A REPORT
TO THE
ARIZONA LEGISLATURE

Financial Audit Division

Management Letter

Maricopa County Medical Center

Year Ended June 30, 2004

Debra K. Davenport
Auditor General

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STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

DEBRA K. DAVENPORT, CPA
AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

August 10, 2005

Board of Supervisors
Maricopa County
County Administration Building
301 West Jefferson Street, 10th Floor
Phoenix, AZ 85003

Members of the Board:

In planning and conducting our audit of the Maricopa County Medical Center for the year ended June 30, 2004, we performed the following as required by U.S. generally accepted auditing standards:

- Considered the Medical Center's internal controls over financial reporting and
- Tested the Medical Center's compliance with laws and regulations that could have a direct and material effect on its financial statements.

We noted no internal control weaknesses or instances of noncompliance that we consider to be material to the financial statements. However, our audit disclosed internal control weaknesses that management should correct to ensure that it fulfills its responsibility to establish and maintain adequate internal controls. Our recommendations are described in the accompanying summary.

This letter is intended solely for the information of the Maricopa County Board of Supervisors and is not intended to be and should not be used by anyone other than the specified party. However, this letter is a matter of public record, and its distribution is not limited.

Should you have any questions concerning its contents, please let us know.

Sincerely,

Dennis L. Mattheisen, CPA
Financial Audit Director

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The Medical Center needs to accurately record and report its capital assets

The Medical Center has invested a significant amount of money in its capital assets. Capital assets comprise more than half of the Medical Center's total assets. Therefore, it is essential that the Medical Center accurately reports these assets to the County's Board of Supervisors, its lenders, the public, and other interested parties. To accomplish this objective, it must maintain a reliable capital assets system and follow its procedures to accurately identify, record, accumulate, reconcile, and report its capital assets and related depreciation costs. However, the Medical Center did not always follow its established internal control policies and procedures to ensure that its capital assets were accurately recorded and reported. For example, the Medical Center lacked a complete and accurate capital assets listing. Specifically, the listing did not include property control tag numbers, serial numbers, or locations, and included inaccurate accumulated depreciation amounts for some assets. Also, the Medical Center did not reconcile capital additions, deletions, and prior-year adjustments to its current-year capital assets listing. Auditors noted that current-year additions incorrectly included $17 million of prior-year additions, equipment was misclassified as construction in progress, and supporting disposal forms could not be located for some items deleted from the listing. Further, the Medical Center has not taken a physical inventory of its capital assets in the past 12 years.

The following procedures can help the Medical Center safeguard its capital assets against theft and misuse and help ensure that the assets are properly recorded in its accounting records and reported in its financial statements. Management personnel should:

- Inform employees of the Medical Center of its capital assets policies and control procedures and emphasize the importance of following them.
- Monitor adherance to its established polices and procedures by performing test checks of procedures performed.
- Ensure that a complete physical inventory is performed to provide an accurate listing that includes tag numbers, serial numbers, and locations.
- Reconcile the current year's list to the prior year's list using current-year capital additions and deletions, and make all necessary corrections.

- Accurately calculate current-year depreciation expense and accumulated depreciation, and have a second employee verify the accuracy of the amounts recorded.
- Retain documentation such as disposal forms to support deleted capital assets.

A similar recommendation was previously provided in our Management Letter to the Medical Center dated January 9, 2004.

The Medical Center should improve internal controls over patient billing

Patient charges represent more than 90 percent of the Medical Center's operating revenues. Therefore, it is imperative that the Medical Center accurately calculate patient charges for services provided and supplies used. However, the Medical Center's policies and procedures did not ensure that patient charges were calculated using current approved billing rates. Auditors noted that several patient charges for medical supplies were not billed using the current billing rates approved by the Arizona Department of Health Services. As a result, the Medical Center undercharged its patients for medical supplies during fiscal year 2004.

To help ensure that patients are accurately billed for services performed and supplies used in accordance with its approved rate package, the Medical Center should reevaluate its internal control policies and procedures over patient billing to ensure that billing rates on its system are updated at least weekly and cost documentation is retained to support charges.

The Medical Center's internal controls over vouchers payable needs to be improved

The County's Board of Supervisors depends on accurate information so it can fulfill its oversight responsibility and to report accurate information to lenders, the public, and other interested parties. To achieve this objective, the Medical Center must maintain current and accurate accounting records. However, the Medical Center's vouchers payable balance at June 30, 2004, included approximately $1.4 million in vouchers older than 1 year and outstanding credit memos older than 2 years. Further, auditors noted the Medical Center made several payments to vendors based on invoice copies or facsimiles.

To help ensure that its financial information is current and accurate, the Medical Center should make payments based only on original or electronic invoices received from vendors for goods and services received, follow up on outstanding accounts in a timely manner, and request refunds for credit memos older than 1 year.

The Medical Center should protect its information system from damage and equipment failure

The Medical Center uses a computerized information system to process its financial transactions. Therefore, the Medical Center should have an up-to-date contingency plan so it can continue to process financial transactions should a system or equipment failure occur. The Medical Center did have a disaster recovery plan; however, it had not been updated or tested on a regular basis, nor was the plan located in an off-site facility.

