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INTERNAL CONTROL

An important responsibility of management is the establishment and maintenance of the internal control structure. To provide reasonable assurance that a facility's objectives will be achieved, the internal control structure should be under ongoing supervision by management to determine that it is operating as intended and that it is modified as appropriate for changes in conditions.

Formal Definition

Internal control comprises the plan of an organization and all coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies.

Characteristics of Internal Control

The following are general characteristics of a satisfactory system of internal control:

- A plan of organization which provides appropriate segregation of duties.
- Personnel of a quality commensurate with responsibilities.
- Sound practices to be followed in performance of duties and functions of each of the organizational departments.
- A system of authorization and recordation procedures adequate to provide reasonable accounting control over assets, liabilities, revenues, and expenses.

The above summary emphasizes both the organizational structure and the systems of procedures to be used in the organization. Within this framework, internal control can be divided into three types of controls: the control environment, the accounting system, and control procedures.

Control Environment

The control environment represents the collective effect of various factors on establishing, enhancing, or mitigating the effectiveness of specific policies and procedures. Such factors include the following:

- Management's philosophy and operating style
- The facility's organizational structure
- The functioning of the board of directors and its committees, particularly the audit committee

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- Methods of assigning authority and responsibility
- Management's control methods for monitoring and following up on performance, including internal auditing
- Personnel policies and practices
- Various external influences that affect a facility's operations and practices, such as examinations by bank regulatory agencies

The control environment reflects the overall attitude, awareness, and actions of the board of directors, management, owners, and others concerning the importance of control and its emphasis in the entity.

Accounting System

The accounting systems consist of the methods and records established to identify, assemble, analyze, classify, record, and report a facility's transactions and to maintain accountability for the related assets and liabilities. An effective accounting system gives appropriate consideration to establishing methods and records that will--

- Identify and record all valid transactions.
- Describe on a timely basis the transactions in sufficient detail to permit proper classification of transactions for financial reporting.
- Measure the value of transactions in a manner that permits recording their proper monetary value in the financial statements.
- Determine the time period in which transactions occurred to permit recording of transactions in the proper accounting period.
- Present properly the transactions and related disclosures in the financial statements.

Control Procedures

Control procedures are those policies and procedures in addition to the control environment and accounting system that management has established to provide reasonable assurance that specific facility objectives will be achieved. Control procedures have various

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objectives and are applied at various organizational and data processing levels. They may also be integrated into specific components of the control environment and the accounting system.

Generally, they may be categorized as procedures that pertain to--

- Proper authorization of transactions and activities.
- Segregation of duties that reduces the opportunities to allow any person to be in a position to both perpetrate and conceal errors or irregularities in the normal course of his duties. Segregation of duties includes assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets.
- Design and use of adequate documents and records to help ensure the proper recording of transactions and events, such as monitoring the use of prenumbered shipping documents.
- Adequate safeguards over access to and use of assets and records, such as secured facilities and authorization for access to computer programs and data files.
- Independent checks on performance and proper valuation of recorded amounts, such as clerical checks, reconciliations, comparison of assets with recorded accountability, computer-programmed controls, management review of reports that summarize the detail of account balances (for example, an aged trail balance of accounts receivable), and user review of computer-generated reports.

Revenue and Accounts Receivable

Proper accounting for revenues and the related accounts receivable is a matter of considerable importance since no long-term care facility can survive for long without adequate revenues. To assure adequate controls in this area the administrator should ensure that:

- There are effective controls that all charges are billed and properly recorded on the accrual basis of accounting and properly classified by type of service rendered.
- Revenues are based on pre-numbered charge slips, daily census and/or other effective controls.
- Controls are in effect to assure the accuracy and completeness of medical records information.

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- Rates are approved by management and comply with regulatory requirements, if applicable.
- Patient billings are maintained on a current basis.
- Units of service and statistics that affect revenue determination are properly recorded.
- Accounts receivable detailed records are complete and reconciled to the control accounts.
- Accounts receivables are reported at net realizable value.
- To the extent practicable, there is an adequate segregation of duties among billings, accounts receivable, and cash functions.

