



**CITY OF COLORADO SPRINGS
OFFICE OF THE CITY AUDITOR**

**06-320 – MEMORIAL HEALTH SYSTEM'S
CASH DISBURSEMENTS**

PUBLIC REPORT

MARCH 19, 2007

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Office of the City Auditor

PUBLIC REPORT

Date: March 19, 2007

To: Honorable Mayor and Members of City Council
Members of Memorial Health System's Audit Committee
Members of Memorial Health System's Board of Trustees

Re: 06-320 – Memorial Health System's Cash Disbursements

We performed an examination of Memorial Health System's (Memorial) cash disbursements for the 12 months ended December 31, 2005. During that period, Memorial's Accounts Payable department processed 80,239 invoices for 36,602 checks totaling \$235 million.

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

The attached audit report contains 14 findings and recommendations for areas where we believe internal controls could be strengthened. It should be noted this audit was a review of the overall internal control environment and transaction testing was on a limited basis. While we did not find any errors or anomalies in the transactions we did test, we believe our recommendations will improve the internal controls over Memorial's Cash Disbursement process.

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

Sincerely,

A handwritten signature in purple ink that reads "Jeff Litchfield".

Jeff Litchfield
City Auditor

Cc: Richard Eitel, Memorial Health System, Chief Executive Officer
Gary Flansburg, Memorial Health System, Chief Financial Office/Senior Vice President
Tom Kerwin, Memorial Health System, Chief Information Officer/Vice President

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Introduction

06-320 – Memorial Health System’s Cash Disbursements

PUBLIC REPORT

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Introduction

AUTHORIZATION

We performed an examination of Memorial Health System's (Memorial) cash disbursements for the 12 months ended December 31, 2005. During that period, Memorial's Accounts Payable department processed 80,239 invoices for 36,602 checks totaling \$235 million. We conducted this audit under the authority of Chapter 1, Article 2, Part 7 of the Colorado Springs City Code, and more specifically parts 703 through 706, in addition to Chapter 13, Article 1, Part 103 which state:

1.2.703: ENSURE PUBLIC ACCOUNTABILITY:

The City Auditor shall ensure that administrative officials are held publicly accountable for their use of public funds and the other resources at their disposal. The City Auditor shall investigate whether or not laws are being administered in the public interest, determine if there have been abuses of discretion, arbitrary actions or errors of judgment, and shall encourage diligence on the part of administrative officials.

1.2.704: PERFORM POST-AUDIT:

The City Auditor shall perform a current post-audit of the financial operation of the City government and its enterprises, and shall devote full time and effort to post-audit examinations and reporting. The City Auditor shall submit reports to Council of periodic audits of each enterprise, department, group, unit, division or account. The Auditor shall have access to the books and accounts of all City enterprises, groups, departments, administrative officials or employees charged with the receipt, custody or safekeeping of public funds.

1.2.705: DETERMINE EFFECTIVENESS AND EFFICIENCY OF PROGRAMS:

The City Auditor shall determine the extent to which legislative policies are being efficiently and effectively implemented by administrative officials. The City Auditor shall determine whether City programs are achieving desired objectives. The City Auditor shall review the administrative control systems established by the enterprises, department or group managers and by the City Manager, Utilities Executive Director and Memorial Hospital Executive Director and determine whether these control systems are adequate and effective in accomplishing their objectives.

1.2.706: EXAMINE BOOKS, RECORDS:

The City Auditor shall examine and inspect all books, records, files, papers, documents and information stored on computer records or in other files or records relating to all financial affairs of every office, department, group, enterprise, political subdivision and organization which receives funds from the City or under the direct or indirect control of the City Council. The Auditor may require any person to appear at any time upon proper notice and to produce any accounts, books, records, files and other papers pertaining to the receipt or expenditure of City funds, whether general or special. If that person fails to produce the papers, then the Auditor may request Council approval to search for and take any book, paper or record in the custody of that person or public official.

Introduction

13.1.103: ENTERPRISE STATUS; FUNDS; CITY ATTORNEY; CITY AUDITOR:

C. In accord with the provisions of chapter 1 of this Code, the City Auditor shall have those duties and responsibilities imposed by City Council to ensure the public accountability of Memorial Hospital.

