

ACCOUNTS PAYABLE VENDOR PAYMENT

Audit Report No. AP0110

November 06, 2009



**MENTAL HEALTH MENTAL RETARDATION
AUTHORITY OF HARRIS COUNTY**

Internal Audit Report

AUDITOR'S REPORT

Accounts Payable Vendor Payment

Harris County, Texas

Internal Audit Report

November 06, 2009

Henry E. Webb, CFE

Internal Auditor





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MHMRA of Harris County
7011 SW Freeway
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RE: Audit of Accounts Payable
(Report No. AP0110)

BACKGROUND

The Accounts Payable Department of MHMRA of Harris County is responsible for the disbursement of funds for payment of all legal claims against the Agency. The Accounts Payable Department processed approximately 20,262 transactions during the audit period consisting of checks and electronic payments (ACH). Over \$26 million in payments was issued during the audit period September 1, 2008 through August 31, 2009. Of the \$26 million, over \$7 million consisted of 9,297 ACH transactions. The review focused on the internal controls over the accounts payable process, the appropriateness of the payments, and compliance with laws and regulations.

Accounts Payable of MHMRA disburses funds to vendors, employees, and other agencies for payment for goods and/or services received. Payments are made using the ROSS Accounts Payable Purchase Order System. ROSS is a central accounting system which includes, but is not limited to, the general ledger, accounts payable, accounts receivable, and the purchase order subsystem. Payments include invoices related to Purchase Orders, Payment Authorization Vouchers, and Recurring Transactions. A Purchase Order is an agreement made between the Agency and a vendor for goods and/or services. A Payment Authorization Voucher is for the disbursement of funds that do not require a P. O. Recurring payments are invoices paid on a regular basis such as monthly or quarterly payments.

The Agency makes its payments by wire transfers, on-line payments, electronic fund transfers (EFT), and checks. MHMRA has made substantial progress in minimizing manual (non scheduled check processing) to only six (6) checks during the audit period. The Agency is currently in the initial stages of an upgrade to the ROSS system.

MHMRA of Harris County and its component units (Pear Grove, Pecan Village, Villas at Bayou Park, Pasadena Cottage, Acres Home Gardens, Sunny Side, Friends of MHMRA), maintain five (5) bank accounts at various local banks with approximately thirty-one (31) separate accounts. The Finance and Accounting Department provides the day to day accounting and check writing services to the component units through the use of Quick Books. These support activities are separate from the Accounts Payable

Department and require staff, software and IT support as well as other related costs that are not covered by these units.

In Fiscal Year 2009, the Accounting Department processed approximately 4,085 journal entries, wrote 3,143 checks and spent approximately 2,600 hours processing checks, journal entries, data entry correspondence, reviewing documentation, and preparing bank reconciliations for these affiliated companies. For these services, MHMRA was paid \$1,800 for bookkeeping services. In addition, \$25,553 for management fees was deposited in the MH Housing Development Fund which is used for development of future housing projects and those related expenses incurred prior to purchase such as environmental studies (to date, only \$5,000 has been used out of the total balance of \$120,280).

The Accounting Manager for MHMRA responsibilities are divided as follows:

- Treasurer – 35% (cash management, banking, investments)
- Accounting – 40% (General Ledger, Accounts Payable)
- Affiliated Companies – 25% (Review of journal entries, financial statements, check requests, banking)

The Staff Accountant for MHMRA (affiliated companies) responsibilities is divided as follows:

- Affiliated Companies - 34% (Non-Profit and HUD, prepare journal entries, data entry)
- SSI Trust – 66% (process check requests, inquiries, correspondence, etc.)

OBJECTIVES

The objectives of the audit were:

- evaluate internal controls over the accounts payable process;
- verify that payments were made correctly, accurately accounted for, and properly supported;
- review for duplicate payments; and
- evaluate compliance with policy, procedures, and laws and regulations.

