The Regents of the University of California

COMMITTEE ON COMPLIANCE AND AUDIT
January 20, 2011

The Committee on Compliance and Audit met on the above date at Price Center, San Diego campus.

Members Present: Regents Cheng, Hime, Island, Makarechian, Ruiz, and Zettel; Advisory member Pelliccioni; Expert Financial Advisor Schneider and Expert Compliance Advisor Guyton

In attendance: Regent Lansing, Faculty Representative Anderson, Secretary and Chief of Staff Griffiths, Associate Secretary Shaw, General Counsel Robinson, Chief Compliance and Audit Officer Vacca, Executive Vice President Taylor, Senior Vice President Stobo, and Recording Secretary Johns

The meeting convened at 10:05 a.m. with Committee Chair Ruiz presiding.

1. **APPROVAL OF MINUTES OF PREVIOUS MEETING**

Upon motion duly made and seconded, the minutes of the meetings of August 31 and November 2, 2010 were approved.

2. **UPDATE ON LOAN PROGRAMS**

[Background material was mailed to the Committee in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Financial Officer Taylor presented the Annual Report on University Employee Housing Assistance Programs.

Office of Loan Programs Director Ruth Assily recalled that the Mortgage Origination Program (MOP) was established in 1984 in response to the high cost of housing near the campuses. The primary goals of the program are to assist in the recruitment and retention of faculty and senior managers, and to mitigate the high cost of housing in California. MOP provides a predictable source of funding for loans, using the Short Term Investment Pool (STIP), and easier qualifying standards for UC faculty in order to enable them to purchase a home in the vicinity of a campus. MOP loans are made on condition of employment. If a borrower leaves the University, he or she is required to pay off the loan within six months. There is also a requirement that the borrower use the property as the principal place of residence throughout the life of the loan.

The loan program provides security to the University as well as a favorable product for borrowers. All loans are first deed of trust loans secured on the principal residence of the borrower. Payments are made by payroll deduction, as long as the borrower is in the UC payroll system. The rate is tied to the four-quarter average of the rate of return of the STIP. The University lends at its cost of funds. If a borrower qualifies, he or she can receive a loan of up to $1.33 million with a ten percent down payment. The qualifying ratios are considerably more liberal than those available through a conventional lender. No private mortgage insurance is required, and there are no points or origination fees associated with MOP loans.

Assistant Vice President – Financial Services and Controls Dan Sampson reported that since the inception of the program in 1984 the University has funded over 5,000 loans totaling somewhat over $2 billion. Eighty-one percent of the loans were funded for the purpose of recruitment, which corresponds to original MOP goals. Of the over 5,000 loans, 95 percent were funded for faculty members. In addition to the $427 million in loans paid off, the University seeks to sell loans in the secondary market to replenish the STIP and to allow for more loans in the future. To date the University has sold about $909 million in loans, and it strives to achieve 100 percent of the loan value. Loans are sold with servicing rights retained, so that UC borrowers continue to receive high-quality loan servicing.

On average, the University originates about $200 million in mortgage loans annually. There was a slight decrease in the current year. Mr. Sampson ascribed this to decreased faculty recruitments and to the fact that fixed rate mortgages were now at historically low levels. Some individuals, when offered a mortgage loan, may choose a fixed rate loan rather than apply for a MOP loan. Due to the current downturn in the California real estate market, the University is paying close attention to MOP reserves. Compared to other large lenders, the University's reserve balance is strong. Unlike other lenders, however, the UC reserve balance serves two purposes. The University relies on the reserve for potential loan losses and uses it as a hedge against rate changes in the STIP. During the past year there has been an increase in the number of short sales. Mr. Sampson anticipated that this trend would continue and observed that the University's response to borrower requests for financial relief could affect the financial stability of the MOP reserve.

Mr. Taylor noted that the program is highly valued by UC faculty. If a borrower leaves UC, typically the University insists that the loan be paid off within six months. In effect, the University asks the individual to refinance the property if he or she wishes to keep it, or to sell the property and give the proceeds to UC. Like other major lenders in California, the University has properties which are technically "under water," for which the loan value exceeds the market value of the property. These properties account for approximately 30 percent of UC's portfolio. In some cases the University leaves some flexibility, allowing borrowers to keep the property, even though it is no longer the principal residence, as long as they keep the loan current. Borrowers may do this in anticipation that the property value will rebound sufficiently to allow them to recover their down payment. Alternatively, in some instances, the University may facilitate a short sale, in which case the borrower identifies a potential buyer. There has been an increase in the number of short sales in recent years; there were about eight short sales in calendar year 2010, which caused UC to draw on its reserve balance by about $1.2 million. Mr. Taylor stated that UC expects additional short sales in the future.

The University's MOP has generally functioned well. One current challenge is that there are borrowers who intend to continue employment with the University but who wish to walk away from loans and properties. The University has taken a firm position with two borrowers in this situation, making it clear that it does not wish to own property. UC is not in the business of real estate ownership. Although the University has not experienced foreclosures for many years, there are currently two foreclosures in process. Part of the current challenge is to ensure that the program is financially solvent and responsive to the needs of UC employees. In some cases of medical or family emergency, when employees' resources have been reduced, the University has renegotiated loans to include interest-only periods in order to lower monthly payments for a certain period.

