UNIVERSITY OF MINNESOTA MEDICAL SCHOOL

*SELECTED SCOPE FINANCIAL AUDIT

Managing Financial Resources and Private Practice

FOR THE TWO YEARS ENDED JUNE 30, 1992

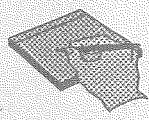
AUGUST 1993

*See description of this new report style in the following Note to Report Readers.

Financial Audit Division
Office of the Legislative Auditor
State of Minnesota

93-44

Centennial Office Building, Saint Paul, MN 55155 ● 612/296-4708



Note to Report Readers

The Financial Audit Division introduces a new report style in nine audits being released during the Summer of 1993. The division plans to use the new style on a trial basis and will later evaluate report readers' preferences. The new style replaces the traditional format of reporting only on an "exception basis." In the traditional format, auditors commented primarily on problems which the reports presented as findings and recommendations. Readers may have grown accustomed to using report length as a gauge for the extent of problems. With the new style, report length is not a reliable indicator of the extent of audit findings. These new reports contain more extensive factual and analytical data. Report readers should find this additional information useful. The division has attempted to make the new report style easy to identify and understand.

Identifying the New Report Style

The division distinguishes the new style reports by printing the report title in red ink, rather than the black ink used for traditional financial audit reports. All Financial Audit Division reports continue to use the gray-colored report covers. The report title shows through the window cutout on the gray cover. The inside cover page highlights the new style. This Note to Report Readers follows the inside cover page and describes the new style.

New Features

The new reports devote a separate chapter to each major audit area. Chapters contain detailed information on the audit scope, analytical results, and conclusions. Each chapter also elaborates on applicable management practices and processes. Financial auditors have always accumulated this additional information, but traditionally retained the information in the working papers and did not publish it as part of the final report.

To provide for a quick understanding of the audit results, the chapter structure allows readers to visually scan for items of interest or concern. Readers should look for the following features in each chapter:

1. The audit conclusions summarized at the beginning of the each chapter,
2. Tables and charts highlighting important financial information, and
3. Any audit findings and recommendations.

Aside from the format for presenting audit findings and recommendations, the new report style preserves the other elements of the traditional financial audit report. Report readers should recognize these other standard elements of the traditional reports: (1) Scope and Conclusions Letter, (2) Table of Contents, (3) Introduction, (4) Agency Response, and (5) an inserted Report Summary (although the new style uses a modified version of the report summary). Audit findings continue to be numbered and presented in bold-faced print. Recommendations are highlighted in italics. However, the Audit Findings and Recommendations are embedded in the appropriate report chapters, rather than aggregated in a separate report section.

Reasons for the Change

The traditional financial audit reports have several limitations. The reports often tend to be very technical documents. Also, reports with few findings communicate the audit results in a very abbreviated manner. Exception-based reporting requires auditors to either present audit findings or to simply state that the audit revealed no findings. This reporting style does not allow for positive conclusions or analysis of areas without audit findings.

The division was concerned about the risk that some report readers may have difficulty understanding audit results. It had begun to narrow its audit scope for several larger, more complex agencies. These "selected scope" audits were an effort to stretch scarce staff resources into as many audits as possible. But the division was particularly concerned that readers would project the audit results from a few selected programs to conclusions about an entity's overall financial management. The new report style more effectively presents the audit scope within the context of the entity's total operations.

Exception-based reporting does not fully accommodate the extent that auditors must exercise professional judgment. Auditors must interpret laws and policies. They must weigh the costs of control deficiencies against the benefits of preventing potential problems. It is particularly challenging to audit entities that are exempt from standard state policies and regulations. For those audits, the auditors must judge whether the entity has adopted "reasonable" and prudent practices for a public entity. Many issues require difficult decisions about whether or not an audit finding exists. Under the traditional report format, the auditor presents comments only when concluding that a finding exists. The new report style removes this limitation. Although the auditor's judgment remains important, the new report style also allows readers to reach their own conclusions.

Audits with the New Report Style

Look for the new report style in the audits of the following nine entities.

Department of Corrections	Department of Human Services
State University System	Community College System
Department of Natural Resources	University of Minnesota Medical School
Minnesota State Lottery	Environment and Natural Resources Trust Fund
State Public Defender	

Eight of the nine are "selected scope" audits covering only some programs of the entity. The Minnesota State Lottery is an entity-wide audit limited to testing for legal compliance with state laws and regulations.

Share Your Comments

If you have comments about the new report style, please contact the Financial Audit Division at (612) 296-1730.

UNIVERSITY OF MINNESOTA MEDICAL SCHOOL

FINANCIAL AUDIT
FOR THE TWO YEARS ENDED JUNE 30, 1992

Public Release Date: August 24, 1993 No. 93-44

AGENCY BACKGROUND

The University of Minnesota Medical School was established in 1888. Dr. Shelley N. Chou is the Medical School Interim Dean. The Medical School has 23 departments, each with its own department head and administrative personnel. For Fiscal Year 1992, Medical School expenditures totalled $212 million, not including an estimated $40 million spent directly by the private practice plans and not recorded on the University's accounting system.

SELECTED AUDIT AREAS

- *Managing Medical School Financial Resources*

The Medical School departments derive their funding mainly from state operations and maintenance fund allocations, federal government and private sector grants, private practice revenue, and gifts. Salaries and fringe benefits account for 73 percent of the $212 million in expenditures.

The Medical School departments conducted their financial activities without adequate oversight. The departments did not provide the dean's office and central administration with comprehensive financial information for decision making. Even when information was available, the dean's office and central administration have not always acted effectively to resolve problems. Weaknesses in the University's accounting system compound the problems and create a weak control environment.

- *Private Practice*

Private practice refers to fees generated by University physicians treating patients in the course of their other duties as faculty. These fees are deposited in accounts of various private practice plans. The plans use the funds to supplement faculty salaries, pay plan expenses, and provide operating funds to the Medical School departments. The plans operated under a 1963 Board of Regents policy statement, which was rescinded and replaced by a new policy on July 8, 1993.

We found that the private practice administrative system in effect prior to adoption of the new Regents' policy did not provide for adequate oversight or sufficient assurance that compliance with operational guidelines is achieved. Because of limited access to financial information, we do not know, and the University does not know, whether funds were properly controlled and expenditures were appropriate. We believe the risk of questionable practices is significant. The implementation of newly adopted changes to private practice plan policies needs to be carefully watched to ensure that it results in improved controls, oversight, and accountability.

Contact the Financial Audit Division for additional information.
296-1730

STATE OF MINNESOTA
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Honorable Jean Keffeler, Chair
University of Minnesota Board of Regents

Members of the University of Minnesota Board of Regents

Dr. Nils Hasselmo, President
University of Minnesota

Dr. Shelley N. Chou, Interim Dean
University of Minnesota Medical School

Scope

We have conducted a financial related audit of selected aspects of the University of Minnesota Medical School, Minneapolis Campus (Medical School) for the two years ended June 30, 1992. Chapter 1 provides a brief description of the Medical School's activities and finances. Chapters 2 and 3 discuss the results of our audit.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance that the financial activities attributable to the selected areas of the University of Minnesota Medical School are free of material misstatements.