SCOPE

The scope of the work did not constitute an evaluation of the overall internal control structure of the unit. The examination was designed to evaluate and test compliance with established policy and procedures and to test the internal control over tested areas and material. The audit scope period was from September 1, 2008 through August 31, 2009.

Department management is responsible for establishing and maintaining a system of internal controls to adequately comply with approved policy and procedures. The objectives of an internal control system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or theft, and that transactions are executed in accordance with management's authorization and are recorded properly.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected timely. 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 procedures may deteriorate.

The purpose of the audit report is to furnish management independent, objective analyses, recommendations, and information concerning the activities reviewed. The audit report is a tool to help management discern and implement specific improvements. The audit report is not an appraisal or rating of management.

Although due professional care in the performance was exercised, this should not be construed to mean that unreported noncompliance or irregularities do not exist. The deterrence of fraud is the responsibility of management. Audit procedures alone, even when carried out with professional care, do not guarantee that fraud will be detected. Specific areas for improvement are addressed later in this report.

Other minor findings, not included in this report, have been communicated to management and/or corrected during the audit process. Internal Audit would like to thank the management and staff for their cooperation throughout the audit.

METHODOLOGY

In order to meet the objectives, Internal Audit used process mapping and evaluated controls over the Accounts Payable Department, reviewed the accounting system for accuracy relating to payment of warrants, as well as reviewed policies and procedures for compliance and completeness. Accounts Payable, Accounting, Information Technology, and Purchasing/Contracts staff were interviewed and audit tests and procedures were conducted as considered necessary.

The sample size and selection were statistically generated using a desired confidence level of 95%, expected error rate of 5%, and a desired precision of +/-5%. Statistical sampling was used in order to infer the conclusions of test work performed on a sample to the population from which it was drawn and to obtain estimates of sampling error involved. When appropriate, judgmental sampling was used to improve the overall efficiency of the audit.

STATEMENT OF AUDITING STANDARDS

The audit was conducted in accordance with generally accepted government auditing standards (GAGAS). Those standards require that Internal Audit plan and perform the audit to afford a reasonable basis for the judgments and conclusions regarding the organization, program, activity, or function under audit. An audit also includes assessments of applicable internal controls and compliance with requirements of laws and regulations when necessary to satisfy the audit objectives. An audit also includes assessing the estimates, judgments, and decisions made by Agency management. It is believed that this audit provides a reasonable basis for the findings, conclusions, and recommendations.

RESULTS

As a result of the audit procedures and surveys conducted, it was determined that departmental compliance with established criteria to govern accounts payable processing generally meet Agency policy and procedures, except for the findings presented in the body of the report.

FINDING

Vendor List Contains Duplicate Entries

MHMRA had very few confirmed duplicate payments during FY'09. However, duplicate vendors are the leading cause of duplicate payments. Despite best efforts, vendor files accumulate duplicates over time. When an invoice is entered into ROSS, the AP processor will select a vendor. If they choose a different vendor than previously selected, a duplicate invoice will occur. Some vendor files contain up to six duplicates, creating increased opportunity for duplicate payments.

Of the 13,672 active vendors in the ROSS system (over 29,000 total vendors), Internal Audit identified over 700 or 5% single duplicate vendors. The 5% single vendor duplicates had been duplicated between 2 and 6 times.

The Accounts Payable Department processes the 1099 forms for the Agency. The 1099 is a reporting form to the Treasury Department (Internal Revenue Service) for independent contractors and other self-employed individuals to indicate payments received. When duplicate vendors are in any system where a

1099 is required to be issued, errors may occur due to multiple payment activity for each duplicate. Further, the Treasury Department issues a report titled "Notice of Possible Name/TIN Discrepancy" to the Agency that requires additional time, effort and cost when vendor information is not accurately entered into the ROSS system.

Storing the same piece of information more than once violates the basic design of a relational data base and may cause problems in other modules and reports because of the integration of the various application modules within ROSS. When vendors are listed in the system multiple times (without reason), it will delay the query time to bring back results from that form, use additional memory, and provide confusion to the user as to which one is the correct one to use. Likewise, building intelligence into data, (for example, adding a letter, a dot or other symbol or word to a piece of data) that is meaningful only to the user can defeat the intended functionality of the system and make standard reports inefficient and even useless.