Regent Zettel asked about the sale of loans as mortgage-backed securities. Mr. Taylor responded that the loans are sold in the secondary market. The buyers are a wide range of investors; recent buyers have been commercial banks and credit unions.

Regent Zettel asked about assumed risk in the case of a short sale. Mr. Taylor responded that the University often gives the buyer in the secondary market the option of trading one loan for another. Technically, the holder of the security in the secondary market would have decision-making authority in the matter. In such cases the University exchanges this loan for another loan, one that has not yet been sold, so that the buyer is not involved in the decision regarding a short sale.

In response to a question by Regent Zettel, Mr. Taylor confirmed that the University assumes the risk when it takes back a loan in this manner. This exchanging of loans is part of the negotiation process and allows the University to avoid losses in selling in the secondary market. Mr. Sampson added that these are adjustable rate mortgages. In the secondary market they are tied to the STIP index, which is unique. To facilitate a sale, the University provides recourse so that, if a loan becomes delinquent, UC will take the loan back. This practice allows the University to attract buyers and to get closer to receiving 100 percent of the loan value on a sale. In $909 million of loan sales, the University has had to exchange only one loan.

Regent Zettel asked how many other universities have similar programs. Ms. Assily responded that other universities, primarily private universities, have similar programs, but that they are not as extensive as UC's.

Regent Zettel asked if the MOP is included as a factor in calculating or comparing compensation packages for faculty. Mr. Taylor responded in the negative.

Regent Makarechian asked how the MOP was reflected on the University's balance sheet. Mr. Taylor responded that it is reflected in the STIP.

Regent Makarechian observed that the University's mortgage loans had a low rate of default and asked why the University was interested in selling them. Mr. Taylor responded that, a year earlier, the University held about $1 billion in loans. He and his colleagues were concerned about such a substantial non-liquid asset in the STIP. The University sold about $200 million in loans over the past year. He recalled the downturn in the secondary market for mortgage-backed securities in 2007-08. The University was unable to sell loans from 2007 to 2009, and is now actively seeking buyers as the market recovers. Mr. Taylor stated that the motivation for selling loans was to improve the University's liquidity, which is an important factor considered by rating agencies.

In response to a question by Regent Makarechian, Mr. Taylor responded that virtually all borrowers are UC employees, and that payment is through payroll deduction.

Regent Makarechian recalled that the program was established as an incentive to retain employees. He expressed concern that the University's conditions – a six-month period to pay off the loan, a willingness to agree to short sales and to take losses – might motivate some individuals to leave the University. He stated that UC should not offer such options to individuals who are leaving the institution. Mr. Taylor responded that he would like employees who leave the University with a loss due to a short sale to repay the loss, but that the law does not allow him to enforce this. Ms. Assily added that the University carries out short sales to avoid foreclosure and with the goal of saving money in the long term. Foreclosures would be costlier.

Regent Makarechian asked if the seven percent reserve amount is calculated on the approximately $700 million in loans in the UC portfolio, rather than on the total amount of loans funded. Mr. Sampson responded in the affirmative.

In response to a question by Regent Makarechian, Mr. Taylor agreed that when loans are sold to investors in the secondary market with the option to exchange one loan for another, the University is assuming risk, even though the loan has been sold. The reason for doing so is to negotiate a better price. He recalled that the UC interest rate is low and that UC does not have fixed rate mortgages. Historically, there has been a low risk associated with this practice. There have been fewer than 12 short sales over a 20-year period.

Regent Makarechian asked how often the University writes down or writes off loans in its financial records. Mr. Sampson responded that UC does not do so. The loans are carried as an investment in the STIP.

In response to a question by Regent Makarechian, Mr. Sampson confirmed that, even if the value of a loan is reduced, the University does not apply a reserve amount against it. Mr. Taylor underscored that UC loans are current and that the quality of borrowers and the payment collection method have been reliable over time. Mr. Sampson added that UC's accounting practices for booking loans and sale treatment have been approved by PricewaterhouseCoopers.

Faculty Representative Anderson referred to Regent Zettel's question about similar programs at other universities. He expressed his view that most private universities have more extensive programs which are not limited to adjustable rate mortgages. Stanford University owns a considerable amount of land and its faculty are eligible to buy houses constructed on that land. The prices of these houses are much lower than those of Palo Alto properties not on Stanford land. Other universities offer shared appreciation loans, making mortgages less costly to faculty members. Mr. Anderson conveyed the view of the Academic Senate that UC is not competitive in housing subsidies for faculty. Home loans are not included in estimates of total remuneration because the loan process is complex. Mr. Anderson expressed his view that, if the calculation of total compensation included home loans, it would indicate that the University lags behind competitor institutions.

Turning to the matter of reserve requirements, Mr. Anderson noted that, because the University is at risk for many of the loans it has sold as well as those it owns, its reserve ratio, quoted as higher than those of commercial banks, may be misleading. He stated that, if the University faced losses for all the loans it has sold, the actual reserve ratio would be around three percent rather than seven percent. He asked what fraction of the loans that have been sold are at risk. Ms. Assily responded that most loans sold include the possibility of exchange. The recourse offered is that, if the loan becomes delinquent for 90 days, the University either repurchases or exchanges it. She estimated that, based on a portfolio balance including both UC-owned loans and sold loans that have a recourse provision, the reserve ratio would be approximately 3.5 percent.

