OFFICE OF THE CITY AUDITOR
COLORADO SPRINGS, COLORADO

11-20
Memorial Health System Cash Disbursements Audit

November 2011

Office Of The City Auditor
Colorado Springs, Colorado

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Purpose

The purpose of this audit was to evaluate the adequacy of the internal control environment related to cash disbursements, and to determine that disbursements were being made in accordance with governing policies and procedures.

Highlights

We initially concluded that the internal control environment related to cash disbursements was not adequate because of a system access issue. However, we expanded the scope of our audit to include additional transaction testing. The additional testing was based on a statistical sample of payments, which allowed us to draw a mathematically based conclusion about all payments. Based on the results of our statistical sample and other audit procedures, we gained enough assurance to conclude that disbursements were made in accordance with departmental policies and procedures. In addition, with the exception of the observations addressed in our report, we conclude that the cash disbursements internal control structure was adequate. We believe the recommendations included in our report will further improve the internal controls over Memorial's cash disbursements process.

Our audit period covered the seven months ended July 31, 2010. During this period, Memorial Health System's (Memorial) Accounts Payable Department processed 22,461 invoices totaling nearly $139 million.

We noted that subsequent to our fieldwork, application access was removed for the Database Administrator and the System Administrator access was changed to read-only for the database and the tables. Additionally, we understand Memorial was in the process of implementing a monitoring technology, which will further address some of our Information Systems user access concerns.

Management Response

Management was in agreement with our audit comments. The complete responses can be found in the body of the detailed report.

Recommendations

1. Accounts Payable should strengthen controls over changes to the vendor database.
2. The approval process for service-related purchase orders needs to be improved.
3. System accounts and Information Systems application users with significant privileges should be restricted to only the minimum required. A monitoring process should also be implemented for periodic reviews of activity by system accounts and users with full privileges in the Accounts Payable system.
4. Memorial should perform background checks for IT consultants or obtain evidence of background checks performed by the vendor.

See the findings and recommendations section of this report for more details.

OFFICE OF THE CITY AUDITOR
PUBLIC REPORT

Date: November 17, 2011

To: President Hente, President Pro Tem Martin, and Members of City Council

MHS Compliance and Audit Committee of the Board of Trustees

Re: 11-20 Memorial Health System Cash Disbursements Audit

We conducted an audit of Memorial Health System (Memorial) cash disbursements for the seven months ended July 31, 2010. During that period, Memorial's Accounts Payable Department processed 22,461 invoices totaling nearly $139 million.

The purpose of this audit was to evaluate the adequacy of the internal control environment related to cash disbursements, and to determine that disbursements were being made in accordance with governing policies and procedures.

During our audit, we noted weaknesses in the general Information Systems control environment, which could allow certain Information Systems users to override manual controls in place within the Finance Department. Due to the control concerns, we expanded the scope of our audit to include additional transaction testing. The additional testing was based on a statistical sample of payments, which allowed us to draw a mathematically based conclusion about all payments. No significant payment errors were identified during our additional testing.

Based on the results of our statistical sample and other audit procedures, we gained enough assurance to conclude that disbursements were made in accordance with departmental policies and procedures. In addition, with the exception of the observations addressed in our report, we conclude that the cash disbursements internal control structure was adequate. However, we identified areas where we believe internal controls can be strengthened. These areas are detailed in the attached report.

As always, feel free to contact me if you have any questions.

Sincerely,

Denny Nester, MBA, CPA, CIA, CGFM, CFE, CGAP
City Auditor

City Council's Office of the City Auditor
City Hall ◆ 107 North Nevada Avenue ◆ Suite 200 ◆ Mail Code 1542
Colorado Springs CO 80901-1575
Tel 719-385-5991 ◆ Fax 719-385-5699 ◆ Reporting Hotline ◆ 719-385-2387
www.SpringsGov.com/OCA

Cc: Dr. Larry McEvoy II, Chief Executive Officer
Mike Scialdone, Chief Financial Officer
Tracy Narvet, Controller
Debbi Colebank, Accounts Payable Manager
Steve Weber, Accounting Manager
Dr. Jonathan Velez, Chief Medical Information Officer, Chief Information Officer
Marilyn Goodloe, Director, Information Systems
Peggy Reichelderfer, Business Systems Support Manager
John Wyckoff, Director of Compliance

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REPORT DETAILS

PURPOSE AND SCOPE

We performed an audit of Memorial Health System (Memorial) cash disbursements for the seven months ended July 31, 2010. During that period, the Memorial Accounts Payable Department processed 22,461 invoices totaling nearly $139 million. The purpose of the audit was to evaluate the adequacy of the internal control environment related to cash disbursements, and to determine that disbursements were being made in accordance with governing policies and procedures.