ORGANIZATIONAL PLACEMENT

The City Auditor's Office of the City of Colorado Springs 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. The audited entity in this audit was Memorial Health System, which is an enterprise fund of the City of Colorado Springs under the direction of its Chief Executive Officer. The Chief Executive Officer reports to the Memorial Health System Board of Trustees, who are appointed by the City Council.

SCOPE AND METHODOLOGY

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

We performed the following audit steps:

- Reviewed the internal control environment related to bank reconciliations, journal entries, user access, physical security of computer system, and cash disbursements.
- Performed tests to verify the December 2005 bank reconciliation.
- Performed tests to verify the user access for cash disbursements was applicable to job function and the duties were appropriately segregated.
- Performed tests to verify the user access for cash disbursements represented valid and current employees.
- Tested 2005 checks issued for duplicates or gaps in check numbers.
- Tested 30 payments and 10 patient refund cash disbursements for validity, approval, documentation, check endorsements and agreement with policy and procedures.

The audit was conducted in a manner that meets or exceeds the 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 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 using statistical sampling techniques. Sufficient competent evidential matter was gathered to support our conclusions.

Introduction

BACKGROUND

Section 1.2.704 of the City Code states: “The City Auditor shall perform a current post-audit of the financial operation of the City government and its enterprises” and section 1.2.705 states “the City Auditor shall examine and inspect all books, records, files, papers, documents and information stored on computer records or in other files or records relating to all financial affairs of every office, department, group, enterprise, political subdivision and organization which receives funds from the City or under the direct or indirect control of the City Council.”

Considering the magnitude of this requirement, 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 that are used to ensure the reliability of financial information. Cash Disbursements is one of the major systems that will be audited on a rotating basis.

OVERALL CONCLUSION

This report contains 14 findings and recommendations for areas where we believe internal controls could be strengthened. It should be noted this audit was a review of the overall internal control environment and transaction testing was on a limited basis. While we did not find any errors or anomalies in the transactions we did test, we believe our recommendations will improve the internal controls over Memorial’s Cash Disbursement process.

FOR THE FUTURE

A Cash Disbursements Monitoring Audit is planned for 2007. The purpose of this audit is to monitor the cash disbursements function to identify and review anomalies on years when a Full System Review is not performed. This Monitoring Review is an integral part of the continual auditing of this major system. During a Full System Review, the cash disbursement function will be reviewed to ensure an adequate internal control environment and compliance with policies and procedures. The Monitoring Review will verify many of the controls that are documented during the Full System Review.

We have made no determination as to which findings are more important than others. Therefore, the findings are not necessarily listed in order of importance.

Findings, Recommendations and Responses

1. Computer data was not adequately protected against unauthorized data entry or modification.

We reviewed all employees with access to enter new vendors, purchase orders (POs), materials received, invoices and general ledger journal entries. We also examined all screens accessible to the cash disbursement staff. Our purpose was to ensure data accessibility was limited to job function and that access was properly segregated.

Multiple (20+) employees throughout Memorial's staff including but not limited to Financial Analysts, Clinical Product Analyst, Coordinator II, Information Systems, City Auditors, Patient Financial Services and Telecom had access to add, change, and delete vendors, POs, receiving, and invoices. Some of these security classes also included add, change and delete access to general ledger entries.

A Purchasing System Administrator, an Operations Supervisor and Operations Administrative Support employee had access to add, change, and delete general ledger journal entries.

Accounts Payable (AP) employees who entered and processed invoices for payment had the ability to add, change, and delete invoices as well as vendors, POs, and receiving materials data.

Accounting Management had access to add, change and delete financial data.

Based on the sample test work performed, we did not identify any instances where security had been breached. However, the risk exists due to weaknesses in the internal control environment that intentional or unintentional errors could occur within Lawson and not be detected.

Auditor's Recommendation:

We recommend Memorial perform a complete review of user access in Lawson. We also recommend that each Manager review their staff's Lawson access for job requirement, segregation of duties, data protection and access type (add/change/delete/inquire) and notify Information Systems for recommended changes. Access should be limited to the minimum necessary to adequately perform job duties.