Mr. Anderson stated his view that the University faces a potential risk of losses exceeding the loan reserve. While there may not be a high probability of losses, given that loans are to UC employees with secure jobs, the University should recognize and determine its response to the risk. He expressed concern about a situation in which employees are in a better position if they leave the University than if they stay, and suggested that UC should treat employees who remain with the institution in the same manner as those who leave. It would be unfortunate if faculty left UC because this was the only means of avoiding a loss.

Mr. Taylor asserted that the reserve was adequate to cover risk in the portfolio. He cautioned that the University would increase its risk substantially if it allowed current employees to walk away from loans and if it used the reserve to pay off such loans; the reserve would soon be exhausted.

Mr. Anderson agreed that, if the University implemented his suggestion, it would lose its advantage over banks, which loan to parties without an employment relationship. In that situation, the borrowers make a strategic decision to pay, to seek a short sale, or to default. He stated that this matter requires further consideration. The Academic Senate would like to be involved in these discussions, because the home loan program affects faculty recruitment, retention, and morale.

Committee Chair Ruiz suggested that this matter could be discussed by the Committee on Finance. Mr. Taylor emphasized that the program must be financially solvent and requested the Regents' guidance regarding his responsibility toward UC employees whose real estate affairs are in jeopardy.

Committee Chair Ruiz underscored the importance of the University's home loan program, which is a great benefit to faculty. It should be managed in a manner that is fair to the University and to borrowers.

3. **HEALTH CARE REFORM AND COMPLIANCE/AUDIT**

[Background material was mailed to the Committee in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Senior Vice President Stobo began his presentation by outlining in what ways health care reform would affect health care. One avenue was legislation, represented by the Patient Protection and Affordable Care Act, signed by President Obama in March 2010. Dr. Stobo anticipated that the Act, regardless of changes it might undergo, would not be the major motivator of health care reform; major reform would come through unofficial, non-legislative pressures, such as societal interest and the rising cost of health care, which is unsustainable in the current financial environment. Another source of pressure would be the recommendations of the December 2010 report of the National Commission on Fiscal Responsibility and Reform. While the report recommendations did not receive the votes necessary to be enacted into law, Dr. Stobo anticipated that they could serve as a blueprint for developments in health care in the coming decade. The report projected an approximately $400 billion decrease in the cost of health care due to reductions in reimbursement to physicians, and reductions in Medicare and Medicaid, known as Medi-Cal in California.

UC Health, the health-related programs of the University, includes ten hospitals and 16 health professional schools with programs in medicine, dentistry, nursing, veterinary medicine, and pharmacy. Dr. Stobo expressed his conviction that, by any measure, UC's health professional schools and medical centers enjoy a leading position among their peers.

Dr. Stobo noted that growth of the federal debt, as a percentage of gross domestic product (GDP), would be a major motivation for health care reform. He presented a chart which showed that federal debt accounted for 30 percent of the U.S. GDP in 2001; this figure had doubled to roughly 62 percent by 2010. The chart included three possible future trajectories projected by the National Commission on Fiscal Responsibility and Reform: if there is no intervention, if certain laws are put in place, or if the Commission's recommendations are implemented. These recommendations would seek to lower the percentage of federal debt in relation to the GDP from over 60 percent to below 40 percent by 2040. In the mid-1990s, there was a great deal of concern regarding the rising cost of health care, but no significant action was taken to stem costs at that time. Since then, the amount of federal debt has become unsustainable.

Dr. Stobo then discussed the implications of health care reform for UC Health. In order to retain their 501(c)(3) status under the Internal Revenue Code, medical centers will be required to document, more than they do now, the benefit they provide to their communities. Beginning in the 2012 tax year, the Patient Protection and Affordable Care Act will require medical centers to conduct a community health needs assessment and to develop a strategic plan to address community health needs. Community members must be involved in the development of the strategic plan. Medical centers will also be required to publicize their processes for handling charity care, including billing, determination of cost, and collection policies. UC hospitals already conduct some of these activities, but Dr. Stobo anticipated that requirements for documentation would become more stringent after 2012. Each UC hospital will need to develop a plan, which will be scrutinized, in order to maintain its tax-exempt status.

Dr. Stobo presented a chart with market share information for four UC medical centers: the percentage of the hospital beds they have and the percentage of charity care they provide in their service area. UC Davis has 19 percent of the hospital beds in its service area but provides 59 percent of the charity care in that area. UCSF and San Francisco General Hospital have 37 percent of the hospital beds in their service area but provide 83 percent of charity care. UC Irvine has ten percent of hospital beds and provides 30 percent of charity care in its area; UC San Diego has 8.4 percent of hospital beds and provides 38 percent of charity care. The University already provides significant service to address community health needs, but it will need to document this service more explicitly.

