SPECIAL STUDY

UNIVERSITY OF ARIZONA, COLLEGE OF MEDICINE AND UNIVERSITY PHYSICIANS, INCORPORATED

STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

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February 26, 1993

The Honorable Fife Symington, Governor

The Honorable John Greene
President of the Senate

The Honorable Mark Killian
Speaker of the House

The Honorable Ann Day, Chair
Senate Health, Welfare & Aging Committee

The Honorable Nancy Wessell, Chair
House Health Committee

The Honorable Carol Springer, Chair
Senate Appropriations Committee

The Honorable Robert Burns, Chair
House Appropriations Committee

Transmitted herewith is a report of the Auditor General, a special study involving the University of Arizona, College of Medicine and University Physicians, Incorporated. This report is in response to the requirements of Chapter 133 of the 1992 Session Laws.

The report contains a review of the indirect cost study performed by the University of Arizona as well as a review of the dean's tax calculation and expenditure of the dean's tax monies. The report also contains information regarding medical practice plans in other states.

My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on March 2, 1993.

Sincerely,

Douglas R. Norton

Douglas R. Norton
Auditor General

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INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a special study involving the University of Arizona's College of Medicine and University Physicians Incorporated (UPI). UPI is a nonprofit corporation, established to provide clinical teaching services to the College of Medicine's students, residents, and fellows.

The study was conducted pursuant to Chapter 133 of the 1992 Session Laws that provides in pertinent part:

A. The Auditor General shall conduct a study which shall address:

1. Whether the four percent dean's tax paid by University Physicians, Inc. to the university of Arizona college of medicine is being done pursuant to the medical services plan of 1985 and whether it is comparable to rates paid in other states.
2. Whether the university of Arizona internal indirect cost rate is reasonable.
3. Whether the financial arrangement of the university of Arizona, college of medicine's resident program is comparable to similar programs in other states.

The University and UPI both acknowledge that UPI provides a benefit to the University. However, determining the extent of such a benefit was not included in the scope of this study.

Organizational Structure

Prior to 1984, the University of Arizona owned and operated University Medical Center which was the main teaching hospital for the College of Medicine. The College of Medicine faculty members performed patient care services at University Medical Center for the purpose of teaching students, residents, and fellows. During this period, physicians billed and fully retained all clinical service revenues.

In May 1984, the Arizona State Legislature passed legislation giving the Arizona Board of Regents authority to form a nonprofit corporation to operate the University Medical Center. In July 1984, the University

Medical Center Corporation (UMCC) was formed by the Board of Regents to operate the hospital. UMCC's Articles of Incorporation require it to lease real property from the Board of Regents for $10 a year for the purpose of operating a health care institution. The Board of Regents also contracts with UMCC to ensure that the hospital and other medical facilities under the governance of UMCC are available to and staffed by faculty members of the College of Medicine.

About the same time that UMCC was formed, with the consent of the Board of Regents the College of Medicine's faculty members formed a nonprofit health care corporation known as University Physicians, Incorporated which began operations in July 1985.

Based on the Articles of Incorporation, as amended, UPI was established and organized for the benefit of the College of Medicine with its primary purpose being to assist the College of Medicine in achieving the fulfillment of its teaching, research, and patient care missions. A contract, known as the Medical Service Plan of 1985, was signed between the Board of Regents and UPI for clinical services provided at the University Medical Center and related facilities. A principle purpose of this agreement is to establish a plan by which members of the clinical faculty of the College of Medicine can be compensated for rendering those clinical services which are part of the curriculum of the College of Medicine.

The Medical Service Plan requires that all members of UPI must be faculty members of the College of Medicine who have no independent outside practice unless approved by the UPI Board of Directors. In addition, all College of Medicine full-time voting faculty physicians who engage in any degree of clinical activity must be members of UPI. UPI's Board of Directors is comprised of all College of Medicine clinical department heads and six directors selected at large. Also, the Dean of the College of Medicine and one departmental head from each clinical department of the College of Medicine having a counterpart UPI department serve as ex-officio board members with voting rights. As a result, a close relationship exists between UPI, the University, and the Board of

Regents. Although UPI was established as a nonprofit corporation and is legally separate, the activities of UPI are integrally related to the College of Medicine, and, therefore, the University.

The relationship between the Board of Regents and UPI is further evidenced by the following requirements outlined in the Medical Service Plan of 1985.

- The Medical Service Plan of 1985 requires an annual audit to be performed on UPI's financial statements and that a copy of the annual audit shall be provided to the Board of Regents.
- UPI's books of account must be available at all times to authorized representatives of the Board of Regents.
- UPI is required to prepare an annual budget and informational copies of that budget must be presented to the Board of Regents.
- UPI's articles of incorporation have provisions that, upon dissolution and/or liquidation of UPI, all of the assets of UPI revert back to the College of Medicine, which is under the control of the Board of Regents.
- UPI cannot make any capital expenditures over $250,000 without the prior written approval of the President of the University.
- The agreement may be terminated by the Board of Regents or UPI by giving 180 days written notice of such intent.

REVIEW OF THE DEAN'S TAX

Background

The Medical Service Plan of 1985 stipulates that "UPI will pay over quarterly to the Dean of the College of Medicine for the benefit of the College of Medicine 4 percent of all of the fees collected by UPI on account of professional health care services delivered by its members and employees." This is commonly referred to as the dean's tax. There are no restrictions or guidelines placed on the expenditure of the funds except that they are to be spent for the benefit of the College of Medicine.

