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Internal Control Audit:

HEALTH CARE AGENCY DISBURSEMENT APPROVAL PROCESS

For the Period July 1, 2009 through June 30, 2010

High **Impact Audit**

During the audit period, HCA disbursed over \$659 million in expenditures for services and supplies; salaries and employee benefits; equipment; structures and improvements; other charges; and other financing uses. HCA, HCA Accounting Services and Auditor-Controller Claims & Disbursing process and approve all disbursements for the agency.

We audited the Health Care Agency Disbursement Approval Process to evaluate internal controls used for approving and processing disbursements (e.g., payments to vendors for commodities and services); to determine if the disbursements approval process is efficient and effective; and to evaluate compliance with Internal Revenue Service 1099 reporting requirements.

Our audit found internal controls are in place to ensure disbursements are valid, supported, and comply with County and HCA policy; the disbursement approval process is efficient and effective; and measures were taken to improve compliance with IRS 1099 reporting requirements. We identified six (6) Control Findings to enhance controls with regards to segregation of duties, payment authorization policies and procedures, audit trails of changes to payment documents, duplication of work, and the identification of payments as IRS 1099 reportable.

> **AUDIT NO: 1025** REPORT DATE: MAY 17, 2011

Director: Dr. Peter Hughes, MBA, CPA, CIA Deputy Director: Eli Littner, CPA, CIA Senior Audit Manager: Michael Goodwin, CPA, CIA Senior Internal Auditor: Lisette Free, CPA, CFE

RISK BASED AUDITING

GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010

American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

> 2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year - Ethics Pays







GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010

Providing Facts and Perspectives Countywide

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Letter from Dr. Peter Hughes, CPA





Transmittal Letter

Audit No. 1025 May 17, 2011

TO: David Riley, Director, Health Care Agency David Sundstrom, Auditor-Controller

FROM: Dr. Peter Hughes, CPA, Director Internal Audit Department

SUBJECT: Internal Control Audit: Health Care Agency

Disbursement Approval Process

We have completed an Internal Control Audit of the Health Care Agency Disbursement Approval Process for the period July 1, 2009 through June 30, 2010. We performed this audit in accordance with our *FY 2010-11 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors. Our final report is attached for your review.

Please note we have a structured and rigorous **Follow-Up Audit** process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). Our **first Follow-Up Audit** will begin at <u>six months</u> from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our **second Follow-Up Audit** will begin at <u>six months</u> from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented. At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

We have attached a **Follow-Up Audit Report Form**. Your agency should complete this template as our audit recommendations are implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

Each month I submit an **Audit Status Report** to the BOS where I detail any critical and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

As always, the Internal Audit Department is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendations. Additionally, we will request your department complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

ATTACHMENTS

Other recipients of this report are listed on the OC Internal Auditor's Report on page 5.

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Audit No. 1025 May 17, 2011

TO: David Riley, Director, Health Care Agency

David Sundstrom, Auditor-Controller

FROM: Dr. Peter Hughes, CPA, Director

Internal Audit Department

SUBJECT: Internal Control Audit: Health Care Agency

Disbursement Approval Process

Audit Highlight

Successes

HCA Accounting Services' Accounts Payable Unit is authorized to approve certain HCA disbursements (provider payments) on behalf of the Auditor-Controller. HCA is one of the County's largest agencies and had over \$659 million in expenditures including salaries and various disbursements.

We found that internal controls are in place to ensure HCA disbursements are valid, supported, and comply with County and HCA policy; the disbursement approval process is efficient and effective; and measures were taken to improve compliance with IRS 1099 reporting requirements.

We also found HCA Accounting Services' disbursement approval process is in alignment with the disbursement approval process in Auditor-Controller Claims & Disbursing to ensure consistency in disbursement processing.

We identified six (6)
Control Findings with
regards to segregation of
duties, payment authorization
policies and procedures, audit
trails of changes to payment
documents, duplication of
work, and identification of
payments as IRS 1099
reportable.

OBJECTIVES

In accordance with our FY 2010-11 Audit Plan and Risk Assessment approved by the Audit Oversight Committee and the Board of Supervisors, the Internal Audit Department conducted an Internal Control Audit of the Health Care Agency (HCA) Disbursement Approval Process. Our audit included an evaluation of internal controls, testing compliance with HCA, HCA Accounting Services' and County policies; and evaluating process efficiencies and effectiveness. Our audit was conducted in conformance with professional standards established by the Institute of Internal Auditors. The objectives of this audit were to:

- 1. Evaluate internal controls in HCA and HCA Accounting Services for approving and processing disbursements to ensure payments are valid, supported, comply with County and HCA policies, and are aligned with disbursement approval processes in A-C Claims & Disbursing.
- 2. Determine if the disbursement approval process is efficient and effective (e.g., no backlogs, duplication of work, manual processes that could benefit from automation).
- 3. Evaluate controls for compliance with IRS 1099 reporting requirements.

RESULTS

Objective #1: HCA and HCA Accounting Services have internal controls in place for approving and processing disbursements to ensure payments are valid, supported, comply with County and HCA policies and are aligned with the disbursement approval process in A-C Claims & Disbursing. We identified **four** (4) Control Findings where controls can be enhanced with regards to enhancing segregation of duties, strengthening payment authorization policies and procedures, and having audit trails of changes to payment documents.

<u>Objective #2:</u> We found no backlogs or processes that could benefit from automation pertaining to the disbursement approval process. We identified **one (1) Control Finding** concerning duplication of work in the disbursement approval process performed by HCA Accounting Services and A-C Claims & Disbursing.