Segregation of duties is fundamental to good control procedures. Conflicting duties for control procedures are those that place any person in a position to perpetuate and to conceal errors or irregularities in the normal course of his or her work. Different people should be assigned the responsibility of authorizing transactions, recording transactions, and maintaining custody of assets. While complete absence of conflicting duties is ideal, it is not always attainable with the limited staff common in smaller long-term care facilities. In the event various duties cannot be adequately segregated, the administrator, or his or her designated representative without conflicting duties, should perform alternative reviews. Such alternative procedures could include a careful review of the monthly aged detail accounts receivable trial balance for unusual items, personal follow up on delinquent account balances, personal review of the reasons for and approval of bad debts, write-offs and other noncash credits to accounts receivable, test posting of credits to patient accounts from revenue and cash receipt journals and a review of the reconciliation of patient census records, charge tickets, and vendor invoices for contract services to the revenue journal.

Cash Receipts

Cash is a necessity in business operations. Due to the large number of cash transactions and the susceptibility to misappropriation, the controls placed over the handling of cash play an important role in any system of internal control. To assure adequate controls over cash receipts the administrator should require that:

- Receipts are deposited daily and intact.
- Currency receipts are effectively controlled by registers, or if impractical, cash receipt slips. Such slips should be prenumbered and accounted for on a periodic basis.
- All checks received should promptly be endorsed for "deposit only" to the appropriate account.

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- To the extent practicable, cash receiving is centralized to a person without authority to sign checks and not involved in reconciling bank accounts.
- The administrator initiate bad debt write-offs or other noncash credits to accounts receivable, and submit write-offs to management for approval.
- Bank reconciliations are performed on a monthly basis and approved by management.

If an adequate segregation of duties cannot be accomplished due to limited staff, the administrator can perform various reviews to compensate for the lack of segregation. The administrator can review the timeliness of bank deposits to assure cash is directly deposited for the institution's use. The administrator can reconcile bank accounts personally or carefully review the reconciliation and test cash receipts posting to patient accounts to assure proper application.

Purchasing and Accounts Payable

The purchasing function creates obligations and the accounts payable function of a facility records the liabilities of the facility. To assure adequate controls the administrator should require:

- Effective use and control of purchase orders by using prenumbered, sequential forms.
- Procedures to assure purchases at competitive prices.
- Effective review of vendor's invoices, pricing and extension and matching invoices with purchase orders and receiving reports.
- To the extent practicable, there is adequate segregation of duties within purchasing, accounts payable and receiving functions.

For a facility without the desired segregation of duties, the administrator should review all invoices of large dollar amounts and others on a test basis. It is also good policy to require signed receiving documents from various departments within the facility, acknowledging receipts of significant purchases of goods such as medical supplies, drugs and medications, and food.

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Cash Disbursements

The need to control cash disbursements is just as great as the need to control receipts. To assure adequate controls over cash disbursements the administrator should require:

- All disbursements of a material amount are to be made by check (minor cash disbursements may be made from a petty cash fund maintained on an imprest basis).
- Checks are to be prenumbered and serially controlled.
- Checks are to be signed only if accompanied by supporting documents. Supporting documents should include evidence of receipt and approval.
- Control totals of amounts should be maintained over the check at each processing point.
- Perforating, stamping, or other procedures to be used to prevent reuse of vouchers, particularly petty cash slips or other cash vouchers and voided checks.
- A policy prohibiting checks being signed in blank.
- Preparation of regular monthly bank reconciliations by an individual independent of all cash related functions.
- The employees responsible for accounting records should be prohibited from having the authority to sign checks.
- Different persons should prepare checks, reconcile bank accounts and have access to cash receipts.

The administrator should perform alternative reviews when segregation of duties is not practical. The administrator should sign checks only with satisfactory documentation that the disbursement is proper. The administrator should also see that checks are mailed directly from his or her office by the check signer without returning to the person who maintains the cash disbursements and accounts payable records. Standard policies should prohibit preparation of checks made payable to "cash" and require periodic reconciliation of the petty cash balance.

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Payroll

Salaries and wages represent a major portion of a long-term care facility's operating expenses. Governmental agencies require the facility to maintain adequate payroll and personnel records. A sound system of internal control is necessary to produce these records accurately. The following procedures help to provide this control:

- Written authorizations are on file for all employees; covering rates of pay, withholdings and deductions.
- Accumulation of hours worked by department is based on mechanical or other independent sources.
- Accounting distribution of payroll costs is on the basis of approved documentation prepared by the administrator or his or her authorized representative.
- Control totals of amounts should be maintained at each processing point.
- To the extent practicable, there is adequate segregation of duties between the maintenance of personnel files, the preparation of checks and journals, and the distribution of payroll checks.