The implementation of electronic health records is a matter of great importance to the federal government and to the Centers for Medicaid and Medicare Services (CMS). Electronic health records will be secure but accessible to health care providers, and will allow for provision of high-quality and more cost-effective care. There are three stages of implementation, which begin in 2011 and must be completed by 2015. There are different criteria for hospitals and individual providers. The criteria for hospitals include 19 objectives and 15 outcomes. Examples of outcomes would be better diabetic management, better control of high blood pressure, or numbers of patients counseled regarding smoking cessation or immunized for pneumococcal infection. The criteria for individual providers include 20 objectives and six outcomes. Initially, there will be financial incentives for implementation, but after 2015, if a provider, hospital, or physician group has not implemented the three stages, there will be financial penalties administered by CMS. Dr. Stobo estimated the cost to UC hospitals and physician providers for full implementation of the three stages by 2015 to be approximately $100 million. The UC medical centers are currently at various stages of implementation, but all will be at Stage 1 or Stage 2 by 2013. He projected that by 2015, all UC medical centers and physician groups will have implemented Stage 3 and will be in full compliance with CMS regulations. The CMS financial incentives would be included in the University's audit, because UC hospitals and physician groups will bill CMS not only for services provided, but also for achieving each stage of the electronic health records implementation.

There has been national concern about the length of work hours for residents, medical school graduates in clinical training. In 2003, the council which accredits residency programs reduced residents' maximum weekly work hours from 120 to 80 hours and shift length to 30 hours. Time between shifts and time off was mandated. In 2011, the maximum shift length for first-year residents was reduced to 16 hours. Dr. Stobo emphasized that the practice of medicine would be more closely regulated. While resident work hours are not considered in audits, UC medical centers and schools must document their compliance with these regulations or risk losing accreditation.

Dr. Stobo noted that one of the most important areas of health care reform would be an increasing emphasis on safety outcomes and accountability. Physicians and medical facilities will be required to achieve certain milestones, document outcomes, and demonstrate that the outcomes provide significant benefit to patients. UC Health is aware of public concern regarding safety and accountability, and has worked to improve its performance in a number of areas. There has been a reduction in the number of central line-associated blood stream infections. In 2008, the incidence of line infections was 3.1 per 1,000 line days, slightly higher than the national benchmark. UC Health took on this matter as a systemwide challenge to implement best practices. In this case, the incidence of blood stream infections was reduced to 2.2 in 2009 and 1.39 in 2010, with a goal of zero infections. Another goal is to reduce the number of pressure ulcers, which occur in patients hospitalized for long periods and which are preventable. The incidence rate has been reduced. A proportion of compensation for UC medical center CEOs is at risk for performance. One performance measure is the systemwide achievement of goals such as these.

The University is assembling other data to provide a dashboard of parameters to demonstrate UC accountability. Dr. Stobo presented charts displaying inpatient heart failure and heart attack mortality rates, and pneumonia vaccination rates by location and compared to the systemwide average, and a chart showing patient satisfaction survey results. These data would allow UC Health to determine appropriate interventions.

Dr. Stobo then discussed the financial impact of these changes. In fall 2010 UC received a renewal of its Medicaid waiver. In the past, UC received $770 million for provision of care under this program. UC requested additional Medicaid funding from CMS, citing inflationary costs. CMS has agreed to provide UC with an additional $110 million, but on condition that UC meet certain benchmarks. As in the case of electronic health records, there are financial incentives and penalties attached to CMS' expectations of the University. Dr. Stobo anticipated that pressures of this kind would continue to motivate improvements in quality, access, and safety in the health care field, and he expressed the hope that they would also eventually reduce the cost of care.

In order to coordinate activities in this area, the University has formed the UC Center for Health Quality and Innovation, a data repository and a source of financial support for campus projects which can be implemented systemwide. Dr. Stobo outlined the membership of the Center's board of directors and operations committee, and noted that it has been capitalized by the medical centers with $5 million. The Center will issue a request for projects in spring and intends to fund five projects in fall. This formalized apparatus will express the University's commitment to quality and innovation and its status as a leader in the development of the national agenda for quality and safety. Dr. Stobo concluded that health care reform would lead to an environment of increased regulation and accountability, and that UC was poised to take a leadership role.

Regent Lansing praised Dr. Stobo's leadership. Through its initiatives, the University had the opportunity to provide leadership at the national level. The efforts for accountability at UC hospitals would have moral, ethical, and financial benefits.

Committee Chair Ruiz asked that copies of the presentation materials be provided to all Regents.

Regent Makarechian referred to the varying market shares or percentages of charity care provided by the various UC medical centers. He asked if these percentages reflected benchmarks which are set or imposed. He asked how the Governor's proposed reduction in funding to the Health and Human Services Agency would affect these percentages. Finally, he recalled the chart which displayed relatively higher heart failure mortality rates at UCLA and UCSF than at other medical centers. He asked if the reason for the higher rates was that these hospitals accept patients who have a high risk of heart failure and who may be rejected by other hospitals. In response to the first question, Dr. Stobo explained that in order to retain their tax-exempt status, hospitals must provide an acceptable level of charity care, approximately ten percent in terms of their net patient revenue. He described this as a rather loose standard. CMS has not yet provided a stricter definition, but in the future it may mandate criteria by which hospitals document their service to the community. For this reason, it would be advisable for UC to get an early start in providing transparent documentation of this service. In response to the second question, he observed that 85 percent of the University's Medicaid funding is provided by the federal government and is not affected by State budget reductions. Dr. Stobo expressed confidence that this program and the funding associated with it would not be adversely affected by events at the State or federal level. At the same time, the University would feel the impact of State cuts to the Health and Human Services Agency in other ways. In response to the third question, he pointed out that comparison of readmission rates at different hospitals is complex. The data presented in the chart would need to be refined to include reasons for readmission. The readmission of a patient may be unrelated to the condition treated during the patient's previous visit.