Our audit did not include a review of payroll disbursements or Purchasing Card transactions as they were considered outside the scope of the audit. In addition, while we did not exclude employee expense reimbursements from the scope, only minimal testing was performed in this area.

BACKGROUND

The City Auditor has established a practice of methodically auditing all major systems at least once every five years. The purpose of these system audits is to evaluate the internal controls used to ensure reliability of financial information. Cash disbursements is one of the major systems audited on a rotating basis. The last audit in this area was issued March 19, 2007 and covered the 12 months ended December 31, 2005. As part of our audit, we performed follow-up on the previous findings to determine if management actions were effectively implemented.

CONCLUSION

While we noted significant improvements in user access restrictions since the prior audit, we observed weaknesses in the general information systems control environment, which are further explained in Observation 3 on page 4 of the report. These weaknesses could allow certain Information Systems users to override manual controls in place within the Finance Department. Due to the control concerns, we expanded the scope of our audit to include additional transaction testing. The additional testing was based on a statistical sample of payments, which allowed us to draw a mathematically based conclusion about all payments. No significant payment errors were identified during our additional testing.

Based on the results of our statistical sample and other audit procedures, we gained enough assurance to conclude that disbursements were made in accordance with departmental policies and procedures. In addition, with the exception of the observations addressed in our report, we conclude that the cash disbursements internal control structure was adequate. However, we identified areas where we believe internal controls can be strengthened. These areas are detailed on the pages that follow.

OBSERVATIONS, RECOMMENDATIONS AND RESPONSES

OBSERVATION 1 – CONTROLS OVER CHANGES TO THE VENDOR MASTER RECORD WERE NOT ADEQUATE.

The Accounts Payable Department consisted of four employees plus a manager who had access to enter and authorize invoices for payment. These employees also had access to add, change, and delete vendors and could run checks. Due to a small staff, Memorial was not able to separate these functions to provide proper segregation of duties.

As a compensating control for the segregation of duties concern, a review process was in place for additions and changes to the vendor master record. This process included a review of two quarterly reports, one with vendor additions and the other with vendor changes. We noted the following weaknesses with this control procedure:

A. The review of the vendor changes report was performed by someone who had access to add, change, and delete vendor records. Without a secondary review by someone independent of the process, any unauthorized changes to a vendor record could go undetected.

B. The vendor changes report for the second quarter of 2010 was not reviewed timely. The review was still in process nearly four months after the end of the quarter.

C. The reviewer of the vendor additions report for the second quarter of 2010 did not date the report as evidence of timely review.

AUDITOR'S RECOMMENDATION

We recommend Memorial implement procedures to strengthen controls over changes to the vendor master record. These procedures should include:

A. A periodic independent review of changes to the vendor master record by someone who does not have access to add, change, or delete vendors.

B. Timely review of all additions and changes to the vendor master record.

C. A requirement that all reviews are documented with the initials of the reviewer and the date of the review.

MEMORIAL'S RESPONSE

We basically agree with the auditors comments. However, the Accounting Manager, who is independent of the Accounts Payable Vendor Add/Change Process, does already perform a secondary review of the vendor change report. We agree that the review should be more timely and in the future all reviews will be documented with initials and date of the review.

OBSERVATION 2 – CONTROLS OVER THE APPROVAL OF SERVICE-RELATED PURCHASE ORDERS COULD BE IMPROVED.