To compensate for the lack of segregation of duties the administrator can maintain control of all blank payroll checks, review time cards prior to signing checks, reconcile the payroll bank account, review the payroll journal and personally authorize pay rate adjustments and payroll additions and deletions.

Inventories

The primary purpose of control of inventory is to physically safeguard the assets. This can effectively be done by the following procedures:

- Centralized, orderly storage with limited and controlled access to supplies.
- Assignment of responsible persons to receive, store, issue and control inventory.
- Periodic physical counts of the inventory; at least annually, by persons other than the storekeepers.
- Use of a planned and orderly system for purchase and issue of supplies designed to control optimum quantities of supplies on hand.

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- Periodic review of inventory records and other data to determine if quantities on hand are excessive or if any supplies are obsolete or slow-moving.

Property, plant, and equipment

Internal control over property, plant, and equipment is designed to safeguard the assets and provide accurate accounting records for management control, depreciation and salvage value calculations, and to make correct entries for retirements and disposals. The following guidelines will be helpful in establishing this control:

- There is an effective system of authorization and approval with respect to capital expenditures.
- Capitalization and depreciation policies are defined in writing.
- There are detailed records of individual asset items which are balanced periodically with general ledger control accounts.
- There are effective procedures regarding the authorization and accounting for disposals.
- Donated property and equipment is reported at its fair market value on the date of donation.

The administrator may wish to attach an identifying tag to each piece of departmental equipment to track the equipment locations.

Internal Control Checklist

The following checklist has been developed to allow administrators to review their existing system of internal control in a systematic manner to determine areas where improvement of procedures may strengthen controls. In considering changes in accounting controls, the administrator must evaluate the cost-benefit relationship of varying levels of control procedures and select the procedures which are appropriate in the circumstances. Also, it should be recognized that no checklist can contain all procedures that may be appropriate in all circumstances and, accordingly, the administrator should not limit his or her consideration to those items contained in the checklist. Section I of the checklist discusses accounting controls and Section II deals with general controls.

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I. ACCOUNTING CONTROLS

Revenue and accounts receivable

A.. Patient revenue:

1. Are services rendered only on order of physicians?
2. Do procedures ensure that revenue is accrued as services are performed?
3. Are all departmental personnel responsible for initiating charge slips properly instructed and currently advised of policy changes?
4. Are there effective controls that all charge slips prepared are received and recorded by the person recording revenue?
5. Are all patient charges supported by proper authorizations for services?
6. Are voided charge slips approved and retained and appropriately canceled?
7. Is there a periodic review and comparison, on a test basis, of patient's medical records to charges recorded? Is the extent of this procedure adequate for the circumstances?
8. How are prices determined? Are prices which are not based on standard lists approved by a responsible official?
9. Who prices and extends charge slips?
10. Are prices and extensions checked by a second person? To what extent?
11. Do controls ensure that deductions from revenue are recorded in the proper period and are properly classified and authorized?
12. Is the authority to approve deductions from revenue separate from the cashiering and billing functions?

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B. Billing--consider:

1. Are statements rendered at least monthly or at time of discharge or within a few days thereafter?
2. Are statements rendered promptly with an estimate of the self-pay balance prior to receipt of insurance payments?
3. Are statements mailed monthly to all patients having account balances?
4. Who is responsible for billings? Are billings current?

C. Credit:

1. Are preadmission deposits requested or payment terms arranged in advance, or at least at time of admission?
2. Does the admission procedure provide for obtaining necessary insurance and other information for billing and credit use?
3. Is there a current and effective review and follow-up on all accounts?
4. Is reasonable use made of outside collection agencies?
5. If nonprofit, are IRS and Hill-Burton charity requirements met?

D. Accounts receivable--consider:

1. Are accounts receivable ledgers balanced with the ledger monthly?
2. Are aged listings prepared with sufficient frequency to meet the institution's needs? How often?
3. Is the person posting accounts receivable properly instructed as to required approval for noncash credits?
4. Is a record maintained of accounts written off as uncollectible? Are these followed up for recoveries and is there proper control over such recoveries?

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E. Patient statistics--consider:

1. Is there a logical, organized system for accumulating patient statistics?
2. Is the accumulation of patient statistics done simultaneously, or at least coordinated, with the accumulation and recording of revenue? If not, is there a review and comparison made between the two?
3. Are there effective controls, such as review and tests of accumulations by a second person, to ensure the accuracy of statistics?