During our review of the dean's tax monies, we noted that UPI had not included all professional income in the calculation to determine the dean's tax. A portion of the calculated deans' tax was incorrectly remitted to the University of Arizona Foundation. The remaining portion of the dean's tax was retained by UPI and spent at the discretion of the Dean of the College of Medicine. In addition, we noted some expenditures did not appear to benefit the College of Medicine. See Appendix C for information regarding the methodology and scope of our review.

Findings

Some Expenditures Did Not Appear to Benefit the College of Medicine

During our examination of the dean's tax calculation at UPI, we noted that not all of the tax was remitted to the College of Medicine. Instead, the Dean of the College of Medicine authorized expenditures totaling $441,543 and $375,245 in fiscal years 1989-90 and 1990-91, respectively, made from the dean's tax monies by UPI.

Accordingly, we examined expenditures from the dean's tax monies by UPI, the College of Medicine, and the University of Arizona Foundation to determine whether expenditures were for the benefit of the College of Medicine. Some expenditures did not appear to benefit the College of Medicine or appeared to be excessive in amount. We found that these monies were spent on food and entertainment, parties, employee incentives, and other items. The College of Medicine received criticism for making similar expenditures over ten years ago in a newspaper article in the Tucson Citizen published on August 11, 1982.

Because the funds are being spent by UPI, the Dean does not feel University policies apply. As a result, the dean's tax monies appear to have been spent by UPI without regard to any guidelines from the University. These monies are State revenues as defined by Article 9, §17(2) of the Arizona Constitution. Therefore, these monies should be spent in accordance with University policies.

In addition, the Medical Service Plan of 1985 specifically states that UPI will remit the dean's tax quarterly to the Dean of the College of Medicine. This agreement does not provide for the reduction of the dean's tax for any reason. Accordingly, the expenditure of monies prior to remittance to the Dean constitutes a violation of the Medical Service Plan of 1985.

Some examples of expenditures the Dean authorized from the dean's tax monies that did not appear to benefit the College of Medicine in fiscal years 1989-90 and 1990-91 follow.

- Incentive payments totaling $94,549 to three doctors were inappropriately paid by the College of Medicine. The Medical Service Plan of 1985 specifies that all compensation to voting members of the faculty of the College of Medicine for incentive payments shall be paid by the University from funds provided in advance by UPI for that purpose. In addition, Article 9, Section C of the UPI by laws requires the dean's tax monies not be used for incentive payments to doctors.

- We noted several expenditures for food, party supplies, and gifts for employees totaling $26,720.

- We noted a $12,000 payment for a portion of the UPI's attorney's salary for the two years ended June 30, 1991.

- $4,500 was paid for a doctor's personal malpractice insurance premium for his own practice, which is in addition to his position with the University administration. He is not a practicing UPI physician. Therefore, it is inappropriate for the College of Medicine to pay for his private malpractice coverage.

- We noted charitable contributions of $3,350. The University policy states that charitable contributions are not allowable expenditures from any funds.

Some examples of expenditures the Dean authorized from the dean's tax monies that were not in accordance with the University policies in fiscal years 1989-90 and 1990-91 follow.

- Based on the expense records for the 1989-90 and 1990-91 fiscal years, over $280,000 was spent for travel to present position papers and attend medical seminars. Travel destinations included Puerto Rico, Hong Kong, Taiwan, Switzerland, Australia, Europe, and Hawaii. Because these expenditures were made at UPI instead of the University, many of the reimbursements exceeded the limits as prescribed in the University travel policy.

- Furniture and equipment items totaling $13,705 were purchased from the dean's tax monies, but there were no existing procedures to ensure the items were added to the University's inventory listing and identified with University tags. Such items should be considered University property, but were not considered as such when purchased through UPI with the dean's tax monies.

Dean's Tax Monies Improperly Remitted to the Foundation

The Dean of the College of Medicine authorized $1,362,872 and $1,813,466 of dean's tax monies be remitted to the University of Arizona Foundation instead of to the University in fiscal years 1989-90 and 1990-91, respectively. The Foundation is a private, nonprofit corporation established to provide financial support to the University and its operations. According to the College of Medicine's Associate Dean for Administration and Finance, dean's tax monies were transferred to the Foundation because the College received a better return on its investment. In addition, because the monies were transferred to the Foundation, she felt that the expenditure of such monies was not subject to University procurement rules.

These monies should only be deposited with the University and not a private organization. The dean's tax monies are considered public monies and depositing the monies with the University of Arizona Foundation could be considered a gift of public monies which is in violation of Article 9, §7 of the Arizona Constitution.

Dean's Tax Not Remitted On All Revenue

UPI did not include all professional income in its calculation of the dean's tax which resulted in an estimated loss of monies to the College of Medicine of $44,000 and $54,800 for the years ended June 30, 1990 and 1991, respectively. In addition, based on our review of UPI's financial statements, we estimated the loss of monies to the College of Medicine of $82,000 for the fiscal year ended June 30, 1992, due to the incorrect calculations.

UPI has several agreements with UMCC primarily related to medical direction support provided by UPI. For example, UPI entered into an agreement to provide physician staff who were responsible for the medical direction and professional administration and supervision of clinical diagnostic cardiology services for the University Medical Center. But, UPI did not apply the dean's tax to the revenue derived for this support. UPI claims that the fees generated from administrative services provided to University Medical Center are not subject to the dean's tax and excluded them from its calculations of professional income. However, administrative service fees are defined as professional income in the UPI by-laws and are subject to the dean's tax pursuant to the Medical Service Plan.

Recommendations

1. The dean's tax should be applied to all professional income, including income derived from providing administrative services to the University Medical Center, in accordance with the Medical Service Plan of 1985 and the UPI by-laws.

