

AUDITOR'S REPORT

HARRIS HEALTH SYSTEM CAPITAL EQUIPMENT CONTROLS



February 27, 2014

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HARRIS COUNTY AUDITOR

February 27, 2014

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

RE: Harris Health System Capital Equipment Controls for the 12 months ended March 31, 2013

The Audit Services Department (Audit Services) performed procedures relative to the Harris Health System (Harris Health) Capital Equipment Controls. The objective of the engagement was to evaluate critical controls for acquiring, securing, recording and disposing of capital equipment. Our procedures included the following:

- Assessed physical security at locations where capital equipment is delivered and held until it is transferred to departments.
- Reviewed and selectively tested controls for:
 - Ensuring equipment received is identified for tagging and inspection.
 - Recording newly received equipment for maintenance tracking and Harris Health System's financial records.
 - Verifying the accuracy of equipment records through physical inventories.
 - Investigating, reporting, and accounting for equipment not located.
 - Recording transfers of equipment between locations or departments.
 - Documenting and obtaining authorization for removing equipment.
 - Determining the appropriate disposition of equipment removed from departments.
 - Ensuring that a fair value price is received for capital equipment auctioned or traded-in.
 - Ensuring proceeds from the sale of equipment are properly received and recorded.

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.

Mr. David Lopez
President and Chief Executive Officer

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. Less significant issues and recommendations have been verbally communicated to your staff.

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
 El Franco Lee
 Jack Morman
 Steve Radack
Devon Anderson
Vince Ryan
William J. Jackson

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OVERVIEW

Harris Health's policy is to record equipment that has an estimated useful life greater than one year and a cost greater than \$5,000 as depreciable capital equipment in the financial records. Equipment costing less than \$5,000 is expensed as minor equipment unless purchased in bulk via a large capital project.

Controls over minor equipment were not reviewed in this Audit Services engagement. However controls over information technology (IT) minor equipment have been reviewed (see Auditor's Report for Harris County Hospital District Information Technology Equipment Inventory Controls, dated July 26, 2012).

The Property Management Department (Property Management) and the Financial Accounting Department (Financial Accounting) utilize the PeopleSoft Asset Management Module (Asset Module) to account for and record the locations of capital equipment.

Acquiring and Recording Capital Equipment

Harris County Purchasing procures capital equipment requested by Harris Health departments. Harris Health Materials Management Technicians in the receiving areas notify the Property Management Property Inventory Technician (Property Inventory Technician) when capital equipment is delivered to Harris Health. The Property Inventory Technician assigns numbered identification tags to all capital equipment and secures the identification tags to non-medical capital equipment received.

For medical capital equipment received, the Property Inventory Technician orders a technical inspection and provides the numbered identification tags assigned to a Technician in the Biomedical Engineering Department (Biomed Tech). The Biomed Tech performs the technical inspection, secures the assigned identification number, and records the description and other information for the medical capital equipment in a computerized maintenance management system, Total Maintenance Solutions. The Total Maintenance Solutions system tracks and provides notification of required preventive maintenance.

Capital equipment received is delivered to requesting departments by the Property Inventory Technician, and the delivery is documented on an Equipment Data Sheet signed by the department receiving the equipment and retained by Property Management. The Property Management Systems Analyst (Systems Analyst) records the identification tag number, the serial number, and the location of the new capital equipment in the Asset Module and provides documentation to the Financial Accounting Assistant to add the equipment to the financial records.

Transfers of capital equipment that are requested by departments are documented using Asset Transfer Worksheets approved by transferring and receiving department management. The Systems Analyst updates the capital equipment's location code, adds explanatory comments in the Asset Module, and forwards documentation of the transfer to the Financial Accounting Assistant to record the transfer in the financial records if necessary.

Annual Capital Equipment Inventory

Harris Health departments conduct annual capital equipment physical inventories which are initiated, monitored, and documented by Property Management to confirm the location and existence of the capital equipment. Property Management coordinates with executive management of the hospitals, clinics, and ancillary support areas to facilitate the inventories and communicate the results.

