

AUDITOR'S REPORT

HARRIS HEALTH SYSTEM CONTRACT ADMINISTRATION CONTROLS



July 28, 2016

**Barbara J. Schott, C.P.A.
Harris County Auditor**

Mike Post, C.P.A.
Chief Assistant County Auditor
Accounting Division



1001 Preston, Suite 800
Houston, Texas 77002-1817
(713) 755-6505

Mark Ledman, C.P.A., M.P.A.
Chief Assistant County Auditor
Audit Division

FAX (713) 755-8932
Help Line (713) 755-HELP

BARBARA J. SCHOTT, C.P.A.
HARRIS COUNTY AUDITOR

July 28, 2016

Mr. George Masi
President and Chief Executive Officer
Harris Health System
2525 Holly Hall
Houston, Texas 77054

RE: Harris Health System Contract Administration Controls for the six months ended April 30, 2015

The Audit Services Department (Audit Services) performed procedures relative to the Harris Health System (Harris Health) Contract Administration Controls. The objective of the engagement was to evaluate critical controls for administering Harris Health contracts for the acquisition of goods and services.

Preliminary procedures included reviewing policies and procedures and meeting with personnel to obtain an understanding of the controls. In addition, we evaluated and selectively tested controls for the following objectives:

- Assigning responsibilities for monitoring contracts.
- Developing adequate monitoring procedures.
- Verifying invoices to contractual terms prior to payments.
- Adhering to policies when creating a requisition for ordering supplies and services.
- Purchasing equipment and supplies approved by standardization committees.
- Evaluating and reporting contract vendor performance.

The engagement process included providing you with engagement and scope letters and conducting an entrance and exit conference with your personnel. The purpose of the letters and conferences were to explain the process, identify areas of concern, describe the procedures to be performed, discuss issues identified during the engagement, and solicit suggestions for resolving the issues. A draft report was provided to you and your personnel for review.

Our procedures did not include any kind of review of remote access. In addition, the procedures performed required our staff to exercise judgement in completing. As the procedures were not a detailed examination of all transactions, there is a risk that errors or fraud were not detected during this engagement. Harris Health therefore, retains the responsibility for the accuracy and

Mr. George Masi
President and Chief Executive Officer

completeness of their financial records and ensuring sufficient controls are in place to detect and prevent fraud.

The enclosed Auditor's Report presents the significant issues identified during our procedures, recommendations developed in conjunction with your staff, and any actions you have taken to implement the recommendations.

We appreciate the time and attention provided by you and your staff during this engagement.

Sincerely,



Barbara J. Schott
County Auditor

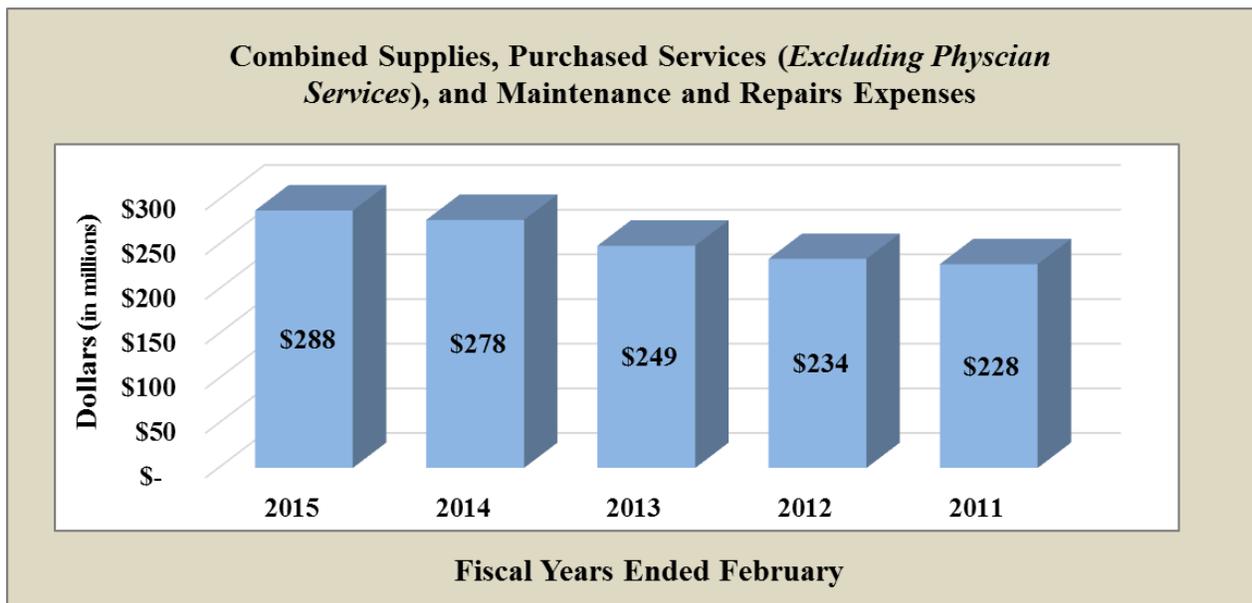
cc: Harris Health System Board of Managers
District Judges
County Judge Ed Emmett
Commissioners:
R. Jack Cagle
Jack Morman
Steve Radack
Gene Locke
Devon Anderson
Vince Ryan
William J. Jackson

