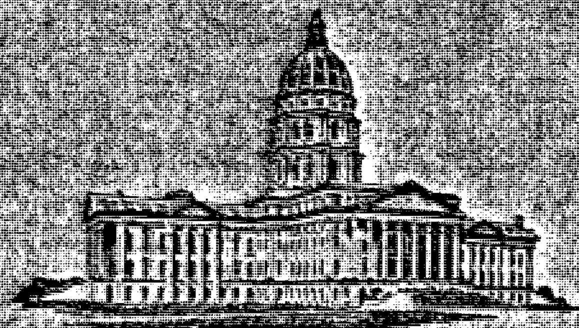

AUDIT REPORT

PHYSICIANS' CORPORATIONS AT THE UNIVERSITY OF KANSAS MEDICAL CENTER

A Report to the Legislative Post Audit Committee

LEGISLATIVE DIVISION OF POST AUDIT

State of Kansas

Topeka

September 1978

LEGISLATIVE POST AUDIT COMMITTEE

The Kansas Legislature created the Legislative Division of Post Audit in 1971 and charged it with the responsibility of auditing State agencies. The Division is headed by an appointed Legislative Post Auditor, and it reports the results of its work to the Legislative Post Audit Committee, a bipartisan legislative committee.

Through its audit work, the Division provides the Legislature with information for evaluating the work of State agencies. This information helps the Legislature decide what should be done to bring high-quality services to Kansans in the most effective and economical manner.

Legislative Post Audit performs its work in the following ways.

1. The Division reviews the financial affairs and operations of each State agency. By law, an audit of each agency must be conducted at least once every two years. During these audits, Legislative Post Audit conducts such examinations and tests as are deemed necessary to determine whether receipts have been accounted for and deposited, whether State funds have been spent for the purposes the Legislature authorized, and whether the requirements of law have been met in such areas as accounting systems, records, and agency rules and regulations. The Division also reviews other aspects of an agency's operations to determine whether the State's laws, policies, and programs are being carried out effectively, efficiently, and economically.

2. At the direction of the Legislative Post Audit Committee, the Division reviews and assesses particular State programs. These reviews address such matters as how effectively and efficiently a program is meeting its goal.

The Legislative Post Audit Act directs the Division to conduct its audit work "according to accepted auditing standards." As its professional guidelines, the Division uses the publication, *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*, issued in 1972 by the Comptroller General of the United States in consultation with state and local finance officials and such related professional organizations as the American Institute of Certified Public Accountants.

Legislative Post Audit presents its findings in two kinds of reports—agency audit reports and program audit reports. The reports often contain recommendations that range from relatively small adjustments in agency operations to full-scale revampings of major programs. These recommendations are referred to the Legislative Post Audit Committee for consideration. Through the independence given to the Division by the Committee and by the provisions of law, and through the independent and rigorous nature of its audit and review procedures, Legislative Post Audit strives to produce findings and recommendations that are impartial, objective, and useful to the Legislature and the people of Kansas.

LEGISLATIVE DIVISION OF POST AUDIT

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PHYSICIANS' CORPORATIONS AT THE UNIVERSITY OF KANSAS MEDICAL CENTER

September 12, 1978

Legislative Division of Post Audit
State of Kansas
Topeka

FOREWORD

Perhaps the most complicated relationship between the State of Kansas and any people working for it is the State's relationship with the physicians who teach at the University of Kansas Medical Center. These physicians work full-time at the Medical Center, but they work only part-time for the State. Part of their time is spent in teaching and research; part is also spent in private medical practice within the Medical Center. The physicians are organized along departmental lines into corporations, and legal contracts between the 15 corporations and the University define the relationship between physicians' private practices and their responsibilities to the Medical Center.

The Legislative Division of Post Audit conducted this program audit to assess whether this contractual relationship between the physicians and the University was an effective way to operate the School of Medicine. It became apparent during the audit, however, that because the relationship was complicated--and perhaps frequently misunderstood--the final report should not only assess the relationship but also spend considerable time explaining it. Three chapters of the report are devoted largely to explaining how physicians' corporations developed, how the revenue generated in physicians' medical practices is used, and how physicians spend their time among their various responsibilities. This information should give those not closely associated with the Medical Center a clearer understanding of how the relationship works--and in the process, an awareness of its advantages and disadvantages.

The current relationship has several advantages. Through their medical practices, physicians at the Medical Center provide a greater part of the total revenue for operating the School of Medicine than do physicians at medical schools in neighboring states. The present structure of independent corporations provides advantages and incentives that may encourage physicians to generate high revenues. The physicians apparently earn this higher amount of revenue by working more hours, not by reducing the amount of time they would be expected to spend teaching and conducting research. At the same time, however, Legislative Post Audit's review found a number of issues and problems within the relationship that revolve around a common conclusion: contracting with 15 different corporations poses difficulties for the effective management of the Medical Center. These difficulties range from procedural matters--for example, confronting a hospital patient with as many separate bills as there are corporations represented by the physicians who treat that patient--to such larger issues as the Medical Center's ability to shift funds to help meet its goal of supplying more primary care physicians for the State.

The present contracts will remain in effect until 1980. If the Legislative Post Audit Committee and the Legislature wish to address some or all of the problems outlined in the current relationship, the two best alternatives appear to be directing the University to solve the problems by renegotiating 15 contracts or directing the University to negotiate a single contract with all physicians and departments--in essence, creating a single physicians' corporation. There are advantages and disadvantages to each approach. Most physicians will likely prefer the existing structure of 15 corporations to a single corporation; as a result, retaining that structure will probably produce smoother negotiations. At the same time, such important issues as overhead rates, unified billing for all departments, and meaningful transfer of funds for development can be less easily addressed and solved under the existing structure of so many corporations and contracts.

A "Summary of Matters for Legislative Attention" follows this foreword. It contains the report's major findings and conclusions, its recommendations, and a summary of the University's response to the recommendations contained in the draft report. Throughout this audit, officials of the University have been most helpful in supplying information and have demonstrated a great concern for solving any problems that exist in the current relationship. Their assistance during the audit is greatly appreciated.

Richard E. Brown

RICHARD E. BROWN
Legislative Post Auditor

Summary of Matters for Legislative Attention

Audit Findings and Conclusions

This program audit examines the relationship between the University of Kansas and the physicians in the clinical departments of the University's School of Medicine. These physicians teach and conduct research, and they also maintain private medical practices at the Medical Center. Within the various departments, they are organized into 15 corporations, and their relationship to the University is defined in contracts negotiated with the University. This report explains and assesses this contractual relationship. More specifically, it addresses these questions:

1. What is the current relationship between the physicians and the Medical Center, and how did it come about?

2. What is the financial relationship between the corporations and the Medical Center? What happens to revenues generated by the corporations through their members' medical practices at the Medical Center, and how is this revenue related to other sources of funds?

3. How do members of physicians' corporations discharge their obligations to teach medical students?

4. What issues within the current relationship need to be addressed by the Legislature, and what alternatives are available for making changes the Legislature may wish to make as a result of its assessment of that relationship?

Legislative Post Audit selected six of the 15 corporations for in-depth review. The six are the corporate organizations of the departments of anesthesiology, gynecology and obstetrics, medicine, pediatrics, radiology, and surgery. Together, they account for a large majority of all revenue received from patients by physicians' corporations, and they represent the diversity the corporations show in their contractual relationship to the University. They also demonstrate the wide differences corporations show in their ability to generate revenue from their members' medical practices.

Development of Physicians' Corporations at the Medical Center

Although the current contracts between the Medical Center and the physicians' corporations were not signed until 1975, in many ways they are the result of a relationship that has been developing for approximately 30 years. During this time, the relationship has grown more formal and more clearly defined. Many of the changes were attempts to solve problems that developed, and most of them have been the result of administrative decision and direction, not legislative action.

Beginning in 1948, a faculty was recruited that taught part-time, conducted research, and maintained private medical practices at the Medical Center. Various agreements defining the relationship between the physicians and the Medical Center then developed over the years. In the early 1960s, physicians began organizing into associations that pooled revenue from their patients and paid salaries from the combined income. When laws were passed in 1965 allowing corporate medical practice in the State, most of the associations became legal corporations and thus acquired such benefits as limited professional liability, tax shelters, and corporate pensions.

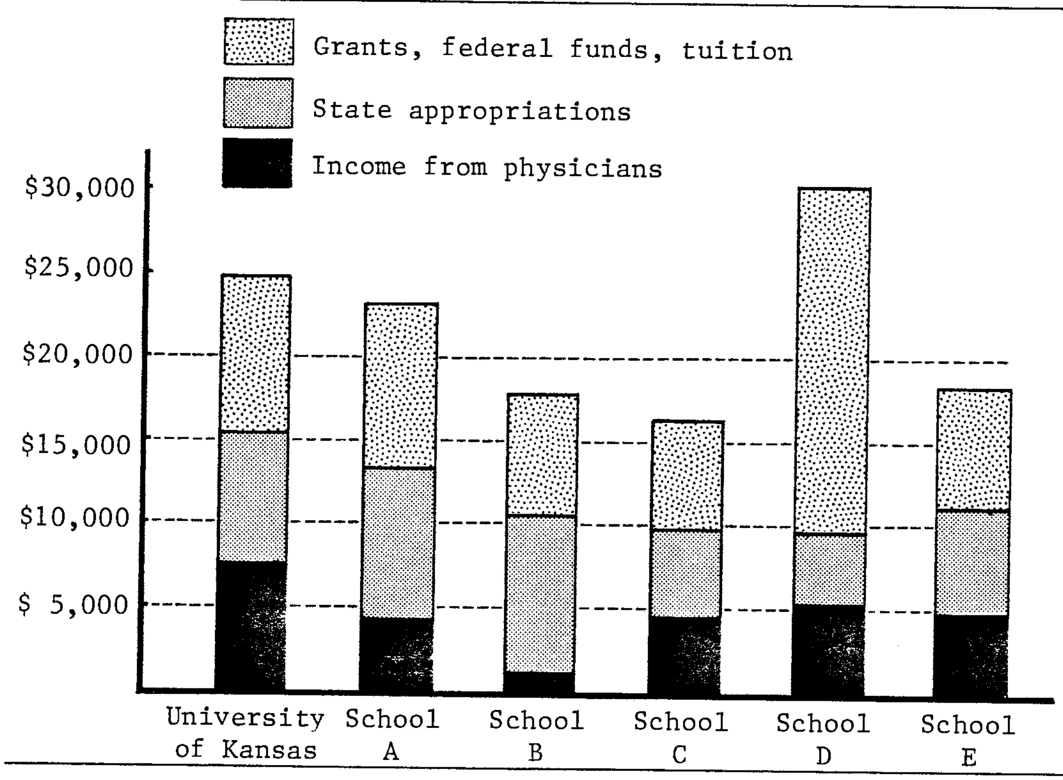
Legal contracts between the physicians' corporations and the Medical Center were signed in 1975, following questions about the use of private practice fees in one of the departments. These contracts make both sides' obligations more formal and more explicit. They will remain in effect until 1980, when they will be renegotiated.

The Financial Relationship Between the Physicians' Corporations and the Medical Center

An important aspect of the current contractual relationship is the revenue physicians generate in their medical practices. This revenue provides a greater part of the total funds for operating the School of Medicine than does revenue generated by physicians at medical schools in neighboring states, as the figure on the next page shows. The figure also shows that Kansas spends more as a whole to educate its medical students than do most neighboring states. The amount of State appropriations per student is also higher than most of the other states.

The physicians' corporations vary greatly in their ability to generate revenue. Corporations whose members are in medical specialities such as surgery generate considerably more revenue per department member than corporations whose members are in primary care fields such as pediatrics. In turn, members of higher-earning

Projected Expenditures per Student(a)
University of Kansas Medical Center and
Five Regional Medical Schools(b)
Fiscal Year 1977



(a) Includes all students taught by medical faculty. Totals were weighted, however, to reflect the actual expense of educating different types of students.

(b) To protect the confidentiality of certain information in the audit, schools other than the University of Kansas are not identified by name.

corporations have higher average salaries than members of the lower-earning corporations. In the four specialized departments examined, average salaries ranged from $47,487 to $58,138 in fiscal year 1976, while average salaries in the two primary care fields examined were $31,299 and $38,028. Fringe benefits, which are paid largely out of corporate revenues, likewise varied with a corporation's earning power. In the four specialities, average benefits ranged from $10,802 to $13,532 in fiscal year 1976, while average benefits in the two primary care fields were $4,017 and $4,075. The differences in earning capacities reflect similar differences at other medical schools and in the private practice of medicine.

Revenue generated by physicians' corporations is used for purposes other than salaries. Part is retained by the Medical Center as payment for overhead, part goes to pay other expenses of the corporations, and part is deposited with the Kansas University Endowment Association in development funds to purchase equipment and pay the salaries of additional personnel. With regard to these other uses of corporate revenues, the audit found that the Medical Center does not have an effective way to determine whether overhead payments by the physicians' corporations cover actual overhead expenses. The amounts to be deducted for overhead expenses are established by contract, vary by corporation, and are not tied to any determination of actual overhead expenses. The audit also found that the corporations paid considerably more into development funds than the minimum specified by contract. The contracts specify a minimum of 11 percent of gross income; collectively the six corporations paid at least 35 percent during the years examined. Most of the money paid into development funds is used by the corporation depositing the money. Higher-earning corporations pay in more money than lower-earning corporations and thus have more revenue available for purchasing equipment and hiring personnel.

The Educational Role of the Physicians' Corporations at the Medical Center

To determine how the members of physicians' corporations divided their time between the various duties of teaching, research, and patient care, Legislative Post Audit surveyed them and compared the results to national averages developed from a similar survey. Members of physicians' corporations reported working an average of eight more hours a week than the national average (60 hours, as compared with 52), and they reported spending most of this additional time seeing private patients, many of whom were also used in their teaching activities. Corporate faculty members reported spending an average of 32 hours per week in direct teaching and in research and patient care activities that involved teaching; the national average was 22 hours per week.

To provide some measure of the education at the Medical Center, Legislative Post Audit compared the performance of the Medical Center's students with the performance of students at other medical schools. The comparisons, which were based on students' scores on national examinations and on the percentage of students repeating course work, were not conclusive because of the Medical Center's problems with an accelerated curriculum and because of a previous lack of emphasis on national examinations at the Medical Center. For the years reviewed, however, the median score at the Medical Center was below the national median, and more students at the Medical Center had to repeat course work than the national average. As the Medical Center accustoms itself to a four-year curriculum and a requirement that students pass national examinations to graduate, these measures of performance should become more useful.

Issues for Legislative Attention Within the Current Relationship

Over the past 30 years, the University has assumed greater powers of management over the revenues and activities of the physicians, but through the mechanism of the physicians' corporations, it has still allowed the physicians a large degree of independence and autonomy. The current contractual relationship appears to have several important benefits for the State. The most important of these benefits can be summarized as follows:

1. Physicians at the Medical Center provide a greater part of the total revenue for operating the School of Medicine than do physicians at medical schools in neighboring states. The corporate structure offers advantages to physicians that may encourage them to generate high revenues. This high earning power reduces the need for State appropriations within the current level of total spending for the School of Medicine.

2. The physicians apparently earn this higher amount of revenue by working more hours, not by reducing the amount of time they would be expected to spend teaching and conducting research.

The audit found, however, that several issues in the current relationship between the University and the physicians' corporations merit legislative attention. Briefly described, these issues are as follows:

Duplication of Social Security payments. Because the physicians have two employers, the State and the corporation, employer contributions for Social Security are duplicated. These duplicate payments cannot be recovered. For fiscal year 1976, the duplication was approximately $50,000.