Regent Lansing stressed that the University has initiatives that address the situation of treatment which results in readmission. Dr. Stobo added that CMS would scrutinize data on this matter.

Regent Zettel asked about the types and impact of financial penalties for lack of high-quality care. Dr. Stobo responded that the University does not know what these penalties will be or have a sense of their overall financial impact. He recalled that the additional $110 million UC would receive under the Medicaid waiver was at risk for performance. Some penalties are already in effect. CMS does not pay for patient readmissions with certain infections. Dr. Stobo anticipated that the financial impact would become significant enough in the coming years to change behavior.

Regent Zettel praised the University for its promotion of best practices.

Committee Chair Ruiz thanked Dr. Stobo for his work.

Regent-designate Pelliccioni asked if clinical data that would be used for evaluating the performance of UC Health would be adjusted to reflect the health profile of the patient population. Dr. Stobo responded that for a factor like mortality from heart attacks, patient populations at a community hospital would likely have a better health profile, with fewer compounding conditions than UCLA patients. This was an important adjustment when data are analyzed.

Regent-designate Pelliccioni asked if current data reflect such adjustments. Dr. Stobo responded that he believed that they did, but that he would have to verify this. He underscored that CMS understands the importance of such factors and that CMS standards take the patient population health profile into account.

Regent-designate Pelliccioni asked about the nature of penalties for failure to meet quality benchmarks, and specifically if all such penalties were financial. Dr. Stobo responded in the negative. Internally, UC can impose suspension or removal of medical privileges for health care professionals who do not follow standard procedures. CMS can remove a hospital from federal programs. This occurred in the case of the Martin Luther King hospital in Los Angeles. He confirmed that exclusion from federal programs was a potential penalty for failure to meet quality benchmarks.

4. **HEALTH SCIENCES ACTIVITIES IN COMPLIANCE**

[Background material was mailed to the Committee in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

UC San Diego Assistant Vice Chancellor – Audit and Management Advisory Services Stephanie Burke began her presentation with an overview of the governance structure of the San Diego campus and the place of audit and compliance in that structure. The UCSD Compliance, Audit, Risk and Ethics (CARE) Committee reports to Chancellor Fox and to Chief Compliance and Audit Officer Vacca. The CARE Committee addresses audit issues, compliance and monitoring, risk assessment, research oversight, and communication and training. It is chaired by Vice Chancellor – Resource Management and Planning Matthews, who also serves as the Chief Ethics and Compliance Officer for the campus. There are CARE subcommittees devoted to health sciences compliance, information privacy and security, and student, staff, and faculty ethics.

Ms. Burke discussed the allocation of audit, compliance, and line management responsibilities at UCSD. Focused reviews are generally the responsibility of audit. Auditing controls are performed outside of the line management structure by representatives of the audit function on a sample basis through a risk assessment process to assess the overall existence and effectiveness of the entire internal control environment. Oversight controls are the responsibility of the compliance function. These controls are performed on a frequent or regular basis, generally within the UCSD line management hierarchy by middle or senior managers to gauge the effectiveness of operating and monitoring controls. In selected high-risk cases such as health sciences billing, controls are performed by an organizationally separate compliance function. Monitoring controls can be considered a general supervisory responsibility. These controls are performed within the process or immediately after the process by first-line supervisors or representatives to ensure that operating controls are working effectively. Finally, operating controls are the responsibility of employees, who have an interest in accountability and control.

Risk management at UCSD is a line management responsibility, a responsibility of the vice chancellors. Risk assessment activity and coordination is the responsibility of the CARE Committee. Annual risk assessments are discussed with the CARE Committee. The campus audit plan is developed with significant input from campus management, analytical review of prior coverage, consideration of regulatory reforms in process, comparison of risk at UCSD with risk at other campuses, and use of a formalized risk model.

UCSD Chief Compliance and Privacy Officer – Health Sciences Kathleen Naughton presented an organizational chart showing reporting relationships within the UCSD health sciences compliance program. She observed that the components of compliance programs nationwide are modeled after the Federal Sentencing Guidelines, and identified three of these guidelines as especially important: education, monitoring, and enforcement of policies.

The campus has numerous education initiatives planned for fiscal year 2011. There will be compliance program training for new employees, clinical providers, and coders, including provision of specific billing guides, in response to the complexity of billing rules. There will be training focused on privacy and research compliance.

Focus areas for the UCSD health sciences compliance program include an annual risk assessment, monitoring, and enforcement. Monitoring activities examine billing, privacy, clinical trials, and conflict of interest. Enforcement activities include refunding for overpayments, implementing corrective action plans, updating policies, and applying sanctions.

