinions. (Sen. Fin. Co. E.7) 	<ul style="list-style-type: none"> - Regulatory bodies have determined it is time to take a look behind the financials, calling for disclosures that can only be made if effective, controlled disclosure processes are maintained. - Penalties will be levied on entities that do not disclose apparent self dealings, and those that do will be hard-pressed to justify their actions.
Best Practices	<ul style="list-style-type: none"> - Chief Executive certification of federal filings stating, under penalty of perjury, that procedures are in place to ensure filing compliance, and that the CEO has reasonable assurance of the accuracy and completeness of all material aspects of a tax return. (Sen. Fin. Co. E.1) - Management representations regarding responsibility for fraud deterrence and detection (Audit and Review Standards) 	<ul style="list-style-type: none"> - Similar to Sarbanes Oxley requirements, executives will not be able to "delegate away" their authority and responsibility for ensuring filings have been produced in a controlled, fraud-free environment.



The regulatory landscape is not only adding volumes to the compliance procedures hospitals face, but offering incentives – without penalties for avoidance – as well. For instance, effective compliance and ethics standards, updated in 2004 by the U.S. Sentencing Commission, are in line with features of Sarbanes Oxley and the Senate Finance Committee proposed reforms for tax-exempt organizations. These are significant because according to the U.S.S.C. sentencing guidelines, two factors *mitigate* the punishment culpable organizations may receive. One such factor is the existence of an effective compliance and ethics program. Demonstration of this program can reduce fine ranges by up to 95% if “an organization can demonstrate that it had put in place an effective compliance and ethics program and that a criminal violation represented an aberration within an otherwise law-abiding community”.

Sound governance structures effectively design and implement comprehensive policies and procedures that provide:

1. Assurance that business transactions comply with controls
2. Knowledge that control systems are designed and operate to account for all transactions
3. Assurance that data is accurate and reliable

Weak policies and procedures facilitate control lapses that expose firms to risks:

1. Fraud
2. Overpayments
3. System security breaches
4. Reporting inaccuracies or regulatory violations

Where hospitals have taken the initiative to critically analyze their processes, the following is a selected list of sample benefits which have been realized:

Actual (Historical) Process Improvement Opportunities

Governance

Achieved cross-functional coordination and understanding, improving organizational capabilities associated with:

- Sustaining a culture of control and continuous improvement through use of departmental control certifications provided to senior management and the board
- Implementing action plans and tracking implementation
- Identifying control gaps and over-controlled operations
- Defined board monitoring practices, identifying performance and success standards for:
 - Internal and external audit procedures
 - Accounting period-end close
 - I.T. staffing and investment to meet evolving I.T. requirements

Functional

- Purchasing
 - Identified purchasing volume discounts for one commodity, saving \$500,000 annually
 - Implemented analytical and control procedures over all system-based and manually written checks to detect and prevent duplicate, fraudulent, and egregious disbursements



- Employed data mining software to discover over 100 duplicate and similarly named vendors and identified procedures to control such vendor proliferation so that cost, delivery, and vendor history data can be accurately analyzed and reported on
- Improved procedures for disbursement recognition in the accounting system to ensure all ledger entries are recorded in the appropriate period

Billing

- Created new reports for management to identify over \$600,000 in unbilled and unreported (unknown) patient services by applying data analysis techniques to multiple system source data files
- Increased revenue by identifying process, system, and healthcare coding incongruities that perpetuated partial patient billings for recurring service codes

Information Technology

- Reorganized security profiles to ensure access to sensitive system modules and tables could be tracked and limited
- Defined system security profiles to accurately reflect assignment of separate duties, e.g. ensured users' system authorities match job responsibilities and did not permit incompatible tasks such as check writing and account reconciliation
- Corrected instances where terminated employees retained system logon rights

Cash Management

- Identified improvements in the bank reconciliation process to safeguard cash and improve efficiency
- Coordinated cash account oversight so cash position can be readily verified