Sound internal controls require that management review vendor activity reports to reduce the occurrence of duplicate vendors due to the sensitive nature of their work and their capability to authorize new vendors, address changes, and other updates to vendor documents.

RECOMMENDATION

- Restrict access to the master vendor file so that only one person plus a back-up can set up or change vendor records.
- Obtain a W-9 or equivalent form prior to vendor set-up and payment.
- Validate the TIN and vendor name using the free IRS TIN matching system.
- Validate the vendor's address and phone number prior to vendor set-up.
- Check vendors against the Federal Bureau of Industry and Security's lists of excluded persons and companies.
- Establish and enforce a policy for data entry formats.
- Purge vendors that have had no activity in the last 12 – 18 months (ensure that data is merged in with the file that will remain to prevent loss of any supplier payment history).
- During the upgrade to ROSS, special care should be given to duplicate vendors. If an invoice is dated prior to the system switchover, the old system should be checked to determine if payment was made.
- Review changes to the master vendor file on an on-going basis.
- Establish a written procedure manual to cover every aspect of master vendor file maintenance.

Management Response

"Management acknowledges the Auditor's recommendations that the Agency reevaluate, develop and or implement the following recommendations and govern the processes accordingly.

- *Restrict access to the master vendor file so that only one person plus a back-up can set up or change vendor records.*
- *Obtain a W-9 or equivalent form prior to vendor set-up and payment.*
- *Validate the TIN and vendor name using the free IRS TIN matching system.*
- *Validate the vendor's address and phone number prior to vendor set-up.*
- *Check vendors against the Federal Bureau of Industry and Security's lists of excluded persons and companies.*
- *Establish and enforce a policy for data entry formats.*
- *Purge vendors that have had no activity in the last 12 – 18 months (ensure that data is merged in with the file that will remain to prevent loss of any supplier payment history).*

ROSS upgrade project is currently in progress. Vendor review, evaluation, validation, and purging will be performed prior to conversion and implementation."

FINDING***Lack of Adequate and Full Reimbursement from Affiliated Companies***

The accounting staff spends approximately 360 hours in overtime to meet deadlines and process work for the affiliated companies and the financial statements are frequently not reviewed due to time constraints.

Neither the Staff Accountant nor the Accounting Manager has been trained in HUD regulations or non-profit accounting.

Accounting and Bank transfers to the escrow and reserve accounts do not occur in a timely manner.

Management fees are not paid timely and bookkeeping fees are seldom paid and are below market value for services rendered.

Bank statements are sent directly to the affiliated companies and are generally late which results in the bank reconciliation not being prepared in a timely manner. Bank accounts are opened and at times lack documentation to provide the Accounting Department the proper source documents to record transactions since the Accounting Department is not allowed direct contact with the banks.

Not all affiliated companies bank accounts are provided fraud deterrent technology such as positive pay.

RECOMMENDATION

- It is recommended that bank statements for all MHMRA affiliated companies be sent directly to the Accounting Department at MHMRA for processing in order that reconciliations can be completed in a timely manner.
- It is recommended that a cost analysis be completed to determine the exact amount of cost for Accounting that is provided by MHMRA and that the affiliated companies reimburse MHMRA those cost.
- It is recommended that all transfers to escrow and reserve accounts occur as required.
- It is recommended that the Accounting Department of MHMRA be given access to banking relations at each bank in order to provide more adequate supportive services to the affiliated companies.
- It is recommended that the Accounting Department initiate fraud deterrent technology such as positive pay for each bank account as determined feasible.
- It is recommended that the Accounting Department receive specialized training in non-profit and HUD regulations and banking.
- It is recommended that the escrow and reserve amounts be set up to automatically deducted from the respective bank accounts through ACH.
- Consideration should be given to having an external CPA firm perform the bookkeeping services for the affiliate companies in order for the accounting staff to better serve the basic accounting and treasury functions for MHMRA.