Accounts Payable employees normally sent invoices for service-related purchase orders (POs) to the user department for approval prior to payment. This manual approval process was in lieu of the independent receiving of materials by central warehouse personnel , which occurred for material goods POs. We noted patient implants were also set up in the Accounts Payable system as service POs in order to bypass the required independent receiving of materials. Instead of being receipted by the central warehouse, these items were sent directly to the ordering doctor for the patient's procedure. Time constraints for patient surgeries prevented implants from going through the normal receiving process.

During our review, we noted inconsistencies in the way service POs were handled by Accounts Payable. Of the ten service POs we tested, we noted three instances when there was no way to verify the individual authorizing payment of the invoice was a valid approver for the user department. While Accounts Payable maintained a list of valid service POs, the list did not always indicate specific individuals authorized to approve the payment.

Although Memorial had a policy for service POs, the policy was not documented in sufficient detail to provide guidance to Accounts Payable employees on the approval requirements for processing service POs. In addition, the policy did not address the approval process for patient implants. Without independent verification that services were rendered or patient implant items were received, disbursements could be processed for deficient services or incomplete goods.

AUDITOR'S RECOMMENDATION

We recommend the process for approval of service POs be strengthened. The review and approval of invoices should be performed by someone who can verify the services rendered, or goods received, are consistent with the invoice for payment. In addition, Accounts Payable should maintain records of individuals who are authorized to approve invoices for specific vendors or POs. The review should be documented and maintained by Accounts Payable to provide evidence and accountability of the approval.

We further recommend that Memorial update its policies and procedures for service POs to reflect the implemented process in adequate detail. The policies and procedures should address the approval process for patient implants.

MEMORIAL'S RESPONSE

We agree with the auditors' recommendation and will develop a more detailed process for implant related service POs.

OBSERVATION 3 – COMPUTER DATA WAS NOT ADEQUATELY PROTECTED AGAINST UNAUTHORIZED DATA ENTRY OR MODIFICATION.

We performed follow-up on the previous audit's findings and recommendations to determine if management actions were effectively implemented. Compared to the prior audit, we noted user access to the cash disbursements module of the Accounts Payable system was more restricted and access appeared to be removed in a timely manner for job changes and terminations. In addition, we noted Finance Department management implemented a periodic review process to ensure Finance employees had proper access on an ongoing basis. While we acknowledge the improvements made to restrict access to the Accounts Payable system, we noted the following concerns related to user access used by the Information Systems Department:

A. Two Information Systems users had both database and open application level access. With this access, the users had the ability to add or delete any information in the application with the capability to remove the evidence in the underlying data tables.

B. Four system accounts were used for unknown processes. These accounts had open access to all data entry and modification functions in the cash disbursements module of the Accounts Payable system. While the System Administrator was aware of these system accounts, he did not want to disable the accounts until he could determine whether they were needed to run jobs.

C. Two Information Systems users were consultants and had open production level application access. This type of access provided the consultants with access to all data entry and modification functions in the cash disbursements module of the Accounts Payable system. According to the System Administrator, this access was required for the consultants to perform their job responsibilities.

Memorial Information Systems Department did not have logging or other review processes in place to monitor activity by system accounts or users with full privileges in the Accounts Payable system. The lack of a review process further compounded the concerns noted above. Although the Accounts Payable system currently has very few auditing capabilities that would allow such a review process, we noted Memorial Information Systems Department was in the process of implementing a new security module that includes a monitoring technology. It is our understanding that this new technology will provide information needed to identify inactivity of system accounts in order to minimize unnecessary access and will also provide a method for periodically reviewing activity of certain users with excessive privileges. The expected full implementation date for the monitoring technology is January 31, 2012. A major portion of the technology was implemented in September 2011.

While we recognize the controls in place within the Finance Department to prevent and detect errors and misappropriations with payments, we noted it would be possible for certain Information Systems users mentioned above to override these controls. However, for the statistical sample of transactions we tested, no payment errors were identified.

AUDITOR'S RECOMMENDATION

We recommend Memorial's Information Systems Department perform the following:

A. Remove application access from the Database Administrator and remove table access from the System Administrator in order to properly segregate these functions. We also recommend that appropriate backup personnel be identified and trained in support of these two functions for this application.

   We noted as of April 2011, application access was removed for the Database Administrator and the System Administrator access was changed to read-only for the database and the tables. In addition, appropriate backup personnel were assigned to provide support for these two functions.