Our audit objectives concentrated on the financial control structure governing two general aspects of the Medical School:

- the budgeting and monitoring process used to control the financial resources of the Medical School, and

- the University's policies and procedures used to oversee the financial activities of the private practice plans operated by the Medical School faculty.

To accomplish these objectives we interviewed Medical School and individual department administrators. Those interviews provided us with general information about Medical School operations. Because the Medical School's administrative and accounting functions are decentralized, we focused our detailed testing primarily on two departments: Medicine and Dermatology.

We performed tests of selected Medical School transactions to obtain reasonable assurance that, for the areas reviewed, the Medical School had, in all material respects, administered its programs in compliance with laws and regulations applicable to the areas reviewed. However, it was not our objective to provide an opinion on overall compliance with such provisions.

Scope Limitations

The scope of our audit was limited by the following conditions:

- The Medical School private practice plans refused to give us unfettered access to their records for financial transactions processed outside of the University's accounting system. The plans provided us with some summarized financial data. However, we were not able to audit or substantiate this information.

- We were not permitted to interview key staff, or review financial information, in the Department of Surgery, which is one of the largest departments in the Medical School. A federal investigation into alleged improprieties related to the Minnesota Anti-lymphocyte Globulin (MALG) program precluded our audit in this department. Since affected staff in the Department of Surgery provided accounting services for the Department of Urologic Surgery, we also excluded that department from our audit scope.

We think that our statutory authority provides us with clear, legal access to the financial records of the private practice plans. After much consideration, however, we decided not to use our subpoena powers to compel the release of these records. Because the plans showed a strong and united conviction to withhold records from us, we anticipated they would challenge our subpoena authority in court. Although we were confident that we would prevail in a legal proceeding, we were concerned about the potential delay in gaining access to the records. Such a delay would have required us to reschedule audit staff. Because of other commitments, we could not have reassigned staff to examine these records until 1994.

Also, University officials urged us to avoid a legal confrontation with the private practice plans. The University was in the process of negotiating administrative reforms with the plans. University officials were concerned that our legal action would be disruptive to the negotiations. Because of the financial risks evident with the existing controls over the private practice plans, we were also eager for the University to strengthen its oversight of the plans.

As a result of these considerations, we decided against initiating an aggressive legal pursuit of the private practice plan records. Rather, we chose to conduct this audit based on records available through the University. Without examining the private practice plan records, we have many unanswered questions about how the plans managed and spent the funds. Therefore, we are considering scheduling a future audit to pursue answers to these questions. However, we believe it ultimately is the University's responsibility to ensure proper accountability for private practice plan financial resources. Our role will primarily focus on periodic reviews of the control structure established to provide accountability.

Management Responsibilities

The management of the University of Minnesota Medical School is responsible for establishing and maintaining an internal control structure. This responsibility includes compliance with applicable laws and regulations. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute assurance that:

- assets are safeguarded against loss from unauthorized use or disposition;
- transactions are executed in accordance with applicable legal and regulatory provisions, as well as management's authorizations; and
- transactions are recorded properly on the University's accounting system in accordance with their policies and procedures.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Internal Control Structure

We identified the significant internal control structure policies and procedures related to our audit objectives. For purposes of this report, we classified the significant internal control structure policies and procedures in the following categories:

- budget monitoring and financial resource control;
- private practice revenue; and
- private practice expenses, including payroll and fringe benefits and other plan expenses.

For these areas, we obtained an understanding of the design of the relevant policies and procedures and, to the extent possible, we determined whether they have been placed in operation, and we assessed control risk. We were not able to determine if the controls related to private practice revenue and expenses had been placed in operation because of the scope limitations discussed previously. Our review was more limited than would be necessary to express an opinion on the Medical School's internal control structure taken as a whole.

To the extent possible, due to scope limitations, we also considered whether the Medical School's financial activities for the selected areas were conducted in a reasonable and prudent manner for a public entity. To achieve this objective, we reviewed selected financial policies and practices in effect during the audit period and as of the time of our fieldwork in May 1993.

Conclusions

The University central administration and the dean's office are not able to make appropriate budgetary decisions because the Medical School departments do not provide them with comprehensive financial information. In addition, we do not think the dean's office and central administration have provided appropriate oversight of Medical School financial activities. Chapter 2 explains how the Medical School controls its resources, how use of those resources is monitored and why we are concerned with current practices.

The financial resources of the private practice plans are integral to the operation of the Medical School. The design of the control system established to ensure compliance with policies and procedures governing these plans has serious weaknesses. Therefore, we do not think that the University can determine whether compliance with these policies and procedures has occurred. Chapter 3 describes the evolution of the current private practice plans, details the weaknesses we found, and highlights the changes recently authorized by the Board of Regents.

This report is intended for the information of the Legislative Audit Commission and officials of the University of Minnesota. This restriction is not intended to limit the distribution of this report, which was released as a public document on August 24, 1993.

James R. Nobles
Legislative Auditor

John Asmussen, CPA
Deputy Legislative Auditor

End of Fieldwork: June 11, 1993

Report Signed On: August 18, 1993

University of Minnesota
Medical School

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

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Exit Conference

The issues in this report were discussed with the following staff of the University of Minnesota on August 13, 1993:

Robert Erickson	Senior Vice President for Finance and Operations
Richard Pfutzenreuter	Associate Vice President of Budget and Finance
E. Wayne Drehmel	Associate Dean for Administration, Medical School
William Donohue	Associate University Attorney
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Patrick Spellacy	Director of Audits

University of Minnesota
Medical School

Chapter 1. Introduction

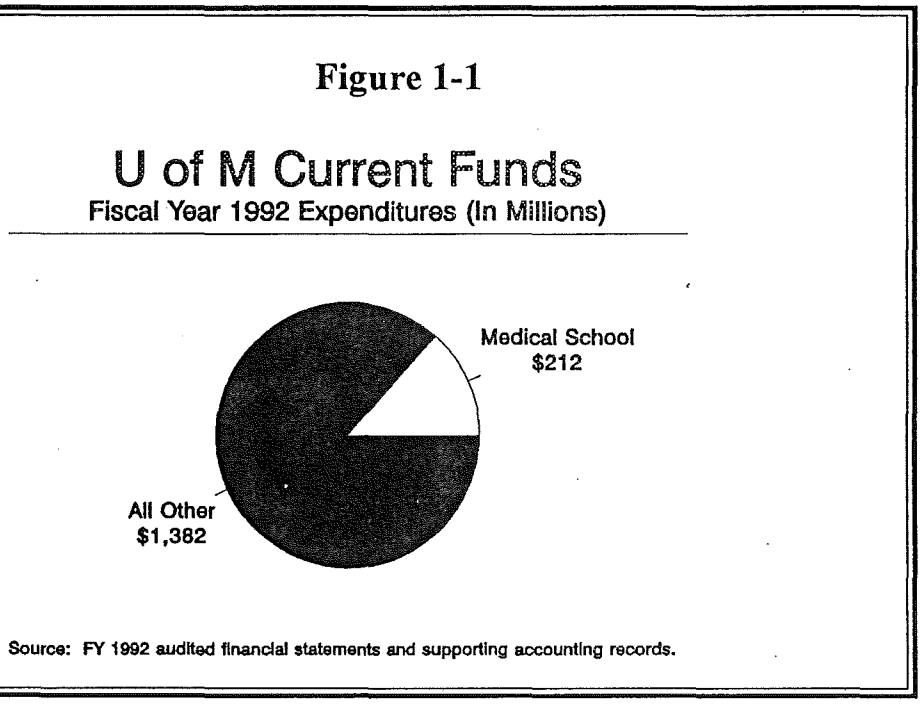
The University of Minnesota first established a Medical School in 1888. As described in its Mission Statement, the Medical School was created:

> to conduct high quality programs of research, education and service through which the college contributes significantly to the provision of excellent health care for the people of Minnesota.

In 1992, the Medical School had approximately 2,080 academic employees, including medical residents and other salaried students, plus 1,370 civil service and bargaining unit employees.

The Medical School is a significant component of University financial activity. As shown in Figure 1-1, it accounted for approximately 13 percent of University current funds expenditures in Fiscal Year 1992.

Figure 1-1



University of Minnesota
Medical School

The president of the University appoints the dean, who is the administrative head of the Medical School. The dean reports to the vice president of Health Sciences, who in turn reports to the president of the University. Dr. David Brown was appointed dean in 1984. Dean Brown resigned effective June 30, 1993. Dr. Shelley Chou currently serves as interim dean of the Medical School and deputy vice president for medical affairs.

The Medical School has 23 medical departments, each with its own department head and administrative personnel. Figure 1-2 shows the Medical School components. The five basic science departments center their activities around teaching and research. The 18 clinical departments have the added responsibility of patient care. In addition to these departments, the Medical School has various administrative offices and research institutes.

The Medical School has delegated nearly full, unfettered control over financial activities to the individual departments. Table 1-1 shows expenditures by Medical School department for Fiscal Years 1991 and 1992, as reported on the University's accounting system. Departments do not deposit private practice fees directly with the University. Therefore, the University's accounting system records only expenditures attributable to private practice revenues transmitted to the Medical School. These records do not account for amounts spent directly by the private practice plans on additional compensation to physicians and other plan expenses. The University has estimated these additional private practice expenditures at about $40,000,000 annually. Without examining private practice records, we could not substantiate this estimate. The private practice plans do not provide the dean's office or University central administration with financial data. Chapter 2 discusses the effect that this restriction has on the administration's ability to provide management oversight to the Medical School departments.

Physicians' private practice activities are governed by an agreement with the Board of Regents. We discuss the details of this agreement and the mechanics of the private practice plans in Chapter 3.

Figure 1-2
Medical School Organization

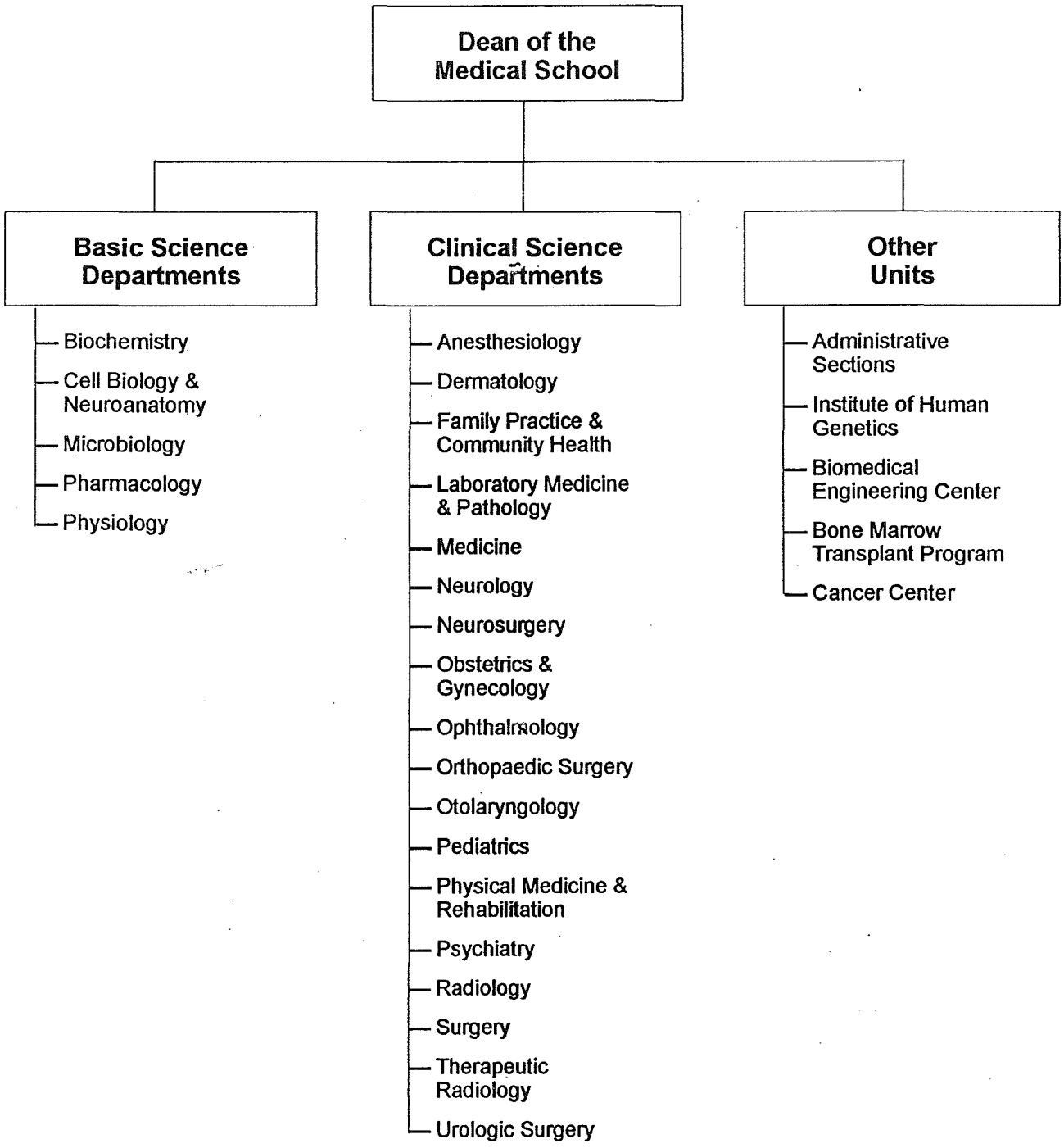


Table 1-1
University of Minnesota Medical School
Expenditures by Department
Fiscal Years 1991 and 1992