Memorial's Response:

We agree with the auditors' recommendation. Currently, accounts are being reviewed throughout the Lawson system to ensure that segregation of duties exist and that access is limited to functions needed for employees to perform their job appropriately. City Auditor access was modified to the access that was appropriate for performing audits (read only).

Findings, Recommendations and Responses

2. User access was not adequately updated and eliminated for job changes and terminations.

Many individuals who had terminated employment with Memorial or changed jobs within Memorial continued to have user access to Lawson. In some cases, this access allowed them to add, change and delete data as well as inquire. Thirteen people that terminated as far back as September 2004 continued to have access to system data. One City Auditor that no longer works in our office appeared on the access report. Audit notified Memorial of the employment termination November 21, 2005. Data integrity and privacy rights are compromised when terminated individuals have access to Memorial's financial data.

Auditor's Recommendation:

We recommend Memorial perform a complete review of user access in Lawson. Information Systems should work with Human Resources to delete all terminated employees and appropriately change user access for employees that have changed positions. A procedure should be developed to report terminations and job changes to Information Systems in a timely manner.

Memorial's Response:

We agree with the auditors' recommendation. All users that were terminated, as identified by the auditor, had their Lawson access immediately terminated upon receipt of the preliminary findings. A complete review of Lawson user access was matched against actual employed personnel. Discrepancies were noted and personnel that were no longer employed had their access terminated.

A SAR (Security Access Request) form could not be located from the City requesting access be removed from the city auditor indicated in the report. Upon speaking with the auditor for this finding, it was concluded that an email had been sent, but that email could not be reproduced by the City as proof. We have requested that when the City Auditors request access changes, they submit a SAR form to the Information Systems department for appropriate access control tracking.

Procedures already exist related to terminations and transfers of employees. When employees are terminated, a list is generated out of Human Resources and emailed to personnel that are responsible for security in various systems. For terminations, those employees are to have access removed. When employees are transferred, it is up to the supervisor to generate a SAR form indicating the access that is now needed for the employee. Proper controls to ensure that user access terminations are actually accomplished are being reviewed.

Findings, Recommendations and Responses

3. Documented policies and procedures did not adequately specify job processes and internal control activities in place.

The documented policies and procedures for cash disbursement and related processes did not adequately define the activities or controls in place. Several of the audit recommendations in this report include clarification or improvement in current policies and procedures including the areas of service related POs, payment authorization signatures, patient refund processing, password management, bank signature approval and outstanding checks.

Documented policies and procedures are an integral part of an internal control framework. Codified Section of AICPA Professional Standards AU Section 319.06, Definition of Internal Control, states “Control activities are the policies and procedures that help ensure that management directives are carried out.” Policies and procedures that do not sufficiently document processes can create varying degrees of inconsistency within Accounting’s operations and make it more difficult to train personnel in their job duties. Accountability issues may also arise as there is no detail standard to which an employee would be held.

Auditor’s Recommendation:

We recommend Memorial Accounting Department document policies and procedures for all types of transactions, approvals and activities as well as segregation of duties. The policies and procedures should contain sufficient detail to provide appropriate guidance.

Memorial’s Response:

We agree with the auditors’ recommendation. Policies and Procedures for Accounts Payable and Cash Disbursement are currently in the process of being updated and rewritten.

Findings, Recommendations and Responses

4. There was no evidence that monthly bank reconciliations were being reviewed by the Accounting Manager.

Bank reconciliations with supporting documents were prepared monthly. We examined the June 2005 and December 2005 bank reconciliations prepared by the Accountant and did not see evidence of the Accounting Manager's review by way of notes, questions, signature or date. The December 2005 ending general ledger cash balance was \$9.6 million.

Auditor's Recommendation:

We recommend the monthly bank reconciliation be signed and dated upon review by the Accounting Manager and the review be performed in a timely manner.

Memorial's Response:

The Accountant and Accounting Manager meet monthly to review reconciliations, including the bank reconciliations prior to closing the month. The Accounting Manager will now initial the bank reconciliations to indicate that the review was performed.