Inadequacies in control of property. Under the existing contracts, equipment purchased through department development funds becomes State property. These development funds are outside the State's accounting system, however, and when equipment is purchased it is not effectively subject to inventory controls that are a part of the accounting system. The Medical Center has improved its inventory system by updating inventory records annually, but further changes are necessary to ensure that new items are recorded and tagged as soon after receipt as possible.

Receipt of multiple bills by hospital patients. Physicians' corporations use several different methods to bill and collect their fees. As a result, hospital patients can receive bills from a number of different corporations. This practice can be confusing to patients, especially to those who may not understand their separate obligations to the various doctors who treat them.

Difficulties in making funds visible for review. The different kinds of funds used at the Medical Center are subject to different levels of review. Some, like State appropriations, enter the budgeting and accounting systems in such a way that they are directly controlled by University officials. Expenditures from department development funds do not enter these systems but require the approval of University officials. The corporations' own expenses other than salaries are not subject to University approval but are reviewed and are audited annually. Although this diversity offers a great deal of flexibility in spending funds, it is not as effective from a managerial point of view as a system under which all expenditures could be more easily controlled and traced.

Difficulties in distributing funds to meet educational goals. Under the current contracts, corporations in specialized fields have more money for development than corporations in primary care fields. The Medical Center does not have the authority to move large sums of corporate revenues across departmental lines. The present contractual relationship may thus hamper the Medical Center's ability to devote more financial resources to such problems as the shortage of primary care physicians in the State.

If the Legislative Post Audit Committee and the Legislature decide that changes should be made in the relationship between physicians and the University, they could consider directing the University to follow one of these alternatives:

1. Eliminating physicians' corporations entirely.
2. Adjusting contracts during negotiations to make the desired changes.
3. Negotiating a single contract with all physicians and all departments--in essence, creating a single physicians' corporation.

Eliminating physicians' corporations or reducing them to one would have several advantages from the standpoint of improved management of the Medical Center. A single overhead rate could be negotiated, a single billing service could be more easily developed, and development funds could be more easily transferred across departmental lines. Changes could be made using the existing structure of 15 corporations, but some of these changes would be harder to bring about.

Changes in the existing structure of physicians' corporations are not without potential disadvantages. Turmoil and faculty turnover might occur, and some physicians' revenues available to the Medical Center might be lost because physicians could have less incentive to generate revenue or because non-corporate status would mean fewer tax shelters and greater loss of revenue to taxes. Eliminating corporations entirely would probably cause the most problems; making changes within existing contracts would probably cause the fewest.

Audit Recommendations

If the Legislative Post Audit Committee decides that the current contractual relationship between the University and the physicians' corporations should be changed, it should consider directing that the University, acting in conjunction with the Board of Regents, develop a plan for making the desired changes either by strengthening the current contracts or by contracting with one corporation or one "umbrella" corporation. Such a plan should be submitted to the Legislative Post Audit Committee within a time specified by the Committee. At the Committee's direction, the plan should address the following items:

Establishment of overhead rates. Methods should be established to develop overhead rates that are directly related to actual overhead expenses. These rates should be reviewed annually by University officials and adjusted as necessary to meet actual expenses.

Improvements in corporate budget procedures. A corporate budget should be established for each corporation and should be approved by the Executive Vice Chancellor and the Chancellor. The budget should not be exceeded unless the corporation demonstrates that unforeseen circumstances have arisen and that it has funds available. Approval by the Executive Vice Chancellor and the Chancellor should be required if the budget is to be exceeded. In addition, monthly expenditure reports should be submitted for review.

Establishment of a single billing service. Charges for physicians' services should be handled by a centralized billing operation that would include all physicians' charges in one bill. Hospital charges should continue to be billed by the Hospital Billing Department.

Improvement in oversight of physicians' salary ceilings. To help ensure compliance with the salary ceiling established for the practice of medicine on a continuing basis, corporation members should keep records of all such income, including that earned outside the Medical Center, on file in the corporation offices. These records should be made available for audits by independent auditors or by the Legislative Division of Post Audit.

Visibility of department development funds. To ensure greater visibility of department development funds, budgets for each fund should be developed and should be submitted to the Legislature for its information as part of the University's annual budget process. The budgets should include expenditures for the previous fiscal year and projected expenditures for the current and coming fiscal years.

Greater flexibility in distributing funds. The University's financial flexibility to meet the educational goals of the Medical Center should be increased. Possible alternatives include the following:

--Expanding the current practice of channeling State appropriations to low-earning corporations or to key programs and requiring higher-earning corporations to support themselves even more fully than at present.

--Expanding the portion of department development funds made available to the Chancellor for redistribution, perhaps from the current one percent of corporate income to five percent.

Improvement in inventory procedures. The University should take additional steps to ensure that equipment purchased with department development funds is recorded and tagged as soon after purchase as possible.

Membership on the board of a single corporation. If one corporation is the preferred alternative, one or more members of the governing body should be appointed by the Chancellor. These members of the governing body should not be members of the corporation.

Agency Response to Audit Recommendations

The draft report was sent to the University of Kansas for review. This procedure is followed in the preparation of all audit reports and offers an opportunity for the agency to point out any errors of fact, to provide information pertaining to the audit's findings, and to indicate its agreement or disagreement with the recommendations. The response was signed by the Chancellor of the University. The text of the University's response to the recommendations will be found in Appendix B. The following is a summary of the response to the recommendations.

Strengthening current contracts or contracting with one corporation. "We believe that if we were starting from scratch," the response said, "it might be possible to form a single corporation." The response said, however, that an attempt to do so now would be harmful because it would have the following effects: an "unusual amount of disruption," including the loss of physicians; a reduction of incentive and a resulting reduction in corporate revenues; an increasing dependence on State funds; and possible tax problems for the single corporation.

The response stated that the University would seek improvements under the existing system of contracts with 15 corporations. "We do believe it is appropriate," it said, "to seek ways of strengthening the contractual relationships between the corporations and the University, and we plan to do so when the contracts come up for renewal in 1980. We hope, therefore, that the decision by the Legislative Post Audit Committee will be to approve this plan rather than mandating the formation of a single corporation."

Establishment of overhead rates. The University agreed with the recommendation and said the Office of Business and Fiscal Affairs was developing an annual review process to provide for adjusting overhead rates so they would meet actual expenses.

Improvements in corporate budget procedures. The University agreed with all aspects of the recommendation and said it would take steps to comply.

Establishment of a single billing service. The University agreed with the recommendation but said it should not proceed with putting it into effect. The response pointed to difficulties in dividing partial payments between corporations and said major efforts would be needed in planning, system design, and computer programming. "We have been looking into this matter for some time and intend to keep trying to work toward a single billing service for the convenience of our patients. However, for the time being we believe we should maintain the present system until we have resolved the problems involved in changing to a single billing service," the response said.

Improvement in oversight of physicians' salary ceilings. The draft report recommended that salary ceilings be set on a fiscal year basis and that copies of tax returns be filed in the corporate office for an auditor's review. The University disagreed. A discussion with University officials during the University's review of the draft report showed that the problem addressed by the recommendation could be solved more simply by having physicians keep copies of records of all income relating to the practice of medicine on a continuing basis on file in the corporate office. As a result, this recommendation was changed in the final report.

Visibility of department development funds. The draft report recommended that corporate earnings now deposited in department development funds be deposited instead in a State restricted fee fund for greater visibility and more effective budget review. The University disagreed with the recommendation. It said the proposed change would reduce physicians' incentive to generate additional revenue and would cause difficulties in purchasing highly specialized medical equipment as soon as the equipment was needed. The response also said improved controls over development funds had been established. Because the reason for the recommendation was improved legislative oversight of expenditures and not full State control of development funds, Legislative Post Audit modified the recommendation. It now calls for the development of annual budgets for each department development fund and for these budgets to be submitted as information to the Legislature during the University's annual budget process.

Greater flexibility in distributing funds. The draft report recommended a redistribution of corporate revenues within the framework of a State restricted fee fund. The University's response did not address this recommendation. The recommendation has been modified because the report no longer recommends that development funds be deposited in a restricted fee fund. Instead, the recommendation lists two alternatives for legislative consideration in making department development funds more available to meet the educational goals of the Medical Center.

Improvement in inventory procedures. Under the recommendation in the draft report calling for development funds to be placed in a State restricted fee fund, all equipment would have been entered on the inventory when it was received. The change in the recommendation produced the need for this new recommendation.

Membership on the board of a single corporation. The University agreed with the recommendation but restated its preference that a single corporation not be formed.

Matters Remaining for Legislative Attention

The audit report recommends two basic alternatives for consideration if the Legislative Post Audit Committee wishes to make changes in the current contractual relationship between the University and the physicians' corporations: creation of a single physicians' corporation or negotiation of changes within the existing framework of 15 corporations. The Legislative Post Audit Committee needs to review these alternatives.

The University has agreed with several of the recommended changes in the current contracts. Several recommendations with which the University disagreed have been modified but still meet the intent of the original recommendations. The Legislative Post Audit Committee needs to determine the University's intent regarding these modified recommendations. The Committee also needs to decide which of the issues, if any, it wishes the University to address in contract negotiations with the physicians at the Medical Center.

TABLE OF CONTENTS

CHAPTER I

INTRODUCTION

The University of Kansas College of Health Sciences and Hospital, known generally as the Medical Center, is one of the most complex organizations sponsored by the State. It contains schools of Medicine, Nursing, and Allied Health, and it conducts a wide variety of research activities relating to its role as an educational institution. It contains one of the largest hospitals in the Kansas City metropolitan area. It also includes a branch campus in Wichita and a variety of other programs in various parts of the State. Money to run the Medical Center comes from many different sources--State appropriations, federal grants, hospital charges, physicians' fees, tuition, and others. In fiscal year 1977, total expenditures were $72.6 million.

The Legislative Post Audit Committee directed the Legislative Division of Post Audit to conduct a program audit analyzing the relationship between the Medical Center and the organizations of physicians who teach in the clinical departments of the School of Medicine. There are 15 such organized physicians' groups within the Medical Center; 14 of these are chartered corporations providing services under contracts with the University. The Legislative Post Audit Act provides for audits of State programs as a basis for evaluating their efficiency and effectiveness and for recommending improvements. The Act also authorizes audits relating to "the contract relationships and the fiscal records related thereto of any (corporation) that contracts with the state."

Scope and Objectives of the Audit

This audit evaluates the effectiveness of the contractual relationship between the physicians' corporations and the University of Kansas. This relationship is a complicated one, made so by the many responsibilities of the physicians at the Medical Center, the complex handling of funds from many different sources, and the number and diversity of the corporations themselves. As a result, this report actually has two basic purposes: to explain the relationship between the Medical Center and the physicians' corporations, and then to assess that relationship. More specifically, the report develops answers to the following questions:

1. What is the current relationship between the physicians and the Medical Center, and how did it come about?

2. What is the financial relationship between the corporations and the Medical Center? What happens to revenue generated by the corporations through their members' medical practices at the Medical Center, and how is this revenue related to other sources of funds?

3. How do members of physicians' corporations discharge their obligations to teach medical students?

4. What issues within the current relationship need to be addressed by the Legislature, and what alternatives are available for making changes the Legislature may wish to make as a result of its assessment of that relationship?

To conduct an audit that would be manageable in scope yet representative of the general relationship between the Medical Center and the physicians' corporations, Legislative Post Audit selected six corporations for in-depth review. The six corporations are the corporate organizations of the departments of anesthesiology, gynecology and obstetrics, medicine, pediatrics, radiology, and surgery. These six corporations were selected for several reasons. First, they account for a large majority of all revenue received from patients by physicians' corporations. Second, they are representative of the diversity the corporations show in their contractual relationship to the Medical Center. And third, they are representative of the wide differences corporations show in their ability to generate revenue from their members' medical practices.

Parts of Legislative Post Audit's analysis also go beyond the six corporations selected for in-depth review. The analysis of the history and development includes all corporations, for example, as does a survey of how physicians spend their time. Legislative Post Audit's recommendations, which are contained at the end of Chapter V, also relate to all physicians' corporations.

Method and Organization of the Audit

For this audit, staff members of Legislative Post Audit conducted a variety of research activities. Statutes, minutes, administrative directives, and other sources were studied to prepare the analysis of the development of corporations at the Medical Center. Many different kinds of records, both for the entire Medical Center and within the six corporations, were analyzed to develop the information on which much of the audit is based. To determine how the physicians spend their time at the Medical Center, Legislative Post Audit developed and administered its own time study.

To compare the organization of the Medical Center with organizations of other medical schools, staff members reviewed many documents and studies by other states, the federal government, and private companies and organizations. Visits were made to five regional medical schools--the universities of Arkansas, Iowa, Missouri, Nebraska, and Oklahoma.

Chapter II of this report discusses the history, development, and general characteristics of the Medical Center's relationship to the physicians' corporations. Chapter III analyzes the financial relationship, and Chapter IV, the educational relationship. Chapter V describes issues in the relationship that merit legislative attention and discusses the alternatives available if the Legislature should decide that changes are necessary.

CHAPTER II

DEVELOPMENT OF PHYSICIANS' CORPORATIONS AT THE MEDICAL CENTER

Although the current contracts between the Medical Center and the physicians' corporations were not signed until 1975, in many respects they are the result of a relationship that has been developing for approximately 30 years. During this time, that relationship has grown more formal and more clearly defined. Informal agreements or policies established by memorandum have given way to legal contracts. Many of the changes were attempts to solve problems that developed, and most of them have been the result of administrative decisions, not legislative direction or intent. To understand the physicians' corporations and their relationship to the Medical Center more clearly, the developments of these 30 years need to be examined.

Development of a Full-Time Faculty

Until 1948--roughly the first 50 years of its existence as a medical school--the Medical Center had few full-time faculty members. Most of the teaching was done by physicians who served part-time and received little if any salary. In 1948, with the approval of the State Board of Regents, the Medical Center began to recruit a full-time faculty that would operate under a "geographic full-time system." Under this system, physicians moved their private practices to the Medical Center. They received faculty appointments, taught part-time, made their patients available for instruction, and received most of their income from fees paid directly to them by their patients. For their services as faculty members, they also received a salary from the State. By 1950, a substantial geographic full-time faculty had been recruited.

The Medical Center soon established financial agreements with the physicians. In 1950, to cover State expenses for space and support personnel, the Medical Center began to require physicians to pay 10 percent of the revenue above $2,500 they received from private patients. Physicians were to pay an additional five percent of this revenue to the Kansas University Endowment Association for funds to expand and improve the departments. These funds were called "department development funds." Expenditures from these funds required the authorization of the department chairman and the approval of the Dean of the School of Medicine. Although changes have been made in overhead payments and department development funds over the years, both are still part of the relationship between the Medical Center and the physicians.

These financial arrangements had been worked out administratively within the Medical Center; minutes of the Board of Regents do not reflect any consideration of the matter at the time. In 1956, however, the Board did take action to endorse the concept of a geographic full-time system and to change the percentage of income collected for overhead and for department development funds. The Board required faculty members collecting their own fees from patients and earning more than $2,500 per year from those fees to remit seven percent to the Medical Center for space and support personnel, and it requested that each of these faculty members make "a voluntary contribution" of 11 percent of patients' fees to the department development fund. In some departments, such as radiology and anesthesiology, it was not practical for physicians to collect their own fees because their services were performed as part of hospital care. The Board directed that physicians in these departments be paid specific percentages of the department's income collected by the hospital. The rest of the income would be retained by the Medical Center to cover overhead costs and to deposit in the department development fund. This "commission" form of compensation is still in effect for several departments. The Board also made formal a number of other agreements that had previously been informal. It stipulated the amount of time that could be spent seeing outpatients, stipulated that all hospital patients be made available for teaching, and stipulated that the portion of a physician's salary paid by the State be set by the Dean of the School of Medicine with the approval of the Chancellor of the University and the Board of Regents.