MEMORIAL'S RESPONSE

We agree with the recommendation. As of April 2011, application access was removed for the Database Administrator and the System Administrator access was changed to read-only for the database and the tables. In addition, appropriate backup personnel were assigned to provide support for these two functions. The ERP Analyst is the designated back up for the System Administrator, utilizing the DBA, Lawson support, and third party consulting for additional assistance. The Programming/DBA manager is the designated back up for the Lawson DBA.

Memorial Health System has a 24 by 7 maintenance/support agreement with Lawson. This provides the needed level of support for day to day issues as well as serious system and downtime issues. Memorial Health System has a Master Agreement with Kinsey and Kinsey, a consulting company specializing in Lawson which allows Memorial to engage experienced Lawson consultant when needed.

AUDITOR'S RECOMMENDATION

B. Review the activity of system accounts once the monitoring program is in place and restrict access to the minimum level required.

MEMORIAL'S RESPONSE

We agree with the recommendation. These system accounts are used to run internal jobs. We are in process of identifying which jobs these system accounts are running. We will then restrict access to the system accounts to only run the identified jobs. Expect completion by 12/31/2011.

AUDITOR'S RECOMMENDATION

C. Review the activities of consultants with open production level application access on a routine basis.

MEMORIAL'S RESPONSE

We agree with the recommendation. A transaction audit tool with Lawson was implemented as of September, 2011. This tool enables a robust auditing of all system account users of Lawson including consultants.

The consultant's user accounts will be set up in the transaction auditor to create log entries for all activity. We will work with the data owners (Finance, Accounts Payable, and Materials Management) to identify procedures for monitoring the activity of the consultants. Projected implementation is 1/31/2012.

AUDITOR'S RECOMMENDATION

D. Implement a standard policy to address Information Systems access for consultants. The policy should detail the type of access granted, approval requirements, system limits (particularly in production environments), and termination procedures.

MEMORIAL'S RESPONSE

We partially agree with the finding (and/or) the recommendation. MHS has already existing security policies and procedures for both internal and external (ie consultant) system access. A Remote Access Policy currently exists and was last reviewed/updated in September, 2010. This policy addresses how and when vendors/consultants can access systems. It also addresses logging and auditing of remote access. Other standard security policies and procedures will be reviewed and updated as needed related specifically to application access for consultants. We will review to address the areas noted in the recommendation. Projected implementation date is 1/31/2012.

AUDITOR'S RECOMMENDATION

E. Implement a monitoring process to systematically log any changes by system accounts and users with full privileges in the Accounts Payable system. Once in place, a process should be established for the periodic review of the activity log by knowledgeable individuals who do not have full system privileges.

MEMORIAL'S RESPONSE

We agree with the recommendation. A transaction audit tool with Lawson was implemented with the Lawson security project as of September, 2011. Currently the Lawson ERP Analyst, System Administrator, and DBA activity is being monitored. We are in process of setting up the system accounts and full privileges users in the transaction audit tool. We will work with the data owners (Finance, Accounts Payable, and Materials Management) to identify procedures for monitoring the activity of the consultants. Projected implementation is 1/31/2012.

OBSERVATION 4 – MEMORIAL DID NOT ENSURE BACKGROUND CHECKS WERE OBTAINED FOR IT CONSULTANTS AS REQUIRED BY THE PERSONNEL POLICY MANUAL.

Memorial Personnel Policy Manual required background checks to be performed for employees prior to hiring. The policy also specified that vendors providing contract employees were responsible for conducting background checks on those employees. We noted Memorial did not verify background checks were performed by the vendor for two IT consultants who had open production level application access in the Accounts Payable system. In addition, there was no mention of the requirement to perform background checks on consultants in the agreement with the vendor.

Procedures should be in place to ensure compliance with Memorial Personnel Policy Manual related to background checks for vendors. This is also an important control activity to mitigate the risk of granting IT consultants full access to the Accounts Payable system.

AUDITOR'S RECOMMENDATION

We recommend Memorial perform background checks for IT consultants or obtain evidence of background checks performed by the vendor. In addition, the requirement to perform background checks on contract employees should be incorporated into future vendor agreements. We also recommend Memorial consider obtaining credit reports for employees and consultants with full access to the Accounts Payable system at the time of hire.