TABLE OF CONTENTS

OVERVIEW	4
RESULTS	6
ISSUES AND RECOMMENDATIONS	7
Tracking Contract Purchases.....	7
Verifying Compliance with Contract Pricing	9
RISK ASSESSMENT AND SUMMARY OF RECOMMENDATIONS.....	11

OVERVIEW

Harris Health acquires supplies, services, and equipment to support its mission and operations through contractual relationships with contract vendors. Purchases from contract vendors are recorded as operating or capital expenditures in Harris Health's financial records. A significant portion, but not all, contract purchases are recorded as supplies, purchased services, and maintenance and repairs expenses. To provide a perspective on the significance of contract expenditures to Harris Health, expenses in those three categories are presented in the following graph for the five fiscal years ended February 2015:



Source: PeopleSoft Financial Reports

Purchasing for Harris Health is under the control of the Harris County Purchasing Agent and is handled through the Harris County Purchasing Office (Purchasing). The Purchasing Agent has prepared the Harris County Hospital District Purchasing Manual in accordance with Texas Local Government Code, Section 262.011(o) to establish the rules and procedures applicable to Harris Health. In addition, Harris Health Policies No. 3.23, *Outside Medical Services Vendor Contracting, Validation, and Monitoring*, and No. 3.46, *Contract Initiation, Review, Approval, and Monitoring*, (Policies) provide policies for establishing and monitoring contractual relationships.

Purchasing ensures that Purchasing Manual rules and procedures are followed and that appropriate methods are used to select contract vendors. In addition, the Harris County Attorney's Hospital District practice group (County Attorney) helps prepare and/or modify contract documents, and reviews them to ensure that Harris Health's legal rights and responsibilities (contract terms and conditions) are appropriately defined.

Under the Purchasing Manual rules and procedures, the Purchasing Agent presents the Harris Health's Board of Managers (Board) with purchases of \$100,000 or more (including renewals or amendments) for approval. Board approval is not required for purchases less than \$100,000; however purchases for \$50,000 to \$99,999 are presented to the Board for informational purposes.

The Harris Health Corporate Compliance Department (Corporate Compliance) monitors contract documents for proper approval and signatures in accordance with Harris Health policies. The President and Chief Executive Officer (CEO) is authorized to sign Board approved contracts for \$100,000 or more. The Harris County Purchasing Agent is authorized to sign contracts less than \$100,000. In addition, contracts for \$25,000 or greater require that the Harris Health Controller sign to certify that Harris Health has the funds available to satisfy the amount Harris Health is committed to pay through the contract.

These Policies require that a Contract Monitoring Officer (Monitoring Officer) be appointed by Senior Management for every contract. The Monitoring Officer works with Purchasing and the County Attorney to establish new or renew existing contractual relationships, and monitors Harris Health and the contract vendor's compliance with contract terms and conditions after contract execution.

Verification of the contract vendor's compliance with contract pricing terms is performed electronically for some supply items that are frequently purchased and have been recorded in the "item master" in Harris Health's purchasing system (PeopleSoft). There are also automated price verification controls for contracted supplies that are processed through GHX Procurement Suite (P-Suite) and ordered from vendors that participate with Harris Health in electronic data interchange (EDI) ordering and invoicing. Verification that contract vendors are charging Harris Health at the agreed to contract prices must be performed manually for purchased services or products that are not in the item master or processed through P-Suite.