In 1961, the Board began requiring 11 percent contributions to department development funds rather than making them voluntary. The Board also empowered the Dean of the School of Medicine and the department chairmen to charge additional amounts for overhead or department development, and it stipulated that development funds had to be spent for "purposes of research and development as authorized by the Dean of the School of Medicine."

Development of Department Organizations and Corporations

In the early 1960s, members of departments began organizing into associations. These departmental associations pooled patients' fees and paid salaries to their members from the combined income.

They continued to pay seven percent of the gross income collected to the Medical Center for overhead and at least 11 percent to the Endowment Association for department development funds. They also retained funds within the organizations for such professional expenses as travel, organizational dues, and bookkeeping.

The creation of department associations brought a need for more formal relationships between the physicians and the University. In 1961, the Division of Accounts and Reports decided that a contract would have to be made between the Radiology Association and the Medical Center before the Division could issue State warrants payable to the Radiology Association. The Division also required that such a contract be approved by the Board of Regents. The Board approved it in 1962. This contract, however, was narrower in scope and less detailed than current contracts, stating only that the Medical Center would pay the Radiology Association 50 percent of the fees it collected on behalf of the Association each month.

With the passage of the Professional Corporations Act of 1965 (K.S.A. 17-2701 et seq.), which allowed corporate medical practice in the State, most of the associations became legal corporations. Incorporation provided a number of benefits for the physicians, including limited professional liability, tax shelters, group insurance, pensions, and more efficient operation through centralized management. However, no comprehensive contracts defining the relationship between the Medical Center and the corporations were signed when these corporations were established.

Development of Formal Contracts Between the Medical Center and the Physicians' Corporations

In the 1970s, the University took further steps to provide central administrative control over the spending of funds by the physicians' corporations. In 1973, the Vice Chancellor for Health Affairs (formerly called the Dean of the School of Medicine) issued a directive changing the designated use of department development funds from "research and development" to "education and research." Improper use of the funds was described as use "that cannot be construed as being in the interest of education and research development." Deposits with the Endowment Association in excess of 11 percent had to be made a matter of written record, and requests for expenditures from the funds had to be documented according to the policies of the Endowment Association. The Endowment Association was to accept the Vice Chancellor's approval of an expenditure from a fund as an indication that it was for education and research. The Vice Chancellor also stated that expenses customarily incurred in the conduct of private medical practice were to be paid out of practice income, and he limited the use of "clinical practice" funds retained within the corporations to expenditures that were deductible as business expenses under the income tax laws.

Later in 1973, however, questions arose regarding the use of private practice fees in one of the departments. The matter was reviewed both by the University and by the Legislative Division of Post Audit. The Chancellor directed that legal contracts be developed between the University and the corporations to formalize the relationship and to make both sides' obligations more explicit. These contracts were signed in January 1975 and are to be in effect until 1980. In addition, the Board of Regents took formal action to require regular independent audits of the corporations, to request Legislative Post Audit to perform any other necessary audits, and to place the expenditure of department development funds under the Chancellor's approval.

Current Contracts Between the Physicians' Corporations and the Medical Center

At present, physicians at the Medical Center are organized into 15 physicians' groups. Most of these corporations are similar in that they are legal corporations chartered in Kansas and have a membership composed of physicians from a single department such as pediatrics or pathology. There are exceptions, however, to each of these characteristics. One physicians' group, Associates in Psychiatry, has not become a legal corporation because it contains many members who are not physicians; one group, Ophthalmalogical Associates, is chartered in Missouri rather than Kansas because it was first established there; and one group, the University of Kansas School of Medicine--Wichita Faculty, P.A., is an umbrella corporation that includes members from all Departments at the Wichita Branch of the School of Medicine.

The University of Kansas has a separate contract with each of these 15 groups. The contracts, which were signed in January 1975 and run for five years, cover the following seven topics:

1. Basic obligations of the University and the corporation
2. Legal status of the corporation
3. Property of the University and the corporation
4. Employees of the corporation
5. Liability and insurance
6. Financial records
7. Expenditure of funds

Although the contracts with each corporation cover these same basic areas, the relationships specified between the University and the corporation are not the same in all contracts. Many differences between contracts are the result of different ways that the corporations are compensated for their members' services. Some corporations, such as family practice, collect fees directly from private patients, while others, such as pathology, supply services to private patients as a function of hospital services and have the Medical Center collect the fees. In turn, such corporations receive a percentage of the fees collected. At the Medical Center, the first type is called a "fee-for-service" corporation, the second a "commission" corporation. Nine corporations receive fees for services, three receive commissions from the Medical Center, and three receive a combination of the two. The corporations in each group are as follows:

Fee for Service	Commission	Combination
Ear, Nose, and Throat	Anesthesiology	Internal Medicine
Family Practice	Pathology	Neurology
Gynecology and Obstetrics	Radiation Therapy	Rehabilitation Medicine
Ophthalmology		
Pediatrics		
Psychiatry		
Radiology		
Surgery		
Wichita Faculty		

Despite these differences in the method of compensation for services, the corporations have many similarities. In general, their relationship to the Medical Center can be described in the following ways:

1. <u>Relationship between corporation and department</u>. The structure of the corporation and the department is virtually the same. The president of the corporation is usually the chairman of the department. With few exceptions, only members of corporations may practice medicine at the Medical Center, and only faculty members may be members of a corporation.

2. <u>Sources of salaries</u>. Members of the corporation receive salaries from more than one source. Part of each clinical faculty member's salary is paid from State funds. Most faculty members receive a substantial portion of their total salary from their corporation; many also receive a portion from grants or other sources. The University establishes a ceiling for each physician's salary from the State and the corporation, but it does not guarantee that he or she will receive the total amount. For example, if corporate income from patients is not sufficient to pay the agreed-upon portion of physicians' salaries, the difference is not made up from State money or other sources.

Like other faculty members, physicians may also receive additional income from honoraria and consulting fees--that is, income not directly related to the practice of medicine on a continuing basis.

3. Payment of overhead. Corporations pay, either directly or indirectly, for space, utilities, personnel, and other overhead costs of the Medical Center. Fee-for-service corporations pay seven percent of their gross income from patient fees. The Medical Center retains a negotiated percentage of the fees it collects from patients on behalf of the commission corporations.

4. Payment of department development funds. Corporations contribute a minimum of 11 percent of gross revenue from patients to the Kansas University Endowment Association for department development funds. These funds are used primarily for equipment and for salaries of such employees as nurses, technicians, secretaries, interns, and residents. (These employees are paid from revenue generated by the physicians' corporations but are neither employees nor members of the corporation.)

5. Payment of corporate expenses. Corporations use part of their earnings from patients' fees for payment of such private practice expenses as supplies, bookkeeping, taxes, professional dues and licenses, professional liability insurance, and fringe benefits for members. Expenditures from these funds are reviewed by administrators at the Medical Center and must be tax deductible.

6. Reviews of corporate expenditures. To help ensure the propriety of all expenditures, corporations must submit monthly financial statements to the offices of the Executive Vice Chancellor and the Chancellor for review. Expenditures from department development funds are submitted monthly to the Executive Vice Chancellor by the Endowment Association. The corporations' contracts require annual audits of corporate financial records by a certified public accountant or a firm acceptable to the University.

7. Relationship to non-corporate faculty. Although corporation members form the major part of the teaching staff in advanced levels of the School of Medicine, many non-corporate faculty members also work at the Medical Center. Most of these non-corporate faculty members are State employees, and most teach courses not directly related to medical specialties. Non-corporate faculty include microbiologists, chemists, pharmacologists, technicians, service workers, and others. There are approximately 380 non-corporate faculty members at the Medical Center; by comparison, there are approximately 120 members of physicians' corporations.

The chapters that follow examine aspects of the relationship between the physicians' corporations and the Medical Center in greater detail. It is important to note at this point, however, that very little of the development of physicians' corporations was delineated by statute. The details of the relationship have evolved gradually and have been based largely on tradition, not on legislative intent.

CHAPTER III

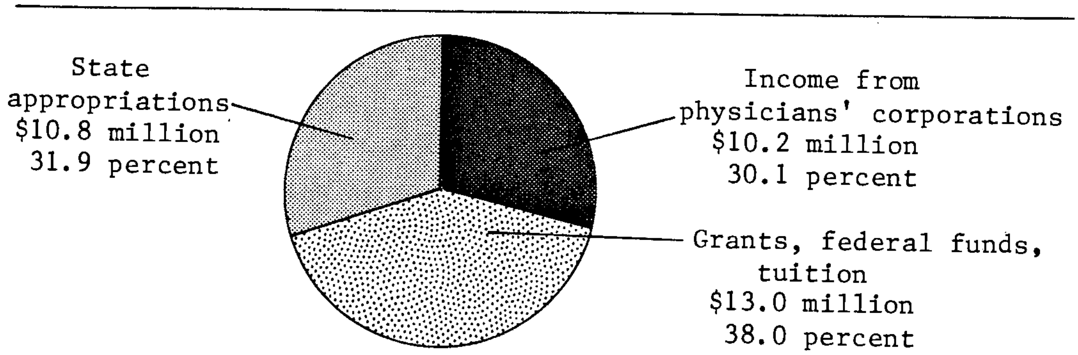
THE FINANCIAL RELATIONSHIP BETWEEN THE PHYSICIANS' CORPORATIONS AND THE MEDICAL CENTER

Like many medical schools, the University of Kansas School of Medicine operates on a combination of State appropriations, fees earned by faculty members in their private medical practices, and revenue from such other sources as research grants and federal funds. This chapter describes the financial relationship between the physicians' corporations and the Medical Center.

Revenues Generated by Physicians' Corporations

The combined revenues of all 15 physicians' corporations constitutes almost one-third of the total budget of the School of Medicine and the allied health departments. (The budget for the hospital is omitted from this discussion of the medical school.) Figure III-1

Figure III-1
Projected Sources of Funds(a)
University of Kansas School of Medicine and Allied Health Departments
Fiscal Year 1977



(a) Amounts are approximate and may vary from those listed by other sources.

Developed by Legislative Post Audit from Peat, Marwick, Mitchell, & Company, Health Sciences Education Costs, September 1976.

shows that revenues from the corporations supply about as much of the total funds as do State appropriations. The remainder comes from such sources as research and teaching grants, federal funds, and tuition.

Physicians' corporations at the University of Kansas provide a greater part of the total revenue for the School of Medicine than do physicians at medical schools in neighboring states. Figure III-2 shows the estimated expenditure per student in fiscal year 1977 at the Medical Center and five other Midwest medical schools. (To protect the confidentiality of certain information released by the schools for this audit, the schools are not specifically identified.) The figures show the following about the University of Kansas:

1. The Medical Center has the second highest projected expenditure per student, $24,833. (Because these projections included other students taught by medical faculty as well as medical students, they may differ slightly from the University's own projections of the cost of educating a medical student. The University's own analysis placed the annual expenditure per medical student at about $22,500.)

2. Of the total expenditure, the Medical Center receives a greater amount from physicians' private practices than do the other schools. The projected amount for the Medical Center was $7,462. This amount also represents a higher percentage of total expenditures than at the other schools.

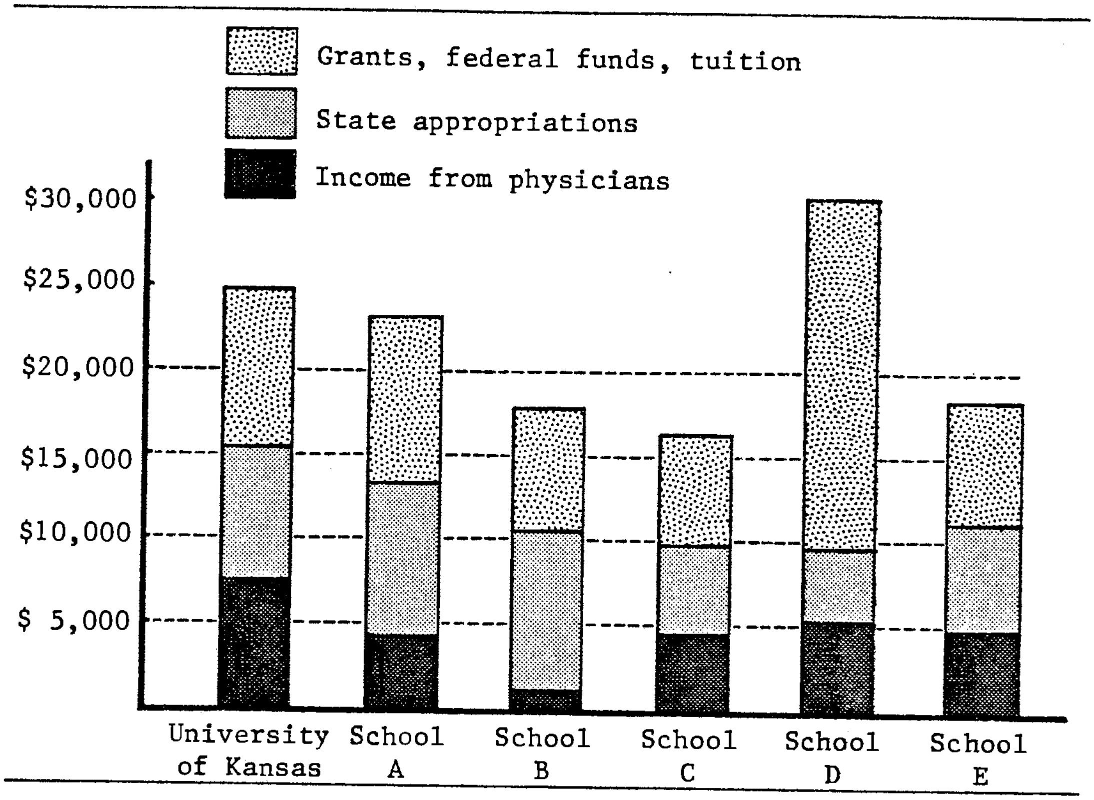
3. The Medical Center has the third highest projected level of state appropriations per student, $7,917.

Revenues and Expenditures in the Six Corporations Audited

During this audit, Legislative Post Audit examined the revenues and expenditures of six physicians' corporations. The six were chosen because they account for the majority of all professional fees received by corporations at the Medical Center, because they reflect the diversity of contractual relationships between the corporations and the University, and because they are representative of the wide differences between corporations in their ability to generate revenue. The six corporations are as follows:

1. Associated University Anesthesiologists, P.A.
2. Associates in Gynecology and Obstetrics, Chartered

Figure III-2
Projected Expenditures per Student(a)
University of Kansas Medical Center and
Five Regional Medical Schools(b)
Fiscal Year 1977



(a) Includes all students taught by medical faculty. Totals were weighted, however, to reflect the actual expense of educating different types of students.

(b) To protect the confidentiality of certain information in the audit, schools other than the University of Kansas are not identified by name.

