Documenting Revenue Cycle Processes for Optimization and Section 404 Compliance
Agenda

- Year One – Overview
- Our Approach to 404
- Provider Revenue Cycle – What are the Risks?
- Provider Revenue Cycle – What are the Controls?
Year 1 – Overview
Recent SOX Discussions

- On May 6, 2005, the Dow Jones Newswire reported that during a speech, Congressman Michael Oxley conceded the following:
  
  ✓ "Pendulum had probably swung too far, and that it probably would have been reasonable to limit Sarbox requirements to companies with assets above a $5 billion threshold."

  ✓ Oxley further stated that "any changes will be up to the SEC and PCAOB, and that trying to reopen the legislation now is ‘not realistic.’"
Recent SOX Discussions

- On April 21, 2005, the **U.S. House Committee on Financial Services** held a hearing on the impact of SOX.

- Testifying at the hearing were SEC Chairman William Donaldson and Public Company Accounting Oversight Board (PCAOB) Chairman William McDonough.

- Highlights included:

  - "**Short-term costs**" will improve internal control over financial reporting, and the **long-term benefits** would be "structurally sounder corporate practices and more reliable financial reporting."

  - The SEC expressed a sensitivity to the need to recalibrate and adjust its rules and guidance to avoid unnecessary costs or unintended consequences, and will **remain committed to SOX**.
Recent SOX Discussions

- Additional highlights included:

  - Some participants in the initial implementation phase may have taken an approach that resulted in **excessive or duplicative efforts**.

  - Some companies have charged that auditors are implementing the PCAOB Auditing Standard No. 2 (AS2) with a "**check-the-box" mentality**, an approach that focuses on minutiae that are unlikely to affect the financial statements.

  - The **focus of auditor should be on what is "material to the financial statements, not on the trivial."**

  - Auditors should not allow an emphasis on computer systems, for example, to distract them from the more qualitative risks of misconduct by top management.
SOX Year 1 Compliance - Overview

- SOX is the **most sweeping U.S. securities legislation** since the Securities Act of 1933 and the Securities Exchange Act of 1934.

- Estimates of the **total cost** to U.S. companies for SOX compliance in 2004 are **in excess of $35 billion**.

- The legislation is "**here to stay**" even if modified in the future as a result of current SEC roundtable meetings and other discussions.

- As of March 16, 2005, **11% of filers had reported material weaknesses** under provisions of the Sarbanes-Oxley Act.

- Overall, **stocks on filers reporting material weaknesses did decrease slightly**, however, only around 2% to 4% (small cap companies were more affected than larger cap).

- The following slides are highlights from a study by the Corporate Executive Board, entitled "SOX 404 Triggering Delayed Filings And CFO Turnover," which include some interesting results from Year 1.
SOX Year 1 Compliance - Overview

The study at left highlights the average Year 1 resources spent on SOX compliance (Section 404).
Compliance Week - Overview

Based on a large sample of 2005 disclosures, "financial systems and procedures" and "personnel issues" continue as the most commonly cited internal control deficiencies. The following weaknesses were cited:

- Lease Accounting
- Accounting Policies and Practices
- Inexperienced Staff or Lack Thereof
- Taxes
- GAAP Calculations and Policies
- Revenue Recognition
- Monitoring
- Third-Party Relationship (e.g., strategic supplier relationship, etc.)
- International and Merger and Acquisitions
- Control Environment (e.g., integrity, ethical values, etc.)
**SEC Roundtable Discussion**

- On Wednesday, April 13, 2005, the **SEC hosted a roundtable discussion** on the implementation of the internal control reporting requirements for public companies as outlined under Section 404 of SOX.

- The Commission invited representatives of public companies, auditors, investors, members of the legal community, and others to participate in the roundtable and discuss "lessons learned" from Year 1 compliance.

- Several themes emerged, including:
  - Overall consensus was that the **Section 404 "concept" is valid**
  - Year 1 compliance and auditing **costs were too high and must be reduced going forward** ("cost / benefit equation is out of balance")
    - Lack of documentation
    - Inadequate attention to and emphasis on improving internal control over financial reporting
SEC Roundtable Discussion

- Several themes emerged, including (continued):
  - **Year 1 was a learning experience** impacted by the timing of the release of PCAOB AS2 and other guidance materials
  - **Year 2 cost reductions should be realized** due to the carry-forward of Year 1 documentation and implementation of a risk-based approach
  - The Year 1 approach gave **equal weighting and emphasis to high risk and low risk areas**
  - A **risk-based** approach is needed
  - **Best practice examples** are needed
  - **Not all material weaknesses are created equal**
    - Companies need clarification around the assessment, aggregation, and classification of control deficiencies
Other Lessons Learned

- **Answer key scoping questions early**
  - Which financial reporting elements?
  - Which units and locations?
  - Which processes?
  - Which systems?