Findings, Recommendations and Responses

5. Journal entries were not reviewed and approved.

For the month of December 2005, we reviewed the controls over the initiating, reviewing and recording of 27 manual journal entries totaling a net \$19 million credit to the cash account. These transactions were prepared and entered into the general ledger without an independent review. Accounting Management indicated there were no requirements for general ledger journal entries to be reviewed or approved. Although we did not identify any errors based on the test work performed, the risk exists that intentional or unintentional errors could occur and not be detected.

Accounting Management indicated that compensating controls existed through the monthly reconciliation of balance sheet accounts and analytical review of income statement accounts. Although this may identify some errors, given the volume of account transactions and large number of journal entries, analytical review and account reconciliations are not sufficient to identify journal entry errors.

Having controls at the front end of a process (preventative) are generally preferred over controls at the end of a process (detective). Preventative controls are proactive to identify an error or omission before it occurs while detection controls serves to detect the error or omission after the fact. Preventative controls are deterrent in nature and ultimately considered less costly than detective controls.

Best practices for internal controls over financial reporting require that journal entries be reviewed and approved by a knowledgeable person before posting to the general ledger and that there be segregation of duties regarding the journal entry creation and approval.

Auditor's Recommendation:

We recommend that journal entries be reviewed and approved by a knowledgeable person before posting and that there be adequate segregation of duties between the journal entry creation and approval. It would be acceptable to establish a minimum threshold for journal entries that would require approval.

Memorial's Response:

We agree with the auditors' recommendation. We will require that an independent person review and approve all non-computer-generated journal entries prior to final closing the month. MHS will update the policies and procedures regarding journal entry review and approval.

Findings, Recommendations and Responses

6. Memorial did not have adequate controls over the approval of service related purchase orders.

AP, upon input of a service related invoice, systemically queued the Purchasing Department regarding the invoice. Purchasing approved the invoice in the system to authorize payment. Purchasing did not review the actual invoice and did not verify services were rendered prior to authorizing payment. This practice was in lieu of the independent receiving of materials by Materials Management which occurs for material goods POs.

Further, Purchasing selected the vendor in the AP system, initiated the PO and received the service thereby authorizing the invoice for payment. This results in a conflict of segregating the initiation, receiving and approval of a transaction.

Adequate segregation of duties and independent verification of services rendered reduces the likelihood of paying for incomplete or deficient services.

Memorial's AP Policy did not address the approval of service related POs.

Auditor's Recommendation:

We recommend a process be implemented that requires an independent review and approval of service related POs. The review should ensure services rendered are consistent with the invoice for payment. The review process should be documented to provide evidence and accountability of the approval.

Memorial's Response:

We agree with the auditors' recommendation. While no errors were found in relation to the service purchase orders (POs), Memorial is in the process of rewriting the policies and procedures for the use of service POs.

Findings, Recommendations and Responses

7. The control environment surrounding check requests could be improved to prevent unauthorized disbursements.

Out of 12 check requests tested, we identified four (33 percent) that presented concerns. One was a Worker's Compensation payment where AP procedures did not require approval. Two were not approved by AP that should have been. And one did not have an invoice attached to provide adequate supporting documentation.

Disbursements, according to AP policy, that are not a patient refund or purchase order are paid by a check request. Check requests for material goods up to \$1,000 require approval by a department manager and above \$1,000 by a Director. Check requests are to be approved for payment by a Finance Manager prior to being entered into Lawson. Worker's Compensation payments do not require any review.

Because check requests do not have the same system controls (i.e., three way match) that PO's have, their review and approval becomes a critical control to verify that check requests were processed properly.

Auditor's Recommendation:

We recommend that all check requests be approved by an independent and knowledgeable person and that this function be segregated from the processing of the check request, including Worker's Compensation check requests. We further recommend all check requests for materials be accompanied by the packing slip in addition to the invoice as substantiation for goods received.

Memorial's Response:

We agree with the auditors' recommendation. While no errors were found in the above mentioned checks, Memorial is in the process of rewriting all policies and procedures related to Accounts Payable and Cash Disbursements.