2. The dean's tax monies should be remitted intact quarterly to the University and expended in accordance with University policies.

REVIEW OF INDIRECT COST STUDY

Based on our review of the indirect cost study, we noted that UPI receives many services from the University such as equipment, payroll processing, radiation safety, security, and purchasing, but does not reimburse the University for the full cost of providing these and other services.

Background

The University performed a cost study to allocate a portion of its operating costs to auxiliary departments and other applicable outside organizations that receive services from the institution. This study was begun in 1987 and was completed in 1989. Implementation of the study results was to begin in fiscal year 1991-92.

The study identified 25 Auxiliary departments and two outside organizations. UPI was identified as one of the outside organizations that benefited from University services. The indirect cost study identified $1,747,417 of services or benefits that were provided to UPI by the University based on expenditures for the year ended June 30, 1987. This amount represents 11.22 percent of UPI expenditures processed through the University. The methodology developed under the study was to be used as the basis for subsequent billings for indirect costs.

However, UPI has refused to pay for total charges associated with this study. Instead, UPI has entered into a temporary agreement with the University which has resulted in the payment of $778,147 and $798,245 for fiscal years 1989-90 and 1990-91, respectively.

Findings

Based on the Cost Study, UPI Should Have Been Paying the University an Additional $800,000 per Year for Goods and Services Received

Based on our review of the cost study, we determined that the overall methodology used to identify costs benefiting UPI was sound and the methods used to allocate the costs to UPI were reasonable. The cost study identified $1,747,417 of services provided by the University; however, we determined that only 56 of the 65 cost pools allocated to UPI provided substantial benefit to UPI. The 56 cost pools total $1,571,508 which represents 10.1 percent of UPI expenditures processed through the University in fiscal year 1986-87. UPI should have been paying the University an additional $800,000 during each of the fiscal years 1989-90 and 1990-91, which is the difference between $1,571,508 and the actual amount paid. Examples of the cost pools identified that benefited UPI were for computer, accounting, personnel, security services, and equipment use. (See Appendix A for a complete listing of those cost pools that benefited UPI.) Although numerous cost pools were identified that benefited UPI, the building use allowance cost pool was the most significant.

Building Use Allowance - UPI operates clinical facilities (67,379 square feet) within University-owned buildings. These facilities produce patient care revenue for UPI. Currently, UPI does not pay rent to the University for the use of these facilities, yet, the University provides the building space, trash pick-up, custodial services, general repair and maintenance services, mail services, etc. Based on data included in the indirect cost study, we calculated that the cost to the University for providing these services was $8.53 per square foot, or $574,743 per year. Lewin - ICF, Inc., the consulting company contracted by UPI to determine the economic contribution of UPI to the University, stated in a report dated June 24, 1992, that the standard rental charge per square foot within the Tucson area was $20, or $1,347,580 per year.

Cost pools totaling approximately $176,000 included in the study, should not have been allocated to UPI - Even though the overall methodology for the cost study was reasonable, we found that some cost pools were included that did not appear to benefit UPI. (See Appendix B for a complete listing of these cost pools.) The following are two examples of cost pools we noted that did not appear to benefit UPI.

- <u>Fee waivers - Faculty/Staff</u>: The University waives registration fees for all faculty members, their spouses, and their dependents to attend classes. We determined that this is not a benefit to UPI since the physicians were also faculty members. Therefore, we do not believe that this cost should be allocated to UPI.

- <u>President</u>: The benefit that the President of the University provides to UPI is so indirect that we did not feel the cost should be allocated to UPI. We determined that the President's office represents a direct function to the overall administration of the University.

<u>Some of the Services Provided to UPI Have Changed Since 1987</u>

Certain services provided to UPI have changed since the indirect cost study was performed, which may change the amount billed to UPI. For example, from interviews with employees of the Security and Radiation Safety departments, we determined that services provided by these departments to UPI have increased since 1987. However, from interviews with employees of the personnel department, we determined that services provided to classified staff affiliated with UPI have decreased. There are other services provided to UPI that have increased or decreased since 1987.

The University also prepares an indirect cost proposal in accordance with the Federal Cost Principles for Educational Institutions, OMB Circular A-21. The proposal is submitted to the Federal cognizant agent for approval and a rate is generally negotiated for a two to three year time period. The purpose of the proposal is to identify allowable University overhead costs associated with conducting research activities that are reimbursable by the Federal government. Patient care is identified within the proposal as a function of the University for which space related overhead costs are allocated that are not reimbursable by the Federal government. With some modifications, this proposal could contain the necessary information to bill UPI.

The methodology used to develop the study was sound, and was applied uniformly between departments. However, it was very complex and required extensive time to prepare. The University's Federal indirect cost proposal produced similar results for patient care and, accordingly, could be used as the basis for billing UPI. This would eliminate the duplication of effort and provide the University and UPI with timely billing information.

Recommendations

1. Based on our review of the University cost study, the methodology is sound and reasonable and it should be used annually as a basis to bill UPI. The annual billing should be calculated by applying the rate established by the cost study as adjusted by the amount of UPI expenditures processed through the University for that year. In addition, the University should consider using the information obtained from the Federal proposal when updating the study to avoid any duplication of effort.