- **Focus on priority financial reporting elements, assertions and risks**
  - Use process maps and / or other supporting documentation to provide the most effective "walkthrough"
  - Link priority elements, processes, key assertions, risks and controls
  - Integrate IT risks and controls with the assessment

- **Engage the unit managers and process owners**
  - Both in-house and outsourced
  - Establish accountability
  - Make sure they are ready for the walkthroughs
Other Lessons Learned

- **As early as possible in the process**
  - ✓ Assess your entity-level controls
  - ✓ Evaluate your general IT and application controls
  - ✓ Plan on making fraud explicit in the assessment

- **Pay attention to details**
  - ✓ Read the standard and document your roadmap for complying with the standard
  - ✓ Expect Year 1 compliance to be a learning experience

- **Work with the external auditors throughout the process**
  - ✓ Understand expectations and timing requirements
  - ✓ Conduct periodic checkpoints
  - ✓ Plan to give the auditors sufficient time
Other Lessons Learned

- Define the testing plan / "rules of engagement" up-front
  - Filter the controls to test
  - Define the "failure conditions"
  - Articulate testing documentation protocols
  - Decide what to do when failure conditions are encountered
  - Vary testing scopes according to frequency of the control
  - Test at least to the same degree that the auditor would
  - Automated controls need be tested only once
  - Use competent and objective evaluators
  - Don’t forget year-end updates
Other Lessons Learned

- Consider nature and extent of remediation timely
  - Begin evaluation process ASAP - classifying borderline deficiencies will be difficult
  - Tackle significant design deficiencies ASAP
  - Thoughtfully remediate operating deficiencies
  - Be sure to retest remediated controls
Management Best Practices

- **Top management support is vital**: the project can’t succeed without it.
- **Budget for it and commit – be serious and set the tone:**
  - Don’t ignore the clock – this is a BIG effort
  - FEI studies report an under-estimation of overall effort
  - Start as early as you can
- **Take charge – some common pitfalls to avoid:**
  - Project is managed at too low a level within the organization
  - Project team gets lost in irrelevant details
  - Key scoping decisions remain unaddressed too long
- **Walk through the major processes yourself**
Management Best Practices

- Insist on status reports
- Obtain sub-certification by others
- Communicate up, down and across the organization
- Establish a Steering Committee to maintain senior management sponsorship
- Top management support is vital; the project can’t succeed without it
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Management Best Practices

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Potential Obstacles / “Nightmares”

- Company or external auditor testing of remediated controls prove they are not working
- "New scope" items created by external auditor
- No time left to remediate issues
- Fraud occurs, not contemplated by existing controls
- Key fourth quarter or annual controls do not work
- Large financial statement adjustment NOT detected by management
- Large financial statement adjustment detected by management but affecting prior quarters
- Audit Committee is deemed ineffective
- Fraud programs and controls not thoroughly documented
- Issues in general IT control environment
- Sample sizes not large enough
- Deficiency / material weaknesses definition disagreements
- SAS 70 issues
Protiviti Approach
Our Recommended 404 Methodology

Components of Internal Control Reporting

- Financial Reporting Requirements
- Entity-Level Controls
- Relevant Processes
- Process Risks
- Control Design
- Control Operation
- Control Improvements
- Internal Control Report

PHASE I
- Set Foundation
- Assess Current State and Identify Relevant Processes

PHASE II
- Document Design and Evaluate Critical Processes and Controls

PHASE III
- Design Solutions for Control Gaps

PHASE IV
- Implement Solutions for Control Gaps
- Report

Protiviti’s Approach

- Project Management
- Knowledge Sharing
- Communication
- Continuous Improvement

IT Controls

- IT Organization and Structure
- IT Entity-Level Control Evaluations
- IT Process Level Control Evaluations

Tools & Technology

- Sarbanes Diagnostics
- Process Management (SarbOX Portal™)
- Assessment Management (The Self Assessor™)
- Knowledge Management

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### Factors to consider in determining key financial reporting elements:

1. Materiality of financial statement items;
2. Degree of volatility of the recorded amount over time;
3. Degree of subjectivity used in determining account balance;
4. Susceptibility to error or omission as well as loss or fraud;
5. Complexity of calculation.