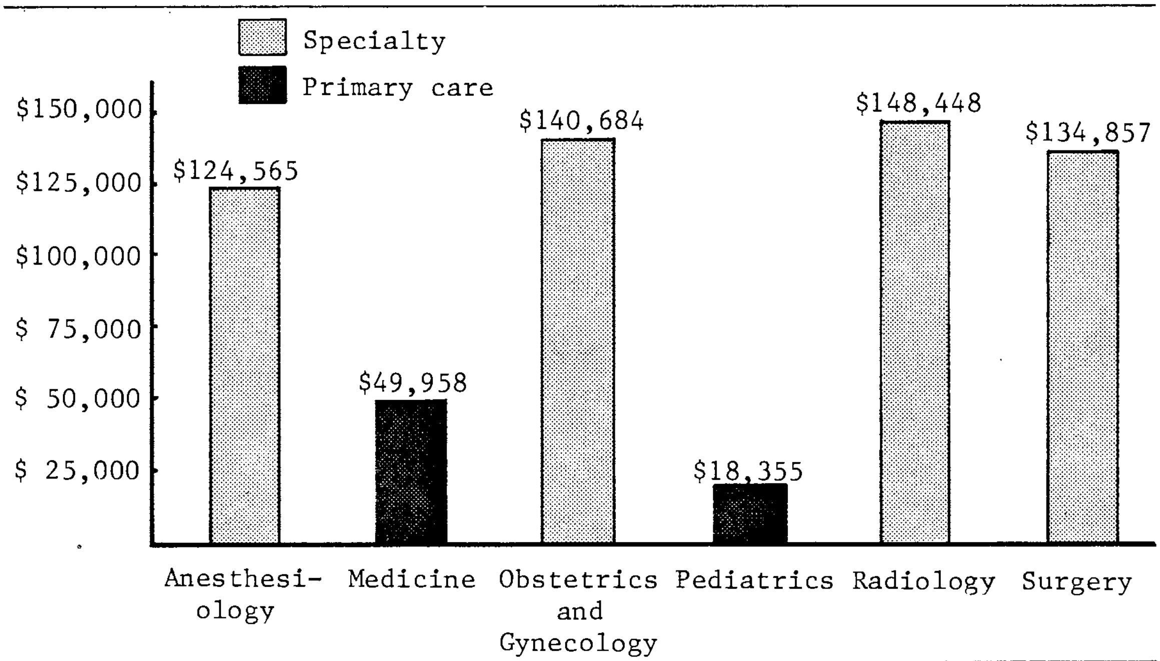
Developed by Legislative Post Audit from Peat, Marwick, Mitchell, & Company, Health Sciences Education Costs, September 1976.

3. The Medical Association, Chartered (Medicine)
4. Pediatrics Professional Association
5. Radiology Professional Association
6. Surgery Professional Association

Total Revenues of the Six Corporations

Between fiscal years 1973 and 1976, the six corporations had combined total revenues of slightly more than $52 million. Annual revenues rose steadily during that period, from $10.9 million in fiscal year 1973 to $16.1 million in fiscal year 1976. Taken individually, however, the six corporations show wide differences in their ability to generate revenue. If the corporations' revenues are considered on the basis of the amount per full-time faculty member, the four departments involved in specialized fields--anesthesiology, obstetrics and gynecology, radiology, and surgery--have a much higher rate of revenue than do the two primary care departments of medicine and pediatrics. Figure III-3 shows that the average amount of revenue per full-time faculty member in fiscal year 1976 ranged from $18,355 in pediatrics to $148,448 in radiology.

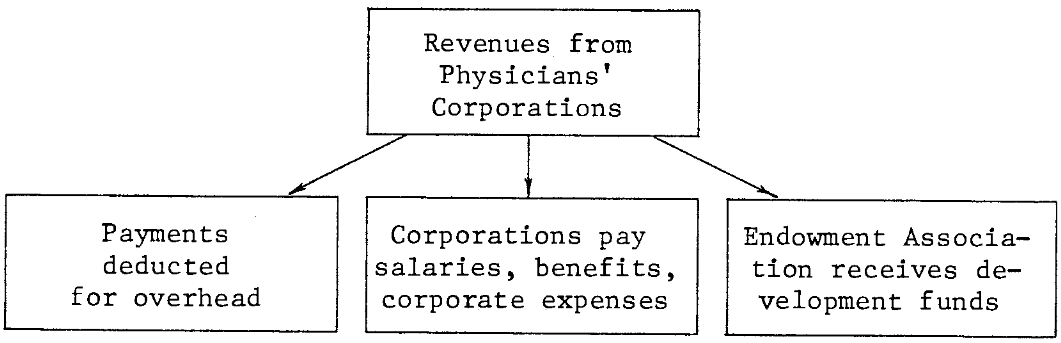
Figure III-3
Gross Revenue Per Full-Time Faculty Member
Six Selected Physicians' Corporations
Fiscal Year 1976



Developed by Legislative Post Audit from Medical Center records.

The revenue of the physicians' corporations is subject to a three-step process of distribution, as Figure III-4 shows. First, payments to the Medical Center are deducted for such items as space, facilities, and support services. Corporations that receive fees directly from patients remit seven percent of their gross revenue to cover these overhead costs. Corporations whose fees are collected by the Medical Center do not make such payments, but their commission from the Medical Center is established in such a way that the Medical Center retains a negotiated amount for overhead. Second, part of the revenue that remains is retained by the corporations for faculty salaries and for such other expenses as supplies, bookkeeping, taxes, professional dues and licenses, and professional liability insurance. Third, the remaining revenue--no less than 11 percent of the total--is remitted to the Endowment Association for development funds. These funds are used mainly for equipment and for additional personnel. The sections that follow in this chapter treat each of these steps in further detail.

Figure III-4
Distribution of Revenue from Physicians' Corporations



Developed by Legislative Post Audit.

Payments for Overhead

One question the audit tried to answer was whether the overhead payments of the physicians' corporations actually covered overhead expenses. At present, the University does not have a way to answer the question, and Legislative Post Audit found itself unable to develop an effective way to answer the question within this audit. In large part, the difficulty lies in the lack of a clear definition of which overhead expenses the corporations are expected to pay. The contracts between the University and the physicians' corporations do not define overhead expenses in specific terms. The contracts provide that the corporations are to receive "space and facilities owned by the University," along with maintenance and utilities for that space. They also provide that the corporations are to receive the right to use the University's equipment and that they are to receive support services, including reasonable supplies and administrative, technical, secretarial, maintenance, janitorial, and library services. However, the contracts do not address the question of how to divide costs into those that relate directly to the physicians' private practices and those that relate to teaching and research or to hospital activities that would normally be supported through hospital charges rather than through physicians' fees. In some cases, physicians conduct much of their private practice in space that can be readily identified as office space; but in other cases, specialists such as radiologists and anesthesiologists generate their revenue in operating rooms, laboratories, and other hospital areas.

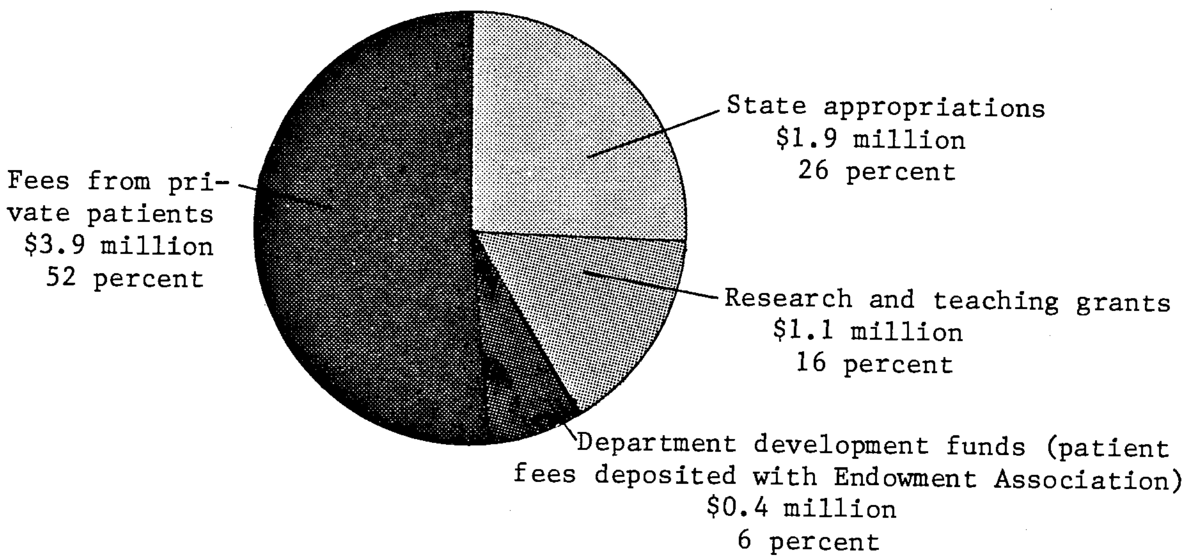
Legislative Post Audit attempted to determine whether overhead payments were adequate, but it found that the lack of clear definitions of overhead made its findings inconclusive. The findings did point out, however, that until procedures are established to clarify what constitutes overhead expenses and how these expenses are to be calculated, there is likely to be disagreement about whether the physicians' corporations are paying too much, too little, or about enough for overhead. The five other medical schools surveyed for this audit determine their overhead costs and levels of reimbursement annually to reflect changes in the costs of the services provided. Four of the five medical schools charge a percentage of revenues as a reimbursement for overhead expenses, just as the University does. The University is the only one of the six that does not have an annual review and adjustment of overhead costs and assessments, although the current contracts allow for such adjustments to be made.

Legislative Post Audit's recommendations for improvements in determining overhead costs will be found in the recommendations at the end of Chapter V.

Salaries and Fringe Benefits

Funds for physicians' salaries come from the revenue of physicians' corporations, but they also come from other sources. Figure III-5 shows the sources of funds for salaries in the six corporations. Taken together, the corporations receive 58 percent of the funds for salaries from fees collected in private practices--

Figure III-5
Sources of Funds for Salaries
Six Selected Physicians' Corporations
Fiscal Year 1976



Developed by Legislative Post Audit from Medical Center and Endowment Association records.

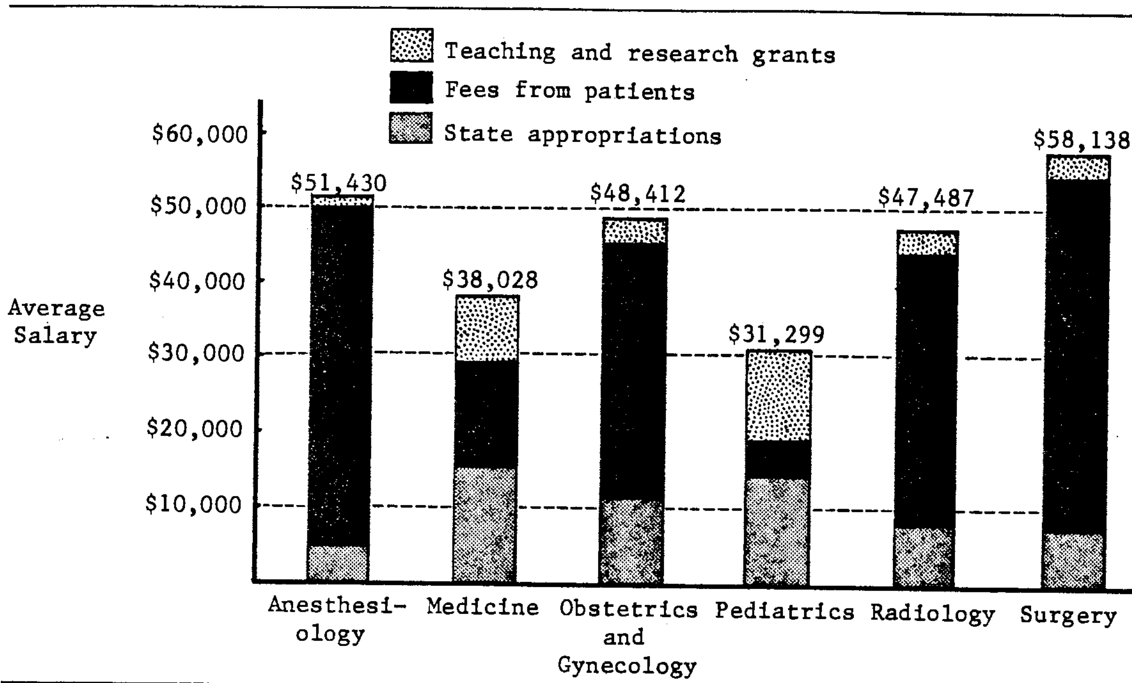
52 percent directly from corporate funds and six percent from department development funds deposited with the Endowment Association. These six corporations receive 26 percent of salary funds from State appropriations and 16 percent from various kinds of research and teaching grants.

The University establishes a salary ceiling--an upper limit--for each member of a corporation. This ceiling applies to such sources of salaries as State appropriations and fees received in private practice. Like other faculty members, physicians can earn additional income from such sources as honoraria and consulting fees not related to the practice of medicine on a continuing basis, and these sources of income are not included in the salary ceiling. Although adherence to these salary ceilings is checked as part of the independent audits of the corporations each year, this check relates only to income earned at the Medical Center. If a physician earns other income related to the practice of medicine on a continuing basis, that income is not necessarily included in the check. Legislative Post Audit reviewed a small sample of 1976 income tax returns to determine whether the income subject to the salary ceiling was within the established ceiling. Precise conclusions could not be drawn because tax returns are filed on a calendar-year basis and salary ceilings are established on a fiscal-year basis. More detailed checking of more returns would be necessary to verify whether the ceilings were being strictly adhered to, and even this more detailed checking may not allow verification of adherence to salary ceilings because of such problems as relating fiscal year earnings to calendar years.

Technically, the salary ceiling is not the same as a physician's salary, because the ceiling is not guaranteed. If total corporate income from patients' fees is not sufficient to pay the corporate share of members' salaries, the difference is not made up through State or other funds. In practice, however, physicians generally reach their salary ceilings, and in this report the ceilings are considered to be the same as physicians' salaries.

The average salaries in the six corporations vary widely, as Figure III-6 shows. The average salaries in the specialized fields are considerably higher than the average salaries in the two primary

Figure III-6
Sources of Funds for Salaries
Six Selected Physicians' Corporations
Fiscal Year 1976

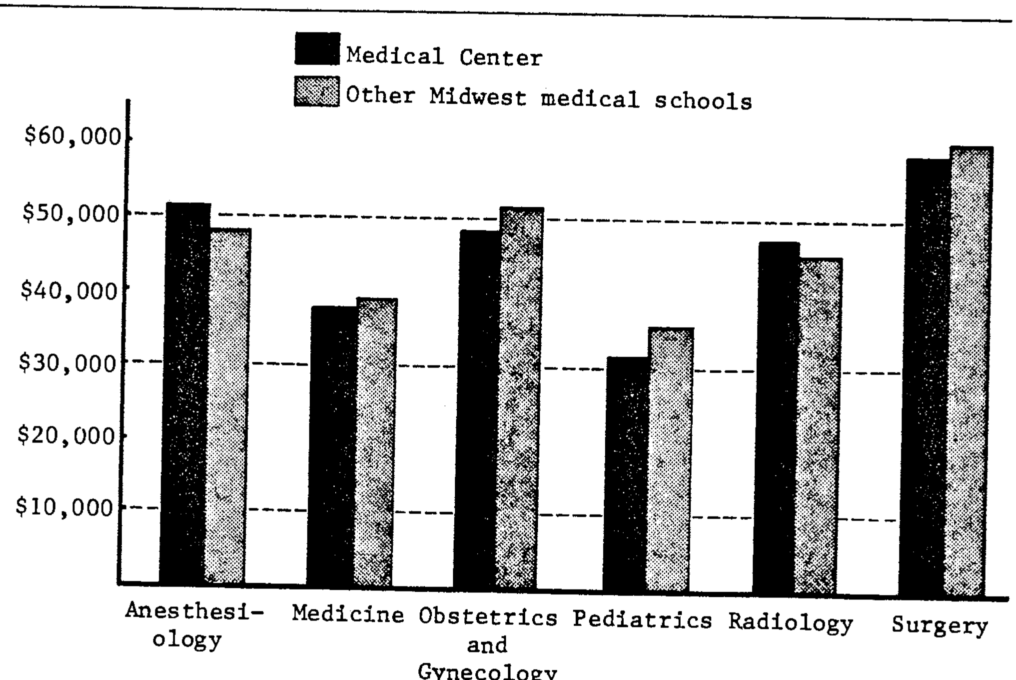


Developed by Legislative Post Audit from Medical Center records.

care fields. Average salaries in the four specialties range from $47,487 to $58,138; average salaries in the primary care fields are $31,299 and $38,028. The differences in salaries are directly related to the corporations' ability to generate revenue in members' private practices. The figure shows that the specialties received from 72 to 92 percent of their salary funds from patients' fees and from 7 to 24 percent from State appropriations. The two primary care corporations, on the other hand, received only 14 and 34 percent of their salary funds from patients' fees and had to place greater reliance on State appropriations and teaching and research grants.