The inventories are initiated when the Systems Analyst prints out report lists (lists) of capital equipment by location from the Asset Module. The Property Inventory Technician distributes the lists to department management with instructions for the department personnel to physically locate and inspect capital equipment that has not been located, inspected and provided repair or maintenance services within the last 12 months. The personnel are instructed to mark on the lists whether the capital equipment was located, not located, or moved to another location.

The completed marked lists are approved by department management and returned to the Systems Analyst. The Property Inventory Technician tests the accuracy of the marked lists by locating a sample of equipment items from the lists. Unlocated capital equipment is recorded in the Asset Module by the Systems Analyst and reported in the Cannot Locate Report.

The Cannot Locate Report is sent to department managers monthly to investigate unlocated capital equipment. If unlocated capital equipment is not located after one year, the Property Management Manager obtains approval from the executive management of the department with the unlocated equipment to have the Financial Accounting Assistant remove the equipment from the financial records.

Disposing of Capital Equipment

Capital equipment no longer used by departments is traded-in, redeployed to another department, auctioned, or scrapped. Departments send a form with equipment information, the reason for removal, and the approval of department management to the Property Inventory Technician to request physical removal. The Property Inventory Technician adds additional information from the Asset Module to the form when it is received, and requests that the Logistic Move Services Department transport the capital equipment to the Kirby Warehouse.

A BioMed Tech inspects medical capital equipment transported to the Kirby Warehouse for eligibility for redeployment to another department. Eligible equipment is offered to other departments for four weeks. Equipment selected for redeployment is relocated by the Logistic Move Services Department and the Property Management Coordinator (Coordinator) updates the location code and comments fields in the Asset Module and forwards the information to the Financial Accounting Assistant to record the transfer if necessary.

Capital equipment that is not scrap is offered for sale through auction by posting the equipment on an independent vendor's (Public Surplus) internet website. The website allows the public to bid on the capital equipment and the equipment is sold to the highest bidder. Winning bidders

pay Public Surplus and Public Surplus remits the proceeds directly to the Cash Management Department for deposit and recording in the financial records if necessary.

Auctioned capital equipment is picked up at the Kirby Warehouse by the winning bidders after they provide their personal identification and their copy of the Public Surplus receipt. The Coordinator also reviews the receipt on the Public Surplus website to verify payment before releasing the equipment. If equipment does not have a salvage value or does not sell after two auction attempts, it is disposed of by the Logistic Move Services Department through an independent scrap vendor.

The Systems Analyst reconciles equipment sold or scrapped to invoices and disposal records from Public Surplus and the independent scrap vendor. Information on disposal of capital equipment is sent to the Financial Accounting Assistant by the Systems Analyst to record the disposal in the financial records.

RESULTS

Based on the procedures performed and capital equipment transactions selectively tested, controls appeared to be adequate for:

- Ensuring equipment received is tagged and inspected.
- Recording new equipment for maintenance tracking and financial reporting purposes.
- Verifying capital equipment records through annual physical inventories.
- Investigating, reporting, and accounting for equipment that cannot be located.
- Recording transfers of equipment between locations or departments.
- Documenting and obtaining authorization for removing equipment.
- Determining the appropriate disposition of equipment removed from departments.
- Submitting retired capital equipment with a salvage value to be sold by public auction.
- Depositing and recording proceeds for capital equipment sold.

A need for improvement was identified for controls to:

- Timely recover funds for returned equipment or trade-in credits.
- Maintain evidence of delivery of IT equipment to the IT Asset Management Department and update IT minor equipment records.
- Secure certain locations where capital equipment is temporarily held in storage.
- Enforce certain capital equipment policies.

These and other issues are discussed in more detail in the following Issues and Recommendations matrix.