2. The University should bill UPI for only those cost pools that benefit UPI.

RESULTS OF SURVEYS OF OTHER STATES

Background

As part of the effort to determine if the financial arrangement between UPI and the University was similar to financial arrangements in other states, we surveyed other medical practice plans around the nation. Our surveys were performed to determine whether the four percent dean's tax paid by UPI to the University of Arizona, College of Medicine, and the financial arrangement with the University of Arizona, College of Medicine's resident program are comparable to similar arrangements in other states. The results of our survey indicated that there are many types of medical practice plans currently being used to facilitate the clinical teaching missions of the various universities.

Scope and Methodology

According to the 1989 Association of American Medical Colleges (AAMC) Faculty Practice Plans report, "The Organization and Characteristics of Academic Medical Practice," represents 126 accredited U.S. medical colleges, many of which have implemented faculty practice plans for the organized arrangement of billing, collecting, and distributing professional fee income. Since time constraints prohibited us from surveying all 126 medical colleges, we reviewed other national studies regarding these issues. In addition, we solicited input from individuals who were considered experts in the area of faculty practice plans. We obtained information regarding:

- medical schools that were considered leaders in the development and administration of faculty practice plans,
- medical schools (public and private) in other western states that have implemented faculty practice plans, and
- institutions with similar health care populations and teaching missions as that of the University of Arizona, College of Medicine.

From the information provided, we contacted the following 15 universities.

- Johns Hopkins University
- Northwestern University
- Oregon Health Sciences University
- University of California at Los Angeles
- University of California at San Diego

- University of Colorado
- University of Michigan
- University of Missouri
- University of New Mexico
- University of North Carolina at Chapel Hill
- University of Texas at Galveston
- University of Texas at San Antonio
- University of Washington
- Stanford University[(1)]
- Harvard University[(2)]

Findings

Approximately 62 Percent of the Faculty Practice Plans are Organized Within the School

Our survey results basically were identical to those of AAMC which reported (Graph 1) that eight of the plans (62 percent) were organized within the school and the remaining five plans (38 percent) were nonprofit corporations similar to that of UPI. In addition, for the plans organized within the school, separate, self-supporting auxiliary funds were generally used by the university to account for the plan's operations. The following universities have the faculty practice plans organized within the school.

University of California at Los Angeles
University of California at San Diego
Johns Hopkins University
University of Michigan
University of Missouri
University of North Carolina at Chapel Hill
University of Texas at Galveston
University of Texas at San Antonio

All of the Plans we Surveyed Make Contributions in the Form of a Dean's Tax to the Medical Schools

The dean's tax contributions ranged from a low of five percent at Northwestern University and the University of California at Los Angeles to a high of 18 percent at the University of Texas at San Antonio, with the average contribution being approximately nine percent. AAMC reported that

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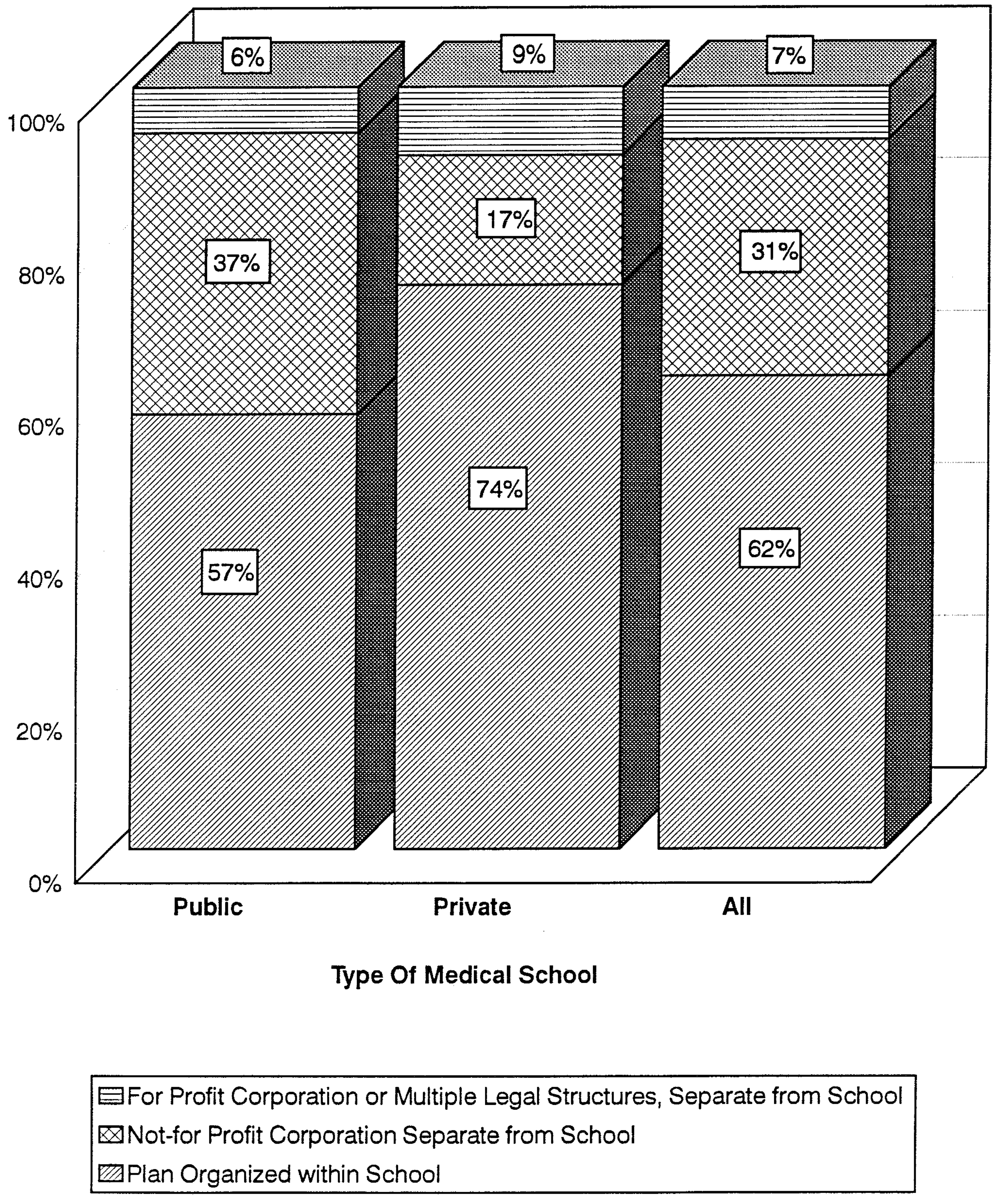
(1) Stanford University did not respond.