These differences in salaries are typical of many medical schools, just as they are typical of differences in salaries between many specialists and primary care physicians in private practice. Figure III-7 compares the average salaries of faculty members in the six corporations to the salaries in the same departments at other Midwest medical schools in fiscal year 1976. Four of the six corporations had average salaries that were below the

Figure III-7
Salaries at the Medical Center
and Other Midwest Medical Schools
Six Selected Departments
Fiscal Year 1976



Developed by Legislative Post Audit from Medical Center records and from Association of American Medical Colleges, Annual Salary Survey, Fiscal Year 1976.

Midwest average for their department. Two corporations, anesthesiology and radiology, were slightly above the average.

To develop a more accurate picture of the income of members of the six corporations, amounts paid in fringe benefits must also be considered. Each corporation at the Medical Center has established its own "package" of fringe benefits because the salaries of corporation members come for the most part from corporation revenue. Fringe benefits paid by the State are calculated on only the State's share of a physician's salary. In general, the benefits provided by the corporations include retirement plans, disability insurance, professional liability insurance, license fees, travel expenses, medical insurance, professional dues and journals, and parking fees.

Although the six corporations differ little in the items each fringe benefit package covers, they differ markedly in the amount paid into that package. Table III-1 shows the average fringe benefit package for members of the six corporations in fiscal year 1976. As

Table III-1
Average Fringe Benefits
Six Selected Physicians' Corporations
Fiscal Year 1976

	Anesthesiology	Medicine	Obstetrics and Gynecology	Pediatrics	Radiology	Surgery
Benefits Provided by the Corporation:						
Insurance--life, disability, travel and accidental death, personal liability	$ 1,736	$ 738(a)	$ 1,294	$ 520	$ -0-	$ 1,326
Health Insurance	870	-0-	1,364	-0-	-0-	-0-
Retirement	8,170	613	5,827	756	11,977	8,586
Parking	80	50	102	-0-	-0-	-0-
Social Security	895	305	895	69	895	895
Subtotal	$ 11,751(b)	$ 1,706	$ 9,482(b)	$ 1,345	$ 12,872	$10,807(b)
Benefits Provided by the University:						
Retirement	$ 209	$ 1,244	$ 548	$ 1,663	$ 225	$ 542
Social Security	245	895	640	895	263	634
Health Insurance	172	172	172	172	172	172
Subtotal	$ 626	$ 2,311	$ 1,320	$ 2,750	$ 660	$ 1,348
Total	$ 12,377	$ 4,017	$ 10,802	$ 4,075	$ 13,532	$12,155

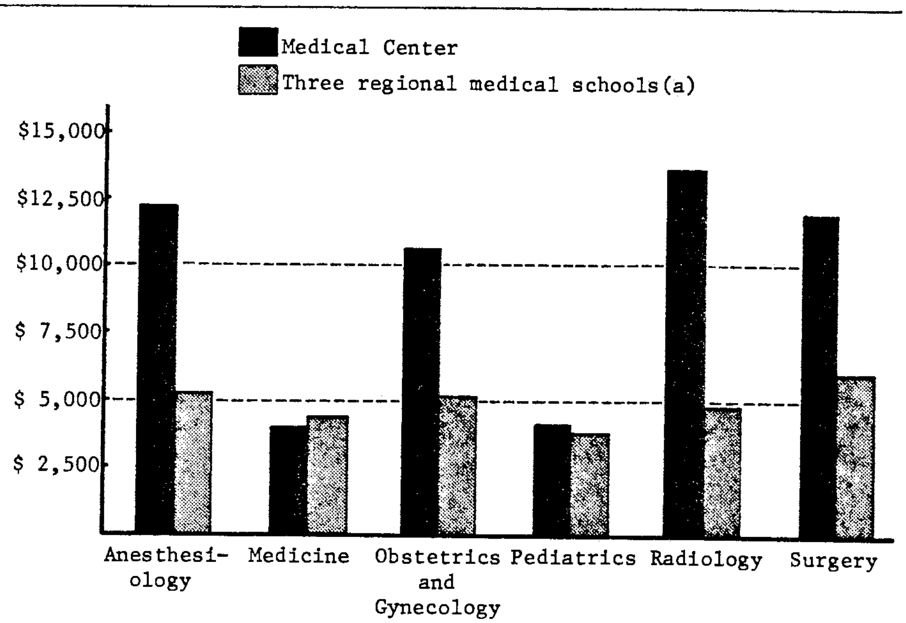
(a) Does not include personal liability.
(b) Does not include lease of automobile, a benefit discontinued during fiscal year 1976.

Developed by Legislative Post Audit from Medical Center records.

the table shows, benefits for the four specialties ranged from $10,802 to $13,532, and benefits for the two primary care fields were $4,017 and $4,075. If only the amounts contributed by the corporations are considered, the difference between specialties and primary care fields is even higher. Corporate contributions ranged from $9,482 to $12,872 in the specialties and were $1,706 and $1,345 in the primary care fields.

The Midwest medical schools reporting their salaries in the survey compiled by the Association of American Medical Colleges did not report the amounts their faculty members received in fringe benefits. In its own survey of five regional medical schools, however, Legislative Post Audit obtained information on how fringe benefits are determined at three of the schools. Legislative Post Audit computed the fringe benefits physicians at these schools would receive if their average salaries were the same as the salaries in the six corporations. Figure III-8 shows the results. Fringe benefits in

Figure III-8
Average Fringe Benefits at the Medical Center
and Three Other Regional Medical Schools
Six Selected Departments
Fiscal Year 1976



(a) To protect the confidentiality of certain information in the audit, the schools are not identified by name. The amounts for the three schools were based on the schools' fringe benefit formulas but were computed for the average salary at the Medical Center.

Developed by Legislative Post Audit from Medical Center records and from information compiled during a survey of regional medical schools.

the four specialties are much higher at the Medical Center; fringe benefits in the two primary care fields are about equal to benefits at the other schools.

Because information about fringe benefits at all Midwest medical schools is not available, it is not possible to determine whether the three-university average for fringe benefits is representative. If a representative average could be obtained, the total compensation of salaries and fringe benefits for members of physicians' corporations could be compared to the Midwest average. If the three-university average for fringe benefits is representative of the Midwest average, however, the combination of salary and fringe benefits at the Medical Center would be higher than the Midwest average in the four specialties and lower than the Midwest average in the two primary care fields.

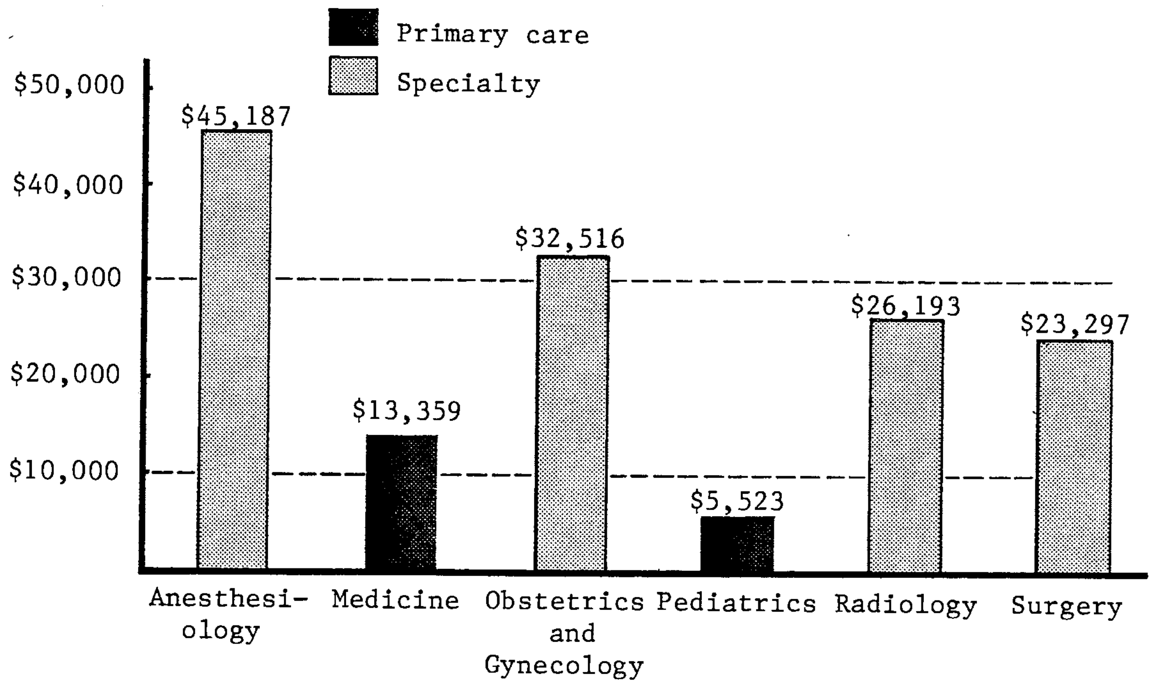
Payments to Department Development Funds

After the physicians' corporations have paid for overhead expenses, and after they have paid salaries, fringe benefits, and other corporate expenses, they are required by contract to deposit the remaining income in department development funds. The amount deposited must be a minimum of 11 percent of gross income. The development funds, which are deposited with the Kansas University Endowment Association, are used mainly to purchase new equipment and to pay the salaries of nurses, technicians, secretaries, clerks, interns, and residents. Between fiscal years 1973 and 1976, the six corporations paid nearly $12 million into these funds.

Legislative Post Audit examined the amounts deposited in the funds by the six corporations to determine whether the minimum contribution of 11 percent was being met. All six corporations were found to be making payments above the minimum. Between fiscal years 1973 and 1976, the six corporations collectively paid at least 35 percent of their gross income to the funds each year. When the amounts are separated by corporation, however, the results again show the wide differences in earning power between the specialties and the primary care departments. Figure III-9, which presents the amount contributed per full-time faculty member in fiscal year 1976, shows that the specialties contributed from $23,297 to $45,127 per faculty member while the two primary care fields contributed $5,523 and $13,359 per faculty member.

Nearly all revenue in department development funds is used by the department that deposited it. One percent of a corporation's gross income is retained by the University Chancellor for general use at the Medical Center, and two percent is set aside for equipping

Figure III-9
Department Development Funds Deposited
per Full-Time Faculty Member
Six Selected Physicians' Corporations
Fiscal Year 1976



Developed by Legislative Post Audit from Medical Center records.

the new facilities at the Medical Center. The rest of the amount--at least eight percent of gross income--is used by the department with the review and approval of the Executive Vice Chancellor and the Chancellor. Thus, the higher-earning corporations have more money for development than do the lower-earning corporations. This money can be used to buy new equipment and to pay salaries of more personnel, allowing the higher-earning corporations to earn still higher revenues.

Conclusions

1. The revenue generated by members of physicians' corporations in their medical practices is highly important to the current levels of funding at the University of Kansas Medical Center. Physicians' corporations at the Medical Center provide a greater part of the total revenue for operating the School of Medicine than do physicians at medical schools in neighboring states. However, Kansas also pays more as a whole to educate its medical students than do most of these neighboring states, and the amount of State appropriations per student is above the average for the region.

2. The physicians' corporations vary greatly in their ability to generate revenue. Corporations whose members are in medical specialties generate considerably more revenue per corporate member than corporations whose members are in primary care fields. In turn, members of these higher-earning corporations have higher salaries and fringe benefits than members of lower-earning corporations. The differences in salaries reflect similar differences at other medical schools and in the private practice of medicine.

3. The University does not have an effective way to determine whether overhead payments by the physicians' corporations cover actual overhead expenses. Under the current contracts, the University would probably have to develop separate ways to compute overhead for all 15 corporations.

4. Corporate faculty members' adherence to salary ceilings cannot be effectively judged under current procedures. Additional controls and procedures would be needed to help determine whether members of physicians' corporations are complying with the ceilings established.

5. The corporations studied in this audit all provided more money for development funds than the minimum specified in their contracts. Higher-earning corporations provide more money than lower-earning corporations and thus have more revenue available for purchasing equipment and hiring personnel.

Legislative Post Audit's recommendations concerning these conclusions will be found together with the audit's other recommendations on pages 43-44.

CHAPTER IV

THE EDUCATIONAL ROLE OF THE PHYSICIANS' CORPORATIONS AT THE MEDICAL CENTER

As the previous chapters have shown, the members of the physicians' corporations have several roles at the Medical Center. Under the terms of their contracts with the University, they provide patient care. In addition, they conduct medical research and teach medical students. This chapter examines several aspects of the physicians' role as educators.

Members of physicians' corporations are not the only teachers at the Medical Center. Actually, they are a minority of the teachers, making up only about 120 of the 500 faculty members. Other faculty members include microbiologists, chemists, pharmacologists, technicians, and social workers. In general, these non-corporate faculty members teach the first half of a medical student's undergraduate course work--anatomy, physiology, biochemistry, pathology, microbiology, pharmacology, and behavioral science. They also teach most of the courses in other health professions besides medicine. Members of physicians' corporations limit their teaching almost exclusively to medical students, and then to the second--or clinical--half of the undergraduate course work. They are the primary teachers in such clinical areas as medicine, surgery, obstetrics and gynecology, pediatrics, and psychiatry.

The responsibility corporate members have for teaching is defined only generally in the corporations' contracts with the Medical Center. The contracts make no provisions for the number of hours that must be spent teaching, the number of courses or students taught, or other matters relating to instructional duties. This chapter examines how the physicians fulfill their role as teachers by determining how physicians spend their time and--to a limited extent--by assessing how well the students are taught.

Analysis of Time Surveys

To determine how clinical faculty members at the Medical Center divide their time between their various duties, Legislative Post Audit developed a survey and sent it to all clinical faculty members, both corporate and non-corporate. The survey was patterned after a national survey conducted by the Institute of Medicine within the National Academy of Sciences. Faculty members were asked to list how much time, on the average, they spent in the following responsibilities: research, teaching, patient care, joint research and teaching, joint patient care and teaching, and administration. The "joint" categories are included because physicians often use their research projects for teaching and because they often use their private patients in clinical instruction. The results of the survey, together with comparative figures from the national survey, are shown in Table IV-1.