#### Individual risk rankings

#### Overall element risk ranking
Overall Financial Element Ranking

In order to prioritize processes that affect financial reporting controls, the most recent fiscal year ending financial statements will be reviewed to determine the critical reporting elements.

Each key financial statement element will be rated (on a scale of high-medium-low) by management on the following factors:

– Materiality of the balances
– Degree of volatility in balances from quarter to quarter
– Velocity (the number of transactions in the account)
– Subjectiveness in determining significant estimates
– Susceptibility to error or omission as well as manipulation or loss
– Complexity of calculation

Materiality will be determined based on

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<th></th>
<th>LOW</th>
<th>MEDIUM</th>
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<tbody>
<tr>
<td>Total Assets</td>
<td>0% - 5%</td>
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<tr>
<td>Liabilities &amp; Net Assets</td>
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<td>Operating Revenue</td>
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In establishing the overall score, materiality will be counted twice. The overall score will be established by assigning weights of 3, 2 and 1 to factors that were rated high, medium and low, respectively. An overall rating will be assigned to each financial statement element, based on this overall score.

A high level analysis will be performed to ensure the results are in line with expectations (ie. Expected A/R to be assessed as high, is it?) (Does it pass the “sniff” test?).
Process Classification Scheme is a tool to categorize key business processes within a business, and to develop an enterprise’s “process universe”

The universal model shown here can be customized to include the key processes for any organization

The objective, however, is to identify the major transaction flows
## Process Prioritization

### Financial Elements / Business Process Matrix

| Key Business Processes / Key Sub-Processes | Cash and cash equivalents | Receivables | Merchandise inventories | Deferred income taxes | Other current assets ( prepaid expenses, etc) | Property | Goodwill | Intangible assets | Other long-term assets | Accounts payable | Employee compensation and benefits | Taxes payable | Current portion of long-term debt | Other current liabilities | Long-term debt | Deferred income taxes and other long-term liabilities | Shareholders’ equity | Sales | Cost of sales | Operating and administrative expenses | Net Income | Income Tax | Financial statement notes and disclosures | (a) Importance to financial reporting | (b) Likelihood of control issues |
|------------------------------------------|---------------------------|-------------|-------------------------|----------------------|-----------------------------------------------|---------|---------|------------------|----------------------|-------------------|-----------------------------|--------------|------------------|---------------------------------|-----------------|--------|--------------------------------|---------------------------|----------------------|
| 1. Cash Management                      |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 1.1 Manage Line of Credit and Other L/T Debt |               |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 1.2 Cash Handling                       |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 1.2.1 Stores                           |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 1.2.2 Corporate Offices                |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 1.3 Bank Reconciliations               |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 1.4 Investments                        |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 2. Accounts Payable                    |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 2. Accounts Payable                    |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 3. Payroll                             |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 3.1 Payroll Processing                 |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 3.2 Benefits Processing                |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 3.3 Workers’ Compensation              |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 3.4 Bonuses                            |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 4. Revenue                             |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |
| 4.1 Revenue Recognition                |                           |             |                         |                      |                                               |         |         |                  |                      |                   |                             |              |                  |                                 |                |        |                                |                           |                      |

### Framework Interpretation:

- The business processes listed represent sample processes that affect significant transaction flows.
- The matrix links priority financial reporting elements to business processes
Process Prioritization

**Processes**

**Treasury:**
- Cash Management & Marketable Securities
- Debt Management
- Fundraising

**Revenue Cycle:**
- Registration/Admissions
- Medical Records
- Charge Capture/Charge Posting
- Charge Master Maintenance
- Billing
- Receivables Management
- Allowances

**Procurement:**
- Purchasing
- AP & Cash Disbursement
- Asset Management
- Inventory Management
- Amortization of Prepaid/Intangibles
- Manage Travel and Entertainment Expense

**HR and Payroll:**
- Payroll/Benefit Changes
- Employee Managed Benefit Plan
- Payroll Management
- Incentive Compensation

**Risk Management**
- Risk Management

**Taxes**
- Income Tax Provisions and Compliance

**Financial Reporting:**
- Close the Books
- Third Party Payor Settlements
- Budgeting, Forecasting and Management Reporting
- Financial Statement Disclosures

**Information Technology**
- IT General Controls
One of the key processes in developing a project plan is to determine how many business units / locations are part of the SOX scope. The process used to reach the decision is the Accounting Standards Board (and Public Company Accounting Oversight Board’s) "decision tree" shown below.