ISSUES AND RECOMMENDATIONS

Subject	Background	Issue	Recommendation	Management Response
Returned Equipment Credits	When Property Management returns new capital equipment to vendors for credit, the Property Inventory Technician completes a Returned Merchandise Authorization form documenting the return. A copy of the Returned Merchandise Authorization form is retained by Property Management.	<p>Property Management does not report returned equipment credits to the Accounts Payable Department (Accounts Payable) or follow-up to verify credits are recovered. Of the 15 capital equipment additions selected for testing, two (13.3%) had returned equipment credits and the funds had not been recovered. The credit amounts and periods outstanding were as follows:</p> <ul style="list-style-type: none"> • One credit for \$20,271 was outstanding for over one year. • One credit for \$3,937 was outstanding for over 90 days. <p>Not reporting credits to Accounts Payable and following up to verify they are recovered increases the risk that credits will not be</p>	<p>Property Management should provide timely notifications to Accounts Payable of credits due from vendors for new equipment returned. A list of completed Returned Merchandise Authorization forms should be retained for tracking and periodic verification of recovery of the credits with Accounts Payable.</p> <p>In addition, Property Management, in conjunction with Accounts Payable Management, should collect the two unrecovered credits identified and should compare past Returned Merchandise Authorization forms to Accounts Payable records to determine whether other credits are outstanding.</p> <p>Subsequent to reporting this</p>	<p>Management agrees and has worked to improve the accountability process to ensure the recovery of credits due. When an item needs to be returned to vendor, the Medical Capital Project Manager will contact the vendor for a Returned Merchandise Authorization (RMA). Once equipment is returned to vendor, a copy of the RMA is given to the Property Inventory Technician and is scanned/filed to the original purchase order. The Medical Capital Project Manager will now follow up with the vendor to verify receipt of the returned merchandise and obtain credit documentation. The Project Manager will then notify the Accounts Payable Coordinator that the vendor received the returned equipment, and Accounts Payable will follow up with</p>

ISSUES AND RECOMMENDATIONS

Subject	Background	Issue	Recommendation	Management Response
(Continued) Returned Equipment Credits		recovered, resulting in losses to Harris Health.	issue to Property Management, we were informed that recovery of the un-recovered credits identified had been initiated.	the vendor for a Credit Memo. Once the Credit Memo is received, Accounts Payable will process the credit. The Medical Capital Project Manager will keep a running log of all expected credits until they are received and posted before closing out the project folder.
Trade-in Credits	Credits for equipment trade-ins appear as separate lines on capital equipment purchase orders. Trade-in credits that are not deducted from the original payment for new equipment may require that the department trading-in the equipment notify Accounts Payable after the vendor picks up the traded-in equipment. Otherwise Accounts Payable will not know to recover the credit.	There is no formal process in Property Management to monitor trade-in credits and follow-up to verify recovery. Of the 15 capital equipment additions selected for testing, one (6.6%) had a \$6,000 trade-in credit which had not been recovered after 90 days. Additional procedures were performed on other purchase orders with trade-in credits for the twelve months ended March 31, 2013, and no other unrecovered trade-in credits were identified.	Property Management should review capital equipment purchase orders to identify trade-in credits due and should keep a log of the credits to follow-up with the ordering departments and Accounts Payable to verify that the credits are recovered. In addition, Property Management, in conjunction with Accounts Payable Management, should collect the trade-in credit identified and consider whether additional review for un-recovered trade-in credits should be performed.	Management agrees and has worked to clarify the accountability process to ensure Trade-In credits identified in the PeopleSoft Requisition/Purchase Order Module are also notated within the Project Management documentation. The follow-up for credits was never clearly assigned and assumed to be part of the Accounts Payable, invoicing activity so changes to our project accountability processes were made. We performed an audit of requisitions for the past year and have reconciled one additional open credit and all