Objective #3: We found controls for compliance with Internal Revenue Service 1099 reporting requirements were established and should be maintained to ensure continued compliance. We identified **one (1) Control Finding** concerning payments that were not accurately identified as IRS 1099 reportable.



We commend HCA and HCA Accounting Services for their existing disbursements approval process and controls noted during our audit and for their efforts and adherence to policies and procedures. See further discussion in the *Detailed Findings, Recommendations and Management Responses* section of this report. See *Attachment A* for a description of Report Item Classifications.

BACKGROUND

The Health Care Agency (HCA) mission is dedicated to "protecting and promoting the optimal health of individuals, families, and communities through partnerships; community leadership; assessment of community needs; planning & policy development; prevention & education; and providing quality services." Within HCA, **Financial and Administrative Services** provides internal support to HCA's varied divisions and programs as well as interfacing with the HCA's external community organizations, contractors, and stakeholders. Under Financial and Administrative Services, the following divisions work together to process and approve HCA's disbursements:

- **Central Operations** is comprised of Purchasing, Facilities Operations and Agency Services and are responsible for HCA's procurement processes.
- Contract Development and Management develops, solicits, negotiates, and administers human services contracts and approves contract payments.
- **Financial and Program Support Services** helps ensure compliance with Federal, State, County, and HCA policies, procedures, and guidelines for disbursements, claims, fees, rates, budget, and financial reporting.
- HCA Accounting Services is comprised of Auditor-Controller employees that provide accounting services and support to the Agency. HCA Accounting Services is responsible for reviewing, approving, and processing disbursements on behalf of the Agency and Auditor-Controller. Our audit focused primarily on the disbursement approval process and controls in HCA Accounting Services.

HCA Disbursements

During the Fiscal Year 2009/10, HCA disbursed the following amounts by expenditure category:

	<u>Amount</u>
Salaries and Employee Benefits	\$230,991,279
Services and Supplies	324,265,499
Services and Supplies Reimbursements	(18,067)
Other Charges	7,799,728
Equipment	2,286,139
Structure and Improvements	15,378
Other Financing Uses	92,368,962
Miscellaneous	<u>1,074,505</u>
Total	\$658,783,423

HCA, HCA Accounting Services and Auditor-Controller Claims & Disbursing process and approve all disbursements for the agency. Our audit only included disbursements made for Services and Supplies, Other Charges, Equipment, and Structure & Improvements.

HCA Accounting Services – Accounts Payable (AP) Unit

HCA Accounting Services' AP Unit is responsible for reviewing and processing HCA disbursements. Effective July 1, 2009, disbursements are processed via the upgraded financial system - CAPS+ (County-wide Accounting and Personnel System+). Disbursements are processed either as: 1) Non-Deputy Purchasing Agents (DPA) Contract Invoices, or 2) DPA Contract Invoices.



- 1. Non-DPA Contract Invoices are received from HCA Contract Development and Management (CDM). CDM submits invoices to the HCA Accounting AP Unit for payment processing. An authorized signature by the Contract Administrator indicates the receipt/completion of the contracted services, and that the invoice has been verified to the contract terms and agreements. AP Accounting Technicians audit the invoices and process them for payment by ensuring there is 'legal authority to pay' in accordance with the terms and conditions of the contract. AP maintains contract folders that include copies of the contract's applicable documentation, such as Agenda Staff Reports (ASRs) and Minute Orders to ensure compliance with terms and conditions of the contract. Invoices are reviewed and forwarded to HCA Accounting AP Unit management for their review and signature authorization to pay as follows:
 - a. Payments over \$100,000 require approval by a Supervisor.
 - b. Payments over \$500,000 require approval by an Accounts Payable Manager.
 - c. Payments over \$1 million require approval by the Disbursements Manager.
 - d. All miscellaneous vendor payments require approval regardless of amount.

Once payments are approved, they are input into CAPS+ in HCA Accounting Services, and payment information is sent to A-C Claims & Disbursing for issuance of the payment.

Use of CAPS+ for Processing HCA Disbursements - Non-DPA Contract Invoices

With the implementation of CAPS+, an automated workflow approval process was created for certain purchasing documents, such as Requisitions, Delivery Order, Master Agreements, Contracts, and Purchase Orders. However, we noted the payment documents (i.e. Payment Requests and related documents), Non-Encumbered Expenses, General Accounting Refunds, and On Demand Wire Payments do not have an automated workflow approval process. With CAPS+, the only automated approval process established document is the General Accounting Trust (GAT) payment. Therefore, regardless of the type of payment created within CAPS+; all reviews and approvals other than GAT payments are performed manually. The CAPS+ Implementation Team is responsible for administration of CAPS+ and is outside the scope of HCA Accounting Services' responsibility.

There are certain disbursements that <u>HCA Financial and Program Support Services</u> are responsible for approving, primarily for Federal, State and pass-through payments that have specific guidelines to be followed prior to submission to HCA Accounting Services for further payment processing. These types of disbursements may not be routed through HCA Purchasing or CDM. Once these types of payments are forwarded to AP, they follow the same process as <u>Non-DPA Contract</u> invoices noted above. Approvals are authorized by HCA Financial and Program Support Services staff.