Department	Fiscal Year 1991	Fiscal Year 1992
Administrative Sections/Other Units	$ 19,547,749	$ 21,683,242
Biochemistry	5,555,761	5,880,350
Cell Biology & Neuroanatomy	4,848,823	5,005,017
Microbiology	5,269,103	5,269,666
Pharmacology	5,834,706	6,787,750
Physiology	3,514,831	4,296,845
Subtotal Basic Science	$ 25,023,224	$ 27,239,628
Anesthesiology	$ 2,129,000	$ 2,033,448
Dermatology	1,878,420	1,807,479
Family Practice & Community Health	15,187,900	16,402,978
Laboratory Medicine & Pathology	17,568,946	17,340,646
Medicine	31,176,668	32,630,616
Neurology	5,688,874	5,761,557
Neurosurgery	1,730,580	1,871,399
Obstetrics & Gynecology	2,929,293	3,219,618
Ophthalmology	4,682,172	4,658,739
Orthopaedic Surgery	4,037,315	4,102,180
Otolaryngology	4,647,304	4,352,081
Pediatrics	19,489,560	21,855,259
Physical Medicine & Rehabilitation	2,014,202	2,106,076
Psychiatry	6,497,942	8,059,028
Radiology	5,679,879	6,911,872
Surgery	27,566,419	26,819,489
Therapeutic Radiology	2,106,047	2,131,471
Urologic Surgery	618,140	909,248
Subtotal Clinical Science	$155,628,661	$162,973,184
Total	$200,199,634	$211,896,054

Note 1: The clinical science departments' expenditures do not include amounts spent directly by private practice plans. The University has estimated these direct private practice expenditures at about $40,000,000 annually. Departments have considerable discretion in determining which expenditures derived from practice plan revenue are to be incurred directly by a practice plan through non-University accounts, or alternatively, through applicable University accounts, making comparisons between departments difficult.

Source: University of Minnesota general ledger accounting system records.

Chapter 2. Managing Medical School Financial Resources

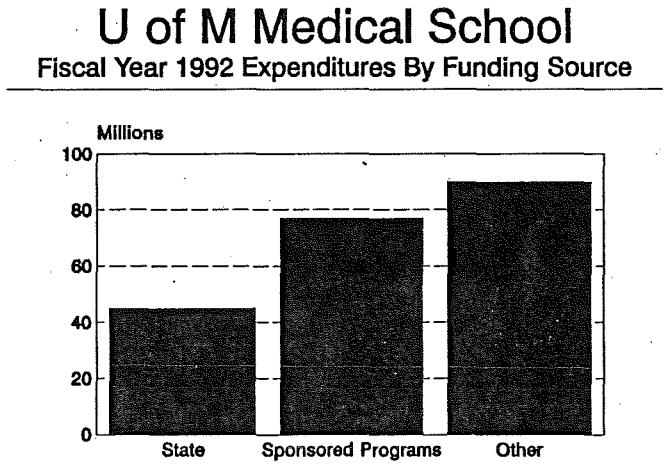
Chapter Conclusions

The Medical School departments conducted their financial activities without adequate oversight. The departments did not provide the dean's office and central administration with comprehensive financial information for decision making. Even when information was available, the dean's office and central administration have not always acted effectively to resolve problems. Weaknesses in the University's accounting system compound the problems and create a weak control environment.

The Medical School departments derive their funding mainly from University operations and maintenance fund allocations (state funding), federal government and private sector grants, private practice revenue, and gifts.

Figure 2-1 shows the relative levels of Medical School funding from various sources in Fiscal Year 1992.

Figure 2-1



Source: Medical School accounting records.

State funding includes operating fund (state general appropriations and tuition) allocations and state special appropriations. Sponsored programs, consisting of federal funding and private sector grants, are subject to oversight by the University's Office of Research and Technology Transfer Administration. Expenditures for these sponsored programs include indirect cost reimbursements, while other funding sources do not. The other category includes gifts, private practice revenue transferred from the plans to fund departmental expenditures, and other miscellaneous income. Amounts shown do not include private practice revenue expended outside of the University's accounting system.

Payroll and fringe benefits constitute the largest Medical School expenditure category. Table 2-1 shows Fiscal Year 1992 Medical School expenditures by type, as recorded on the accounting system. Departments can determine which private practice activities to record on the system. Some departments stated that they report nearly all physician compensation on the system. Other departments report only the physicians' base salaries, with supplemental salary amounts paid directly by the practice plans.

Table 2-1
University of Minnesota Medical School
Expenditures by Type
Fiscal Year 1992

	Amount	Percent
Academic Salaries	$ 87,060,209	41%
Civil Service Salaries	42,666,195	20%
Fringe Benefits	24,565,525	12%
Subtotal Payroll	$154,291,929	73%
Laboratory and Medical Supplies	$ 16,058,474	8%
Indirect Costs	15,502,538	7%
Buildings and Equipment	8,281,004	4%
Repair and Maintenance	2,987,436	1%
Travel	2,936,211	1%
Other	11,838,462	6%
Subtotal Nonpayroll	$ 57,604,125	27%
Total Expenditures	$211,896,054	100%

Note 1: The clinical science departments' expenditures do not include amounts spent directly by private practice plans. The University has estimated these direct private practice expenditures at about $40,000,000 annually. Departments have considerable discretion in determining which expenditures derived from practice plan revenue are to be incurred directly by a practice plan through non-University accounts, or alternatively, through applicable University accounts, making analysis difficult.

Note 2: In some instances, departments report interagency and external reimbursements as expenditure reductions rather than revenue. As a result, some expenditure categories may be understated.

Note 3: Indirect costs are charged only to sponsored programs, which include federal government and private sector grants.

1. Medical School departments conduct their fiscal duties with limited administrative oversight.

The Medical School operates its financial activities in a very decentralized manner, with limited oversight from the dean's office or the University's central administration. This management style has been ineffective because the departments have not provided sufficient comprehensive financial information to these University decision makers. This limits the dean's office and central administration's ability to take appropriate actions when problems occur. Also, even when information on financial problems was available, the dean's office and central administration have not always acted promptly to address the concerns.

University policy requires departments to submit budgets for the state portion of their funding, but not for other sources. As shown in Figure 2-1, other revenue sources provide significant funding to the Medical School. Departments are not even required to disclose to the dean's office the total cost of their operations or the amount of private practice funding anticipated. Consequently, neither the dean's office nor University administrators have the information needed to make meaningful informed decisions about the departments' operations. We discuss the lack of information on private practice activities in more detail in Chapter 3.

The dean's office and central administration have played a limited role in monitoring departmental financial activities. We were particularly surprised to learn that the administration did not effectively intervene when departments were not able to cover their expenses and had negative account balances or overall departmental deficits. For example, at June 30, 1992, University accounting records showed the Department of Dermatology had a deficit balance of about $450,000 in its current nonsponsored funds. The deficit had increased $160,000 from the end of the previous fiscal year. Memos indicate that the department had a deficit of $50,000 as early as July 1986. The dean's office was aware of the department's financial problems and periodically corresponded and met with the department to discuss resolution. However, the deficit continued to grow. An agreement reached in May 1993 provides for a five year payback of the deficit amount, without interest charges.

