

# ***Developing an Internal Audit Plan***

SCHFMA – Finance and Reimbursement Workshop

November 15, 2011

# Risk Assessment Standards

- Going back a few years:

SAS's 104 through 111 effective 12-31-2007

Required Auditors to gain thorough understanding of internal control environment

Required Auditors to bring attention to material weaknesses and design audit accordingly based on internal control understanding

Revenue Cycle

Disbursement Cycle

Debt

Financial

IT

Cash

Payroll

Investments

Property

Cost Reporting

# Consistent Weaknesses

## Revenue Cycle

- Billing staff have authority to adjust charges
- Allowance methodology is not documented nor reviewed
- Management does not approve bad debt write-offs or other AR adjustments
- Periodic reviews not conducted on coding accuracy and appropriate documentation

## Disbursement Cycle

- Receiving and purchase order function not segregated
- Changes to vendor master file not approved by a supervisor
- Debit memos not issued for returned items
- Personnel responsible for approving payments have access to AP ledger and GL functions

# Consistent Weaknesses

## Cash

- Large dollar checks are not subject to additional review
- Manual Checks are written
- Bank reconciliations are not reviewed by a second person
- Person making wire transfers make related journal entries
- Daily deposit slip is not created by person without receipting responsibilities

## Investments

- No Board approved investment policy
- No secondary review investment transactions being posted to GL accounts

# Consistent Weaknesses

## Financial Statements

- No review of non-recurring / unusual transactions for completeness and validity
- No log of manual JE's is kept and reviewed
- Supervisors are not reviewing all reconciliations prepared in the department

## Debt

- No review of bond related covenants

# Consistent Weaknesses

## Payroll

- Current tax withholding tables are not being used
- Checks are not reviewed and signed by a person who does not prepare payroll
- Payroll register is not reconciled to the GL accounts regularly
- PTO accruals are not reviewed monthly by appropriate personnel
- Access to the payroll master file is not restricted to authorized personnel
- All new hires are not approved by HR director and department head

## Property

- Management is not reviewing carrying values of property and equipment
- Periodic physical inventories are not taken and reconciled to detailed fixed asset records
- No annual capital budget
- No capitalization policy
- No ID tags

# Consistent Weaknesses

## Cost Reporting

- No interim settlement is calculated
- Settlement is not reviewed to ensure reserve percentages are representative of NRV
- No independent review of estimated settlements
- No reconciliation of as-filed to tentative to final-settled cost reports

## Information Technology

- Password parameters are not set in accordance with standard settings
- No periodic review of users
- No formal schedule for backup and recovery testing
- No controls in place to ensure segregation of duties regarding access to conflicting systems

# Developing the Internal Audit Plan

- Perform and Document Risk Assessment



# Discovery of Fraud – Must Do's

- Brainstorm about the issue
- Be aware of opportunities to those who may be tempted
- **Respond to known weaknesses in Internal Control**
- **Be careful not to explain away instances of possible fraud as “Isolated Instances”**
- **Remember that people inside the control environment will override controls**
- Pay attention to 3<sup>rd</sup> party transactions



# Developing the Internal Audit Plan

- Begin by considering all areas within your healthcare entity that can be audited and quantifying the risks in those areas.

Areas where risk factors are present:

operational

compliance

financial

environmental

clinical

reputational

# Developing the Internal Audit Plan

- How to identify risk factors

*Possible suggestions:*

Organizational Chart

Audited Financial Statements

VP Summary Reports

Computer system – new entities, accounts, etc.

Internal Financial Statements

Community Benefit Disclosures - Financials or IRS Form 990

# Developing the Internal Audit Plan

- Rate risk areas by order of importance
- Report findings and seek guidance from Board

1<sup>st</sup> Priority – Risks are significant and likely  
Key area of audit focus

2<sup>nd</sup> Priority - Risks are significant but less likely  
Key area of audit focus

3<sup>rd</sup> Priority - Risks are likely but not significant

4<sup>th</sup> Priority - Minimal to no audit significance



# Effective Internal Audit Functions - Financial

- **Payroll**

Verify separation of duties within HR department and Payroll processing

Inspect use of current withholding tables and percentages

Verify timeliness of payroll tax deposits

Reconcile wages per the general ledger to the payroll tax returns

Require (at surprise intervals) employees to personally pick up their paychecks or direct deposit remits

Inquire of unusual variances in payroll withholding G/L accounts



# Effective Internal Audit Functions - Financial

- **Revenue Cycle**

Verify patient subsidiary ledgers agree to general ledger control accounts

Compare analytical relationships of patient AR accounts to related allowance accounts

Verify a plan is in place and documented to periodically review the various insured contracts. Such a procedure will help the hospital to be reassured payments are made in accordance with predetermined plans.

Verify a reasonable allowance methodology is in place that considers changes in payment percentages and changes in payor mix.

Periodically test revenue reasonableness



# Effective Internal Audit Functions - Financial

- **Disbursements**

Verify vendor subsidiary ledgers agree to general ledger control accounts

Periodically scan vendor listings and vouch to approved vendor master file

Ensure proper controls are documented and followed for approval of new vendors. Include verification of segregation of duties for approval and payment to new and continued vendors

Test, on surprise basis, the receiving of goods in purchasing. Receipt should be vouched to approved purchase order.