Recommended best practices would include formalizing this process, including management’s assessment over which business units / locations are in scope, and why management determined that some business units are not part of scope. In order to determine overall "importance," companies are using total revenues, total assets, and / or pre-tax income, as the basis for the materiality decisions.
Phase II - Documentation
Risk and Control Matrix

The Risk and Control Matrix is utilized to link our risks to assertions and ultimately to the risk controls.

The Risk and Control Matrix should answer these questions:

1) What are the risks?
2) What are the controls?
3) Who owns the process/controls?
4) How are the controls performing?

The Risk Control Matrix is one of the key documents developed for each process!
This is an example of a Risk and Control Matrix template. Population of the risk and control matrix is the end objective of the documentation efforts.
Process Maps

• Provides a high level overview of the key components that comprise each cycle

• Process maps provide the blue prints and actually facilitate the development of the process narratives to be completed.

• Serve as an effective tool to source risks and corresponding control points within a given process

• Depicts the interfaces that may exist within the process between key functions.
Sales and Inventory systems are closed (usually on a Saturday - last day of period)

IT Department generates Stock Ledger report for input into the General Ledger (GL) System

Summary page of Stock Ledger report is printed which lists all transactions into the system for the month

GL Group receives Stock Ledger report for manual entry of cost entries GL system

Personnel within GL Group close specific financial statement captions

Recurring entries are made (2 types: (1) same amount each month (2) different amount but recurring entry each month)

Accounts Payable close - all AP related accruals booked by AP Department

The AP close process is a separate process performed by AP Dept. (see narrative on AP close process for further details)

GL Personnel are responsible for entries such as fixed assets, prepaid amort., Payroll, etc.
Process Narrative

• Process narratives are used in conjunction with the process flows to provide detailed descriptions of each process point.

• The process narrative allows the documenter the capacity to qualify processes beyond what graphical documentation can provide.

• The premise for the narrative is to describe why, when and how the process occurs, as well as what is created during the process and who is involved in the process.

• The ultimate objective for creating each process narrative is to extract control detail and determine assertions and related risks applicable to each process.
Provide Revenue Cycle – What are the Risks?
Provider Revenue Cycle

- Scheduling/Verification/
  Pre-Certification/Pre-Admissions
- Registration/
  Admission
- Charge Capture/
  Utilization Review/
  Care Coordination
- CDM/Health
  Information
  Management/
  Coding
- Billing
- Collections/
  Payment Posting
- Account
  Follow-up
- Delinquent
  Accounts/
  Collection
  Agency
What are Risks?

- Risk represents “what can go wrong” in a process. By identifying the risks in a process, the evaluator can focus on whether the controls mitigate the risk.
- Risk is the threat that an event, action, or non-action will adversely affect an organization’s ability to achieve its business objectives and execute its strategies successfully.
- Risk is measured in terms of consequences and likelihood.
Provider Revenue Cycle Risks

- **Registration/Admissions**
  - Patient is invalid or unauthorized
  - Changes to the ADT system are not complete and accurate
  - Eligibility and verification checks are not performed on a timely basis

- **Charge Capture**
  - Charges for services are not captured completely and accurately
  - Charges for services are not posted completely and accurately

- **CDM**
  - Additions/deletions/changes are not processed completely and accurately
  - Additions/deletions/changes are not appropriately authorized
Provider Revenue Cycle Risks (cont.)

- **Billing**
  - Billing occurs for services that have not been rendered
  - Billing does not occur for all services provided
  - Bills are not processed completely, accurately and timely
  - New bills or changes to existing bills are not appropriately captured in the BAR system and GL

- **Collections/Payment Posting/Account Follow up**
  - Payments are not posted completely and accurately
  - Refunds or credits are processed without the appropriate authorizations
  - A/R aging is not reviewed on a timely basis
Provider Revenue Cycle Risks (cont.)