Taken together, corporate and non-corporate clinical faculty members at the Medical Center reported they worked an average of 53 hours per week. The national average was 52 hours. Members of physicians' corporations reported an average work week of 60 hours, compared with 46 for non-corporate faculty members. As the table shows, physicians reported they spent about as much time in research, teaching, and patient care as the national average. They reported spending three more hours per week than the national average in joint research and teaching and eight more hours per week than the national average in joint patient care and teaching. They also reported spending three fewer hours per week than the national average in administration and other activities.

Table IV-1
Comparison of Clinical Faculty Member's Time Surveys with National Averages
University of Kansas Medical Center

	Hours per Week			
		Medical Center Faculty		
Activity	National Average	Combined Average	Corporate Average	Non-Corporate Average
Research	7	9	8	9
Joint Research/Teaching	1	3	4	2
Teaching	10	9	9	10
Joint Patient Care/Teaching	11	13	19	7
Patient Care	8	8	8	7
Administration and Other	15	11	12	11
Total Hours	52	53	60	46

Developed by Legislative Post Audit from a survey of clinical faculty members and from National Academy of Science, Institute of Medicine, Costs of Education in the Health Professions.

The information in Chapter III regarding corporate revenues tends to support the high number of hours per week the physicians reported spending on patient care and joint patient care and teaching. That financial information showed that physicians at the Medical Center brought in more revenue from seeing private patients than did physicians at other regional medical schools. Assuming that physicians' charges are relatively the same at these medical centers, more time spent in patient care and in joint patient care and teaching would be needed to bring in the additional revenue.

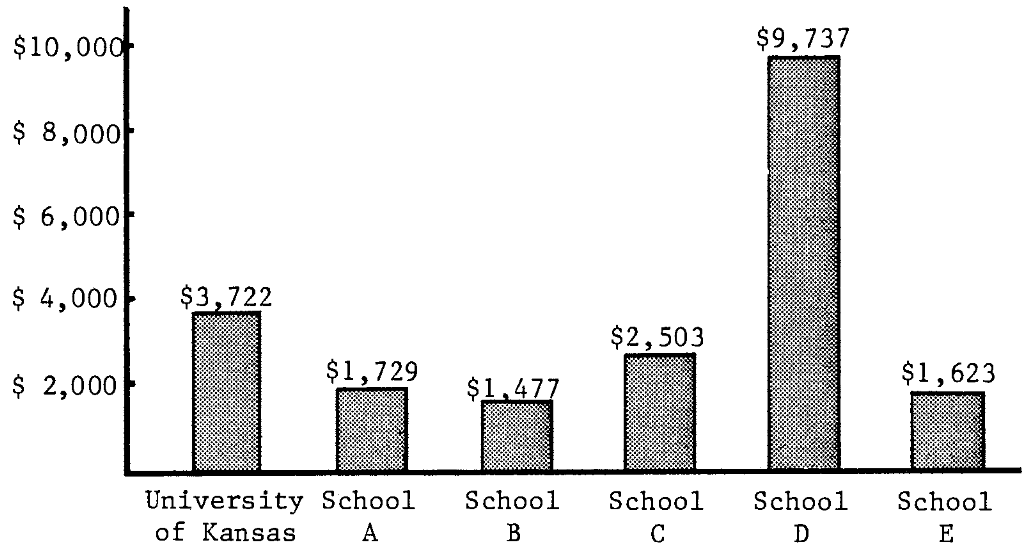
Figures showing the expenditures for research at the Medical Center tend to support the higher number of hours per week the physicians reported spending on research and joint research and teaching. Although nationwide information on research expenditures was not available, the survey of regional medical schools cited earlier in this report showed that research expenditures at the Medical Center were higher than expenditures at four of the five other schools. Figure IV-1 on the next page shows the projected amount spent in research activities per full-time medical student at each of the six medical schools. The University of Kansas ranks second among the six, with a projected expenditure of $3,722 per student. (To protect the confidentiality of certain information released by the other schools for this audit, the schools are not specifically identified.)

According to the time survey, corporate faculty members at the Medical Center spend more time than the national average in teaching and in joint activities that include teaching. The corporate members reported a total of 32 hours per week in teaching, joint research and teaching, and joint patient care and teaching; the national average for these three categories was 22 hours per week. To some extent, the quality of this education can be judged by comparisons with the performance of students at other medical schools. This topic is examined in the next section.

Performance of Medical Students

Available information indicates that medical students who enroll at the Medical Center are of equal ability with medical students across the country. In the fall of 1974, the latest year for which figures were available when this audit was conducted, the mean undergraduate grade point average for all students entering medical schools was 3.42 and the mean raw score on the Medical College Admissions Test was 582. For the students entering the Medical Center, the mean grade point average was 3.54 and the mean raw score on the Medical College Admissions Test was 580.

Figure IV-1
Projected Sponsored Research Per Full-Time Medical Student
University of Kansas Medical Center and
Five Regional Medical Schools(a)
Fiscal Year 1977



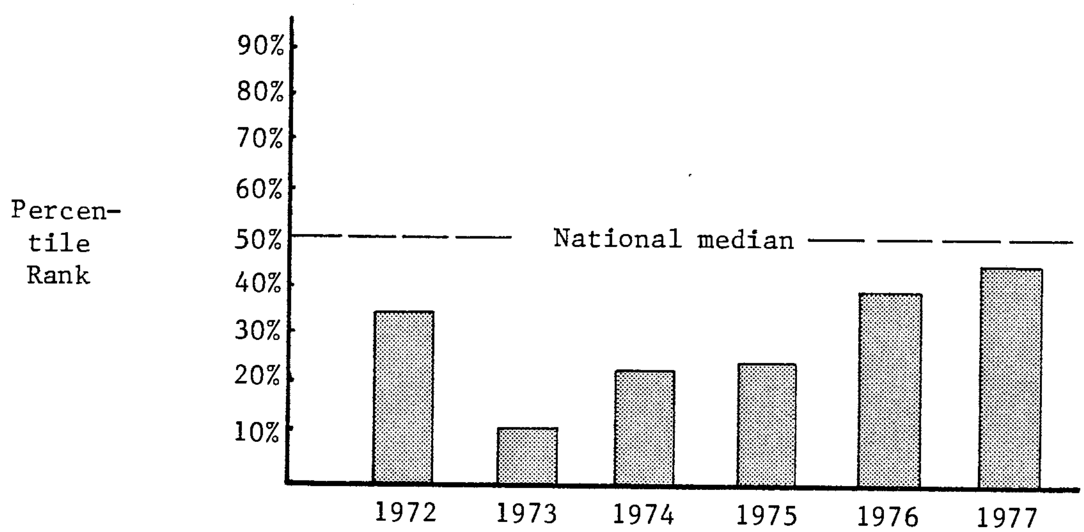
(a) To protect the confidentiality of certain information in the audit, schools other than the University of Kansas are not identified by name.

Developed by Legislative Post Audit from Peat, Marwick, Mitchell, & Company, Health Sciences Education Costs, September 1976.

During their training, students at most medical schools take national examinations. These examinations, which are administered by the National Board of Medical Examiners, consist basically of two parts. Part I is taken about halfway through medical school and covers basic sciences such as anatomy, physiology, biochemistry, and pathology. At the Medical Center, these subjects are generally taught by non-corporate faculty members. Part II is taken at the end of the curriculum and covers clinical sciences such as surgery, obstetrics and gynecology, pediatrics, and psychology. At the Medical Center, these subjects are generally taught by corporate faculty members. According to the Association of American Medical Colleges, approximately two-thirds of the medical schools supplying information about the test indicated that they required medical students to take Parts I and II of the examination. Many schools require students to pass the examinations, and most use the examinations to evaluate their educational programs.

The Medical Center has only recently begun to emphasize these examinations as indications of students' performance. In 1973, the Medical Center began a shift to a policy that now requires students to take and pass Parts I and II in order to graduate. Figure IV-2 shows how well students at the Medical Center performed on Part I between 1972 and 1977. The subjects covered in this part of the examination are generally taught by non-corporate faculty members. In all six years, the scores were below the national median. The scores dropped sharply in 1973 but have risen steadily since.

Figure IV-2
Performance on National Board Examinations--Part I
University of Kansas Medical Students
1972-1977



Developed by Legislative Post Audit from information provided by the National Board of Medical Examiners and the University of Kansas.

Taken by themselves, the scores for these six years are not an accurate assessment of the quality of the first half of a medical student's education at the Medical Center. During these years, the medical school curriculum was changing drastically, and many students were not under a requirement to pass the examination. In brief, the following was occurring:

1. In the early 1970s, the Medical Center changed its four-year curriculum to an accelerated three-year curriculum. The accelerated curriculum did not conform to the normal pattern for taking Part I. Students had to take the test either six months before finishing the course work covered in Part I or six months after finishing it, and neither choice included a summer without classes to prepare for the exam. The Medical Center later decided that the accelerated three-year curriculum was unsatisfactory, and beginning in the fall of 1977, it once again placed its entering class on a four-year schedule.

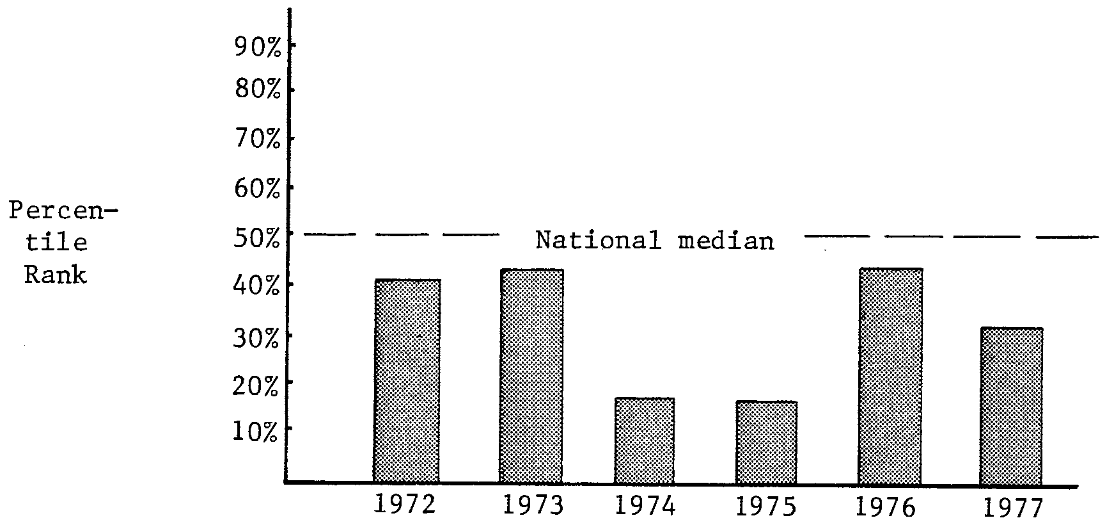
2. Although the Medical Center began in 1973 to adopt a policy that students pass Part I to graduate, the scores for the next several years also include many students who were not under that requirement. Before 1973, many students did not even take the examination. The scores of the most recent years, during which most or all students had to pass the examination, are higher.

If the three-year curriculum and the voluntary nature of the examination affected the scores in the past, they will not do so in the future. In the fall of 1979, students who are again in a four-year curriculum will begin taking Part I. At that time, the test should become a more effective measure of the performance of students at the Medical Center.

Students' scores on Part I of the examination are not dependent on subjects taught by members of the physicians' corporations, who generally teach only those subjects covered in Part II. Scores for Part I were included here to show what happened as the Medical Center moved from a four-year to a three-year curriculum and back again, and as the Medical Center adopted the requirement that students pass the examination. Figure IV-3 shows how well students at the Medical Center have performed on Part II between 1972 and 1977. Students generally take Part II one or two years after taking Part I. Scores in all six years were again below the national median. If these scores were affected by the three-year curriculum and the voluntary nature of the test during several of the years, they too will not be affected in the future. Students in the new four-year curriculum will take Part II in 1981.

Another way to assess the quality of students' performance is to determine the percentage of students who must repeat all or part

Figure IV-3
Performance on National Board Examinations--Part II
University of Kansas Medical Students
1972-1977

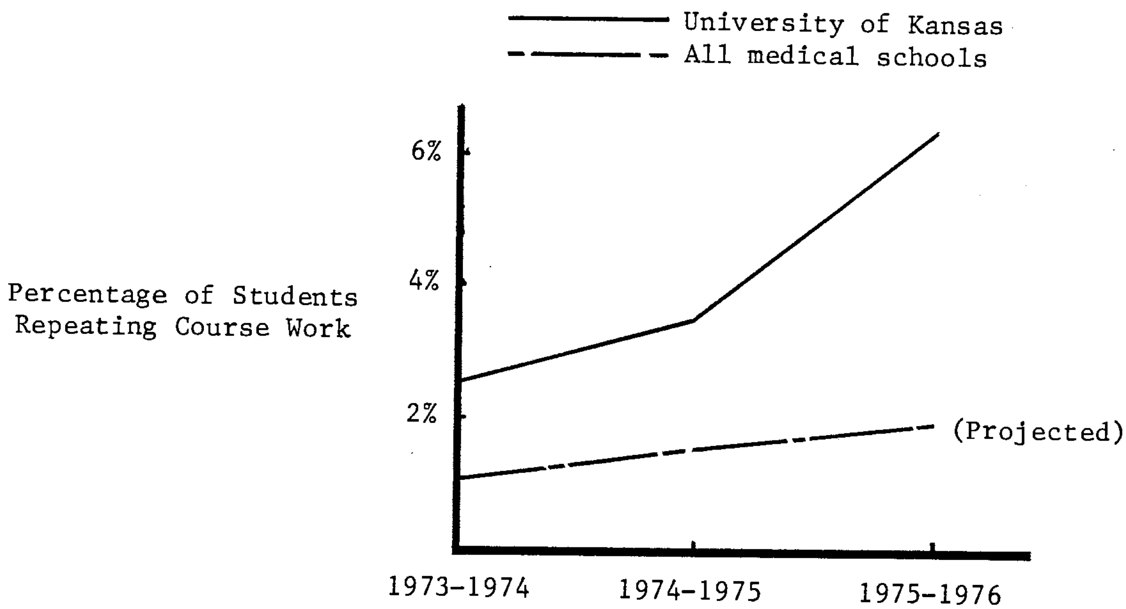


Developed by Legislative Post Audit from information provided by the National Board of Medical Examiners and the University of Kansas.

of their course work. If students must repeat, they may be doing so because of some deficiency in the curriculum. Figure IV-4 on the next page compares the percentage of students at the Medical Center who must repeat all or part of their course work with the national average of students repeating course work. As the figure shows, the percentage at the Medical Center is much higher than the national average and has risen at a much faster rate.

The rise in repeated course work, particularly in the 1975-1976 academic year, may reflect students' difficulties with the accelerated three-year curriculum. As with scores on national examinations, the percentage of students repeating course work should become a more effective means of assessing the quality of education after the four-year curriculum has again been established.

Figure IV-3
Percentage of Undergraduates Repeating Course Work
University of Kansas Medical Students
1973-1976



Developed by Legislative Post Audit from information provided by the Association of American Medical Colleges.

<u>Conclusion</u>

Members of physicians' corporations appear to be spending more time in various kinds of teaching activities than the national average for faculty members at medical schools. Problems with an accelerated curriculum and lack of emphasis on national examinations make it difficult at present to assess the quality of education through students' scores on national examinations or on the amount of course work they must repeat. Nonetheless, for the years reviewed, the median score at the Medical Center was below the national median, and the percentage of students repeating course work was higher than the national average. As the Medical Center accustoms itself to a four-year curriculum and a requirement that students pass national examinations to graduate, these measures of performance should become more useful.