F. Other revenue (operating and nonoperating):

Are there adequate controls over the receipt of other (operating and nonoperating) revenues such as:

- a. Sales of, or income from securities, notes, savings?
- b. Rental income?
- c. Sale of surplus equipment, supplies, etc.?
- d. Cash sales of drugs, medical supplies, etc.?
- e. Vending machines?
- f. Sale of medical records?
- g. Periodic purchase rebates?
- h. Gifts, donations, grants, etc.?
- i. Revenue from educational programs?

G. Cash Receipts:

1. Are all receipts recorded promptly and deposited intact daily (or at other frequent, regular intervals)?

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2. Does the cashier prepare duplicate deposit tickets so that one can be signed by the bank and returned for comparison to the cash receipts record?
3. Is the person receiving cash without authority to sign checks, without access to accounting records other than cash receipts (particularly patient ledgers) and without access to or custody of negotiable assets?
4. Is all cash which should be received, recorded as a receivable prior to receipt, to the extent practicable?
5. Are receipts in currency properly controlled, (i.e., through cash registers, vending machines, prenumbered locked receipt forms, etc.), and are the readings on such registers, machines or locked receipts used as an effective control over cash which should be recorded and deposited?

H. Purchasing and Accounts Payable:

1. Are all purchases of material or services made by authorized personnel and are all commitments covered by purchase orders?
2. Are competitive prices established?
3. Who signs purchase orders and are there any limits above which additional approval is necessary?
4. Is there adequate control over and accounting for purchases orders, (i.e., pre-numbering, purchase order log, consecutive number assignment, etc.)?
5. Does the accounting department match invoices with purchase orders and receiving reports comparing quantities, prices, terms, etc., and are these documents retained together as a voucher package?
6. Are receiving reports attached to invoices?
7. Are unmatched invoices, purchase orders or receiving reports which remain open for some time investigated periodically?
8. Are extensions on invoices and freight charges checked by the accounting department?

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9. Is the account distribution assigned by a second person?
 10. Is there an auditor of disbursements who reviews each voucher to see that proper procedures have been followed?
 11. Is the total of unpaid voucher items agreed to the related general ledger account each month?
 12. Are debit balances followed up for prompt application against other invoices or for cash reimbursement?
 13. Is there a satisfactory procedure for cross-referencing checks to vouchers?
 14. Are the people working with accounts payable different from those working on cash receipts and mailing of checks?
 15. Are accrual accounts maintained for all major items which are not paid promptly or regularly?
- I. Cash Disbursements:
1. Are checks controlled and accounted for with proper safeguards in effect over unused, returned, and voided checks?
 2. Is the drawing of checks to the order of "cash" or "bearer" prohibited?
 3. Do invoices, purchase orders and receiving reports accompany checks for the check signer's review?
 4. Are perforating, stamping or other procedures effectively used to prevent reuse of vouchers, particularly petty cash slips or other cash vouchers?
 5. Are check signers responsible officials or employees in all cases?
 6. Are two signatures required on checks (not essential in all cases where other adequate controls are present)?
 7. Is there adequate control over signature plates, if used?

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8. Are checks mailed without allowing them to return to the person who prepared the check or initiated the voucher (or check request)?
 9. Are all petty cash disbursements required to be reimbursed by check with adequate scrutiny at the time of reimbursement?
 10. Are petty cash slips required and written in ink to prevent alteration?
 11. Is a maximum amount, reasonable in the circumstances, fixed for payments in cash?
 12. Are all bank accounts required to be authorized by the Board of Directors, Governing Board or owners?
 13. Are bank accounts reconciled monthly by someone who does not prepare checks or have access to cash?
 14. Are the reconciliation procedures adequate?
- J. Payroll:
1. Is there a personnel function separate from the payroll function which maintains complete personnel records including rate data?
 2. Are the procedures adequate to assure correct time reporting?
 3. Are labor distribution records independently computed and tabulated in a manner to provide a check of aggregate pay?
 4. Are accounting distributions for salaries and wages carefully made, checked by a second person, and approved by an accounting official?
 5. Are payroll computations independently checked?
 6. Does the person reconciling the payroll bank account examine paid checks for dates, payees, cancellations and endorsements and does he or she account for numerical sequence?
 7. Is there adequate control over unclaimed wages or old outstanding payroll checks to prevent diversion?