ISSUES AND RECOMMENDATIONS

Subject	Background	Issue	Recommendation	Management Response
(Continued) Trade-in Credits		Without a formal process for recording and monitoring trade-in credits and following-up to verify recovery, there is an increased risk that trade-in credits will not be recovered, resulting in losses to Harris Health.	Subsequent to reporting this issue to Property Management, we were informed that recovery of the un-recovered credit identified had been initiated.	other confirmed credits were received. Validating credits on future procurements is now part of the project close-out requirement.
Information Technology (IT) Equipment	<p>The Property Inventory Technician delivers new IT capital equipment to the IT Asset Management Department for inspection and preparation before IT employees deliver and install it in the ordering departments.</p> <p>IT capital equipment is recorded in the Asset Module by Property Management. However, IT equipment costing less than \$5,000 (minor equipment) is recorded in IT minor equipment records that are maintained by the IT Asset Management Department.</p>	<p>Property Management does not consistently maintain evidence of deliveries to the IT Asset Management Department. In addition, some IT capital equipment re-classified to minor equipment and removed from the Asset Module was not recorded in the IT minor equipment records.</p> <p>Not maintaining evidence of deliveries to the IT Asset Management Department, or recording reclassified IT capital equipment to the IT minor equipment records increases the risk of undetected misappropriation of IT</p>	<p>Property Management should maintain evidence of deliveries of new IT capital equipment to the IT Asset Management Department. In addition, Property Management, in conjunction with the IT Asset Management Department, should implement a process to ensure IT minor equipment records are updated if IT capital equipment is reclassified and removed from the Asset Module. The identified reclassified IT equipment still in use should be recorded to the IT minor equipment records.</p>	<p>Management agrees that transfer of custody signatures were not being obtained for IT Capital equipment. Accountability and chain of custody records for those items were not updated until the first annual inventory which increased risk for the items to potentially become lost or misallocated. The Property Inventory Technician now receives change of custody signatures for all capital to include IT equipment. This relieves the technician of custodial accountability until the first inventory and reduces the risk of willful misallocation of property. Review of the IT</p>

ISSUES AND RECOMMENDATIONS

Subject	Background	Issue	Recommendation	Management Response
(Continued) Information Technology (IT) Equipment		equipment.		<p>inventory records since 2009 show that no items less than one year old were identified as Can Not Locate (CNL) on the initial annual inventory.</p> <p>IT Capital assets were reclassified to minor equipment in 2007 when the capital threshold was raised from \$1000 to \$5000. Assets that were reclassified to minor equipment at that time remained on the financial records because of depreciation but were no longer tracked by Property Management due to the capital threshold change. At the time of reclassification in 2007, items should have been added by the managing IT department to the 99999 Business Unit for IT Asset Management to track but were not transferred.</p>
Equipment Security	When capital equipment is received, it may be held at different locations waiting to be transferred to ordering	One location where equipment was held for storage, the Ben Taub crawl space, was not secured	Property Management should ensure all areas where new equipment is held for storage remain	Management agrees and Property Management now participates in quarterly reviews of employee access

ISSUES AND RECOMMENDATIONS

Subject	Background	Issue	Recommendation	Management Response
(Continued) Equipment Security	departments. Retired capital equipment is held at the Kirby Warehouse until disposition. The Kirby Warehouse is shared by four departments and employee physical access is reviewed quarterly.	during our site visit. In addition, Property Management has not participated in the quarterly employee physical access review at the Kirby Warehouse. Not securing areas where new equipment may be held for storage or not participating in the Kirby Warehouse employee access review increases the risk of inappropriate access and misappropriation of capital equipment.	secure at all times. In addition, Property Management should participate in the quarterly review of employee physical access to the Kirby Warehouse.	to the Kirby Warehouse with the IT Department. The Ben Taub crawl space is shared by multiple departments so Property Management is not able to ensure the area is secured at all times or limit access. The Ben Taub crawl space was being utilized to store excess beds due to construction of old Ben Taub. The assets held for trade-in/return are locked in a sub-cage area and secured even though the main area is unlocked at times. The area is being reconfigured due to the Ben Taub Tower renovations and beds will no longer need to be stored in this area after 24 th of January.
Policies and Procedures Enforcement	Policy 5.01, Capital Assets, requires a capital equipment inventory for changes in department management (director or manager). In addition, Property Management's Equipment	Property Management's written procedures for performing inventories for management changes, or for maintaining electronic records of pick-ups and technical inspections for	Property Management should evaluate the written policies and procedures to ensure they are still necessary, and if they are, they should be enforced.	Policy 5.01 is managed by the Financial Accounting department. The current annual inventory process provides consistent accountability for inventory of assets so it is the