CHAPTER V

ASSESSMENT OF THE CURRENT RELATIONSHIP BETWEEN THE PHYSICIANS' CORPORATIONS AND THE MEDICAL CENTER

Up to this point, this report has attempted basically to describe the relationship between the physicians' corporations and the Medical Center. Chapter II has shown that the current contracts between the corporations and the University are part of a relationship that has been developing for approximately 30 years. During this time, the University has assumed greater powers of management over the revenues and activities of the physicians, but through the mechanism of the physicians' corporations, it has still allowed the physicians a large degree of independence and autonomy. The current contractual relationship appears to have several important benefits for the State, as Chapters III and IV of this report have shown. The most important of these benefits can be summarized as follows:

1. Physicians at the Medical Center provide a greater part of the total revenue for operating the School of Medicine than do physicians at medical schools in neighboring states. The corporate structure, with such advantages to physicians as tax shelters, limited personal liability, and a degree of departmental independence, may encourage physicians to generate high revenues. This high earning power reduces the need for State appropriations within the current level of total spending for the School of Medicine.

2. The physicians apparently earn this higher amount of revenue by working more hours, not by reducing the amount of time they would be expected to spend teaching and conducting research. Time surveys completed by the physicians showed that they spend about as much time as the national average for medical school faculty in research and teaching, but more time than the national average seeing patients and using those patients for teaching purposes.

Along with these benefits have come several problems. As the previous chapters have shown, the relationship between the physicians' corporations and the Medical Center is a complicated one. Under this relationship, operation of the Medical Center can be difficult to understand. Physicians' revenues, for example, wind through what may often seem to be a maze of accounts and transfers, and the degree to which these revenues are controlled by University officials is not always clear to those who do not deal with the Medical Center on a daily basis. This complicated system can both perplex and trouble those who, from the Governor and the Legislature on down, share the responsibility for the affairs of the Medical Center.

As a result of its audit work, Legislative Post Audit was able to identify several problems relating to effective management of the Medical Center. The problems confronted most directly as a result of the audit were related to the complex nature of the handling of physicians' revenues at the Medical Center. They include duplication of Social Security payments, inadequacies in management of property, receipt of multiple bills by hospital patients, and difficulties in making funds visible for review. Other problems--perhaps more accurately described as potential problems--deal with the Medical Center's ability to meet goals established for it by the State. All these problems, actual and potential, should be considered in evaluating the effectiveness of the current contractual relationship.

Issues Relating to the Handling of Physicians' Revenues

Duplication of Social Security Payments

Under the current contracts, members of the physicians' corporations receive part of their salary from the State and part from the earnings of their corporation. Because corporate revenues are handled separately from other Medical Center funds, the physicians receive two paychecks and have, in effect, two employers. Each of these employers is required to make Social Security contributions for the physicians, resulting in a duplication that could be avoided if the physicians received income from only one employer. For the six physicians' corporations studied in this audit, the duplication for fiscal year 1976 was approximately $50,000. Neither the State nor the physicians' corporations can obtain a refund of these duplicate contributions from the federal government.

Inadequacies in Control of Property

As Chapter III of the audit report explained, the physicians' corporations are required to deposit a minimum of 11 percent of their gross income with the Kansas University Endowment Association. The corporations use this part of their income, called department development funds, mainly to purchase equipment and to pay salaries of persons hired directly by the corporation. In fiscal year 1975, the six physicians' corporations spent approximately $1.1 million of their development funds for equipment and miscellaneous uses and approximately $2.4 million for salaries of nurses, technicians, secretaries, interns, residents, and other employees.

Expenditures from the funds require the approval of the department chairman, the Executive Vice Chancellor, and the Chancellor of the University. Such approval does not, however, provide a fully effective way to monitor the expenditure of all the funds. Expenditures for salaries do come under additional controls in that when funds are approved for salaries, the money is transferred into the State's accounting system. When expenditures are approved for equipment and other uses, however, the Endowment Association forwards a check to the department, and the money does not enter the State's purchasing and accounting systems. This procedure apparently has led to inadequate control of property.

According to provisions of the contracts between the physicians' corporations and the University, all equipment purchased with department development funds is the property of the University. Because equipment is purchased outside the State's accounting system, however, much of it is not effectively subject to inventory controls that are a part of the accounting system. Legislative Post Audit found in an earlier audit, Selected Support Services at the University of Kansas Medical Center (issued in January 1976), that many of the items purchased with department development funds had not been properly accounted for on inventory records. The report pointed out that items purchased through the State's purchasing and accounting systems were subject to more effective inventory controls because the Medical Center's Property Accounting Section had records of all purchases. When items were purchased outside the system with development funds, the Property Accounting Section had no way of knowing automatically about the purchases. As a result, items were being received and used without being recorded in the inventories. Without accurate inventory records, the Medical Center had no way to determine whether equipment had been lost or stolen. The report recommended that the property inventory system be modified to ensure the recording of all acquisitions at the Medical Center. The Medical Center has improved its inventory system by updating inventory records annually, but further changes are necessary to ensure that new items are recorded and tagged as soon after receipt as possible rather than during the annual update. Although Legislative Post Audit found no indication that loss, theft, or fraud had actually occurred, the possibility of loss is increased under existing procedures.

Receipt of Multiple Bills by Hospital Patients

Physicians' corporations use several different methods to bill and collect their fees. Some corporations use the Patient Charging

Office of the Medical Center, which is the office that bills and collects all hospital charges. Other corporations set up their own billing and collection systems through outside firms, and still others set up their own internal systems. As a result, hospital patients can receive bills from a number of different physicians' corporations. This practice can be confusing to patients, especially for those who may not understand their separate obligations to the various doctors who treat them.

Difficulties in Making Funds Visible for Review

As this report has shown, the different kinds of funds used at the Medical Center are subject to different levels of review. Such funds as State appropriations, research funds, and corporate revenue paid out in salaries, overhead, retirement, and insurance enter the budgeting and accounting systems in such a way that they are directly controlled by University officials. Expenditures from department development funds must be approved by University officials, though as the discussion above has shown, control over certain aspects of these expenditures is still lacking. The corporations' own expenses for such activities as travel, hospitality, and office supplies are not subject to University approval, although University officials review summary statements of these expenditures and require an independent audit of all corporations each year.

Although the system used by the Medical Center allows the departments a great deal of flexibility in spending funds, it is not as effective from a managerial point of view as a system under which all expenditures could be more easily controlled and traced. If all funds used for operation and development of the Medical Center were channeled through the University's budgeting system and the State's accounting system, for example, comprehensive financial statements showing all receipts and expenditures could be developed, and University and other State officials would have more complete knowledge of actual and projected expenditures in all categories of spending. The Medical Center's accounting system could then be used to prepare comprehensive statements showing all receipts and expenditures, including those involving revenues from physicians' fees.

Issues Relating to the Educational Goals of the Medical Center

In recent years, considerable attention has been given to the growing shortage of primary health care physicians in Kansas, particularly in rural areas. The Legislature, concerned that the Medical Center may be placing too much emphasis on specialized medical fields and not enough emphasis on primary health care for the State, has considered--and in some cases adopted--a number of ways to help solve the problem, including such incentives as scholarships, lower tuition rates, or complete cancellation of tuition for students who agree to practice in certain areas of the State. Under the direction of the Chancellor and other University officials, the Medical Center has increased the size of its entering class, screened applicants to determine those who indicate an interest in practicing in rural areas, established additional internships and training programs in less populated areas of the State, developed regional health education centers, and proposed or implemented a number of other programs to encourage graduates to practice in the State. The problem continues, however, and other steps are likely to be considered to help solve it.

This audit did not directly address the problem of the shortage of primary care physicians on the State. The audit's purpose was rather to analyze and assess the relationship between the physicians' corporations and the Medical Center. However, the nature of that relationship may affect the Medical Center's ability to control the resources needed to produce more primary care physicians. The current relationship may weaken that control in the following ways:

1. Under the current contracts, corporations in specialized fields have more money for development than corporations in primary care fields. Corporations in specialized fields generate more revenue, pay higher salaries and fringe benefits, and have more money to spend on equipment, improvements, and additional staff members. Corporations in primary care fields generate less revenue, pay lower salaries and fringe benefits, and have less money to develop programs in their departments.

2. Under the current contracts, the Medical Center cannot change significantly the imbalance of corporate revenues available for development. The contracts do not give the Medical Center the ability to move large sums of corporate revenues across departmental lines. Most of a corporation's revenue for development is used within that corporation itself.

These points do not mean that under the current contractual relationship, objectives such as increased emphasis on primary care cannot be met. The Medical Center may be able, for example, to concentrate State appropriations even more heavily than it currently does in those primary care areas it wishes to develop. The points also do not imply that strong programs in specialized fields are not important to the Medical Center or to its primary care program. The points do show, however, that the effect of physicians' corporations must be kept in mind when deciding how to meet goals of the Medical Center.

Alternatives for Addressing Issues Relating to Physicians' Corporations

If the Legislative Post Audit Committee decides that improvements should be made at the Medical Center in such areas as more effective management control or greater visibility and review of funds, it may wish to consider a number of alternatives for making these improvements. One question likely to be raised is whether another medical school might have systems or procedures that could effectively address the issues pointed out in this report. During the audit, members of the Legislative Post Audit staff visited other medical schools and talked with officials on both state and national levels about the organization of medical schools. The results of this work indicate that the organization of other medical schools offers no quick or easy answer to questions about what changes, if any, should be made at the Medical Center.

Legislative Post Audit examined five regional medical schools in some detail--the universities of Arkansas, Iowa, Missouri, Nebraska, and Oklahoma. These five medical schools illustrate the variety of approaches to the relationship between faculty members and the medical school. Only one of the five has a structure that includes physicians' corporations. Most have structures that make all funds more visible for review by administrators and others. The current relationship between physicians and the medical school is only a few years old at some schools; at others, the structure of the relationship is long-standing. If the Medical Center were to adopt any of these patterns of organization, considerable change would be required. The organization of these other medical schools is described in Appendix A.

The present contracts between the University and the physicians' corporations expire in 1980. If the Legislative Post Audit Committee and the Legislature decide that changes should be made in the relationship between physicians and the University, they could consider directing the University to follow one of these alternatives:

1. Eliminating physicians' corporations entirely.
2. Adjusting contracts with the physicians' corporations to make the desired changes.
3. Negotiating a single contract with all physicians and all departments--in essence, creating a single physicians' corporation.

Eliminating Physicians' Corporations

At many medical schools, physicians are not organized into corporations. Under a non-corporate relationship with the physicians, the University could require that all physicians's revenues either become State funds or fall under the State's accounting system. As such, these funds would be subject to complete oversight and review. Comprehensive planning and management at the Medical Center could be improved, and problems related to contractual negotiations could be eliminated.

Eliminating physicians' corporations could also cause problems. Without corporate status, physicians' organizations could lose many of the benefits they currently have. Tax rates on revenues could rise, for example, because the tax-exempt status of department development funds could be lost, and the current tax-sheltered retirement plans might not be allowed under non-corporate organization. These changes could reduce the amount of money available for development of the departments, and more money from other sources such as State appropriations could be needed to pay physicians' salaries and benefits. Eliminating the corporations could cause considerable turmoil and faculty turnover. In addition, because some of the incentives for generating revenue in private practice would be taken away, revenue generated by physicians could decrease. Such a change could increase the need for State appropriations at the Medical Center.

Adjusting Contracts with the Physicians' Corporations

The issues and problems raised in this audit report could become items that are addressed in contracts taking effect in 1980. These issues and problems include the following:

1. Establishing overhead rates that are directly related to actual overhead expenses.
2. Establishing improved procedures for making all funds, corporate and non-corporate, more visible for review.
3. Establishing a centralized billing system for all physicians' charges.
4. Establishing the University's ability to transfer greater portions of department development funds to meet educational goals.

Adjustments within the framework of existing contracts would probably be the least disruptive alternative for making changes at the Medical Center. However, opposition to some or all of the changes would probably still occur.

Creating a Single Physicians' Corporation

If the University were to negotiate a single contract with all departments, that contract could address the same issues outlined immediately above. A single contract would have several advantages for the Medical Center over the 15 separate contracts that now exist. A single corporation would simplify the University's transfer of development funds between departments, and it would simplify the establishment of procedures for better financial review, oversight, and planning. A single contract could shorten the time and effort involved in contractual negotiations as well.

Under a single physicians' corporation, physicians would still have the same benefits of corporate status they now have. However, a single corporation would take away part of the independence of the various departments. Opposition to such a change, particularly from the higher-earning departments, would probably occur, and incentive to generate income could be reduced.

Conclusion

Several issues in the current relationship between the University and the physicians' corporations merit legislative attention. Some issues relate to the handling of revenues of the physicians' corporations--duplication of Social Security payments, inadequacies in the control of property purchased with department development funds, receipt of multiple physicians' bills by hospital patients, and difficulties in making funds visible for review. Other issues, which center on the disparity in revenues between higher-earning specialty fields and lower-earning primary care fields, relate to the Medical Center's ability to meet educational goals established for it by the State.

If the Legislative Post Audit Committee and the Legislature decide that changes should be made to address these issues, they would appear to have three basic alternatives in directing the University to make these changes--eliminating physicians' corporations entirely, adjusting contracts within the existing relationship, or establishing a single physicians' corporation. The first of these alternatives has a number of disadvantages both for the physicians and the State, and it would probably be the least desirable alternative.

Recommendations

If the Legislative Post Audit Committee decides that the current contractual relationship between the University and the physicians' corporations should be changed, it should consider directing that the University, acting in conjunction with the Board of Regents, develop a plan for making the desired changes either by strengthening the current contracts or by contracting with one corporation or one "umbrella" corporation. Such a plan should be submitted to the Legislative Post Audit Committee within a time specified by the Committee. At the Committee's direction, the plan should address the following items:

Establishment of overhead rates. Methods should be established to develop overhead rates that are directly related to actual overhead expenses. These rates should be reviewed annually by University officials and adjusted as necessary to meet actual expenses.

Improvements in corporate budget procedures. A corporate budget should be established for each corporation and should be approved by the Executive Vice Chancellor and the Chancellor. The budget should not be exceeded unless the corporation demonstrates that unforeseen circumstances have arisen and that it has funds available. Approval by the Executive Vice Chancellor and the Chancellor should be required if the budget is to be exceeded. In addition, monthly expenditure reports should be submitted for review.

Establishment of a single billing service. Charges for physicians' services should be handled by a centralized billing operation that would include all physicians' charges in one bill. Hospital charges should continue to be billed by the Hospital Billing Department.

Improvement in oversight of physicians' salary ceilings. To help ensure compliance with the salary ceiling established for the practice of medicine on a continuing basis, corporation members should keep records of all such income, including that earned outside the Medical Center, on file in the corporation offices. These records should be made available for audits by independent auditors or by the Legislative Division of Post Audit.

Visibility of department development funds. To ensure greater visibility of department development funds, budgets for each fund should be developed and should be submitted to the Legislature for its information as part of the University's annual budget process. The budgets should include expenditures for the previous fiscal year and projected expenditures for the current and coming fiscal years.

Greater flexibility in distributing funds. The University's financial flexibility to meet the educational goals of the Medical Center should be increased. Possible alternatives include the following:

--Expanding the current practice of channeling State appropriations to low-earning corporations or to key programs and requiring higher-earning corporations to support themselves even more fully than at present.

--Expanding the portion of department development funds made available to the Chancellor for redistribution, perhaps from the current one percent of corporate income to five percent.

Improvement in inventory procedures. The University should take additional steps to ensure that equipment purchased with department development funds is recorded and tagged as soon after purchase as possible.