- 2. DPA Contract Invoices are received directly in the mail with a few exceptions. HCA Purchasing maintains an Access database (known as Purchasing Access) to track all DPA Contract expenditures/invoices. The database is shared with HCA Accounting. HCA Accounting Services reviews the invoices to the terms and conditions of the agreement; verifies the charges are valid by either a 'three-way match' between requisition, invoice and packing slip or written verification from the Agency that the services were performed; and ensures there is sufficient funding to cover the payment prior to submission to A-C Claims & Disbursing. Once HCA Accounting Services reviews and approves the invoices, the documentation is sent to A-C Claims & Disbursing for further payment processing and approval. Note: HCA Accounting does not enter these payments into CAPS+. A-C Claims & Disbursing enters these types of payments into CAPS+ after conducting their review.
- 3. **One-Time Purchase Orders** are <u>not</u> routed to HCA Accounting Services for review; instead, they are submitted directly from HCA Purchasing to A-C Claims & Disbursing for review and approval, and issuance of payment.



Internal Revenue Service 1099 Reporting Requirements

The Internal Revenue Service (IRS) requires entities to issue a Form 1099 to individuals or entities if they meet certain requirements. CAPS+ requires communication of data from the vendor table to capture IRS 1099 reporting at the end of the year. Due to system limitations, any IRS 1099 reportable payments must be identified at the time a payment is processed. Therefore, a determination must be made as to whether a payment is IRS 1099 reportable when entering the payment in CAPS+.

SCOPE AND METHODOLOGY

Our audit covered the period July 1, 2009 through June 30, 2010 and included the following:

- 1. Evaluated whether internal controls are in place over the disbursement approval process in HCA and HCA Accounting Services to ensure the disbursements are accurate, valid, adequately supported, and properly recorded. *Note: For purposes of this review, disbursements are defined as cash, check, and electronic wire disbursements.*
- 2. Determined if disbursements are reviewed and authorized by the initiating HCA divisions, such as Contract Development and Management, Purchasing, and Financial and Program Support Services in compliance with policies & procedures and management directives.
- Assessed policies, procedures and controls in HCA and HCA Accounting Services to determine if they are aligned and consistent with disbursement approval processes in Auditor-Controller Claims & Disbursing.
- 4. Evaluated controls for compliance with IRS 1099 reporting requirements.
- 5. Evaluated the efficiency and effectiveness of the disbursement approval process, such as for instances of backlogs, duplication of work, manual processes that could benefit from automation, and utilization of CAPS+ for processing of disbursements.

SCOPE EXCLUSIONS

Our audit scope did not include the controls, policies and processes in HCA Purchasing, Contract Development and Management, Financial and Program Support Services, and HCA programs/divisions concerning their roles in reviewing and approving disbursements, except for reviewing disbursement approval procedures and verifying that individuals designated as "authorized signers" in those areas were properly authorized on HCA's Access Request Forms.

Management's Responsibilities for Internal Controls

In accordance with the Auditor-Controller's County Accounting Manual section S-2 *Internal Control Systems*, "All County departments/agencies shall maintain effective internal control systems as an integral part of their management practices. This is because management has primary responsibility for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls." Control systems shall be continuously evaluated by Management and weaknesses, when detected, must be promptly corrected. The criteria for evaluating an entity's internal control structure is the Committee of Sponsoring Organizations (COSO) control framework. Our Internal Control Audit enhances and complements, but does not substitute for HCA's and HCA Accounting Services' continuing emphasis on control activities and self-assessment of control risks.



Inherent Limitations in Any System of Internal Control

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in HCA and HCA Accounting Services' operating procedures, accounting practices, and compliance with County policy.

Acknowledgment

We appreciate the courtesy extended to us by the Health Care Agency and HCA Accounting Services during our audit. If we can be of further assistance, please contact me directly or Eli Littner, Deputy Director at 834-5899 or Michael Goodwin, Senior Audit Manager at 834-6066.

Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Steve Dunivent, Deputy CEO, Government & Public Services, CEO
Bob Wilson, Assistant Agency Director, HCA
Jeff Nagel, Ph.D., Deputy Agency Director & Chief Compliance Officer, HCA
Shaun Skelly, Chief Deputy Auditor-Controller
Jan Grimes, Director, A-C Central Accounting Operations
Victoria Ross, Senior Manager, A-C Claims & Disbursing
Kimberly Engelby, Manager, HCA Accounting Services
Brent Scarborough, Manager, Disbursements, HCA Accounting Services
Chi Vu, Manager, Accounts Payable and Payroll, HCA Accounting Services
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors



<u>Objective #1</u>: Evaluate internal controls in HCA and HCA Accounting Services for approving and processing disbursements to ensure payments are valid, supported, comply with County and HCA policies, and are aligned with disbursement approval processes in A-C Claims & Disbursing.

Finding 1 – Segregation of Disbursement Processing and Approval Duties

Summary

HCA Accounting Services' management personnel are authorized to approve vendor invoices and process disbursements as noted in HCA's Access Request Forms (forms in CAPS+ which designate an employee's authorized responsibilities along with their authorized signature). Effective segregation of duties should not enable an employee the ability to both process and approve payments. (Control Finding)

Details

HCA Accounting Services' management (Disbursements Manager, Accounts Payable & Payroll Manager, and AP Supervisor) each have the ability to process and approve payments for DPA Contract vendor invoices. These contracts are initiated by HCA Deputy Purchasing Agents and the related contract invoices are sent to HCA Accounting Services for payment processing. We noted the above individuals are authorized to process and approve the vendor invoices on behalf of the HCA division receiving the goods/services. After approving the invoice, the payment package is sent to A-C Claims & Disbursing for input into CAPS+ and issuance of the payment.