(2) Harvard University's medical practice plan was not considered comparable.

Graph 1

Practice Plan Organizational Structure



Source: Group on Faculty Practice Survey, AAMC, 1989 the amount ranged from two percent to 18 percent with the large variances possibly caused by whether or not the plans were responsible for personnel and overhead expenses (i.e., plans paying for most personnel and overhead expenses may have a lower contribution than those with expenses paid directly by the medical school or hospital). In addition, 69 percent of the schools we surveyed (nine of thirteen) used total receipts to calculate the contributions.

AAMC's report indicated that most of the plans make contributions to the medical school. Only five percent of the schools surveyed by AAMC (all of which were private schools) did not have a dean's tax, and the majority of the plans (62 percent) used gross collections to calculate the tax (Graph 2).

The dean's tax rates are usually negotiated between the faculty practice plans, the universities, and the governing boards. There does not appear to be a standard across the states for calculating the rate. With the exception of the following faculty practice plans, all made contributions directly to the Dean of the College of Medicine.

- Oregon Health Sciences University - The physicians have the option of having the dean's tax automatically deducted from their payroll checks or paying it to the Dean of the College of Medicine directly.

- University of Texas at Galveston - Eight percent of gross collections is paid to the President of the University, who distributes the dean's tax monies to the various college departments including the College of Medicine. (The College of Medicine normally receives approximately 50 percent of these dean's tax monies).

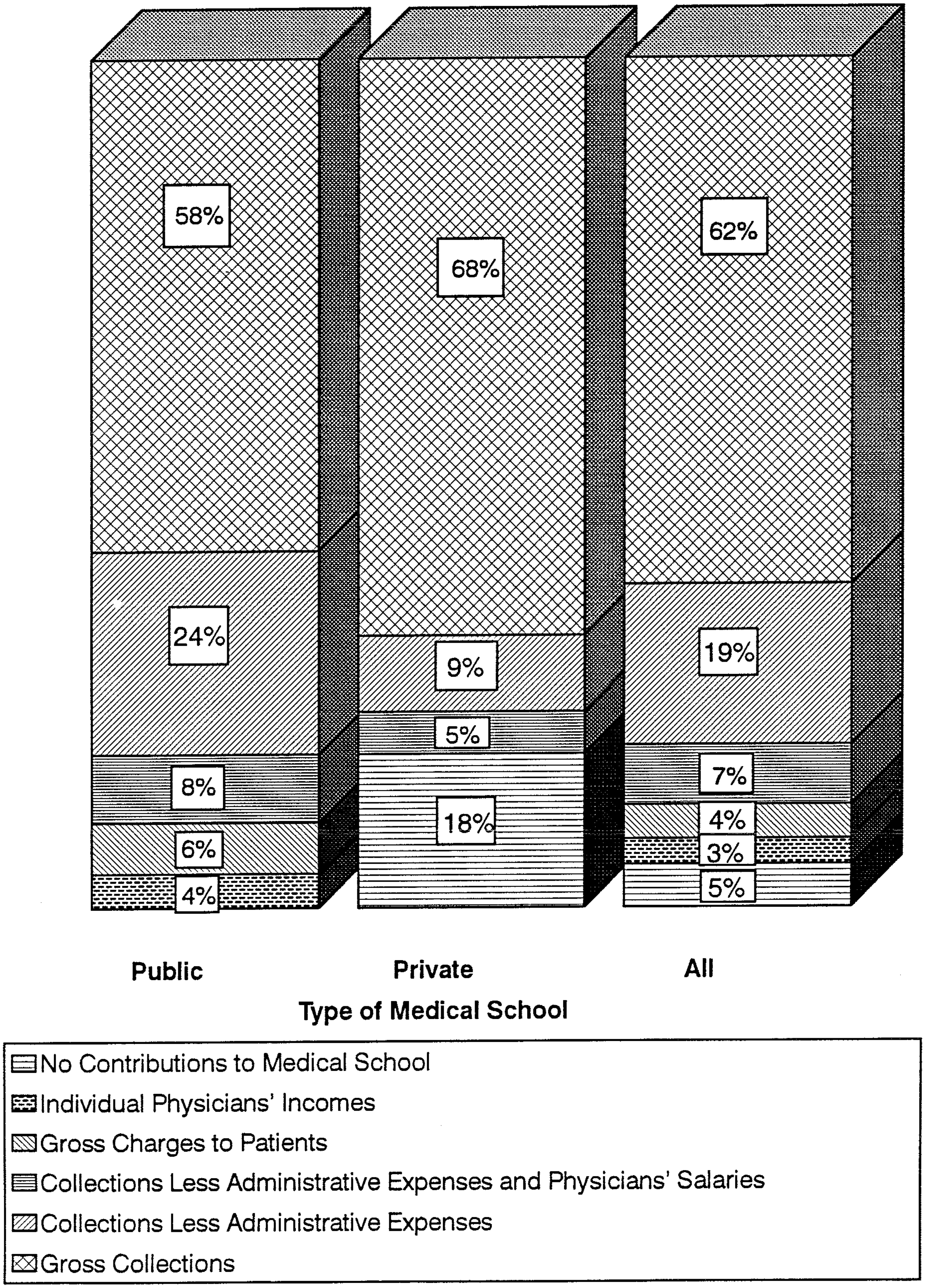
- University of Texas at San Antonio - The plan contributed 18 percent of collections less administrative expenses. Ten percent was remitted to a Fringe Benefit Fund; five percent was remitted to a Development Fund; and the remaining three percent was remitted to the departments' deans' accounts, including the College of Medicine's dean's account, and spent at the deans' discretion.