Supplies and equipment are evaluated for quality, consistency, cost, and clinical efficiency through the Harris Health Standardization Committee (Committee). The evaluation identifies acceptable vendors before the process of entering into new or renewing existing contractual relationships begins. The Committee includes representatives from Harris Health medical staff, executive management, and department management. Products for new and existing contracts are evaluated by subcommittees appointed by the Committee and product recommendations of the subcommittees are approved by the Committee.

Contract vendor performance is evaluated using standard forms created and distributed by Purchasing and completed by personnel in departments that use the contracted services or products. Completed forms are returned to Purchasing and copies of the completed forms are to be sent to Corporate Compliance for filing.

RESULTS

Based on procedures performed, processes are being performed to evaluate and report contract vendor performance. In addition, processes are in place to increase automated monitoring of contract vendors' compliance with contract pricing terms using the PeopleSoft item master or P-Suite.

Opportunities to improve critical controls were identified as follows:

- Considerations should be given to acquiring and implementing a contract management module to:
 - Monitor whether policies are adhered to when creating requisitions for ordering contracted supplies (approved by the Committee) or services.
 - Improve the availability and accuracy of contract purchase information.
 - Prevent contract spending from exceeding authorized amounts.
- Processes should be improved for assigning responsibility and accountability to Monitoring Officers for monitoring contract vendor compliance with contract pricing terms and for documenting monitoring procedures in contract monitoring plans.

These issues are discussed in more detail in the Issues and Recommendation matrix below.

ISSUES AND RECOMMENDATIONS

Subject	Background	Issue	Recommendation	Management Response
Tracking Contract Purchases	More than one department or pavilion may order from a contract after it is executed.	<p>PeopleSoft does not automatically track spending by contract. In addition, manual tracking cannot be effectively performed for contracts utilized by more than one department or pavilion.</p> <p>As a result, there is an increased risk of:</p> <ul style="list-style-type: none"> • Unidentified off-contract spending resulting in additional cost. • Inaccurate and/or incomplete contract spending information used for analysis and contracting purposes. • Spending more on contracts than the amount presented to the Board for approval or for informational purposes. 	<p>Harris Health Management should evaluate the costs and benefits of acquiring the PeopleSoft contract management module to improve contract management and administration, and to better track purchases by contract. The evaluation should determine if the improvements justify the expenditure required to acquire and implement the module.</p> <p>In the interim, Harris Health Management should consider using purchasing data available from the PeopleSoft material management module and analytical reporting tools to implement additional contract monitoring processes.</p>	<p>Harris Health is upgrading the PeopleSoft financial system as part of its Fiscal Year 2017 capital budget. The Contract Management module is within the current scope of that upgrade. Resources for implementation and oversight of key decisions regarding the build are in the process of being evaluated. Completion of the upgrade is currently projected for May 2017.</p> <p>The first two risks identified are operational risks that are partially mitigated by the oversight of the Administrative Director of Materials Management and his team as they routinely evaluate actual spending against contract expectations. That oversight will be substantially enhanced by the implementation of the</p>

ISSUES AND RECOMMENDATIONS

Subject	Background	Issue	Recommendation	Management Response
(Continued) Tracking Contract Purchases				PeopleSoft Contract Management module. The third risk of spending more on contracts than the amount presented to the Board is primarily mitigated by the matching of vendor invoices with the supporting purchase order prior to payment. Billed amounts exceeding the authorized purchase amounts are not paid until appropriate authorization is provided and the purchase order is amended. In some instances, the invoice may not reference the correct purchase order, which could result in purchases in excess of the purchase order contract amount if the error is not immediately detected as part of the payment process. This is much more likely to occur for recurring contracted services than for supply or equipment purchases. Until the PeopleSoft upgrade is