This process resulted in several DPA Contract invoices not consistently having an approval signature by an authorized employee from the Agency; and instead, only had an approval signature by HCA Accounting Services' management. At the time of audit, HCA Accounting Services' management were the only authorized signatures for these types of invoices. For DPA Contract invoices, HCA Accounting obtains verification that the goods or services were received by performing a three-way match or obtaining a confirming e-mail from Agency personnel. For DPA Contract invoices pertaining to commodities, HCA Accounting Services only requires an initial/signature on the packaging slip or an e-mail confirmation and an approved requisition. For DPA Contract invoices pertaining to services, HCA Accounting Services requires program manager approval for services received. A department approval signature is not required for equipment leases since the equipment is listed on approved contracts.

To ensure proper segregation of duties, no single individual should have control over two or more phases of a transaction or operation. In addition, approval of a transaction is an important control activity; therefore, only authorized agency personnel should approve payment transactions. Should HCA Accounting Services decide to continue this process; a mitigating control would be to require authorized signatures from the initiating HCA divisions.

Recommendation No. 1

HCA Accounting Services amend the Access Request Forms for HCA Accounting Services management to ensure segregation of duties over the disbursement process are in place for the above positions. In addition, HCA Accounting Services should verify the payment approval signatures with HCA's Access Request Forms prior to processing payments.

Auditor-Controller/HCA Accounting Services Management Response:

Concur. Although the process had been mitigated within the units, the issue of segregation of duties on the Access Request Forms had been identified internally at an earlier date. The correction action plan involved a significant change in invoice processing whereby all invoices are now approved by an authorized signer in the Health Care Agency and verified to the Access Request Form. This process was implemented in January 2011. All Access Request Forms for HCA Accounting staff in Disbursements were modified to remove the ability to manually approve any identified Accounts Payable or Check Writing document. Recommendations were implemented by April 30, 2011.



Finding 2 – Adherence to Disbursement Approval Procedures

Summary

Our testing of transactions found areas where the disbursement approval process should be strengthened to ensure the payments are valid, supported, comply with County and HCA policy, and align with disbursement approval processes in A-C Claims & Disbursing. (Control Finding)

Details

Our testing of fifty (50) payment authorization transactions disclosed the following:

- Four (4) disbursements where HCA Accounting Services did not obtain the contractor's Expenditure and Revenue Report prior to processing the payment per their internal procedures. The Expenditure and Revenue Reports are maintained by HCA Contract Development Management (CDM) and therefore, HCA Accounting Services relies on the CDM approval signature. However, HCA Accounting Services obtains the Expenditure and Revenue Reports to support the monthly billing when the provisional payment amount is increased on the invoice. There is a risk that the payment amount is not accurate when required supporting documentation is not consistently obtained from CDM.
- One (1) disbursement was missing the required authorization from the CDM Contract Administrator to allow a disbursement over the contractual monthly maximum. The monthly payment of \$30,046 exceeded 10% of the total maximum obligation by \$2,346.

Certain invoices require an authorized signature from the initiating division approving the payment. There is no requirement for the authorized signer to print their name in addition to their signature on the payment request. HCA Accounting Services verifies that the original authorized signature is provided on the invoice and is from an authorized individual as stated on the Access Request Form. We noted instances where signatures were not easily recognizable and identifiable. If the HCA Accounting Technician does not confirm a signature that is not easily recognized, there is a risk that the payment request is not approved by an authorized signer.

Recommendation No. 2

HCA and HCA Accounting Services strengthen its disbursement approval process to ensure:

- Contractor's required supporting documentation (i.e. Expenditure and Revenue Reports) are obtained and reviewed, when required, to ensure the correct payment amount is paid;
- Contractual monthly maximums are not exceeded unless a contract allows for the Contract Administrator to approve in writing the amount over the monthly maximum, and signed approval is obtained and documented in the contract folder; and
- Signatures that are not easily recognizable have documentation of the verification of the authorized signature.

Health Care Agency Management Response:

Concur. HCA Contract Development Management (CDM) will ensure all invoices are submitted with proper approvals and supporting documentation as stipulated in the terms and conditions in the agreement. All agreements require the Contract Administrator to analyze the supporting documentation submitted by the provider with the invoice to ensure the amount is appropriate. CDM will work collaboratively with HCA Accounting to identify the type of supporting documentation that will be acceptable while also not duplicating efforts. Any applicable policy and procedure will be modified to include this change no later than October 1, 2011.

Auditor-Controller/HCA Accounting Services Management Response:

Concur. HCA Accounting will work collaboratively with HCA's Contract Development Management unit to clarify when supporting documentation will be required and the format that will be acceptable. Only payments that are properly approved will be processed. Additionally, the printed name of the authorized signer will be included and matched to the Access Request Form prior to processing for payment. Any applicable policy and procedure will be modified to include this change no later than October 1, 2011.



Finding 3 – Enhancing Disbursement Approval Policies and Procedures

Summary

HCA Accounting Services should establish policy and procedures defining the requirements for supervisory/management review and approval of invoices exceeding the \$100,000, \$500,000 and \$1,000,000 dollar thresholds and for miscellaneous vendor payments to help ensure their disbursement approval process is aligned with A-C Claims & Disbursing. In addition, procedures should be established to ensure that all payment requests exceeding \$100,000 have the required manual supervisory/management approval performed. (Control Finding)

Details

Disbursements over \$100,000 are reviewed to ensure there is legal authority to pay and disbursements are in accordance with HCA and County policies and procedures. Because these payments are <u>not</u> workflowed in CAPS+, a manual supervisory/management approval and signature is also required as follows:

- Payments over \$100,000 require approval by a Supervisor.
- Payments over \$500,000 require approval by an Accounts Payable Manager.
- Payments over \$1,000,000 require approval by the Disbursements Manager.
- All miscellaneous vendor payments require approval regardless of amount.

