

Internal Control Challenges in a Down Economy

HFMA Northern California Meeting March 25 & 26, 2010 Sacramento, California

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The Challenge

- Underestimating the potential for wrongdoing
- Increasing pressure
- Compliance/Internal controls are often overlooked priorities
- Law/rules aren't always logical/intuitive



Ethics

- Perception: _____
- Reality
 - Cheating
 - Stealing
 - Resumes
 - Reporting

- Stanford prison experiment
- “Shocking” behavior
- Culture is an important predictor of problems
- Pressure + opportunity = misconduct!

Internal Control Basics

- Appropriate process/procedure
- Training
- Thoughtful metrics
- Management commitment
- Audits/reviews
- Discipline for non-compliance

Internal Control Issues

- Weak systems
- Failure to follow policy
- Management neglect/incompetence
- Missing the red flags
- Trust Is Not An Internal Control!!!

Pressure Points

- Internal
 - Overtime
 - Staffing ratios
 - Other metrics
 - Quality
 - Productivity
- External
 - Mortgage
 - College tuition
 - Spouse job loss
 - Credit and Debt
 - Gambling

Addressing the Problem

Problem: Incentives are skewed

Solution: Align Incentives

- Specific, measurable objectives
- Link to compensation
- Transparency
- Culture matters

Specific, Measurable Objectives

➤ Structural (OSGs)

orientation	investigation
education	remediation
screening	reporting

➤ Substantive (high risk areas)

Tip: Metrics easier to “sell” if management understands the benefits.

See Appendix 1 for metric ideas.

What are your facilities biggest risks?

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What controls are in place to ensure you don't have issues?

Reporting: Culture of Compliance

- Evaluate, Report, Enforce
 - Insist on regular, transparent reporting
 - Conduct audits to validate reporting/ performance
 - Report key metric results to management & board

Tip: Tie to compensation. Treat compliance as a threshold element in the performance and incentive evaluation process, particularly for key management employees.

Addressing the Problem: Internal Controls

- Trust is not an internal control!
- Build controls into processes
- Build control checks into management performance
- Do your metrics encourage bad behavior?
- Hold management accountable for control failures

Resources

Why It's Hard to Be Good , Al Gini, Rutledge 2006

The Lucifer Effect: Understanding How Good People Turn Evil, Philip Zimbardo, Random House 2008

The Seven Signs of Ethical Collapse: How to Spot Moral Meltdowns in Companies . . . Before It's Too Late, Marianne M. Jennings, J.D., St. Martin's Press 2006

How to Pad Your Expense Report . . . And Get Away with It, Employee X, Easy Money Press 2005

Crucial Conversations: Tools for Talking When Stakes are High, Kerry Patterson et. al., McGraw-Hill, 2002

Difficult Conversations: How to Discuss What Matters Most, Douglas Stone et. al., Penguin Books 1999



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Resources

2004 Federal Sentencing Guidelines, Organizations, Chapter 8 – Part B. Remedying Harm from Criminal Conduct, and Effective Compliance And Ethics Programs.

<http://www.ussc.gov/orguide.htm>



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