The Department of Obstetrics and Gynecology also had an overall deficit balance (of approximately $340,000) in its current nonsponsored funds at the end of fiscal year 1992. Many other departments had individual accounts which were negative. Departments do not incur any penalties as a result of being in a deficit situation.

The University's accounting system has the ability to withhold payments if there are insufficient funds in an account. However, the University currently does not use those controls. In lieu of that level of control, the University should have a process in place to identify accounts experiencing financial difficulties. Central administration has not developed a reporting or monitoring system to identify problem accounts. Departmental and central administrators would have had to deal with financial problems in a more timely manner if the accounting system limited expenditures to funds available.

Recommendation

- *The dean's office and University central administration need to be more active in their oversight of departmental financial activities to ensure that financial problems are detected and corrected as timely as possible.*

2. Underutilization of the University's accounting system weakens the Medical School's ability to control financial resources.

The University's accounting systems have not generated reports in formats that are helpful in managing departmental financial activities. As a result, many of the Medical School departments have established parallel accounting systems known as "shadow" systems. Department personnel input transaction data and generate management reports. For example, the Department of Medicine inputs the entire payroll into a shadow system because the payroll system does not generate a report showing payroll postings to the many departmental accounts. Considering that Medicine has hundreds of employees, this duplicate recording requires a significant investment of staff time and effort.

The department administrators also expressed other frustrations about the new accounting system. For example, departments have not had timely account balance information. Consequently, administrators do not know the amount of prior year carryforward amounts or funds available for expenditure. It is extremely risky to make spending decisions without knowing how much money is available.

We noted a specific problem, related to an allocation of special project funds to the Department of Medicine, where an account deficit on the accounting system reports should have triggered the detection and correction of an error. The dean's office originally awarded the Department of Medicine $75,000 to renovate a research laboratory. The award was later increased to $100,000. In our examination, we found that the additional $25,000 had never been transferred to Medicine and that the account was in deficit status. Neither the dean's office nor Medicine had noticed that the additional funds had not been transferred.

Also, some of the central University practices introduce additional risks to the departments' funds. For example, Medical School staff told us that the University's central stores can process payments against any accounts without departmental authorization. If not properly controlled, this could result in expenditures charged to programs that violate the terms of a grant agreement or gift restriction.

Recommendations

- *The Medical School should work with University central administration to improve departmental information provided by the accounting system.*
- *In addition, the University administration should ensure that appropriate system controls are present to limit transactions to those authorized by departmental personnel.*

Chapter 3. Private Practice

Chapter Conclusions

The private practice administrative system does not provide for adequate oversight or sufficient assurance that compliance with operational guidelines is achieved. Because of limited access to financial information, we do not know, and the University does not know, whether funds are properly controlled and expenditures are appropriate. We believe the risk of questionable practices is significant. The implementation of newly adopted changes to private practice plan policies needs to be carefully watched to ensure that it results in improved controls, oversight, and accountability.

Generation of private practice income is a significant by-product of the Medical School's primary mission. Private practice refers to fees generated by University physicians treating patients in the course of their other duties as faculty. These fees are deposited in accounts of various private practice plans. The plans use the funds to supplement faculty salaries, pay for plan expenses, and provide additional operating funds to the Medical School departments. We found basic flaws in the policies and procedures established to oversee the private practice plans. In this chapter, we discuss the history of these policies, the risks to the Medical School and the University, and corrective measures the University has initiated.

History of private practice at the Medical School

Prior to midcentury, most University hospital patients were indigent. The wider availability of health insurance in the 1950's and 1960's, however, reduced the number of indigent patients and created an untapped financial resource for the Medical School. In 1963, the Board of Regents adopted a Statement of Policy and Implementing Resolution allowing faculty members to accept private patients. The plan provided that private patient funds "should be used in an appropriately flexible manner, in the spirit of a gentlemen's agreement based on mutual trust". The plan permitted the faculty to establish private businesses to collect and distribute patient fees. The policy provided broad guidelines for setting faculty salaries. It did not, however, establish a way to determine compliance with those guidelines.

After a 1975 Legislative Auditor's report criticized the Regents' policies and administration of the private practice system, the University entered into a private practice monitoring agreement with the faculty. This agreement authorized the president to appoint a monitor to serve as a reviewer and referee of compliance with the Regents' policy. The monitor's responsibilities included reviewing faculty compensation and verifying that private practice

plans only incurred legitimate business expenses. The agreement authorized the monitor to substantiate the data reported, but did not require such a verification. The purpose of the monitor's reviews was to assure that the Medical School received its appropriate amount of private practice revenue. A Minneapolis attorney has served as the monitor since 1976.

In another report in 1978, the Legislative Auditor stated, "We believe the monitoring system established by the University has not adequately dealt with the problems noted in our prior audit report." The Legislative Auditor went on to recommend that the monitoring system be discontinued. The University responded that "both accountability and control over private practice income is achieved with the present system". No changes were made.

Six years later, in 1984, the University added seven new provisions to the private practice monitoring agreement. These supplemental provisions authorized the dean to collect an annual assessment from each clinical department. Known as the dean's tax, it provided the dean with discretionary funds for the general benefit of the Medical School. The Fiscal Year 1992 dean's tax assessments totaled approximately $1,500,000.

The Medical School's private practice plans have come under great scrutiny in recent months. Newspaper articles have cited the Medical School for poorly administering private practice funds. The University ordered a management study of the Medical School. The consulting firm of Deloitte & Touche conducted the study and released its final report in July 1993. The study concluded that deteriorating values and changing economics have caused problems for the Medical School. It its section on fiscal integrity, the report concludes that the Medical School, "in general, has a lack of regard and accountability for proper financial management". The report notes particular concern with the areas of fundraising and faculty practice plans.

On July 8, 1993, the Board of Regents rescinded the 1963 private practice plan policy and replaced it with a new private practice policy. Many of the changes made in the new policy should enable the University to limit and control practice plan activity. The University administration is developing procedures to implement the policy. The effectiveness of the new procedures in achieving compliance with the Regents' policies needs to be carefully watched.

Problems with the accountability structure for private practice activities

To the extent possible, we examined the current structure and practices of the private practice plans. According to the monitor, there are 39 private practice plans for the 18 clinical departments. Some plans are sole proprietorships or partnerships, but most are nonprofit or for profit corporations. Many departments have only one private practice plan; some departments such as Family Practice and Neurology have several. Often, the key decision makers in the plans are the heads of the Medical School departments.

The private practice plans collect and disburse a considerable portion of the medical school's revenue and expenses. University officials estimate that the combined annual revenue of the private practice plans is $75,000,000. An estimated $40,000,000 of this revenue is accounted for outside the University. Without access to the private practice financial records, we could not substantiate these estimates.