We noted there are no written procedures describing the supervisory/management review process, except for a procedure for Non-PO Contract invoices stating if a "payment transaction is over \$100,000, give invoice and folder to AP Supervisor for approval." The Accounting Technician notifies the AP Supervisor of the payment request requiring the manual supervisory/management approval. Our audit found that supervisory/management review verifies that the Accounting Technicians performed the required audit steps. However, HCA Accounting Services' procedures are silent on the supervisory/management review process for disbursements over \$500,000 and \$1,000,000. In addition, we noted the procedures are silent on who approves payments greater than \$100,000 in the event the designated individual is on a leave of absence. Our testing of fifty (50) transactions noted one (1) miscellaneous vendor payment was missing HCA Accounting Services management's documented signature approval. HCA Accounting Services began reviewing and approving miscellaneous vendor payments in May 2010.

A-C Claims & Disbursing has *Procedure No. II.A.36 – Payment Voucher Over Limit and Miscellaneous Vendor Code Approvals*, dated October 16, 2008, that can be used as a guide for HCA Accounting Services to establish a policy and procedure in this area.

In addition, because these payment requests are not workflowed, AP Accounting Technicians have the ability to "submit" payment requests directly to A-C Claims & Disbursing for payment. There is no verification in HCA Accounting Services that all payment requests exceeding \$100,000 received a manual supervisory/management approval. Our testing did not disclose any instances where manual supervisory/management reviews were not obtained.

Recommendation No. 3

HCA Accounting Services develop written policies and procedures that define requirements of the supervisory/management review and approval process for the three dollar thresholds (\$100K, \$500K, and \$1M). In addition, HCA Accounting Services should enhance its procedures to ensure the supervisory/management review of disbursements exceeding \$100,000 and miscellaneous vendor payments is performed and documented.

Auditor-Controller/HCA Accounting Services Management Response:

Concur. HCA Accounting will work collaboratively with Central Claims to update the policies and procedures for the processing of Non-DPA invoices to include the requirements for the supervisory and managerial review for invoices over the thresholds of \$100K, \$500K, and \$1M.



In addition, all payments in CAPS+ will be required to include a scheduled date to allow the utilization of a CAPS+ report identifying those payments requiring additional reviews. This report will be documented to support the verification that the additional supervisory and managerial reviews occurred prior to payment being made. Updated policies and procedures will be in place and staff trained no later than October 1, 2011.

Finding 4 – Audit Trail for Changes Made During Payment Processing

Summary

For disbursements exceeding \$100,000, an audit trail is not maintained for any changes made to payment documents during the supervisory/management review in instances when the supervisor/manager inputs and submits the changes in CAPS+. This is because the process is not workflowed and does not show when the creator of the payment document is different from the supervisor that "submits" the revised payment document for disbursement. (Control Finding)

Details

Our audit noted that disbursements over \$100,000 require a manual supervisory/management review; therefore, the Accounting Technician does not 'submit' the payment document in CAPS+ and provide the hardcopy payment documentation for a supervisory/management review. If a change is warranted to the payment document in CAPS+, the HCA Accounting supervisor/manager makes the necessary changes and 'submits' the payment document for disbursement. However, as a result of the supervisor/manager submitting the revised payment, CAPS+ does not generate an audit trail of any changes made to the payment document. CAPS+ only documents that it was created and modified by another individual (in this case the supervisor/manager). We also noted if disbursements over \$100,000 are altered or modified, there is no other independent review performed.

Because the process is not workflowed, CAPS+ does not provide any visibility to the changes that were made from the first time it was created and the last time it was updated unless a payment document is 'submitted.' CAPS+ does have the ability to create a modified payment document only when changes are made to submitted documents, and potentially could be modified to workflow the payment request process which would then establish an audit trail of modified documents.

To ensure CAPS+ maintains an audit trail of changes made to payment requests, an evaluation should be made to see if the process could be workflowed regarding the supervisory/management review. If that is not feasible, then the creator of the requests should input and submit the transaction in CAPS+. Any subsequent modifications will create a revised payment document and an audit trail of the changes made.

Recommendation No. 4

Auditor-Controller evaluate the feasibility of establishing a workflow process in CAPS+ for the payment review and approval process. If this is not feasible, then HCA Accounting Services Accounting Technicians should 'submit' all payment documents as the creator, regardless of amount, to ensure an audit trail is maintained within CAPS+ for revisions made during the supervisory/management review.

Auditor-Controller/HCA Accounting Services Management Response:

Concur. The addition of an established workflow in CAPS+ would be an enhancement to the system and is not considered to be a reasonable option at this time. Thus, the policies and procedures for the processing of Non-DPA invoices will be updated to include the requirement that all payments, regardless of amount, be "submitted" prior to supervisory or managerial review. Any changes required would result in a modified version of the initial transaction and the audit trail would be documented. Updated policies and procedures will be in place and staff trained no later than October 1, 2011.



<u>Objective #2</u>: Determine if the disbursement approval process is efficient and effective (e.g., no backlogs, duplication of work, manual processes that can be automated).