To help ensure that the Medical Center can provide for the continuity of its financial operations and help prevent the loss of data in the event of a system or equipment failure, the Medical Center should update and test its disaster recovery plan annually. In addition, the Medical Center should ensure that the plan is stored at an off-site location and includes the following:

- A listing of employees assigned to disaster teams, including telephone numbers.
- Employee assignments and responsibilities.
- A risk analysis identifying critical transaction cycles.
- A designated alternative computer facility.
- Details of off-site storage locations.
- A list of procedures for processing critical transactions, including forms or other documents to use.

The Medical Center needs to establish internal control policies and procedures for its medical supplies inventory

The Medical Center maintains pharmaceuticals and general hospital supplies inventories at its various locations throughout the County. Effective stewardship requires the Medical Center to safeguard and account for these medical supplies. To accomplish this objective, the Medical Center should maintain an inventory system that can provide accurate inventory balances and account for purchases and uses of inventory items during the year. However, the Medical Center's inventory system was unable to provide accurate year-end balances that reflected purchases and uses of inventory items during the year. Also, physical inventory counts were performed by employees who had access to inventory items, the inventory was not arranged in an orderly manner or systematically counted, obsolete and damaged items were not removed from the inventory, opened containers and loose items were not consistently counted, and physical inventory counts were not reconciled to recorded balances.

To help ensure that all pharmaceuticals and medical supplies inventories are adequately safeguarded and properly accounted for, the Medical Center should develop written internal policies and control procedures to track these inventories. At a minimum, the policies and procedures should include the following:

- Develop an inventory system that will account for all inventory activity and provide accurate and complete inventory balances.
- Assign employees who do not have access to inventory to count the items.
- Issue written inventory instructions for counting, recording, pricing, and calculating inventory to employees who are taking inventory to increase their efficiency and reduce errors.
- Remove all obsolete and damaged items from the inventory and destroy them, if applicable.
- Reconcile the physical inventory listings to the accounting records.

July 22, 2005

Dennis Mattheisen
Office of the Auditor General
2910 N. 44th Street, Suite 410
Phoenix, AZ 85018

Dear Mr. Mattheisen:

The following is Maricopa Integrated Health System's (MIHS') response to the Management Letter findings for fiscal year 03-04.

Recommendation 1: The Medical Center needs to accurately record and report its capital assets

A team will be convened consisting of representatives from the Finance Department, Materials Management and Health Information Technology to develop an action plan for ensuring that all MIHS managers understand the importance of the fixed asset policies and procedures. The MIHS Finance Department will develop an action plan for random audits.

We will explore the possibility of retaining an outside firm to perform a complete physical asset inventory. However, the cost for this service may preclude us from being able to proceed.

The fixed asset accountant will continue to reconcile monthly the current year's asset listing to the prior year's asset listing using current year capital additions and deletions and make necessary corrections. In addition, the fixed asset accountant will continue to reconcile our fixed asset accounting system to the general ledger monthly. The fixed asset accountant will also randomly test the depreciation expense and accumulated depreciation calculated by our fixed asset system to insure accuracy.

MIHS' Finance Department will work with Environmental Services and the Maintenance Departments to develop a policy regarding the disposal of assets.

Recommendation 2: The Medical Center should improve internal controls over patient billing

This issue was addressed during 2005 fiscal year when the auditors brought this to the attention of the Finance Department. Materials Management currently notifies the Business Office whenever there is a price update from our supply vendors. The chargemaster is then updated accordingly based on our percentage markups. However, MIHS concurs that supplies were undercharged to patient accounts for the fiscal year ending June 30, 2004 due to incorrect supply rates in our system.

Recommendation 3: The Medical Center's internal controls over vouchers payable needs to be improved

The Accounts Payable Department in conjunction with Information Technology and Materials Management reviewed and corrected the vouchers payable report in January 2005. The next scheduled review date is June 30, 2005 and has been completed. Thereafter we will audit the vouchers payable report every six months and make corrections as needed.

The Accounts Payable Department requested statements from vendors in March 2005 to identify outstanding credits owed to MIHS. These credits have been taken against a future payment or if no future payments are owed to the vendor the Accounts Payable Department has requested refunds.

MIHS does not concur with the recommendation to make payments to vendors only from an original or electronically submitted invoice. The majority of payments are processed from an original invoice. However, the STAR Accounts Payable system does not allow duplicate processing of invoices therefore a facsimiles is an acceptable means of invoicing if it a more efficient way of expediting the payment of an invoice.

Recommendation 4: The Medical Center should protect its information system from damage and equipment failure

MIHS IT is writing a project charter to begin revisions of the current Disaster Recovery plan for information systems. The Disaster Recovery plan will address procedures for critical transactions. Some transactions have been identified and documented, such as Startup and Shutdown procedures for systems. A completed list of IT personnel and responsibilities is drafted for use in the event of an IT disaster.

MIHS Emergency Operations Committee meets monthly to discuss preparedness for incidents. The committee is pursuing business continuity processes and a risk analysis is an integral part of this assessment.

Currently, there is no alternative computer facility identified as a hot or a warm site for recovery of systems. The IT department utilizes DataPros as the vendor for all off-site tape storage.

<u>Recommendation 5: The Medical Center needs to establish internal control policies and procedures for its medical supply inventory</u>

A team will be convened consisting of representatives from the Finance Department, Materials Management, Warehouse, Pharmacy, Surgery, Laboratory, Radiology and other clinic areas to develop policies and procedures regarding our inventory practices in order to provide accurate and complete inventory balances. At a minimum these policies will address the issues raised in this Management Letter.

Sincerely,

Joyce Graham
Chief Financial Officer