ISSUES AND RECOMMENDATIONS

Subject	Background	Issue	Recommendation	Management Response
(Continued) Policies and Procedures Enforcement	Disposal Procedures requires electronic records of pick-ups and technical inspections for redeployed or disposed of capital equipment.	redeployed capital equipment are not followed. Not following written policies and procedures reduces the effectiveness of financial and operational controls.		recommendation of the Property Management department to drop this section from the policy at the next revision.
Annual Inventory Tests		There are no procedures to ensure adequate testing of the annual inventory. As a result, there is an increased risk that testing procedures or sampling methodologies will not achieve the desired objectives.	Property Management should develop written procedures or process maps for the Property Inventory Technician to follow when documenting testing of annual capital equipment inventories.	Property Management performs a 10% validation test count of all inventoried areas and a higher level validation test if there is a measurable increase in “cannot locates” (CNL) for a specific area. Management agrees that developing a written process map would increase consistency and remove subjectivity from determining trigger levels for increased inventory test counts and additional follow-on action. Property Management is developing process maps for all critical internal procedures for standardized implementation.
Duplicate Serial Numbers		There is no systematic process to verify the accuracy of serial numbers	Property Management should verify the accuracy of serial numbers entered	The duplicate serial numbers were a result of a data sheet template that was being used

ISSUES AND RECOMMENDATIONS

Subject	Background	Issue	Recommendation	Management Response
(Continued) Duplicate Serial Numbers		<p>recorded for capital equipment in the Asset Module. As a result, as of May 31, 2013, computer assisted auditing techniques identified 22 instances out of 7,258 (0.3%) capital equipment records where the same serial number was recorded for more than one capital equipment item. Not entering the correct serial numbers could cause errors in performing preventive maintenance and/or identifying recalled capital equipment.</p>	<p>into the Asset Module by reviewing reports showing information entered, or by performing analytical analysis of data entered searching for duplicates. In addition, the 22 instances of incorrect serial numbers identified should be corrected.</p>	<p>for all Philips Patient Monitoring Purchase Orders. Data was typed and saved on the original template and only the asset numbers and descriptions were changed as new Purchase Orders came in throughout the year. The Property Inventory Technicians have since been advised to use a blank template and type in all new data. All 22 duplicate serial numbers identified during the audit have been identified, verified and corrected in PeopleSoft and on the original data sheets.</p>

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: To evaluate critical controls for acquiring, securing, recording and disposing of capital equipment.			
Outstanding Audit Recommendations:			
Priority Rating:	Audit Recommendations: Harris Health System		
1	Timely notify Accounts Payable of credits due from vendors for new equipment returned. A list of completed Returned Merchandise Authorization forms should be retained for tracking and periodic verification of recovery of the credits with Accounts Payable. Collect the two un-recovered credits identified and compare past Returned Merchandise Authorization forms to Accounts Payable records to determine whether other credits are outstanding.		
1	Review capital equipment purchase orders to identify trade-in credits due and should keep a log of the credits to follow-up with the ordering departments and Accounts Payable to verify the credits are recovered. Collect the trade-in credit identified and consider whether additional review for un-recovered trade-in credits should be performed.		
1	Maintain evidence of deliveries of new IT capital equipment to the IT Asset Management Department. Implement a process to ensure IT minor equipment records are updated if IT capital equipment is reclassified and removed from the Asset Module, and the identified reclassified IT equipment still in use should be recorded to the IT minor equipment records.		
1	Ensure all areas where new equipment is held for storage remain secure at all times. Participate in the quarterly review of employee physical access to the Kirby Warehouse.		

1	Evaluate the written policies and procedures to ensure they are still necessary and should be enforced.
2	Develop written procedures or process maps for the Property Inventory Technician to follow when documenting testing of annual capital equipment inventories.
1	Develop a process for verifying the accuracy of serial numbers entered into the Asset Module. The 22 instances of incorrect serial numbers identified should be corrected.
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.).