Finding 5 – Duplication of Work in HCA Accounting Services and A-C Claims and Disbursing

Summary

Our audit noted that HCA Accounting Services reviews and approves invoices for DPA Contracts prior to sending them to A-C Claims & Disbursing for further payment processing. A-C Claims & Disbursing performs the same reviews that HCA Accounting Services performs resulting in duplication of work. With the implementation of CAPS+, it is feasible that HCA Accounting Services and other Satellite Accounting Offices can perform on-site disbursement processing, approval and input of these payments into CAPS+ rather than the work being duplicated in A-C Claims & Disbursing. (Control Finding – Efficiency/Effectiveness)

Details

Currently, A-C Claims & Disbursing is responsible for processing, reviewing, approving, and inputting payments into CAPS+ for HCA's DPA Contracts and Purchase Order invoices that are initiated by HCA Deputy Purchasing Agents (DPAs).

This is the policy for all A-C Satellite Accounting Offices. This process was established for DPA agreements because they could be shared among various departments/agencies and was at the time, more effective to have them centralized. With the implementation of CAPS+, decentralization of these types of disbursements is feasible for Satellite Accounting Offices because master agreement/contract information is accessible to departments/agencies.

We were informed that A-C Claims & Disbursing had once considered delegating this responsibility to Satellite Accounting Offices, but did not pursue it due to other work priorities. A-C Claims & Disbursing is willing to evaluate this issue again and should discuss the proposed change of responsibilities with HCA Accounting Services and other Satellite Accounting Offices prior to delegating these duties for impact on their workload and staffing resources. Specifically, the impact on additional training needed for HCA Accounting Services should be considered since they currently do not process purchase order invoices or other special handling items such as sales and use tax, garnishments, etc.

Recommendation No. 5

Auditor-Controller Claims & Disbursing evaluate the feasibility of delegating disbursement approval responsibility for DPA agreements and purchase orders to HCA Accounting Services (and to other Satellite Accounting Offices) given the availability of such information in CAPS+.

Auditor-Controller/HCA Accounting Services Management Response:

Concur. HCA Accounting is open to the evaluation of delegating disbursement approval for DPA agreements. Purchase orders are not currently processed by HCA Accounting and the addition of these invoices would have an adverse impact on current workload and cannot be absorbed with current staffing levels. An analysis will be done collaboratively between HCA Accounting and AC Central Claims to determine the feasibility of delegating disbursement approval responsibility and the results will be reported to AC management no later than October 1, 2011.



Objective #3: Evaluate controls for compliance with IRS 1099 reporting requirements.

Finding 6 – Internal Revenue Service 1099 Reporting Process

Summary

HCA Accounting Services took measures to improve their process for identifying payments subject to IRS 1099 reporting requirements. Our testing of transactions noted that some disbursements were not accurately identified as IRS 1099 reportable. HCA Accounting Services should continue to ensure disbursements subject to IRS 1099 reporting are identified. (Control Finding)

Details

The implementation of CAPS+ impacted the processing of IRS 1099 reporting requirements in which business entities (including local governments) are required to report an entity's income made during the calendar year if they meet certain requirements. Disbursements for medical services are required to be identified when payments are scheduled that they are subject to 1099 reporting for individuals, sole-proprietors, partnerships as well as corporations. Since HCA deals with many human services contractors that provide medical services, this requirement primarily affects that agency. Prior to CAPS+, the vendor was designated as either 1099 reportable or not, so all of its invoices were either reportable or not. Currently, CAPS+ enables each individual line item on an invoice to be reported as 1099 reportable. A-C Claims & Disbursing provided the coding requirements and 1099 reporting guidelines to departments/agencies.

We were informed that identification of a vendor subject to IRS 1099 reporting can not be coded into CAPS+ when the vendor is established in the system. Instead, IRS 1099 reporting is identified at the time vendor payments are processed; therefore, an HCA Accounting Services Technician is responsible for identifying payments requiring 1099 reporting. To help identify IRS 1099 reportable vendors during payment processing, HCA Accounting Services maintains a Contract Payment Schedule that identifies the vendor as being 1099 reportable. In addition, HCA Accounting Services performs a review of its payments to ensure it captured all 1099 reportable payments. This helped to identify these vendors, but it could also be overlooked as indicated by the results of our testing of fifty (50) disbursements where we identified the following exceptions with regards to IRS 1099 reporting requirements that were subsequently corrected by HCA Accounting Services:

- Three (3) disbursements were for a corporation and/or partnership providing medical services that were not identified as reportable.
- One (1) disbursement was for a partnership providing non-medical services that was not identified as reportable; and
- Two (2) disbursements were for rent payments paid to an individual/sole proprietor that were not identified as reportable.

Although these exceptions were noted and subsequently corrected, HCA Accounting Services should continue to monitor disbursements during payment processing for compliance with IRS 1099 reporting requirements.

Recommendation No. 6

HCA Accounting Services ensure disbursements subject to Internal Revenue Service 1099 reporting are accurately identified.

Auditor-Controller/HCA Accounting Services Management Response:

Concur. HCA Accounting will update its policies and procedures to include verification of the required 1099 Sub-Object as part of the supervisory/managerial review criteria. In addition, HCA Accounting worked closely with Central Claims to develop a post audit strategy to ensure 1099 reporting is accurate. No less than semi-annually, a review will be done by HCA Accounting on their payments posted in CAPS+ to ensure proper 1099 coding. This review will be documented and all policies and procedures will be updated and in place no later than October 1, 2011.



ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we will classify audit report items into three distinct categories:

Critical Control Weaknesses:

Serious audit findings or a combination of Significant Control Weaknesses that represent critical exceptions to the audit objective(s) and/or business goals. Management is expected to address Critical Control Weaknesses brought to their attention immediately.

Significant Control Weaknesses:

Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses generally will require prompt corrective actions.

Control Findings:

Audit findings concerning <u>internal controls</u>, <u>compliance issues</u>, or <u>efficiency/effectiveness issues</u> that require management's corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.



ATTACHMENT B: Auditor-Controller/Health Care Agency Accounting Services **Management Responses**



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CAPS+ PROGRAM MANAGEMEN FOFFICE

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DAVID E. SUNDSTROM, CPA AUDITOR-CONTROLLER

May 4, 2011

TO: Dr. Peter Hughes, CPA, Director

Internal Audit Department

SUBJECT: Response - Internal Control Audit: Health Care Agency Disbursement Approval

Process, Audit No. 1025

The Auditor-Controller's Department has received the Internal Control Audit of the Health Care Agency Disbursement Approval Process for the period of July 1, 2009 through June 30, 2010, Audit No. 1025. As requested, the following narrative summarizes the six (6) control findings and responses from Auditor-Controller/HCA Accounting Services Management. The one (1) control finding requiring HCA Management's response will be addressed by the Health Care Agency directly in a separate correspondence.

Finding 1 - Segregation of Disbursement Processing and Approval Duties

Recommendation No. 1:

HCA Accounting Services amend the Access Request Forms for HCA Accounting Services management to ensure segregation of duties over the disbursement process are in place for the above positions. In addition, HCA Accounting Services should verify the payment approval signatures with HCA's Access Request Forms prior to processing payments.

Auditor-Controller/HCA Accounting Services Management Response:

Concur. Although the process had been mitigated within the units, the issue of segregation of duties on the Access Request Forms had been identified internally at an earlier date. The correction action plan involved a significant change in invoice processing whereby all invoices are now approved by an authorized signer in the Health Care Agency and verified to the Access Request Form. This process was implemented in January 2011. All Access Request Forms for HCA Accounting staff in Disbursements were modified to remove the ability to manually approve any identified Accounts Payable or Check Writing document. Recommendations were implemented by April 30, 2011.

Internal Control Audit: Health Care Agency Disbursement Approval Process Audit No. 1025



ATTACHMENT B: Auditor-Controller/Health Care Agency Management Response Continued

Response – Internal Control Audit: Health Care Agency Disbursement Approval Process May 4, 2011 Page 2 of 4

Finding 2 - Adherence to Disbursement Approval Procedures

Recommendation No. 2:

HCA and HCA Accounting Services strengthen its disbursement approval process to ensure:

- Contractor's required supporting documentation (i.e. Expenditure and Revenue Reports)
 are obtained and reviewed, when required, to ensure the correct payment amount is paid;
- Contractual monthly maximums are not exceeded unless a contract allows for the Contract Administrator to approve in writing the amount over the monthly maximum, and signed approval is obtained and documented in the contract folder; and
- Signatures that are not easily recognizable have documentation of the verification of the authorized signature.

Auditor-Controller/HCA Accounting Services Management Response:

Concur. HCA Accounting will work collaboratively with HCA's Contract Development Management unit to clarify when supporting documentation will be required and the format that will be acceptable. Only payments that are properly approved will be processed. Additionally, the printed name of the authorized signer will be included and matched to the Access Request Form prior to processing for payment. Any applicable policy and procedure will be modified to include this change no later than October 1, 2011.

Finding 3 - Enhancing Disbursement Approval Policies and Procedures

Recommendation No. 3:

HCA Accounting Services develop written policies and procedures that define requirements of the supervisory/management review and approval process for the three dollar thresholds (\$100K, \$500K, and \$1M). In addition, HCA Accounting Services should enhance its procedures to ensure the supervisory/management review of disbursements exceeding \$100,000 and miscellaneous vendor payments is performed and documented.

Auditor-Controller/HCA Accounting Services Management Response:

Concur. HCA Accounting will work collaboratively with Central Claims to update the policies and procedures for the processing of Non-DPA invoices to include the requirements for the supervisory and managerial review for invoices over the thresholds of \$100K, \$500K, and \$1M. In addition, all payments in CAPS+ will be required to include a scheduled date to allow the utilization of a CAPS+ report identifying those payments requiring additional reviews. This report will be documented to support the verification that the additional supervisory and managerial reviews occurred prior to payment being made. Updated policies and procedures will be in place and staff trained no later than October 1, 2011.

Finding 4 - Audit Trail for Changes Made During Payment Processing

Recommendation No. 4:

Auditor-Controller evaluate the feasibility of establishing a workflow process in CAPS+ for the payment review and approval process. If this is not feasible, then HCA Accounting



ATTACHMENT B: Auditor-Controller/Health Care Agency Management Response Continued

Response – Internal Control Audit: Health Care Agency Disbursement Approval Process May 4, 2011 Page 3 of 4

Services Accounting Technicians should 'submit' all payment documents as the creator, regardless of amount, to ensure an audit trail is maintained within CAPS+ for revisions made during the supervisory/management review.

Auditor-Controller/HCA Accounting Services Management Response:

Concur. The addition of an established workflow in CAPS+ would be an enhancement to the system and is not considered to be a reasonable option at this time. Thus, the policies and procedures for the processing of Non-DPA invoices will be updated to include the requirement that all payments, regardless of amount, be "submitted" prior to supervisory or managerial review. Any changes required would result in a modified version of the initial transaction and the audit trail would be documented. Updated policies and procedures will be in place and staff trained no later than October 1, 2011.