External government audit activity increased over the past year. The Medicare Recovery Audit Contractor (RAC) program affects both hospital and professional fee billing. Its goal is to detect inappropriate payments and to ensure that monies are recovered. Medicaid has recently launched a similar program, the Medicaid Integrity Program. Ms. Naughton indicated that there will be a Medicaid RAC program as well. UCSD has received a request for a Medicaid Integrity Program audit; the results are still pending. The Office of Inspector General occasionally requests that health care entities conduct self-audits. Ms. Naughton anticipated that, with national health care reform, there would be increased government funding to combat fraud and abuse, and, as a result, increased auditing.

Under California State law, licensed medical facilities are required to report unauthorized access to patient records to the California Department of Public Health. UCSD has reported 17 such incidents during the past year. Most cases involved human error and the accidental release of patient information to the wrong patient. The campus has received no fines in the past year. There have been no large-scale information security breaches.

In the coming year there will continue to be a focus on billing accuracy, with scheduled reviews, investigation of billing complaints, and action to ensure that overpayments are refunded within 60 days, as required under current law. Outside professional activity will continue to be monitored. UCSD is participating in systemwide education initiatives concerning new diagnosis coding structure and clinical research billing. The expansion of electronic medical records will require continued electronic surveillance, investigation of complaints, and security of data stored on mobile devices. Employees are encouraged to use mobile devices only as a means of last resort, and data stored on such devices must be encrypted.

5. **HEALTH SCIENCES ACTIVITIES IN AUDIT**

[Background material was mailed to the Committee in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Systemwide Audit Manager Hicks observed that the health care environment is dynamic, in a constant state of change, and that the University's internal audit program can add value to the key components of this environment: executive management, faculty and staff resources, clinical information systems, business systems, and facility operations. Internal audit can assist with system implementations, improve efficiency, and ensure that appropriate control mechanisms are in place. The discussants would present examples of health sciences audit activities on three campuses.

UC Davis Health System Associate Audit Director Jeremiah Maher noted that the health care revenue cycle is complex and unique. The UC Davis Health System conducts one revenue cycle audit per year. The objective of the audit is to ensure that the institution is being paid for its services. An essential requirement for success in this revenue cycle is that information gathered at the time of patient registration is complete and accurate.

Mr. Maher described specific challenges. The UC Davis Health System deals with over 100 insurance companies and 1,200 payer plans, with varying requirements regarding eligibility, pre-authorization, and co-payments. Outpatient registration is a decentralized function occurring in multiple locations. Patient registrars have other duties, are not content experts, and are not supervised. The solution has been to provide guidance and training to the registrars and to retain a decentralized function. The UCD Health System makes use of pre-bill editing; bills are checked for accuracy before being sent to insurance companies.

There has been a shift of focus from simply correcting problems to engaging in root cause analysis, setting goals, and measuring against those goals. The UCD Health System carries out 1.6 million outpatient laboratory tests annually. In one year, charges for 32,000 tests were written off due to invalid account numbers. The pre-bill editing function now detects invalid account numbers and extracts valid data from prior patient records.

Registration staff are held accountable. Their performance is evaluated and they receive feedback. Error trends are tracked. The UCD Health System has excellent audit processes in place for a highly complex environment. Mr. Maher emphasized the importance of root cause analysis and the need for different solutions for different units and departments.

UCLA Health Sciences Audit Manager Sherrie Mancera discussed UCLA physician clinic audits. An important focus in these audits is on front-end business processes, the collection of patient co-payments and the processing of charge documents. Due to limited front office staffing, these duties are often assigned to one individual, an inadequate segregation of responsibilities which increases the possibility of misappropriated payments or suppressed charges. In such cases a payment would not be recorded or would be fraudulently voided after being recorded. UCLA has experienced losses in this area. The losses may be concealed by not processing the charge documents. The audit program has worked with management to realign job responsibilities and segregate duties, with different individuals processing payment and charge documents. When this is not possible due to limited staffing, compensating controls are implemented. One such control, which has been implemented to varying degrees depending on location, is independent reconciliation of the appointment schedule to the charges processed. In those locations where only spot checks have been carried out, the audit program has recommended reporting of revenue to physicians and signage reminding patients that they must receive a receipt upon making a payment. There has been an overall recommendation for removal of payment field data from the charge documents. This eliminates the possibility of using a charge document in lieu of an official University receipt. Management has indicated that audit activity reveals the need for more centralized and standardized oversight, and as a result intends to recruit an executive director for ambulatory services.

UCSD Health Sciences Audit Manager Terri Buchanan discussed a recent review of the campus' electronic health record system. UCSD has been implementing electronic health records since 2006. This implementation is complex; beyond its clinical aspects, there are also business unit requirements, such as requests for medical documents in support of claim forms or requests by external parties. Due to lack of standardized process at the beginning of the implementation, documentation extracted from the system was inconsistent. The audit program worked with various departments in a collaborative manner to provide additional education to staff and standard access paths to electronic health records.

Regent Makarechian asked how the University is paid for health care services. He asked if charges, when not paid, are recorded as charity care. Chief Compliance and Audit Officer Vacca distinguished charity care and debt service. Certain procedures, which vary by hospital, must be followed to designate care as charity care. Charges would be recorded in the general ledger for services rendered and some part of those charges might be considered debt service. Mr. Maher added that the determination of charity care generally must take place at the time of patient registration. If payment is not received and the patient is not eligible for charity care, this is considered bad debt.

Regent Makarechian asked if each hospital has its own budget for charity, determined annually. Mr. Maher responded in the affirmative.