Findings, Recommendations and Responses

8. There was no list of authorized signatures to verify appropriate approval by AP.

The AP department did not have a list of authorized signatures to reference in order to verify that an invoice had been approved by an authorized person and that the signature was authentic. They relied on personal knowledge of who was authorized in a department and what their signature looked like.

The risk exists that an invoice could be approved by someone not authorized to approve the payment or that a signature could be forged and not detected.

Auditor's Recommendation:

We recommend that a list be compiled showing the persons authorized to approve payments with an original signature to verify authenticity. A policy should be implemented and documented which would require AP personnel to verify that the person approving the invoice is authorized and that the signature is valid.

Memorial's Response:

A list of all managers' signatures will be maintained and referenced for check request authorizations over \$1,000.

Findings, Recommendations and Responses

9. Controls for processing patient refunds could be strengthened.

According to Memorial's records, 5446 patient refunds to individuals were issued in 2005, totaling \$490,073. The Patient Refund Supervisor reviewed and approved refunds in excess of \$5000. However, patient refund requests under \$5000 were not reviewed and had no supporting documents attached to the payment request form sent to AP.

Memorial's policies do not require patient refunds under \$5000 to be reviewed as they believe it to be cost prohibitive (i.e., patient refunds are high volume, low dollar transactions).

Although we did not identify any errors in our test work, the risk exists that an account could be refunded incorrectly and the error would not be detected.

Memorial believes there is a compensating control to this risk due to the system automatically billing any accounts that have a credit balance. This does minimize some of the risk but not all. Memorial now has the risk of collecting on an account that was incorrectly refunded.

Additional risk exists if the Patient Refund Specialist user access allows them to add, change, and/or delete customer accounts. We did not review the user access in the billing department as it was out of the scope of the audit.

Auditor's Recommendation:

We recommend patient refunds be reviewed and approved by another knowledgeable person. This would allow for adequate segregation of duties between the preparation and approval of the refunds. AP should validate the preparer and approval of these requests for payment. This process should be documented in disbursement policies and procedures.

We also recommend user access for the Patient Refund Specialist be reviewed to ensure the proper segregation of duties between adding, changing, and/or deleting customer accounts and issuing patient refunds.

Memorial's Response:

On September 5th, 2006, Memorial's Patient Financial Services Department Policy & Procedures for patient refunds were modified. As a result, we have reduced the manager approval threshold from \$5,000 per account to \$500 per account. We feel this modification should address the concern regarding adequate controls for the preparation and approval of patient refunds. Additionally, a routine security access/audit report will be prepared semi-annually and reviewed to ensure no inappropriate adjustments are performed on the patient's portion of the account. We feel this modification should address the concern regarding user access for the Patient Refund Specialist.

Findings, Recommendations and Responses

10. The staffing level in the AP department may not be adequate to handle the volume of transactions.

Dollars disbursed and invoices processed increased approximately 33 percent in the 12 months ending 2005 over 2004. Checks issued increased 40 percent over the same period. According to the organizational charts we were provided, staff size grew by approximately one administrative person and one half (0.5 FTE) supervisor in the past five years. The quality of work and internal controls could be compromised if staffing is insufficient.

Volume Statistics

	2004	2005	% Change
Invoices	60,310	80,239	33%
Dollars Disbursed	\$177,359,737	\$235,032,831	33%
Checks Issued	26,095	36,602	40%

Many of the internal control deficiencies we identified during this audit could be explained by insufficient staffing. Management indicated more detailed policy and procedures were not available due to time constraints. Other areas of improvement noted in our report such as segregation of duties and lack of reviews could also be the result of staff limitations.

Auditor's Recommendation:

We recommend Memorial's Human Resources and the Accounting Department review the staffing level surrounding the AP functions. If the review indicates that additional staff is needed, staff should be increased accordingly.

Memorial's Response:

We continually review our staffing needs and balance that with the effective use of our limited resources. Based on this review process, we have added an additional FTE (full time equivalent) to the Accounts Payable department.