Finding 5 - Duplication of Work in HCA Accounting Services and A-C Claims and Disbursing

Recommendation No. 5

Auditor-Controller Claims & Disbursing evaluate the feasibility of delegating disbursement approval responsibility for DPA agreements and purchase orders to HCA Accounting Services (and to other Satellite Accounting Offices) given the availability of such information in CAPS+.

Auditor-Controller/HCA Accounting Services Management Response:

Concur. HCA Accounting is open to the evaluation of delegating disbursement approval for DPA agreements. Purchase orders are not currently processed by HCA Accounting and the addition of these invoices would have an adverse impact on current workload and cannot be absorbed with current staffing levels. An analysis will be done collaboratively between HCA Accounting and AC Central Claims to determine the feasibility of delegating disbursement approval responsibility and the results will be reported to AC management no later than October 1, 2011.

Finding 6 - Internal Revenue Service 1099 Reporting Process

Recommendation No. 6:

HCA Accounting Services ensure disbursements subject to Internal Revenue Service 1099 reporting are accurately identified.

Auditor-Controller/HCA Accounting Services Management Response:

Concur. HCA Accounting will update its policies and procedures to include verification of the required 1099 Sub-Object as part of the supervisory/managerial review criteria. In addition, HCA Accounting worked closely with Central Claims to develop a post audit strategy to ensure 1099 reporting is accurate. No less than semi-annually, a review will be done by HCA Accounting on their payments posted in CAPS+ to ensure proper 1099 coding. This review will be documented and all policies and procedures will be updated and in place no later than October 1, 2011.



ATTACHMENT B: Auditor-Controller/Health Care Agency Management Response Continued

Response – Internal Control Audit: Health Care Agency Disbursement Approval Process May 4, 2011 Page 4 of 4

The Auditor-Controller's Department appreciates the collaborative approach taken by Internal Audit in finalizing the report and in providing assistance in understanding the findings noted. Should you have any further questions, please contact Kim Engelby, HCA Accounting manager, at 714-834-5264.

Thank you.

David E. Sundstrom Auditor-Controller

DS:ke

Attachment

cc: Thomas G. Mauk, County Executive Officer Stephen Dunivent, Deputy CEO David L. Riley, Director, Health Care Agency Bob Wilson, Assistant Director, Health Care Agency Shaun Skelly, Chief Deputy Auditor-Controller Victoria Ross, AC Disbursements Manager Kim Engelby, HCA Accounting Manager



ATTACHMENT C: Health Care Agency Management Response



COUNTY OF ORANGE HEALTH CARE AGENCY

OFFICE OF THE DIRECTOR

DAVID L. RILEY
DIRECTOR

BOB WILSON ASSISTANT DIRECTOR

MAILING ADDRESS: 405 W. 5th STREET, 7th FLOOR SANTA ANA, CA 92701

TELEPHONE: (714) 834-6021 FAX: (714) 834-3660 E-MAIL: <u>driley@ochca.com</u>

May 6, 2011

TO:

Dr. Peter Hughes, CPA, Director Internal Audit Department

SUBJECT:

Internal Control Audit: Health Care Agency Disbursement Approval Process - Responses MEGRINAL AUDIT DEPARTHEN
2011 MAY | 1 NN 10: 42

The Health Care Agency has received the Internal Control Audit of the Health Care Agency Disbursement Approval Process for the period of July 1, 2009 through June 30, 2010. As requested, below summarizes the one (1) control finding and response from the Health Care Agency Management. The remaining control findings noted in the report will be addressed by HCA Accounting Services Management in a separate correspondence.

Finding 2 - Adherence to Disbursement Approval Procedures

Recommendation No. 2:

HCA and HCA Accounting Services strengthen its disbursement approval process to ensure:

- Contractor's required supporting documentation (i.e. Expenditure and Revenue Reports)
 are obtained and reviewed, when required, to ensure the correct payment amount is paid;
- Contractual monthly maximums are not exceeded unless a contract allows for the Contract Administrator to approve in writing the amount over the monthly maximum, and signed approval is obtained and documented in the contract folder; and
- Signatures that are not easily recognizable have documentation of the verification of the authorized signature.

Health Care Agency Management Response:

Concur. HCA Contract Development Management (CDM) will ensure all invoices are submitted with proper approvals and supporting documentation as stipulated in the terms and conditions in the agreement. All agreements require the Contract Administrator to analyze the supporting documentation submitted by the provider with the invoice to ensure the amount is appropriate. CDM will work collaboratively with HCA Accounting to identify the type of supporting documentation that will be acceptable while also not duplicating efforts. Any applicable policy and procedure will be modified to include this change no later than October 1, 2011.



ATTACHMENT C: Health Care Agency Management Response Continued

HCA appreciates the collaborative approach taken by Internal Audit in the finalizing of the report and in providing assistance in understanding the findings noted. Should you have any further questions, please contact Kim Engelby, HCA Accounting manager, at 714-834-5264.

Thank you.

David L. Riley, Director

DLR:ke

Attachment

cc: Thomas G. Mauk, County Executive Officer Stephen Dunivent, Deputy CEO David Sundstrom, Auditor-Controller Bob Wilson, Assistant Director, Health Care Agency Shaun Skelly, Chief Deputy Auditor-Controller Kim Engelby, HCA Accounting Manager