

**UNIVERSITY OF CALIFORNIA, DAVIS
INTERNAL AUDIT SERVICES**

**University of California, Davis Health System
Reference Lab Billing
Internal Audit Services Project #12-21**

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MANAGEMENT SUMMARY

BACKGROUND

The Reference Lab has operated as a unit within the Department of Pathology for the past 25 years providing laboratory tests and services to local, regional, and national clients, including independent physicians and health care facilities. Operating 24 hours a day, seven days a week, it offers one of the most extensive routine and esoteric testing menus in Northern California. The Reference Lab is planning to increase its outreach sales volume and marketing to fill excess capacity. Efforts to increase lab sales to outside hospital and physician offices include developing an Outreach Client Services team, utilizing a website, brochures, routine communications and educational events to promote market visibility.

The Reference Lab grossed approximately \$2 million during Fiscal Year (FY) 2011. Pathology is setting a sales target of ten million dollars in annual gross charges in the next five years to justify implementation of new esoteric tests and to help offset expenses incurred from send-out lab tests.

PURPOSE AND SCOPE

The Reference Lab was audited as part of our planned reviews for FY 2012. The purpose of the audit was to review the system and process for capturing the information necessary to ensure complete and timely billing for hospital and professional services performed. We also evaluated the controls to ensure appropriate charge capture and cash collection. Additionally, we reviewed process and procedures in establishing the contractual agreements and sales arrangements with outreach customers.

To conduct our review, we interviewed Reference Lab personnel to determine lab services performed along with associated charge capture, billing and collection processes and systems. We used a risk based approach to focus our review on specific key processes such as lab requisitions, charge entry, management oversight, and agreements with outreach customers.

CONCLUSION

Based on our review, we concluded the Reference Lab has implemented well designed coding and billing policies and procedures, and that sufficient internal controls are in place to provide reasonable assurance that lab services are billed in a complete and timely manner. We also concluded that outreach customers undergo a thorough management review process before acceptance and that procedure rates are reviewed and updated on a regular basis. Finally, sufficient segregation of duties exists for billing and cash collection.

We also identified opportunities for improvement in contract management and fiscal oversight. Applied outreach customer discount rates were not consistently supported by existing business agreements and terms of service were not formally communicated for all sales arrangements with outside health care clients. In addition, key financial reports were not reviewed to identify opportunities for operational improvements.

Our observations and recommendations are presented within the body of this report along with corresponding corrective actions management has agreed to implement.

OBSERVATIONS, RECOMMENDATIONS, AND MANAGEMENT CORRECTIVE ACTIONS**1. Outreach Customer Business Agreements*****Contract management for agreements with outreach customers could be improved.***

We selected seven outreach customers on a test basis to review the supporting business agreements and found only one contract that properly supported the applied discount rate during FY 2011. As a result, discounts totaling approximately \$300,000, or 40% of the total discounts applied, were granted to six outreach customers without valid business agreements reflecting the discounts applied. Legal negotiations reportedly delayed the business agreement process between UCDHS and some customers, and insignificant sales to small customers also contributed to a perceived lack of need to obtain updated business agreements. Discount rates ranging from 34% to 67% were applied to these six customers. According to UC Davis Policy 330-05, *Administrative Business Agreements*, agreements for revenue and expense related activities at or for the UCDCM and the School of Medicine are processed by the UCDHS Contracts office. The initiating department is responsible for ensuring that all terms and conditions of the business agreement are processed and documented.

According to the California Commercial Code Section 2201, a sale of goods or services for the price of five hundred dollars or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his or her authorized agent or broker. Failure to formalize written agreements reflecting current pricing structures and discount rates may jeopardize future business arrangements and expose the department to avoidable pricing and cash collection disputes.

Recommendation

The Reference Lab should update business agreements to properly reflect present pricing structure and discount rates applied for the outreach customers and maintain a record archive of the business agreements to ensure that the applied business terms are consistent with present agreements. In lieu of formal agreements, or pending execution of new and/or revisions to existing agreements, the Reference Lab should issue terms of service letters to clients reflecting key business terms that apply to the services requested by the client.

Management Correction Action

Outreach Client Services will establish a record archive of the outreach business agreements and coordinate with Health System Contracts to update business agreements with outreach customers that reflect current pricing structure and discount rates by April 30, 2013. For pre-existing agreements that are in the process of being renewed and for other client relationships that do not require formal agreements, Outreach Client Services will issue terms of service letters summarizing key business terms for each customer by April 30, 2013.

2. Management Fiscal Oversight

Procedures for monitoring fiscal activities should be implemented.

We noted no management review over re-circulating error files and reports reflecting deleted hospital charges. Pathology had not established clear lines of responsibility for reviewing these activities after the former finance manager retired.

Hospital Policy & Procedures (HPP) 1205, *Outpatient Charge Submission*, requires oversight and monitoring of the entire process of charge submission, including delete reports and re-circulating error file activities. During FY 2011, 147 hospital charges totaling \$18,000 were deleted from the re-circulating error file because they accumulated for over a year. Although minimal charges had accumulated and/or were deleted from the re-circulating error file, these activities should nevertheless be monitored on a periodic basis to minimize the risk of billing delays and lost revenue.

Recommendation

Pathology should establish responsibility for reviewing the re-circulating error file and delete reports for the hospital charges on a regular basis.

Management Correction Action

Pathology will assign responsibility for routinely reviewing the re-circulating error file and reports reflecting deleted hospital charges by July 31, 2012.

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