Findings, Recommendations and Responses

11. Password management and workstation security could be improved.

PCs/Workstations did not automatically lock out users after a period of inactivity. Workstations were distinguished between clinical and non-clinical. Clinical workstations were shared stations used in patient wards and emergency departments. They were always logged on. These computers had restricted access and required an individual Lawson user ID and password and should be logged off after use.

Non-clinical workstations were not shared and were used by Accounting, Purchasing, HR, and Payroll. The IS001 Compliance Policy regarding Workstation Security stated for non-clinical workstations 'it is suggested that users will log-off the workstation when it is not being utilized or to employ either a screen saver password or by locking (CTRL-ALT-DEL) the workstation when leaving the system for any given period of time.'

Memorial's IS001 Compliance Policy encourages users to change their passwords every six months. The current version of Lawson cannot handle requiring users to periodically change their password.

Auditor's Recommendation:

We recommend a policy requirement to utilize password protected screen savers on non-clinical PCs/workstations after a period of 30 minutes of inactivity. We also recommend the 2007/08 upgrade to Lawson include requiring users to periodically change their passwords. Lastly, we recommend investigating the risk related to shared workstations for Lawson related transactions.

Memorial's Response:

IS001 was written based upon a risk assessment of users and user security. It is recommended users evoke using the CTRL-ALT-DEL functionality to automatically lock their workstation, on non-shared computers, as a better means of securing the desktop. We feel that 30 minutes is too long to wait for a screensaver to be enabled. It will be recommended to the IS Security/ITAC committee to evoke use of the NT logon as a screen saver after 10-15 minutes for non-shared computers. Currently, Memorial Health System is running Lawson version 8.0.3 and is evaluating the cost and benefits of upgrading to Lawson version 9.

Findings, Recommendations and Responses

12. Notification to US Bank of change in Bank Signature Authority was not done in a timely manner.

The Chief Operating Officer terminated employment with Memorial effective April 14, 2006. She was an authorized check signer for Memorial. The letter to notify the bank of a change in signature authority was dated May 16, 2006, 33 days after her last day of employment.

Although we did not detect any unauthorized approval of payments within the sample tested, the risk exists that an unauthorized approval could be made.

Auditor's Recommendation:

We recommend changes in signature authorization be communicated to the bank prior to the last date of employment or as soon as possible thereafter. The responsibility for notifying the bank of such change should be documented in policies and procedures.

Memorial's Response:

We agree with the auditors' recommendation. Memorial is in the process of rewriting all policies and procedures related to Accounts Payable and Cash Disbursements.

Findings, Recommendations and Responses

13. Outstanding checks older than six months should be written off.

The December 2005 outstanding check list included 259 checks totaling \$48,302 dated January through December 2004. These checks were written off on May 31, 2006. Bank Reconciliation Policy and Procedures indicate “outstanding checks for the current year and previous year are kept on the outstanding check list. Checks older than that are cleared in the Bank Transaction Adjustment screen.”

Although the process above is in accordance with current policy, checks that have not cleared the bank within six months of their issue date should be removed from the outstanding check list.

Auditor’s Recommendation:

We recommend outstanding checks be written off at the end of six months and the Bank Reconciliation Policy be revised to reflect this change.

Memorial’s Response:

We disagree with the auditors’ recommendation that checks be written off after six months. Based on the experience and professional judgment of Memorial Finance Department’s management, two years is more efficient and any risk is minimal.

Findings, Recommendations and Responses

14. Invoices could not be located during the audit.

We selected a sample of 40 invoices dated January to December 2005 to test the disbursement process. AP staff could not locate three of the 40 invoices. Subsequently, all invoices were re-filed by AP staff before our audit was complete. We requested the invoices be pulled again. Upon pulling the second time, one invoice that had been missing from the original test sample was located and seven invoices that were filed back could not be located. We noted that temporary employees were used to pull and file invoices.

Auditor's Recommendation:

We recommend processes be improved to ensure records are available and adequately maintained.

Memorial's Response:

We agree with the auditors' recommendation that better procedures for tracking invoices need to be implemented. In addition to the issues raised above, we have no record that the auditors returned the missing invoices to us. We are in the process of updating and rewriting all policies and procedures related to Accounts Payable, Cash Disbursements and document handling during an audit.