3. The University central administration and the dean's office do not have detailed information about a system that utilizes significant public resources.

Administrators have to be able to review complete financial information to reach conclusions about current activity and make decisions about the future. University central administration and the dean's office must make decisions about allocation of staff and fiscal resources, and determine where inefficiencies and duplication may exist. When management makes decisions without sufficient reliable financial data, the potential for waste and misuse of resources increases.

The dean's office and central administration do not know some crucial financial information about the Medical School, including:

- total operating costs of the departments;
- total faculty payroll and related fringe benefits;
- total administrative costs of the private practice plans;
- types of costs incurred by the plans; and
- the amount the plans transfer back to the Medical School.

Faculty payroll is the most significant Medical School cost. A large share is paid directly through the private practice plans and is never recorded on the University's accounting system. Although the private practice agreements state that the dean should be informed of the salaries paid to faculty, the notification that the dean receives does not show the salary amount.

Similarly, the dean does not know the amount and types of administrative or other business costs incurred by the plans. The dean and central administration have no assurance that these costs are appropriate.

It is extremely difficult to even identify the amount of private practice revenue which flows from the plans to the University. The accounting system provides separate funds and revenue source codes for private practice activities. However, we found that departments used the codes inconsistently and often commingled private practice monies with other gift or grant funds. Also, as discussed previously, the departments have a great deal of discretion in determining which financial transactions to record on the University's accounting system.

University of Minnesota
Medical School

Although the practice plans have separate legal status from the University, we found that it is often difficult to distinguish practice plan activities from departmental activities. It is important to recognize that the plans are operated primarily by University employees on University property, with University support. Faculty provide patient care as a part of their regular duties. The department heads have meetings where decisions regarding private practice are made. The administration of private practice plans is intertwined with the other operations of the Medical School departments. Most department administrators serve as practice plan administrators and supervise University employees who perform many of the accounting functions for the private practice plans. Despite the integration of private practice in the operation of the clinical departments, and an obvious impact on the departments' finances, virtually no financial information goes beyond the department heads to the dean or University central administration. In order to have effective management in a decentralized environment such as the Medical School, there must be an appropriate flow of financial information to all administrative levels.

Because of the interrelationship between departmental and plan activities, we believe the University must have complete financial information on this significant financial resource. We were allowed to review the Department of Medicine's private practice plan tax returns, although we were not given access to the supporting financial records. According to the tax return for calendar year 1991, the plan's total revenue was $12,461,301. The plan reported that it contributed $7,585,611 to the University and used the remaining funds for administrative or business expenses. The Department of Medicine is somewhat unique among the plans because it transfers funds and pays the majority of physician salaries through the University's accounting system. However, the plan still expended approximately $5,000,000 in 1991, outside the University's system, on other plan expenses.

The new Board of Regents' policy adopted in July 1993 makes some significant changes in the operation of private practice activities and the availability of financial information. Figure 3-1 shows some of the differences between the old and new Regents' private practice policies.

Table 3-1
University of Minnesota Medical School
Board of Regent's Private Practice Plan Policies

	1963 Policy	1993 Policy
Number of Departmental Plans	Varies	One per Department
Financial Reporting to Dean	No	Yes
Public Disclosure of Salaries	No	Yes
Allowable Plan Expenses	IRS Guidelines	U of M Policy
Reimbursement for Facility Use	No	Yes
Internal Audit Access to Records	No	Yes
Dean's Fund Minimum Assessment	Amount Varies	7% of Distributions

These changes, if properly implemented, should provide significant improvement in the administration's ability to manage the Medical School.

Recommendation

- *When developing implementing procedures for the new Regents' policy, the University should ensure that the private practice plans provide timely comprehensive financial information on their activities.*

4. The Medical School central administration has had little assurance that practice plans are operating in accordance with the Regent's policy.

Until recent policy revisions, the University had not established an effective method of accountability for private practice plans. Since their inception, the private practice plans have remained exempt from public scrutiny and oversight. The University assigned exclusive responsibility for reviewing the plans' financial activities to a "monitor," who was an attorney retained under contract. The monitor did not have the resources to conduct a comprehensive examination of the finances for each private practice plan. The monitor's task was further complicated because the University did not enforce standard spending policies or guidelines for the private practice plans. As a result of this environment, the University accepted a tremendous financial risk with the private practice plans. The monitor was not in a position to detect improper or unreasonable private practice expenditures.

The University relied completely on the monitor to review private practice plan financial activities and determine compliance with the Regent's policy. The structure of the practice plans prevented University and Medical School administrators from examining the practice plans' transactions. The University's internal auditors have not had the authority to audit the plans. The monitor was the only control established to ensure that the 39 private practice plans and the 450 clinical science faculty complied with the Regents' agreement. The monitor was responsible to determine whether salaries paid to faculty complied with policy limits and whether the plans used patient fees only for legitimate business purposes.

The monitor billed the University for services rendered under the monitoring agreement. The Office of the President paid one-half of the monitor's costs from state funds. The private practice plans paid the other half. Table 3-1 shows the compensation paid to the monitor for Fiscal Years 1991 and 1992.

Table 3-2
University of Minnesota Medical School
Monitor's Billings
Fiscal Years 1991 and 1992

Paid By	FY 1991	FY1992
Office of the President	$17,268	$24,682
Private Practice Plans	17,268	24,682
Total	$34,536	$49,363

Note: The monitor's bills included detailed descriptions of work performed. However, the actual hours were not identified on the billings for a portion of the time period. During the six month period December 1991 through May 1992, for which hours were identified on the billings, the monitor and assistant spent a total of 79.5 and 195.5 hours, respectively, working on the Medical School account. During this period, the monitor and assistant's time were billed at $195 and $85 per hour, respectively. The billings also included reimbursement for expenses.

Source: Invoices and other supporting documentation maintained by the University General Counsel and the University of Minnesota Medical Foundation.

We believe there were significant shortcomings in the monitor's reviews. As can be seen from Table 3-2, the monitor and assistant did not spend a significant amount of time on the reviews, considering the number of plans and individual physicians. The monitor rarely examined supporting documentation for a private practice plan's expenses. Instead, the monitor analyzed the various categories of expenses summarized on the practice plan's tax return. We believe this review as insufficient to ensure compliance with the Regents' rules, since the practice plan could conceal inappropriate business and personal expenses on these broad tax categories with little fear of detection. In addition, we question whether allowability for income tax purposes should be the only criteria for public sector practice plan expenses. For example, the Minneapolis Star Tribune reported on April 4, 1993, that at least one practice plan made personal loans to members of the plan. We confirmed with the monitor that the loans did occur. We do not believe such transactions are appropriate for University practice plans.

The monitor often did not obtain independent evidence to substantiate salary information reported by faculty and department administrators. Some physicians submitted tax returns and others submitted income disclosure forms. Some of the departments submitted summaries of private practice and University payments. Since the individuals and departments compiled this data, we do not believe it should have been the only source of information used to verify compliance with salary limits.