Regent Makarechian asked about the University's response when insurance companies deny payment. Mr. Maher responded that bills denied by the insurance company are returned to the patient accounting department, which determines the cause of the denial and may refer the matter to an appropriate ancillary department.

Regent Makarechian referred to the large number of insurance companies the UCD Health System interacts with. He asked about the number of rejections and the amount of loss experienced by the campus. Mr. Maher responded that he believed the loss to be minimal. The number of insurance company denials has been tracked, but it is difficult to track the number of denials which were subsequently overturned. Ms. Vacca observed that, in the case of a denial which is justified, the University has a process to approach a patient for payment.

Regent Makarechian asked how unpaid charges are reflected in the University's financial statements. Associate Vice President and Systemwide Controller Arrivas responded that the revenue amount reported in UC financial statements is a net amount, after all amounts reflecting charity care, bad debt, or denials by insurance companies have been written off.

Regent Makarechian asked if the amount written off is shown in the financial statements. Ms. Arrivas responded that there is a disclosure in the footnotes of the amount of charity care written off and a notation on the amount of bad debt.

Regent Makarechian asked if the amount written off is a large percentage of revenue. Ms. Arrivas responded that, in the industry, the amount of bad debt ranges between two and four percent of revenue. The UC medical centers are consistent with industry.

Faculty Representative Anderson observed that there is often a difference between the retail price of a medical procedure and the amount an insurance company will contract to pay for it. He asked, when there is a difference between list price and negotiated price and an insurance company rejects a claim, which price the patient is billed for. Ms. Vacca responded that medical providers bill at their rate and apply the insurance contract rate.

The explanation of benefits includes information on the amount paid by insurance. Patient responsibility is usually related to the contract.

Mr. Anderson asked about a situation in which the insurance company denies coverage. He asked if the University would bill a patient at the retail rate or apply a discounted contract amount. Mr. Maher responded that the University essentially bills charges, regardless of payer. The contract pays a certain amount, a percentage or a fixed amount. If the charge is denied, the University tries to work with the insurance company to resolve the matter; if the charge was denied for reasons related to patient responsibility, the patient is billed the charge. A negotiation process takes place. One reason to bill the patient is to engage the patient and have him or her put pressure on the insurance company to pay the claim.

Committee Chair Ruiz asked if there are industry benchmarks which would allow the University to evaluate its performance. Mr. Maher responded that the University Health System Consortium provides revenue cycle benchmarks for denials and collection rates. He stated that UC medical centers perform well compared to other university hospitals.

Committee Chair Ruiz asked if improvement in addressing billing issues would also lead to improvement in the quality of patient care. Mr. Maher responded that, to the extent that a hospital is on a firm financial footing, it can invest in its facility and indirectly improve the quality of care.

Committee Chair Ruiz asked about reduction of errors. Ms. Vacca responded that audit activity is concerned with various types of documentation, including documentation which demonstrates medical necessity to federal entities, and documentation which ensures that various care providers know a patient's history.

6. **QUARTERLY INTERNAL AUDIT UPDATE**

[Background material was mailed to the Committee in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Chief Compliance and Audit Officer Vacca provided an update on internal audit activities for the quarter ended December 31, 2010. There were 42 audit reports but only six advisory reports. Advisory reports assist management in a proactive manner; unfortunately, the advisory service work capability of the internal audit program is challenged in the current fiscal environment. Internal audit produced 23 investigation reports.

Areas of focus during the quarter were fraud management, research, procurement, and information technology security. The program was required this year by the Institute of Internal Auditors to review its processes regarding fraud management. Audit observations frequently concerned information technology security, cash controls, and safety.

Systemwide Audit Manager Hicks observed that internal auditors may provide their best value when they go beyond the traditional audit work of reviewing controls. The internal audit program is unique in its interaction and relationships with multiple departments and it can add value with process analysis skills.

On the campuses, the internal audit program has facilitated organizational change and identified cost savings. As an example, at UC San Francisco, the program reviewed a leasing contract and identified $120,000 in overcharges.

At UC Davis, the program has provided value over time, helping the campus to develop its information technology security. Mr. Hicks described the original state of information technology security at UCD as one with a decentralized structure, lacking local guidance, local implementation of systemwide policy, or clear lines of accountability. In 2003 a review of information technology controls recommended local implementation of systemwide policy and establishment of monitoring mechanisms. Campus information technology leadership worked with the internal audit program to create the campus information technology auditor position and to develop a formal information technology audit function at UCD. In cyber safety reviews, internal audit assisted management in validating the accuracy of compliance monitoring reports. Over time, internal audit helped to develop a more robust and centralized information technology security environment.

Ms. Vacca briefly outlined the management corrective action process.

Regent Makarechian asked how priorities are determined in the audit plan. Ms. Vacca responded that the internal audit plan is presented to the Committee annually in July. The plan includes priorities for each campus. The campuses carry out a risk assessment process involving management and the campus audit committee to identify and rank these priorities.

Regent Makarechian thanked Ms. Vacca for her work.

7. **QUARTERLY COMPLIANCE UPDATE**

[Background material was mailed to the Committee in advance of the meeting, and a copy is on file in the Office of the Secretary and Chief of Staff.]