ISSUES AND RECOMMENDATIONS

Subject	Background	Issue	Recommendation	Management Response
(Continued) Tracking Contract Purchases				complete, we will develop a monitoring report that compares total vendor spend from Accounts Payable to the total authorized spend from vendor purchase orders, to assure that actual spend does not exceed authorized spend.
Verifying Compliance with Contract Pricing	<p>The Policies include appendices with standard forms to be used to:</p> <ul style="list-style-type: none"> • Document the appointment of and the duties of Monitoring Officers. • Document procedures that will be performed to monitor contract compliance (a contract monitoring plan). 	<p>Verification of contract pricing compliance is not specifically included as a Monitoring Officer duty and responsibility, or as a requirement to be included in contract monitoring plans.</p> <p>For 12 contracts tested, a written plan for verifying that contract vendors charged the agreed to contract prices was not available.</p> <p>Not documenting a plan for verification of compliance with contract pricing terms increases the risk that</p>	<p>Harris Health Management should amend the appendices to the Policies to:</p> <ul style="list-style-type: none"> • Specifically include verification of compliance with contract pricing terms as a duty of the Monitoring Officer. • Require that the procedures to verify compliance with contract pricing terms are documented in the contract monitoring plan. <p>In addition, copies of appointment forms and monitoring plans should be maintained in a central</p>	<p>Harris Health Corporate Compliance will revise the relevant policy appendices to include verification of compliance with contract pricing terms as a duty of the Monitoring Officer and to require that the contract monitoring plan include procedures to verify compliance with contract pricing terms. This will be completed by June 30, 2016.</p> <p>Harris Health Corporate Compliance will maintain Contract Monitoring Officer Appointment Forms and Contract Monitoring Plans in its contract database. A</p>

ISSUES AND RECOMMENDATIONS

Subject	Background	Issue	Recommendation	Management Response
(Continued) Verifying Compliance with Contract Pricing		verification is not being performed, and could result in undetected overcharges and financial loss.	location. Monitoring Officers should also be held accountable by establishing a process of periodic independent testing to ensure verification procedures are performed.	review will be completed by June 30, 2016 to identify missing items and Corporate Compliance will obtain the missing items by September 30, 2016. Harris Health Corporate Compliance will work with Harris Health Management to identify a department within Harris Health to conduct periodic independent reviews of contracts for purchased services or products that are not in the item master or processed through P-Suite by using analytical reporting tools. Harris Health Corporate Compliance will verify the process for independent testing. This will be completed by June 30, 2016.

RISK ASSESSMENT AND SUMMARY OF RECOMMENDATIONS

The risk matrix below presents the assessed level of risk or exposure identified during our procedures. Inherent risk relates to factors that because of their nature cannot be controlled or mitigated by management. Inherent risk includes factors such as legislative changes, number and dollar amount of transactions processed and/or complex nature of transactions. Control risks relate to factors that can be influenced or controlled by management. Controls such as policies and procedures, electronic or manual approvals, system security access, and separation of job responsibilities may be instituted by management in order to mitigate control risk. Control risk is assessed during the planning phase in order to establish the nature, timing, and extent of testing and at the conclusion of the engagement in order to incorporate actions taken to implement our recommendations. The overall risk considers a combination of inherent and control risks.

Inherent Risk:	Control Risk:		Overall Risk:
<input checked="" type="checkbox"/> High <input type="checkbox"/> Moderate <input type="checkbox"/> Low	Prior to Procedures	After Procedures	<input checked="" type="checkbox"/> High <input type="checkbox"/> Moderate <input type="checkbox"/> Low
	Needed Improvement	Needs Improvement	
Type of Procedures: Audit			
Purpose: Evaluate critical controls for administering Harris Health contracts.			
Outstanding Audit Recommendations:			
Priority Rating:	Audit Recommendations: Harris Health System		
2	Evaluate to determine if projected contract monitoring control improvements justify the expenditure required to acquire and implement the PeopleSoft contract management module. In the interim, Harris Health Management should consider using purchasing data available from the PeopleSoft material management module and analytical reporting tools to implement additional contract monitoring processes.		
1	Include verification of compliance with contract pricing terms as a Monitoring Officer duty and require verification procedures to be documented in the contract monitoring plan. Appointment forms and monitoring plans should be maintained in a central location. Implement a process of periodic independent testing of verification procedures.		
Priority Rating	<ol style="list-style-type: none"> 1. Implement immediately (30 – 90 days) – Serious internal control deficiencies; or recommendations to reduce costs, 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 department (i.e., budgetary, technological constraints, etc.). 3. Implement in the future (two – three 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, requires third party cooperation, etc.). 		