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8. Are pay rate adjustments and personnel additions and deletions appropriately authorized in writing?
 9. Are checks distributed by someone not involved in the authorization or preparation of payroll information?
- K. Inventories:
1. Are inventories stored in a systematic manner?
 2. Are they under the direct control of persons who are held responsible for quantities on hand?
 3. Are there controls over access to storage areas for persons without such responsibility?
 4. Is there a planned system for purchase and issue of supplies?
 5. Is there a regular review of inventory records and other data to determine quantities on hand which are slow-moving, excessive or obsolete?
- L. Property, Plant, and Equipment:
1. Are administrative authorizations and approvals required to originate an expenditure which will be chargeable to fixed assets and in this respect are policies adequate regarding minimum amounts capitalized, minimum amounts requiring approval at various levels, distinction between repairs, replacements, renewals, betterments, treatment of freight and other collateral costs, etc.?
 2. Are work orders established to assist in the proper accounting for items to be capitalized?
 3. Are supplemental authorizations required for excess expenditures?
 4. Are there detailed plant records showing the asset values for the individual items of plant and equipment and dates placed in service?
 5. Are the detailed records integrated with the financial accounting system?

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6. Is the accuracy of these records independently checked by periodic, physical inspection?
7. Are records kept of equipment on hand but not carried in the general books, such as fully depreciated equipment still in use, obsolete equipment and idle equipment?
8. Is written authority required for fixed asset dispositions?
9. Does the accounting department receive copies of such authorizations?
10. Is the estimated salvage value shown on all retirement orders and followed up for subsequent cash receipts?
11. Are periodic reports submitted showing obsolete equipment, equipment needing repairs, or equipment not in service for any other reason?
12. Are procedures in effect to prevent depreciation of fully depreciated assets?
13. Is gain or loss computed on all fixed asset dispositions?

II. GENERAL CONTROLS

A. Organization:

1. Is there an organization chart?
2. Is the responsibility clear for the major revenue and expense centers?

B. Planning:

1. Is there an annual operating budget?
2. How are rates established? Are rates based upon full costs?
3. Are cash forecasts prepared routinely, if so how often and for what time period?

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4. Is capital budgeting used? If yes, is it prepared for a period of at least three years?

C Financial statements:

1. Are complete statements prepared monthly?
2. Are the statements constructed to correlate with responsibilities and are departmental reports prepared?
3. Can the statements be directly prepared from the general ledger chart of accounts?
4. Do they highlight important matters and show trends? Are graphs used?
5. Are actual results compared to the budget?
6. Are variances from budget analyzed and are they discussed with departmental heads?
7. If actual results are compared to budget, to what are they compared?
8. Are the interim financial statements prepared in a timely manner?
9. Are the statements reasonably accurate (credibility)?
10. Are year-end adjustments significant? Explain.
11. Is there a need for information between statement dates?

D. Data processing:

1. Are the batch and edit controls generally adequate?
2. Is there a good balance between electronic data processing and manual systems?
3. Are the computer programs adequately documented?
4. Is file protection adequate?

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5. Is file storage secure and adequate?
 6. Is the data processing service responsive to user needs?
 7. Are data processing reports reliable and accurate?
- E. Management of assets:
1. Are cash balances routinely reported and controlled?
 2. Are the amounts and trends of bad debts and past-due accounts receivable favorable?
 3. If perpetual inventory records are used, are they current and accurate?
 4. Is there evidence of excess inventory?
 5. Are there any procedures to detect lost, stolen or excess equipment or other property items?
 6. Are fully depreciated assets identified and written off if no longer in use?
 7. Are group purchasing arrangements used?
 8. Are competitive bids obtained for large dollar purchases?
- F. Accounting systems:
1. Is there a procedures manual?
 2. Are purchase orders used?
 3. Are important accounting documents pre-numbered and are the numbers accounted for?
 4. Are purchase documents approved by the originator?
 5. Are all coding systems logical?
 6. Is the filing system logical?

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7. Is document flow reasonable?
 8. Is staffing adequate? Excessive?
- G. Personnel:
1. Is on-the-job or external training provided to employees?
 2. Do compensation and fringe benefits appear to be reasonable?
 3. How are compensation arrangements developed and administered?
 4. Do the people seem generally productive and motivated?
 5. What is the trend of employee turnover?