Expert Compliance Advisor Guyton provided information on his professional background and experience, including service as a prosecutor in the Office of the District Attorney and the U.S. Attorney’s Office in Philadelphia, private law practice, and service as corporate compliance officer for the University of Pennsylvania and its Health System. Mr. Guyton has been serving as director of compliance for the Microsoft Corporation for ten years.

In addition to his work for Microsoft, Mr. Guyton serves as community representative for the University of Washington School of Medicine compliance committee. He anticipated more government regulation in the future. Compliance programs would become more important. It is important for universities to demonstrate that they enforce their policies and have a mechanism for disciplining noncompliance with policy. He observed that the University's compliance program has become proficient in only a few years and expressed confidence that UC has appropriate mechanisms to satisfy government requirements overall. He urged the Committee to ensure continuing progress and to remain aware of industry developments which could be adopted by the University.

Deputy Compliance Officer Lynda Hilliard outlined compliance program activities in seven key areas. In the first area, standard of conduct/policies and procedures, all locations are reviewing Health Insurance Portability and Accountability Act (HIPAA) policies; policies for the Office of the President are being updated and inventoried; metrics are being developed to demonstrate progress toward compliance program goals; and there is a significant effort to improve clinical research billing.

In the second area, governance, the University is seeking to recruit an export control officer, in order to address a major risk. A full-time campus ethics and compliance officer has been hired at UC San Francisco. UC is participating in an inter-university compliance consortium including the University of Texas, the University of Washington, Stanford University, the California Institute of Technology, and California State University to share best practices and leverage expertise. Ms. Vacca added that this consortium would leverage subject matter expertise and could provide an opportunity for cost sharing.

In the third area, education and training, the program's goal is to assist campuses and provide resources. Training topics include clinical trials research billing and HIPAA privacy and security. A second annual systemwide ethics and compliance symposium will be held. Ms. Vacca added that the symposium also addresses audit issues and would be held in both Northern and Southern California to reduce travel costs. Ms. Hilliard then discussed the "Working Smarter" training initiative. The compliance program is engaged in a process of cataloguing mandatory training at all locations. On average, there are 120 mandatory training programs on each campus. Working with the University Committee on Faculty Welfare of the Academic Senate, the compliance program will seek to leverage resources to reduce time spent by faculty on training and to better organize the University's training programs.

In the fourth area, communication and reporting, Ms. Hilliard noted that most communications to the whistleblower hotline concerned employee misconduct, such as misuse of employee time. In the fifth area, auditing and monitoring, the annual risk assessment process would lead to the development of the annual compliance plan. The compliance program is assisting in the development of materials for campus use in responding to the Higher Education Opportunity Act. Topics of interest in research compliance include intellectual property assignments and royalties. American Recovery and Reinvestment Act (ARRA) monitoring is ongoing.

In the sixth area, response and prevention, Ms. Hilliard called attention to a payroll certification pilot program, part of the UC effort reporting project. Regarding data privacy breach response, the University has reached master services agreements with outside vendors for breach response services. Ms. Hilliard stated that there was no new activity to report in the seventh area, enforcement.

Referring to breach response services offered by outside vendors, Regent Zettel suggested that the California Office of Privacy Protection could offer services at no charge. Ms. Vacca explained that these outside vendors would set up a call center following an information security breach; they would not instruct the University regarding its response. She affirmed that the University is aware of available resources in this area.

Regent-designate Pelliccioni requested a dashboard display of high priority issues by campus, with a column displaying systemwide high priority issues, in order to identify trends and patterns. She asked how Regents become informed about the findings of investigations. Ms. Vacca responded that this request involved the sharing of highly sensitive information. Committee Chair Ruiz is informed of high priority or high risk items which need to be addressed quickly. The Office of Ethics, Compliance and Audit Services also works closely with the Office of General Counsel on communication about and response to these matters. General Counsel Robinson observed that such information can be shared with Regents, but not in an open session meeting. He stated that the University could accommodate Regent-designate Pelliccioni's request for specific issues of concern. He observed that he and Ms. Vacca communicate frequently regarding items which might be brought to the attention of Committee Chair Ruiz, who considers matters to be brought to the Committee's attention. Committee Chair Ruiz confirmed that Committee members would be informed regarding any significant matter.

Faculty Representative Anderson thanked Ms. Hilliard for working with the University Committee on Faculty Welfare on streamlining mandatory training and making it as effective as possible.

Referring to Regent-designate Pelliccioni's request for a dashboard of high priority issues, Ms. Hilliard observed that campus compliance metrics would be provided at a future meeting. Ms. Vacca emphasized the importance of work carried out by campus staff and leadership.

Regent Zettel referred to the materials provided with the previous item, *Quarterly Internal Audit Update*, which included a list of high risk past due Management Corrective Actions (MCAs). She expressed concern about items which remain uncorrected even after a long period and asked if this was due to a lack of resources. Ms. Vacca responded that lack of resources or lack of funding were the main cause for delay of certain MCAs, rather than the existence of other priorities. Campus leadership has been working on the MCAs in question, and while delay was not excusable, Ms. Vacca stated her view that the situation had greatly improved over the past six months.

The meeting adjourned at 12:50 p.m.

Attest:

Secretary and Chief of Staff