MEMORIAL'S RESPONSE

We agree with the auditors' recommendation. In an effort to close this loop hole Mateials Management will strengthen all contracts dealing with consultants having access to patient care areas and sensitive I.S. data. A new exhibit has been created in conjunction with the City Attorney responsible for supporting MHS. This exhibit will be added to all contacts and Materials Management will follow up with the requestor of the service.

OPPORTUNITIES FOR IMPROVEMENT

OPPORTUNITY 1 – PROCEDURES FOR VERIFYING APPROPRIATE APPROVAL OF CHECK REQUESTS COULD BE IMPROVED.

Accounts Payable personnel were responsible for verifying approvers were authorized and signatures were valid for all check requests according to Memorial's signature authorization records. We noted Accounts Payable employees, including the Travel Coordinator, did not maintain a current list of authorized signatures to perform this verification step prior to payment. The listing we obtained from one employee was outdated and another employee did not have a list available for reference at her desk. According to these employees, they relied on personal knowledge of valid signatures or referred to the current list maintained by the Controller's Assistant if there was any question about a signature or approval authority. Established procedures left the decision on whether or not to refer to the current signature authorization records up to the discretion of the individual Accounts Payable employees.

Without proper verification of signatures against the signature authorization records, an invoice could be approved by someone not authorized to approve the payment or a signature could be forged and not detected. The risk of this type of error occurring is increased when verification of signatures is left to the discretion of individual employees.

As an additional control, we noted the Controller reviewed all check requests prior to payment and verified any signatures in question against the current signature authorization records. We did not find any instances when a payment lacked proper approval during our test work.

AUDITOR'S RECOMMENDATION

We recommend Memorial evaluate its procedures for verifying appropriate approval of check requests and consider strengthening this process by requiring Accounts Payable employees to refer to the signature authorization records for all payments over a certain dollar amount. In addition, we recommend implementing procedures to ensure all Accounts Payable employees are accessing the current signature authorization records (old lists should be discarded immediately). Policy should be updated to reflect any changes to the current procedures.

MEMORIAL'S RESPONSE

We agree with the auditor's comments. The signature authorization records are updated yearly and are available online for all Accounts Payable personnel.

City Council's Office Of The City Auditor

Colorado Springs, Colorado

About our Office

The mission of the Office of the City Auditor is to provide City Council with an independent, objective and comprehensive auditing program for operations of the City. Our auditing program includes:

- Evaluating the adequacy of financial controls, records and operations
- Evaluating the effectiveness and efficiency of organizational operations
- Providing Council, management and employees objective analysis, appraisals, and recommendations for improving systems and activities

The Office of the City Auditor is responsible for auditing the systems used by the City of Colorado Springs and its enterprises, including Colorado Springs Utilities, Memorial Health System, and Colorado Springs Airport. We perform a variety of audits for these entities, including financial audits, performance audits, contract audits, construction audits, and information system audits. We also perform follow-up on a periodic basis to monitor and ensure management actions have been effectively implemented.

Authorization and Organizational Placement

Our audits are conducted under the authority of Chapter 1, Article 2, Part 7 of the Colorado Springs City Code, and more specifically parts 703, 705 and 706 of the Code. The Office of the City Auditor is structured in a manner to provide organizational independence from the entities it audits. This independence is accomplished by the City Auditor being appointed by and reporting directly to the City Council.

Audit Standards

This audit was conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*, a part of the Professional Practices Framework promulgated by the Institute of Internal Auditors. The audit included interviews with appropriate personnel and included such tests of records and other supporting documentation as deemed necessary in the circumstances. We reviewed the internal control structure and compliance tests were performed. Sufficient competent evidential matter was gathered to support our conclusions.

City Hall ◆ 107 North Nevada Avenue ◆ Suite 200 ◆ Mail Code 1542
Colorado Springs CO 80901-1575
Tel 719-385-5991 ◆ Fax 719-385-5699 ◆ Reporting Hotline ◆ 719-385-2387
www.SpringsGov.com/OCA