We noted other problems in our limited review of selected private practice plans. We were told of some significant weaknesses in the Department of Dermatology's accounting unit. The current administrator told us that the previous administrator has never balanced the plan's three bank accounts. Balancing and reconciling bank accounts is a basic internal control procedure designed to detect errors and irregularities. Allegedly, the former department administrator had complete control of the private practice account, and even wrote her own paychecks.

The current administrator also told us that the former administrator had received bonuses or supplemental salary payments for the private practice plans. We question the authority for such payments. The administrators are University employees who receive their compensation in accordance with established personnel policies. The agreements governing private practice do not address supplemental payments to administrative personnel.

If these statements are true, we believe there are major weaknesses in the department's internal control structure. As a result, there may be significant errors or irregularities in the private practice accounts of the Department of Dermatology. Since we did not have access to the practice plan records, we could not verify whether problems exist. The Department of Dermatology is greatly dependent on the revenues of its private practice plans. As discussed previously, departmental accounts have operated in deficit status for several years. Subsequent to our review, the department hired an accountant to prepare the plan's records for audit by an independent accounting firm.

Media articles have raised other questions about the practices of some plans. The University has been limited in its ability to respond to allegations of inappropriate activities or unauthorized use of funds. The new private practice policy states that each private practice plan should develop and incorporate mechanisms to ensure compliance. The policy does not elaborate on what those mechanisms should include or what compliance means. The University administration will address those issues in subsequent implementing procedures. We feel that any compliance procedures should provide for verification of salary and administrative expense figures to independent supporting documentation. Incorporating compliance testing into the procedures performed by outside auditors may be a way to achieve this objective. However, to clarify compliance requirements, the University must establish guidelines for allowable plan expenses.

There is a legitimate public interest in the financial activities of the private practice plans. The Medical School is entitled to receive all residual funds not spent on plan operations. This claim on residual funds means the University has a direct interest in how the plans spend monies on operations. If a plan spent its monies in an inappropriate manner or provided excessive compensation or personal benefits to its members, residual funds were reduced and the University lost resources.

Our limited review of private practice plans left many unanswered questions. Most fundamentally, we do not know the total amount of funds managed by the plans, nor if the University received the full residual amount to which it was entitled. We could not determine if the plans spent monies on wasteful, frivolous, or luxurious expenses. We could not determine if the plans provided extra personal compensation or benefits to members or administrators.

Recommendation

- *The Regents and the University and Medical School administrations should continue the private practice system reforms. They should focus on the need for complete, reliable financial data and the ability to verify compliance with salary and expense guidelines.*

UNIVERSITY OF MINNESOTA

August 17, 1993

Office of the Senior Vice President
for Finance and Operations

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100 Church Street S.E.
Minneapolis, MN 55455
612-625-4555

Mr. James Nobles
Legislative Auditor
1st Floor, Centennial Office Building
658 Cedar Street
St. Paul, Minnesota 55155

Dear Mr. Nobles:

During the past several months members of the University community have had the opportunity to meet with representatives of the Office of the Legislative Auditor to discuss financial oversight issues at the Medical School. As you know, the Auditor raised concerns regarding access to the financial records of the private practice plans as well as concerns relating to financial oversight of the Medical School. While full access was not granted with respect to the private practice plans, we feel that discussions have been candid, honest and forthcoming. In our judgment, the work of the staff of the Office of the Legislative Auditor was professional and completed in conformance with the high ethical standards expected during an audit investigation. The members of the audit team deserve a special thank you for their hard work.

The purpose of this letter is to provide a response to the issues and concerns cited by the Legislative Auditor regarding the financial control structure of the Medical School. As you know, the Auditor concentrated its review of the Minnesota Medical School to two specific areas:

* the budgeting and monitoring process used to control the financial resources of the medical school, and

* the University's policies and procedures used to control the financial activities of private practice plans operated by the Medical School faculty.

The senior management at the University have read the Legislative Auditor's comments and consider the recommendations and suggestions for improving financial oversight and control very helpful. Prior to receiving the Legislative Audit report on the Medical School, senior management of the University recognized the need for improvements in

financial oversight and initiated actions to respond to many of the concerns contained in the report.

With this in mind, our response to the Legislative Audit report will include an outline of specific actions the University has taken to respond to the need for improved financial oversight across all organizational units of the University, as well as addressing specific issues for the Medical School. The actions taken in response to University-wide oversight issues will benefit the Medical School as well as the University as a whole.

Budgeting & Monitoring Process

The implementation of a new accounting system at the University of Minnesota resulting from the recommendations of the Spencer Commission in 1988, brought to the University new accounting control capabilities. In addition, the system introduced significant new opportunities relating to the preparation and monitoring of annual spending plans.

The public record surrounding the cut over to the new system and its subsequent successes and shortcomings is widely documented. The scope and breadth of the endeavor to transition the University from an old general ledger to a comprehensive new financial system has been time consuming, complicated, difficult and costly.

For the period covered by the Legislative Auditor's analysis, legitimate questions and concerns have arisen regarding the level of financial oversight of the Medical School by the Dean's Office and central administration. In recent months, the Board of Regents and senior management have directed that critical actions be taken to respond to concerns regarding financial oversight throughout the University.

Specifically, the University of Minnesota has taken actions in the following areas:

* The Board of Regents initiated a management review and analysis of the Medical School by the national consulting firm of Deloitte & Touche. The management audit of the Medical School was reported to the Board of Regents on July 8, 1993. A steering committee, chaired by the President, will evaluate the recommendations prepared by Deloitte & Touche. The steering committee includes the senior vice president for academic affairs, the senior vice president for finance and operations, the special advisor to

the President, interim deputy vice president for medical affairs, and the interim deputy vice president for health sciences. Implementation of the recommendations will take approximately 24 months to complete.

* The Medical School dean's office has initiated a review and approval process with respect to development of annual budgets. The review and approval process includes all University funds. Specifically, the Medical School has initiated the following:

1. Effective July 1, 1993 budget development policies and procedures were instituted to assist in management of expenditures relative to available revenues,

2. Additional staff positions have been approved for the Dean's Office to enhance oversight capabilities, including assistance to department staff, and

3. Effective August 8, 1993 new policies and procedures were instituted within the Medical School to achieve consistency of classification and reporting of gift receipts.

* At the direction of the President and Senior Vice President for Finance and Operations, the University of Minnesota has established an Office of Financial Policy Development. The principal thrust of this new office will be to review, develop, and monitor financial policies and procedures at the University. The establishment of the office represents a significant step in the maintenance of current financial policies, as well as the continual monitoring, formation, dissemination and understanding of financial policies throughout the University community.

* The University has enhanced its financial control efforts through the addition of three new positions within the Office of Internal Audit. These three positions augment a staff of nine. The Office of Internal Audits charged with the important function of testing and monitoring University academic and administrative units for compliance with Federal, State and University financial control requirements.