Most of the Universities had Restrictions on How Dean's Tax Monies Could be Spent

Nine of the 13 universities surveyed required that the dean's tax monies be spent in accordance with university purchasing guidelines. Only two of the universities surveyed (University of Michigan and Northwestern

Graph 2

Basis for Practice Plan Contributions to Medical Schools



Note: Zero values are not displayed

Source: Group on Faculty Practice Survey, AAMC, 1989

University) did not have any restrictions as to how the monies received from the plans could be spent. The following universities had other restrictions regarding the expenditure of the dean's tax monies.

- Johns Hopkins University - Two percent of the monies are distributed for the basic science departments with the remainder being spent in accordance with the purchasing guidelines of the University.

- University of Colorado - Monies cannot be used for faculty salary support; however, they may be used for any other activity within the College of Medicine provided those expenditures are within the purchasing guidelines of the University.

The Majority of the Faculty Practice Plans Compensate the University for Facilities Used

Of the 13 plans surveyed, only one plan (University of New Mexico) did not use any facilities of the University. Four of the faculty practice plans used university facilities but did not compensate the university. The following is a brief description of the manner in which two faculty practice plans compensated the universities for the facilities they used.

- Oregon Health Sciences University (nonprofit corporation) - Rent ranging from $15 to $25 per square foot used is paid by the practice plan's physicians at each facility.

- Universities of Michigan and California at Los Angeles (both organized within the school) - The university is compensated based on square footage of clinical space used at prevailing market rates.

Approximately 92 Percent of the Universities Surveyed Provided Support Services to the Practice Plans; Only 58 Percent of the Plans Reimbursed the University for These Services

With the exception of the University of Washington, all of the universities surveyed provided various support services to the practice plan. There is a wide variety of methods used by those plans to calculate the reimbursement to the university for services provided. The following are some examples:

- University of California at Los Angeles - Reimbursement to the University for services represents approximately 30 percent of the plan's expenditures and is based on a general overhead allocation plan.

- University of Colorado - The University was reimbursed for each service based on a negotiated rate for each service (payroll processing, telephone, etc.). These rates ranged from one percent to one and one-half percent of the related expenditures.

- University of Missouri - The practice plan is charged 0.25 percent of total gross revenues for indirect costs such as equipment use, payroll processing, and purchasing services provided by the University.

Only Three (27 Percent) of the Public Universities we Surveyed Received Appropriations Specifically Designated as Clinical Teaching Support

Since fiscal year 1984-85, the University's College of Medicine has received an appropriation for clinical teaching support to help cover the costs of hospital training for clinical assistants, medical students, and other health care residents and interns. The College of Medicine contracts with the University Medical Center for the training services provided by the hospital. In fiscal year 1990-91, $9,467,000 of the $44,169,800 appropriated to the University of Arizona's College of Medicine was designated for clinical teaching support.

Two of the universities we surveyed (Johns Hopkins University and Northwestern University) were private institutions and, as a result, did not receive any appropriations from the state. Our survey indicated that five percent of the University of Washington's teaching hospital budget is appropriated by the state; however, amounts are not restricted by line item and may be spent as needed. Also, state appropriations for the University of Michigan's College of Medicine is approximately six percent of the University's appropriations but are not designated for a particular purpose. Our survey also revealed that if clinical teaching support appropriations were not received, such support was generally paid from hospital revenues. The following are two examples of universities that received appropriations which included clinical teaching support.

- Oregon Health Sciences University - Approximately 20 percent of budgeted expenditures for the medical school is for clinical teaching support; however, this percentage has been decreasing as many of these expenditures are being paid by the dean's tax monies.

- University of California at San Diego - Approximately $10 million of the College of Medicine's budget of $170 million is allocated for clinical teaching support.

Participation of Full-Time Clinical Faculty was Required in Over 92 Percent of the Plans Surveyed

For all of the universities we contacted, we found that participation in the plan was restricted to faculty physicians and 92 percent of the faculty practice plans required mandatory participation of its full-time clinical faculty. AAMC reported in its 1989 survey that participation of full-time clinical faculty was required by 96 percent of responding plans.

OTHER PERTINENT INFORMATION

UPI Had a $45 Million Fund Balance at June 30, 1992

Based on a review of UPI's audited financial statements for the years ended June 30, 1991 and 1992, we noted that UPI's fund balance increased from $42,435,304 to $45,271,005. We also noted that cash and investments increased from $24,350,658 to $30,188,338. Based on conversations with UPI officials, the monies are being accumulated to finance a new ambulatory care facility. However, these monies were not restricted by the Board of Directors for such a purpose at June 30, 1992. According to the Board of Regents staff, they are aware of UPI's significant fund balance. Copies of UPI's financial statements are submitted to the Board of Regent's resources committee as an informational item, but, current Medical Service Plan language does not require the Board of Regents to act upon or approve any fund balance accumulation.