# Effective Internal Audit Functions - Financial

- **Cash**

Inspect cash reconciliations on a frequent basis and question all reconciling items

Verify reconciliations are reviewed and approved by a supervisor or manager

Verify proper segregation of duties. The person in charge of cash receipts should not be posting payments

For nursing homes, perform surprise audits on the patient account trust fund

Verify proper procedures over wire transfers



# Effective Internal Audit Functions - Financial

- **Property**

Verify property ledger, by asset class, agrees to general ledger control accounts

Verify procedures in place for supervisor to review all asset additions for required purchase approval and assignment of correct AHA useful life

Verify policies are in place and tested on a periodic basis for asset valuation and impairment

Sample test gain / loss computations on asset disposals and verify removal from asset ledger



# Effective Internal Audit Functions - Financial

- **Cost reporting**

Verify procedures are in place for correctly posting cost report tentative and final settlements

Verify appropriate documentation is available to support reserve balance

Ensure reimbursement personnel receive training specific to the cost report function. Such training can help hospital maintain compliance with constant Medicare/Medicaid updates and rule changes



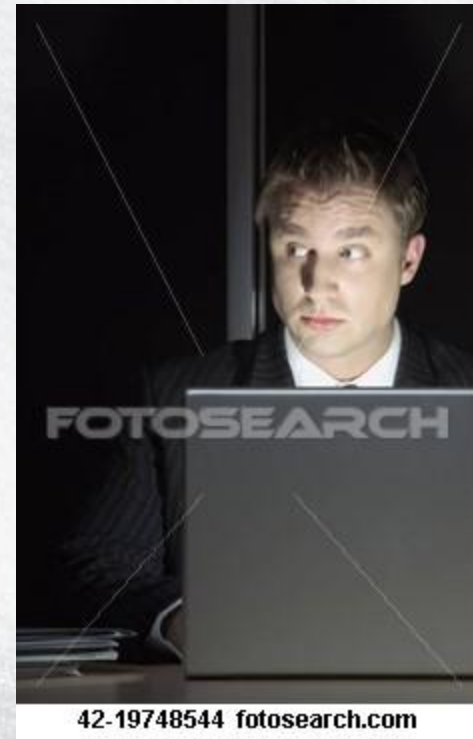
ABC Hospital  
 Cost Report Settlement  
 June 30, 2011

	Medicare G/L # 1003					Medicaid G/L # 1005				
	2009	2010	2011	reserve	6/30/2011	2009	2010	2011	reserve	6/30/2011
<b>As-Filed Cost Report</b>	109,000	110,000	111,000	(25,000)	305,000	209,000	210,000	211,000	(50,000)	580,000
<b>Tentative settlements</b>										
intermediary receipt - FY 09	(75,000)				(75,000)	(175,000)				(175,000)
intermediary receipt - FY 10		(80,000)			(80,000)		(180,000)			(180,000)
<b>Final settlement</b>										
Adjustment required for final settlement to be received FY 12	2,000	0				2,000	0			2,000
<b>Reserve adjustment</b>										
To adjust reserve for remaining 2011 as-filed CR - Possible intermediary bad debt adjustments				(2,500)	(2,500)				0	0
<b>Adjusted GL at 6/30/2011</b>	<u>36,000</u>	<u>30,000</u>	<u>111,000</u>	<u>(27,500)</u>	<u>147,500</u>	<u>36,000</u>	<u>30,000</u>	<u>211,000</u>	<u>(50,000)</u>	<u>227,000</u>
	NPR - Final	NPR - Final	As-filed		Per GL	Final	Final	As-filed		Per GL

# Effective Internal Audit Functions - Financial

## Information Technology

- Inspect policies regarding ensuring and testing password protected access
- Verify policies in place to promptly remove former employee access
- Verify policies in place to ensure supervisor access limited only to necessary sites – proper segregation of duties
- Verify testing of offsite back-up recovery systems. (Most hospitals have a back-up plan, but do not test the recovery process).
- Periodically test and question user access



# Community Benefit Reporting - Reputational

## Pros

- Form 990 provides means for establishing good public perspective
- Gives Board and Management chance to explain areas of hospital business unfamiliar to the public

Compensation relationships

Business dealings

Board relationships

Hospital support within the community

Explanation of the "net revenue concept"

## Cons

- Loss of exempt status
- Loss of property tax exemption
- Loss of sales tax exemption
- Subject to higher interest cost borrowings
- Higher medical fees to compensate for payment of Federal and State income taxes
- Loss of or limited participation in some Medicare/Medicaid subsidy programs

# Effective Internal Audit Functions - Reputational

- Community Benefit – IRS 990

Inspect for timely filing

Inspect for accuracy of information

Verify Board approved policy of sharing and reporting community benefit information

Consider Financial Statement Disclosure

Inspect process of indigent and charity reporting, including completion of applications and approval of write-offs.



# Internal Audit Considerations – Other Concerns

- Operational  
**Segregation of Duties, Abuse of power**
- Compliance  
**Coding issues, Charge Master, HIPPA**
- Environmental  
**Safety concerns, OSHA regulations**
- Clinical  
**Safekeeping of Narcotics, patient safety issues**

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