**Allowances**

- Follow-up on outstanding bad debt is not performed completely, accurately and timely
- Bad debt write-offs are not appropriately authorized
- Appropriate bad debt reserve is not established on uncollectible accounts
- Bad debt reserves are not recorded completely and accurately

- Charity care write-offs are not appropriately authorized
- Appropriate contractual allowance reserve is not established
Provide Revenue Cycle – What are the Controls?
Internal Control

Control is about setting and achieving defined objectives. It’s also about effective procedures. Control activities that help manage risks while encouraging flexibility and innovation.

The CEFI model.

- Clear Objectives
- Effective Procedures
- Flexibility & Innovation

The CEFI model.
Standard Control Model

The standard control model is setting standards, measuring performance, and correcting variances using feedback loops.

Objectives
- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with laws and regulations

Controls at their best:
- Agreed roles and responsibilities
- Documentation that is verified
- Record of income and accountability
- Segregation of duties
- Review and monitoring committee
- Frequent checks

Control Techniques

Controls can be viewed as a series of concentric circles. There are myriad processes within a health system, and the necessary controls to achieve the objectives zero in to ever-tightening focus. Target the revenue cycle controls that mitigate the identified risks.

Prevention techniques are designed to provide reasonable assurance that only valid transactions are recognized, approved and submitted for processing. Many of the preventive techniques are applied before the processing activity occurs.

- Segregation of Duties (Preventive – Manual)
- Configuration/Account Mapping Controls (Preventive – System)

Detection techniques are designed to provide reasonable assurance that errors and irregularities are discovered and corrected on a timely basis. Detection techniques normally are performed after processing has been completed.

- Reconciliations (Detective – Manual)
- Key Performance Indicators (Detective – Manual)
“Front-End” Controls

“Front-end” information is crucial to meeting Revenue Cycle control objectives. If information is not captured correctly, the entire billing process is compromised from the start.

“Front-End” Internal Controls

- Pre-Admissions for Scheduled Procedures/Admits
- Follow-up on Missed Appointments
- Validate ID and Insurance Card
- Required Data Fields
- Verify Insurance Eligibility
- MPI Maintenance & Cleanup

- Meet Regulatory Requirements
  - MSP Questionnaire
  - ABN
  - EMTALA
“Middle” Controls

The “middle” of the Revenue Cycle is where the tests, procedures, supplies, pharmaceuticals, and treatment administered to the patient are documented and codified for billing, regulatory reporting, and risk management purposes.

“Middle” Internal Controls

- Charge Master Review Committee
- Routine Code Updates
- Charge Review Nurse Audit
- Up-to-Date Charge Tickets
- Chart to Bill Audits
“Back-End Controls

The “back-end” processes of Billing, Collections and Cash Posting are the final steps to turning patient encounters into net revenue. In theory, if everything is performed correctly up to this point these processes should be automatic. However, that is rarely the case and internal controls are needed to ensure the final steps of the Revenue Cycle are carried out effectively and efficiently.

“Back-End” Internal Controls

- Daily Billing Control Points Reconciliation
- Feedback loops to Clinical Departments, HIM
- Denial Management Reports
- Electronic Posting
- Lockbox
- Segregation of Duties
- Performance Metrics & QA
- Management approval through delegation of authority guidelines
Effects of Entropy

Effective Revenue Cycle internal controls ensure that the processes that make up the systems are current, relevant, effective, and efficient. If the controls are not properly maintained, over time the Revenue Cycle will break down.

Effects of Revenue Cycle entropy are:
- Inaccurate financial statements
- Loss of Revenue
- Financial Loss
- Regulatory Compliance Violations
- Staff Turnover / Lack of Motivation
- Patient Dissatisfaction
- Facility Closure
Effects of Internal Control

Establishing objectives and strengthening the controls to meet those objectives means positive returns for the health care provider. Risks are mitigated, staff are focused in the same direction, roles and responsibilities are defined, and there is accountability for results.

Returns can be seen in the form of:
- Accurate financial statements
- Improved Cash Flow
- Lower A/R Days
- Reduced Bad Debt
- Regulatory Compliance
- Patient Satisfaction
- Employee Satisfaction
- Healthy Work Environment
Internal Controls Summary

- The starting place for controls is to decide what you really want to do. Everything else flows from this.

- Control is about having an aim, making sure you have the means to achieve it, and managing those risks that can impair your ability to get there. It’s a driving force that moves you in the right direction, but it sets your energies within a framework of policies, guidelines, ethical rules, and accountability.

- It seeks to promote achievement but also depends on compliance with these policies.

- Also, it should provide safeguards against fraud and corruption and make sure value for money is secured.

Questions?