* The Office of Budget & Finance, under the direction of the Senior Vice President for Finance and Operations, has begun the search for a Controller for the University. The Controller will be responsible for the management, coordination and oversight of the financial accounting and control activities of the University. The Controller will direct the activities of general accounting, payroll, accounts payable, purchasing, stores and

inventory, CUFS financial systems support and Business Communication and Training. The Controller is a key participant in the achievement of the University's strategic goal of improved financial management capabilities through the redesign and redevelopment of the financial management operation of the University.

* The University has recently completed the acquisition of four new budget and finance officer positions with the Office of Budget & Finance. These positions are a critical link to academic and administrative units in terms of revenue and expenditure planning, analysis, development and monitoring. These new positions will greatly improve budget oversight and significantly enhance communications between decentralized academic and administrative units and senior management. The University has also begun a new initiative to re-engineer its resource allocation process in order to align scarce financial resources with long-term strategic initiatives of the University. In addition, these new positions will also assist the Board of Regents and senior management with respect to monitoring revenue and expenditure variances in order to provide an early warning system for potential financial problems within academic and administrative units. The Office of Budget & Finance provides a quarterly management report to the Board of Regents listing budget variances at the collegiate and administrative unit level. This report provides an early detection system in order to trigger remedial action in the event that expenditures are exceeding available resources. We plan to continue to improve our capabilities within the accounting system to provide timely financial monitoring and control.

* As mentioned earlier, the implementation of CUFS caused considerable organizational stress within the University. Numerous projects are underway to complete the implementation of the new accounting system and respond to many of the concerns voiced by users of the system. Examples include establishing the best long-term organizational structure for maintaining CUFS software, as well as enhancing response time to daily maintenance problems and concerns of the user community, establishing an ongoing CUFS customer group and leadership structure in order to establish a voice in priority setting of CUFS enhancements, assessing end user informational needs related to CUFS data in order to improve managerial reporting, assessing the condition of CUFS instructions and correcting instructional deficiencies, and a CUFS error reduction project which is designed to develop a method for identifying types, classifications, sources, quantity and significance of CUFS transaction errors and establishing an ongoing improvement process.

The University shares the concerns voiced by the Legislative Auditor regarding duplicate data entry of CUFS accounting information by academic and administrative units. The University is engaged in a effort to provide on-line access to CUFS accounting information. The goal of this project is to provide direct access to CUFS data to academic and administrative unit information systems for purposes of compiling, arranging and reporting accounting information that best meet their financial monitoring and reporting preferences and requirements.

* The Legislative Auditor appropriately documented departmental concerns with regard to the ability of the accounting system to generate reports in formats that are helpful to management. The timely reporting of fiscal year account balances was delayed during fiscal year 1993 by roughly 6 months past the close of the fiscal year. As such, June 30, 1992, year end account balances were provided to departments in January, 1993. On August 10, 1993, academic and administrative units received a new monthly financial report identified as the UA821 - Organization Budget Status Report that is generated directly from CUFS accounting data. This report reflects both budget and actual financial activity by fund-area-organization for all centrally allocated and self-sustaining, fiscal year, current fund accounts. This report includes preliminary year-end balances as of June 30, 1993. In contrast, June 30, 1992, year-end balances were not provided to academic and administrative units until January, 1993. Furthermore, the report includes approved and current revenue and expenditure budgets, pre-encumbrances, encumbrances, fiscal year to date actual revenues and expenditures, unrecognized or uncommitted budget balances by revenue and expenditure object code and percentage unrecognized or uncommitted. This new monthly financial report and the timely inclusion of fiscal year-end account balances represent a significant step forward in terms of budget and accounting oversight and improved managerial reporting at the University.

* The Board of Regents directed a review of revenue producing units at the University. This review is currently underway. The consulting firm of Coopers & Lybrand has been engaged to assist in an analysis of the financial control risks associated with revenue producing units within the University. The University will use the findings and recommendations resulting from this analysis to develop appropriate internal controls and provide corrective action.

* During May and June 1993, academic and administrative units developed annual spending plans within CUFS for only the second time.

The fiscal year 1993 - 1994 annual spending plan preparation process ran considerably smoother than in prior years. Specific enhancements to the budget preparation process included faster financial consolidation reporting in order to verify that spending plans did not exceed available resources, improved instructions emanating from a concise, user friendly budget preparation manual in order to better communicate budget policies and procedures, and refresher training for individuals responsible for annual spending plan development.

The budget preparation process for fiscal year 1993 - 1994 included all non-sponsored, current funds encompassing operations and maintenance funds, state specials, indirect cost recovery funds, central reserves, auxiliaries, internal service organizations and other unrestricted and restricted revenues and expenditures.

The University intends to continue to enhance the process and procedures for preparation of the annual spending plan and has recently initiated a project to identify, review and implement enhanced technical capabilities within the annual spending plan preparation process. Specific areas under analysis include estimating techniques for fiscal year-end account balances, as well as upload and download capabilities between departmental systems and CUFS.

* The Legislative Auditor cited a concern with respect to the ability of other departments to process payments against accounts without departmental authorization. This concern relates to the ability of internal service organizations (ISO's) to charge accounts in order to recover the costs of services provided to a specific department. The University is aware of the concerns highlighted by the Legislative Auditor and has instituted a review of current practices.

Private Practice Plan

In January 1993, the University's Board of Regents passed a resolution supporting a review and revision of the current practice plan policies. In April 1993, the University retained the law firm of Hogan & Hartson to assist in drafting a new practice plan for the clinical faculty of the Medical School. Regents reviewed the issues in June 1993, and approved a practice plan policy in July 1993.

As noted on page 10 of the audit report, on July 8, 1993, the Board of Regents rescinded the 1963 private practice plan policy and replaced it with a new private practice policy. The University is currently developing

and implementing procedures to govern private practice plan funds. The University intends to closely monitor the new procedures in order to ensure that all applicable financial policies, guidelines and regulations are adhered to by the practice plans.

Additional Comments

Chapter 2, page 8, item 2, paragraph 3 cites one instance where funds allocated in two separate transactions to a department by the Dean's Office were not fully transferred to the applicable department as soon as they should have been. This is a single instance among hundreds of transactions, where the Dean's Office accounting person did not receive the appropriate written record to document a second approved fund transfer. We believe the system of fund allocations and the method of accounting for such allocations to be sound, however. The accounting system revealed completion of only a partial transaction in this case. Thus, the full transaction was followed-up and completed.

As noted in the information outlined above, the University has and will continue to take steps to improve financial oversight. As such, views or suggestions by the Legislative Auditor regarding ways in which he judges the new controls we are implementing to be inadequate or in need of additional refinement or clarification, would be greatly appreciated.

On behalf of the Board of Regents, the President, the Senior Vice President for Academic Affairs, and the management team of the Medical School, I would like to thank you for the opportunity to present to you our comments regarding the Medical School Audit. If I can be of any additional assistance in this matter, please don't hesitate to call. I can be reached at 625-4555.

Sincerely:

Robert Erickson
Senior Vice President
for Finance and Operations

BE/pj