APPENDIX A

We determined that the following cost pools provided a substantial benefit to UPI.

Cost Pools

Fee Waivers-Graduate Teaching Assistant/ Graduate Research Assistant
Building and Improvement Use Allowance
Equipment Use Allowance
Physical Plant - Building Specific
Physical Plant - General
Facility Design and Construction Services - General
Attorneys - Personnel/Government Related
Attorneys - Property Related
Attorneys - Procurement/Purchasing
Center for Computing and Information Technology - Administrative Computing
Systems Control
Personnel - Employee Relations/ Benefits/Training
Personnel - Compensation
Personnel - Employment
Personnel Services Administration
Senior Vice President - Finance and Administration
Senior Vice President - Academic Affairs
Budget Office - Plant Funds/Equipment
Budget Office - Plant Funds/Building
Center for Computing and Information Technology - Computing and Telecommunications
Stores
Printing and Reproduction
Student Publications
Garage
Student Union
Animal Resources
University Instrument Shop
Biomedical Communications
Radiation Safety - Radiation Waste/Disposal

Cost Pools

Radiation Safety - Approval Holders
Security - General Protection
Security - Building Specific
Security - Money Escorts
Risk Management and Safety Property Insurance
Risk Management and Safety Property Records-Buildings
Risk Management and Safety Property Records-Equipment
Risk Management and Safety Hazardous Waste/Disposal
Risk Management and Safety Insurance Management/Safety
Asset and Land Management - Leases and Management
Asset and Land Management - Land Related/Miscellaneous
Purchasing - Purchasing and Receiving - Medical Campus
Purchasing - Purchasing and Receiving - Main Campus
Purchasing - Surplus Property
Management Analysis and Research - Space Allocation
Controller - Payroll
Controller - Accounts Payable
Controller - Travel
Controller - General Accounting
Controller - Agency Funds
Controller - Plant Funds/Equipment
Controller - Plant Funds/Buildings
Controller - Cashiering
Graphics/Photography
Radiation Safety - Room Monitoring
Radiation Safety - University Support
Radiation Safety - Machine Calibration

The direct cost associated with these pools was $1,571,508 of the $1,747,417 allocated to UPI.

APPENDIX B

We determined that the following cost pools did not provide a substantial benefit to UPI.

Cost Pools	Cost Pools
Arizona Board of Regents and Statewide Cost Allocation	Fee Waivers - Faculty-Staff
Vice President - University Relations and Development	Asset and Land Management Investment Office/General
President	Public Information - General
Alumni Office - University Relations	Management analysis and Research - All Funds
	Development Office - University Relations

The direct cost associated with these pools was $175,909 of the $1,747,417 allocated to UPI.

APPENDIX C

Methodology and Scope for the Dean's Tax Review

In order to determine if the four percent dean's tax was being calculated correctly, we reviewed all UPI revenue categories that are considered professional income. Specifically, UPI by-laws define professional income as follows.

1. Professional income consists of all collected fees derived from the diagnosis and treatment of patients by the member or employee or consultant.

2. Professional income also includes indirect health care services including, but not limited to, court appearances and malpractice or disability evaluations rendered on behalf of patients the member cares for or has cared for professionally.

3. Professional income also includes compensation for medical administrative positions.

During our examination of the dean's tax calculation at UPI, we noted that not all of the monies were being remitted to the College of Medicine. Instead, the Dean of the College of Medicine authorized expenditures from the dean's tax monies by UPI. As a result, we performed a detailed analysis of a sample of the expenditures from the dean's tax monies for fiscal years 1989-90 and 1990-91 to identify any expenditures that did not appear to be for the benefit of the College of Medicine. All supporting documentation was reviewed. In addition, we contacted University officials to obtain any additional explanations for these expenditures.

Methodology and Scope for Review of the Indirect Cost Study

The University of Arizona Controller's Office - Rate Studies Department, in conjunction with KPMG Peat Marwick, developed a cost determination model. The methodology used by the University to develop the cost determination model was similar to the methodology contained in the Federal Cost Principles for Educational Institutions (OMB Circular A-21). Beginning in 1987, the University used the model to identify those costs that were not readily identifiable to a particular institutional activity, were incurred for a common or joint objective, and supported all facets of the institution. Similar costs were grouped into cost pools. Expenditures of these cost pools were allocated to departments and outside organizations based on usage. Of the 99 cost pools identified by the University, expenditures of 65 pools were allocated to UPI for a billable amount of $1,747,417.

We performed the following procedures to determine the reasonableness of the amount billed.

- We examined the methodology used to allocate expenditures for all of the cost pools included in the UPI calculation.

- We examined detailed financial data for the four largest cost pools (based on dollars) included in the study since they would have the greatest effect on the amount billed. The four largest cost pools were Building and Improvement Use Allowance, Equipment Use Allowance, Physical Plant - Building Specific, and Center for Computing and Information Technology - Administrative Computing.

- We selected an additional 11 pools that appeared questionable as to inclusion in the UPI cost allocation plan. The 11 additional pools evaluated were Fee Waivers, Facility Design and Construction Services - General, Attorneys - Personnel/Government Relations, Purchasing - Surplus Property, Senior Vice President - Finance and Administration, Senior Vice President - Academic Affairs, Management Analysis and Research - All Funds, Center for Computing and Information Technology - Computing and Telecommunications, Student Union, Graphics/Photography, and Alumni Office - University Relations.