Membership on the board of a single corporation. If one corporation is the preferred alternative, one or more members of the governing body should be appointed by the Chancellor. These members of the governing body should not be members of the corporation.

APPENDIX A

THE RELATIONSHIP BETWEEN PHYSICIANS AND THE INSTITUTION IN NEIGHBORING MEDICAL CENTERS

To provide a description of the relationship between physicians and medical centers in neighboring states, members of the staff of Legislative Post Audit visited the universities of Arkansas, Iowa, Missouri, Nebraska, and Oklahoma. The summaries below are based on interviews and other information gathered during those visits.

Like the Medical Center, medical schools at these institutions are also undergoing constant changes, both large and small. It is possible that some aspects of the descriptions of these medical schools may have changed slightly since the interviews were conducted. Taken in general, however, the descriptions are representative of the variety of relationships between physicians and medical schools.

The University of Arkansas

The current relationship between the physicians and the medical school at the University of Arkansas dates basically from a practice plan put into effect in 1969, though more recent changes have also occurred. Under the 1969 plan, physicians were not members of corporations; instead, they belonged to a single non-corporate organization. This organization was responsible, through its membership and steering committees, to the Dean of the College of Medicine. Under the direction of a manager, who is appointed by and responsible to the Dean, the organization collected all revenue generated by the physicians. The practice plan has recently been changed to include physicians' corporations.

Under the University's relationship, revenues generated by the physicians are subject to a high degreee of visibility on the part of University administrators and elected state officials. The revenue collected from physicians' fees is not considered to be state money, but it is deposited in special accounts within the state system and as such is subject to state expenditure procedures. Most of the revenue that is collected is returned to individual departments, where it is also retained by the medical school to pay for centralized functions, including overhead, and to provide some reduction in the differences in earning power between high-earning and low-earning departments.

The Legislature establishes the base salaries for physicians at the medical school. Most of the physicians operate under a total salary ceiling that allows them to double the amount of their base salary through revenues from their private practices. In recent years, the medical school has been developing ways to increase the salary ceiling and to allow greater incentives for physicians to generate additional revenue in their practices.

The University of Iowa

Iowa's practice plan is the oldest of those at the medical schools surveyed, dating from 1946. There are no corporations at the medical school; instead, as at the University of Arkansas, all clinical departments are included in a single non-corporate organization. All revenue generated by the physicians is collected by the University through the organization.

The practice plan at the University of Iowa provides a high degree of visibility for revenue generated by physicians. Salaries, including that portion of salaries that comes from physicians' fees, are a line item in the budget. Most of the revenue from physicians' fees is returned to the departments, but amounts are deducted for centralized functions, including overhead, and for some reduction in the differences in earning power between departments.

Physicians' salaries are established by the Dean of the College of Medicine and the department chairman. Physicians' base salaries are generally composed of state appropriations, grants, and endowment funds, and they may receive up to 150 percent of their base salaries from private practice funds.

The University of Oklahoma

Of the five medical schools surveyed, the University of Oklahoma medical school has undergone the greatest change in recent years. Before 1973, the medical school had a practice plan similar in several respects to the current practice plan at the University of Kansas. Under the old plan, physicians were permitted to generate their own fees, which they deposited in separate accounts outside state control. The physicians supplied annual financial statements for these accounts, but there was little or no way to verify them.

In 1973, the Oklahoma Legislature directed that a new practice plan be drawn up. The plan was to make the following four major changes: separation of the University hospital from the medical school, placement of all revenue generated by physicians into state accounts, establishment of salary ceilings for all physicians, and formation of a centralized billing system. Details of the plan were drawn up by the medical school and by a private consulting firm. The new plan went into effect in January 1974.

Under the current plan, there are no physicians' corporations. Revenues generated by physicians are deposited into state accounts. Physicians receive a base salary from the state, and, as in other states, supplement this salary with the revenue generated from their practices. Uniform salary ceilings have also been established. These ceilings are high enough that physicians in low-earning departments cannot reach the maximum amount; in some high-earning departments, on the other hand, the salary ceiling is guaranteed. The medical school retains portions of the revenue from physicians' practices for overhead, billing, other operational costs, and providing some reduction in the differences in earning power between departments.

The change to the new plan created considerable turmoil at the medical school. A number of faculty members and administrators resigned. According to administrators and faculty members interviewed, however, the plan is now working well.

The University of Missouri

The basic practice plan used by the University of Missouri was established in 1956 and modified in 1974. The 1956 plan was patterned after the plan used at the University of Iowa. It established fixed maximum earnings, part of which was a base salary paid by the state and part of which was earned through income from private practice. In 1974, the plan was changed to allow for increased earning incentives.

Under the current plan, all revenue generated by physicians becomes State money and is placed into restricted departmental accounts. Each faculty member receives a base salary that is set by the Dean of the Medical School; part of this base salary is paid from State and other funds, and part is paid by revenue from patients' fees. If additional revenue from patients' fees is available after the University has received payment for overhead and after base salaries have been paid, physicians receive "incentive" salary based on the amount of income they have generated. As a result, the more revenue a physician generates, the more he or she is paid. Part of this additional revenue also goes back to the department, and part goes into a Dean's account for research, development, and other purposes. Expenditures from all funds must conform to University policy.

Physicians at the medical school are not organized into corporations. For the purpose of determining the amount of their incentive salary, they are permitted to add their revenue with that generated by others.

The University of Nebraska

The medical schools described so far require that all physicians' fees be deposited into state accounts. The practice plan at the University of Nebraska requires that only part of the fees be deposited. The medical school distinguishes between patients who have been referred to a specific physician for treatment and patients who have not. Revenue generated from "non-referral" patients--approximately one-half of the total patient load--must be deposited with the state. Part of this revenue goes to the Dean's Development Fund for use throughout the school; the remainder is divided among the departments on the basis of where it was generated. Revenues from "referral" patients remain with the physician. There is no upper limit on the amount a physician can receive from referral patients.

Physicians receive a base salary from the state. Medical school administrators do not know how much a physician earns beyond the base salary. Of the five schools surveyed outside of Kansas, revenue from patient fees is the least visible at the University of Nebraska.

APPENDIX B

AGENCY RESPONSE

The draft audit report was sent to the University of Kansas for review. This procedure is followed in the preparation of all audit reports and offers an opportunity for the agency to point out any errors of fact, to provide information pertaining to the audit's findings, and tc indicate its agreement or disagreement with the recommendations.

This appendix contains the University's response to the audit's recommendations. The University also responded to other issues in the report, but these responses and Legislative Post Audit's replies were too lengthy to be included in this report. Instead, a separate volume was prepared containing the responses and Legislative Post Audit's replies. This volume was distributed to the Legislative Post Audit Committee. Additional copies are available on request.

Several recommendations addressed in this response have been modified. Explanations of the draft recommendations will be found on pages S-10 and S-11 of the "Summary of Matters for Legislative Attention" at the front of this report.

THE UNIVERSITY OF KANSAS

Office of the Chancellor
223 Strong Hall, Lawrence, Kansas 66045
(913) 864-3131

June 2, 1978

Dr. Richard Brown
Legislative Post Auditor
Division of Legislative
Post Audit
The Mills Building
Topeka, Kansas 66612

Dear Dr. Brown:

With this letter I am forwarding the response of the University of Kansas to the draft audit report on physicians' corporations at the University of Kansas Medical Center. For clarity, the response is divided into three parts: Part I addresses the recommendations found on pages 45 through 47 of the report; Part II addresses other major issues within the report; and Part III suggests some changes in wording at various places throughout the report.

We appreciate having had opportunity to review the draft of the report and to comment on it. If you have questions about our response we would be pleased to visit with you and provide any additional information you might want.

Sincerely,

Archie R. Dykes
Chancellor

ARD:mas

Main Campus, Lawrence
College of Health Sciences and Hospital, Kansas City and Wichita

Response of the University of Kansas
to the Draft Audit Report on
Physicians Corporations at the University of Kansas Medical Center

Part I

Response to Recommendations in the Report

The audit report concludes that some of the issues which merit legislative attention relate to the handling of revenues of the physicians' corporations, while others relate to the Medical Center's ability to meet educational goals established for it by the state. The report further concludes that if changes should be made to address these issues there would be three basic alternatives--eliminating physicians' corporations entirely, adjusting contracts within the existing relationship, or establishing a single physicians' corporation. The report further states that elimination of the physicians' corporations would have a number of disadvantages both for the physicians and the state and would probably be the least desirable alternative.

In its recommendations the report suggests that the Legislative Post Audit Committee consider directing that the University, acting in conjunction with the Board of Regents, develop a plan for making the desired changes either by strengthening the current contracts or by contracting with one corporation or one "umbrella" corporation. We believe that if we were starting from scratch that it might be possible to form a single corporation. Given the long history of the physicians' corporations in the College of Health Sciences and Hospital, however, efforts to dissolve the existing corporations and form a single corporation would create an unusual amount of disruption and perhaps impede progress towards some of our more important goals, especially those involving the dedication of faculty time to health care outreach programs. We do believe it is appropriate, however, to seek ways of strengthening the contractual relationships between the corporations and the University, and we plan to do so when the contracts come up for renewal in 1980. We hope, therefore, that the decision by the Legislative Post Audit Committee will be to approve this plan rather than mandating the formation of a single corporation.

Efforts to form a single corporation would, we believe, result in the loss of some of our top clinicians; and it would undoubtedly result in a reduction of incentive for physicians to earn corporate income. This latter result would have the effect of reducing corporate revenue and adding thereby an additional burden on the state general revenue fund for medical faculty salaries, for salaries for a number of support staff who are now supported from corporate revenues, and for operating funds to replace corporate revenues which support to a significant degree the operations of clinical departments. We believe that by strenthening the contracts with the several corporations we can achieve the goals which we share with the Legislative Post Audit Committee--efforts to meet health care needs of our state and to strengthen further fiscal accountability in the operation of the physicians' corporations.

The draft audit report had several other recommendations which the Division of Legislative Post Audit suggests should be a part of any plan for the strengthening of the contractual relationships between the physicians' corporations and the University. Our responses to these several items are enumerated below.

1. The establishment of overhead rates. We agree that overhead rates should be related to actual overhead expenses. Our Office of Business and Fiscal Affairs is developing an annual review process which will provide for adjustments in overhead rates as necessary to meet actual expenses.

2. Improvements in corporate budget procedures. We agree that a corporate budget should be established for each corporation and should require approval by the Executive Vice Chancellor and the Chancellor. Moreover, as with other units of the University, the budget for a corporation should not be exceeded unless the Executive Vice Chancellor and the Chancellor approve the budget increase, based on evidence that unforeseen circumstances have arisen and that the corporation has funds available. We agree also that monthly expenditure reports should be submitted for review and have taken steps to assure that there is compliance with this requirement.

3. Establishment of a single billing service. We agree that it would be good if a single billing service could be developed to include all physicians' charges for a patient in a single bill. To make such a change, however, would require a major planning, system design, and computer programming effort.

   Going to a single billing system for all physicians' charges would also create a significant administrative problem. If, for example, a patient received a bill for $1,000 but only remitted $300, how would the receipts be prorated among the several corporations involved? How would appropriate adjustments be handled? Clearly, a whole new set of collection rules and reporting procedures would have to be developed and established and associated legal aspects of this whole matter would also have to be determined.

   While we believe it might be a beneficial thing to do, there are a significant number of problems which would have to be worked out before we could go to a single billing service. We have been looking into this matter for some time and intend to keep trying to work toward a single billing service for the convenience of our patients. However, for the time being we believe we should maintain the present system until we have resolved the problems involved in changing to a single billing service.

4. Improvements in oversight on physicians' salary ceilings. We do not believe that salaries for corporate members should be set on a calendar year basis but rather on a fiscal year basis as they are for other state employees. We also have serious reservations about the recommendation that corporate members be singled out and required to file copies of their annual federal and state income tax returns in the corporate offices for review by independent auditors or by the Legislative Division of Post Audit. As reported to Post Audit staff, the University administration receives confirmation reports from the independent audit firms which confirm that salaries as set by the University are not exceeded. We, of course, cannot determine, as we could not with other faculty members, what outside income corporate members might receive from various sources--lecture fees, honoraria, investments, etc.--but we do require, as a part of the contractual relationships, that all of the earnings of a physician member of the physicians' corporations which he or she may earn for "services performed for others..., including fees for consultation to industry, government, and the like, and compensation from institutional sponsors..." become corporate revenue. (See IV, 4.1 of the contracts between the corporations and the University.) Audit reports confirm compliance with this requirement.

5. Deposit and distribution of department development funds. We have serious reservations about the proposed deposit of corporate earnings in excess of budgeted expenditures in a state restricted fee fund (or funds). The corporations have invested a significant portion of their earnings in the purchase of equipment for use in the hospital and for improvement of patient areas, physicians' offices, and clinics. Moreover, with improvements in corporate budget procedures requiring approval by the Executive Vice Chancellor and the Chancellor of expenditures in excess of budgeted expenditures, unusual or inappropriate expenditures cannot be made.

   One of our serious reservations with this proposal is that it would have the serious negative effect of reducing physicians' incentive to earn additional corporate revenues which could be used to attract other highly qualified clinicians for their departments, to purchase necessary equipment, and to make other improvements. Moreover, because of the state's unwieldy purchasing system, such a requirement would create difficulties in the acquisition of highly specialized equipment which the corporations purchase for the Medical Center as funds are available. With the controls we have established through the handling of Endowment Association accounts and with the manifested willingness of the corporations to devote additional income to the betterment of the Medical Center, (as with the dedication of some corporate earnings for the purchase of necessary equipment for the new hospital), we believe the better alternative would be to continue to deposit such additional income in the Kansas University Endowment Association. The current practice provides necessary flexibility in the expenditure of funds, and controls over such expenditures are exercised by the Executive Vice Chancellor and the Chancellor.

6. Membership on the board of a single corporation. While we hope the committee will choose the alternative of having us strengthen our contractual relationships between the corporations and the University, we certainly believe that if a single corporation should be formed one or more members of the governing body should be appointed by the Chancellor.

In summary, we believe the better alternative would be the strengthening of the contractual relationships between the corporations and the University. It is our plan to move in that direction when the contracts are renewed in 1980, because efforts to form a single corporation from the several existing corporations would create unusual problems. Moreover, there could be tax problems involved in combining all the corporations into a single unit; and a single corporation would not avoid the double payments for Social Security noted by Post Audit staff because this is a technical problem which occurs when a person works for two separate legal entities.

We believe that strenthening the contractual relationships between the several corporations and the University will enable us to achieve what we and the Legislative Post Audit Committee believe are necessary improvements.

LEGISLATIVE DIVISION OF POST AUDIT

PROGRAM AUDITS ISSUED

Regulating the Appropriation and Use of Water
December 1975

Selected Support Services at the University of Kansas Medical Center
January 1976

Management of Surplus State-Held Land
May 1976

The Planning and Construction of the State Freeway System
September 1976

Accounts Receivable Management: Establishing an Effective Credit Management System in Kansas
December 1976

The Planning and Construction of New Facilities at the Board of Regents' Institutions
March 1977

Controlling Medical Assistance Costs in Kansas

Part I: Improved Accountability Through Better Program Information and More Effective Budget Review
August 1977

Part II: Options for Containing Costs
December 1977

Collecting Enrollment Fees at the Board of Regents' Institutions
November 1977

Improving General Assistance in Kansas
January 1978

Assessing the Effectiveness of the Kansas Motor Carrier Inspection System
March 1978

The Kansas Community Junior College System

Part I: State Financing and Supervision
June 1978