Management Response

“The Mental Health Division will comply with the recommendations on behalf of the HUD 811 properties. We will schedule a meeting with [REDACTED] and [REDACTED] to develop a schedule for implementation and resolution of the deficiencies.”

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Henry E. Webb, CFE, Internal Auditor

Cc: Rose Childs, MSW, Deputy Director, Mental Health Division
Kenneth Collins, LMSW, Deputy Director, Mental Retardation Division
Barbara Dawson, MSE, Deputy Director, Comprehensive Psychiatric Emergency Program Division
Daryl Knox, MD, Medical Director, Comprehensive Psychiatric Emergency Program Division
Sarah Flick, MD, Medical Director, Mental Retardation Services
Sylvia Muzquiz, MD, Medical Director, Mental Health Services
Jeanne Mayo, MS, JD, General Counsel
Alex Lim, MBA, CPA, Chief Financial Officer
Scott Strang, Ph.D., MBA, Chief Operating Officer
External Audit Firm
Audit Committee:
Tom Hamilton, Ph.D. (Chairman)
Jane B. Cherry
Paige M. Cokinos
Charles O. Buckner, CPA
Vicki S. Raynold, CPA
Bob Borochoff

**ATTACHMENT A
SUMMARY OF RECOMMENDATIONS
November 6, 2009**

Unit: Finance and Accounting			
Area: Accounts Payable			
Inherent Risk:	Low Moderate High	Control Environment:	Well Controlled Acceptable Poorly Controlled
		Overall Risk:	Low Moderate High
Type of Procedures: Audit			
Scope:			
<ul style="list-style-type: none"> * Using Internal Control Evaluation (ICEs) forms, documented the internal controls * Conducted a preliminary survey reviewing applicable policies and procedures, etc. * Interviewed various staff to obtain understanding of management controls * Examined detailed invoices/work orders, statements provided by the vendor, etc. 			
Priority Rating:	Audit Recommendations:		
1	Restrict access to the master vendor file		
1	Obtain W-9 or equivalent ID prior to set up of vendor		
1	Validate TIN		
1	Purge vendors not used within the last 12-18 months (save data)		
1	Establish and enforce a policy for data entry formats		
1	It is recommended that bank statements for all MHMRA affiliated companies be sent directly to the Accounting Department at MHMRA for processing in order that reconciliations can be completed in a timely manner.		
1	It is recommended that a cost analysis be completed to determine the exact amount of cost for Accounting that is provided by MHMRA and that the affiliated companies reimburse MHMRA those cost.		
1	It is recommended that all transfers to escrow and reserve accounts occur as required.		
1	It is recommended that the Accounting Department of MHMRA be given access to banking relations at each bank in order to provide more adequate supportive services to the affiliated companies.		
1	It is recommended that the Accounting Department initiate fraud deterrent technology such as positive pay for each bank account as determined feasible.		
1	It is recommended that the Accounting Department receive specialized training in non-profit and HUD regulations and banking.		
1	It is recommended that the escrow and reserve amounts be set up to automatically deducted from the respective bank accounts through ACH.		
1	Consideration should be given to having an external CPA firm perform the bookkeeping services for the affiliate companies in order for the accounting staff to better serve the basic accounting and treasury functions for MHMRA.		
Follow-up: Six Months			

Priority Rating

1. Implement immediately (30 - 90 days) - Serious internal control deficiencies; or recommendations to reduce cost, maximize revenues, or improve internal controls that can be easily implemented.
2. Work towards implementing (6 - 18 months) - Less serious internal control deficiencies, or recommendations that can not be implemented immediately because of constraints imposed on the unit (i.e. Budgetary, technological constraints, etc.).
3. Implement in the future (2-3 years) - Recommendations that should be implemented, but that can not be implemented until significant and/or uncontrolled events occur (i.e. legislative changes, buy and install major systems, or require third party cooperation, etc.).