The examination included analyzing financial data and conducting interviews with University and UPI personnel. The 15 cost pools we examined represented $1,383,340 or 79 percent of the amount billed to UPI.

We also conducted interviews with personnel from several other departments to evaluate whether the level of benefiting activities changed significantly since the study was prepared.

February 25, 1993

Mr. Douglas R. Norton
Auditor General
2700 North Central, Suite 700
Phoenix, AZ 85004

Dear Mr. Norton:

As we discussed during our last meeting on February 23, 1993, The University of Arizona and University Physicians, Inc., as two separate organizations, have decided to respond jointly to the issues addressed in the Special Study your office performed of the College of Medicine and University Physicians, Inc. Our comments are as follows:

a. First bullet, page 5, incentive payments...

There were three instances of incentive payments to physicians, as noted below:

1. Incentives totaling $60,000 were paid over three fiscal years to the new Chairman of a clinical department. These incentives were paid as part of the recruiting of the Department Head, and were included in the letter of offer. The financial status of this department at the time of recruitment would not permit payment of a clinical salary sufficient to attract the candidate selected by the search committee. In the absence of other funding sources, paying an incentive from funds held by UPI for the use of the Dean, greatly benefited the College of Medicine. It allowed us to recruit an outstanding Department Head whose leadership has enhanced the academic and financial success of this critical department.

2. Incentives totaling $22,474 over a period of two years were paid from funds held by UPI for the Dean to a faculty member in a clinical department. The payment is the result of a personnel action settlement. This agreement in 1986 was developed as part of the transition to a new headship for the Department. The settlement insured that no future action of law would occur. This saved The University of Arizona and College of Medicine thousands of dollars in legal fees and potential court actions. For these reasons, the former leadership of the College and University felt this was justified, and was considered to be a benefit to the College of Medicine and University.

3. Payment of $12,068 to a faculty member in another department was part of a resolution of a personnel action, using this same funding source. This was done to avoid any further actions against the College or The University of Arizona. The payment avoided potential legal proceedings and benefited the College of Medicine.

b. Second bullet, page 5, expenditures for food...

The University concurs with the observation.

c. Third bullet, page 5, UPI attorney expenses...

The University and UPI concur with the observation. The individual involved was not performing legal services for the college in the capacity of an attorney but was facilitating risk management for our residents for the benefit of the College and The University of Arizona. This service is not provided by The University of Arizona Risk Management Office.

d. Fourth bullet, page 5, malpractice insurance payments...

The University concurs with the observation and has taken steps to insure that these funds are not used for this purpose in the future.

e. Fifth bullet, page 5, charitable contributions...

The University concurs with the observation. We would also like to note that some of the expenditures were for purposes other than charitable contributions and constitute memberships or support of a student lecture series.

f. Recommendation 1, page 8, Dean's tax calculation base...

The University and UPI concur with the recommendation and have taken steps to insure that in the future the calculation is done in accordance with the Medical Service Plan of 1985.

g. Recommendation 2, page 8, remission of Dean's tax moneys...

The University and UPI concur with the recommendation and have taken steps to insure that remission of the tax is done in accordance with the Medical Service Plan of 1985.

h. Recommendation 1, page 12, use of University cost study...

The University concurs with the recommendation and will use the University cost study as the base for the future, allowing consideration of the rates outlined in the negotiated indirect cost proposal approved by the U.S. Department of Health and Human Services.

UPI does not concur with this recommendation. UPI as a separate, private corporation is not properly subject to indirect cost allocations within the University system. UPI presently has a four year contract with the University under which it pays an agreed upon amount based upon the services it receives from the University. UPI agrees that in future negotiations of this contract it will consider the cost proposal approved by the U.S. Department of Health and Human Services.

Both UPI and the University of Arizona recognize that UPI provides services to the benefit of the College of Medicine. While these have not been fully documented and validated, they would constitute an offset, upon documentation and validation, to The University of Arizona cost study. Further, the contribution by UPI to the University of Arizona has increased per the University audited financial statements, from $797,075 in FY 91, to $1,089,857 in FY 92, clearly demonstrating UPI's intent to deal with the University in a reasonable and equitable manner.

i. Recommendation 2, page 12, University billing base...

The University concurs with the recommendation as presented in the study.

The UPI does not concur with this recommendation as it is stated. As pointed out earlier, UPI is a separate, private organization not properly subject to an allocation of the University's indirect costs. However, UPI is in complete agreement that it should pay fairly for those services provided to it by the University. It is presently doing so under a written contract with the University. It will consider carefully in any renegotiation of that contract the concerns suggested by the recommendation.

j. Other Pertinent Information, page 19, Fund Balance, UPI...

UPI has furnished separate documentation on the uses, ownership and intended purposes of their fund balance. Essentially, the preponderance of fund balance is owned and controlled by twelve group practice departments. It is used to fund daily clinical operations; such as salaries, malpractice insurance, equipment and support staff. It is also used to pay for teaching and research services not available through the State system and to support core academic programs of the corresponding College of Medicine department. Recently, for example, $2.2M of the UPI physician group practice fund balance was used to support construction of research laboratories in the Steele Memorial Children's Research Center.

Current cash accumulations are targeted towards renovation, expansion and replacement of outmoded clinical facilities. This will significantly improve teaching and instructional opportunities for College of Medicine students and post graduate medical residents, as well as enhance patient care services.

Sincerely,

Bert G. Landau
Associate Vice President for Finance
& Controller, University of Arizona

Paul Capp
Paul Capp, M.D.
President, University Physicians, Inc.