

**UT Southwestern**  
Medical Center

**Southwestern Health Resources  
Financial Review Audit**

**Internal Audit Report 19:20**

**January 9, 2019**

# Table of Contents

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I. Executive Summary	3
· Background/Scope and Objectives	3
· Conclusion	4
II. Detailed Observations and Action Plans Matrix	5
III. Appendices	7
· Appendix A – Risk Classifications and Definitions	7

## **Executive Summary**

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### **Background**

The University of Texas Southwestern Medical Center (UT Southwestern) and Texas Health Resources (THR) entered into an affiliation agreement as of April 1, 2016, to strategically align certain aspects of their respective organizations and create a new organization called Southwestern Health Resources (SWHR). As a part of this affiliation, UT Southwestern and THR, entered into an agreement to form a Joint Operating Company (SWHR JOC), which includes University Hospitals (Clements and Zale Lipshy) and Texas Health Dallas (THD).

Under the agreement, both parties are required to submit financial reports monthly to the Southwestern Health Resources Controller for preparation of a network settlement. The network settlement provides a consolidation of the monthly financial performance and activities of the two parties so that financial performance is shared across the JOC Hospitals. Part of the process is to calculate the network settlement, the amount to be paid from one party to the other depending on the financial results of each entity. At the end of each fiscal year, the total amount due to either party is paid within 90 days of year-end.

### **Scope and Objectives**

The Office of Internal Audit has completed the SWHR Hospital JOC network settlement financial review. This is part of the fiscal year 2018 Audit Plan. The Office of Internal Audit (“OIA”) in coordination with the Financial Compliance (“FC”) team at THR determined common financial audit review procedures to be performed for the network settlement processes and transactions.

The audit scope period included financial activities from September 1, 2017 to August 31, 2018. Audit procedures included interviews with stakeholders, review of policies and procedures and financial documentation reviewed and transaction testing.

The primary objectives of the SWHR JOC audit included the following:

- Assessment of methodology to prepare the monthly network settlement calculation
- Validation of amounts reported in the network settlement to supporting documentation
- Evaluation of compliance with key contract provisions related to the network settlement

We conducted our audit according to guidelines set forth by the Institute of Internal Auditors’ International Standards for the Professional Practice of Internal Auditing.

## Executive Summary

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### Conclusion

The SWHR Finance team has implemented procedures and internal controls to comply with the provisions of the Master Affiliation Agreement (MAA) and to produce financial settlement reporting. There was one immaterial misstatement identified totaling approximately \$30,000, in which an asset was incorrectly included in the FY2018 Cost of Capital calculation.

Included in the table below is a summary of the observation, along with the respective disposition of the observation within UT Southwestern internal audit risk definition and classification process. See Appendix A for Risk Rating Classifications and Definitions.

Priority (0)	High (0)	Medium (1)	Low (0)	Total (1)
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- **#1. Ensure All Capital Assets included in the Calculation of Cost of Capital and Allowable Depreciation and Amortization are Allowed to be included Per the Terms of the MAA** – The Cost of Capital calculation was overstated by approximately \$30,000 due to the inclusion of an unallowable Information Resources asset, increasing the risk of financial misstatement and noncompliance with the MAA.

We would like to take the opportunity to thank the departments and individuals included in this audit for the courtesies extended to us and for their cooperation.

Sincerely,

Valla F. Wilson, Associate Vice President for Internal Audit, Chief Audit Executive, Interim Chief Compliance & HIPAA Privacy Officer

### **Audit Team:**

Melinda Lokey, Director of Internal Audit  
Angeliki Marko, Audit Supervisor  
Delaunda McCown, Senior Internal Auditor

## Executive Summary

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cc: Arnim E. Dontes, Executive Vice President, Business Affairs, UT Southwestern  
Chuck Fox, Controller, Southwestern Health Resources  
Kevin McGuire, Controller, Finance, University Hospitals  
Mark Meyer, Chief Financial Officer, University Hospitals  
Michael Serber, Vice President, Finance and Institutional Chief Financial Officer, UT Southwestern  
John Warner, M.D., MBA Executive Vice President Health System Affairs & Chief Executive Officer, University Hospitals, UT Southwestern and Senior Executive Officer for Southwestern Health Resources Joint Operating Company

## Detailed Observations and Action Plans Matrix

Observation	Recommendation	Management Response
<p><b>Risk Rating: Medium <span style="color: yellow;">n</span></b></p> <p><b>1. <u>Ensure All Capital Assets included in the Cost of Capital and Allowable Depreciation and Amortization are Allowed Per the Terms of the MAA</u></b></p> <p>The Cost of Capital calculation was overstated by approximately \$30,000 due to incorrectly including a \$1M Information Resources asset placed into service during fiscal year 2018. The asset was removed from the asset listing and the Cost of Capital calculation in fiscal year 2019.</p> <p>The addition of excluded assets in the University Hospitals asset listing can result in an overstatement of total asset values in the Cost of Capital calculation as well as noncompliance with key contract provisions.</p>	<p>In addition to the asset approval process currently in place for tangible assets, include a step in the monthly network settlement checklist to scan the asset report and ensure new assets are allowable per the MAA.</p>	<p><b><u>Management Action Plans:</u></b></p> <p>The monthly network settlement procedures and checklist will be updated to include a step to review new assets added during the month and verify that they are allowable per the MAA.</p> <p><b><u>Action Plan Owners:</u></b></p> <p>Controller, Southwestern Health Resources Controller, University Hospitals</p> <p><b><u>Target Completion Date:</u></b></p> <p>Completed</p>

## Appendix A – Risk Classifications and Definitions

As you review each observation within the Detailed Observations and Action Plans Matrix of this report, please note that we have included a color-coded depiction as to the perceived degree of risk represented by each of the observations identified during our audit. The following chart is intended to provide information with respect to the applicable definitions and terms utilized as part of our risk ranking process:

<p><b>Risk Definition- The degree of risk that exists based upon the identified deficiency combined with the subsequent priority of action to be undertaken by management.</b></p>	<b>Degree of Risk and Priority of Action</b>	
	<b>Priority</b>	An issue identified by Internal Audit that, if not addressed immediately, has a high probability to directly impact achievement of a strategic or important operational objective of a UT institution or the UT System as a whole.
	<b>High</b>	A finding identified by Internal Audit that is considered to have a high probability of adverse effects to the UT institution either as a whole or to a significant college/school/unit level. As such, immediate action is required by management in order to address the noted concern and reduce risks to the organization.
	<b>Medium</b>	A finding identified by Internal Audit that is considered to have a medium probability of adverse effects to the UT institution either as a whole or to a college/school/unit level. As such, action is needed by management in order to address the noted concern and reduce the risk to a more desirable level.
	<b>Low</b>	A finding identified by Internal Audit that is considered to have minimal probability of adverse effects to the UT institution either as a whole or to a college/school/unit level. As such, action should be taken by management to address the noted concern and reduce risks to the organization.

It is important to note that considerable professional judgment is required in determining the overall ratings presented on the subsequent pages of this report. Accordingly, others could evaluate the results differently and draw different conclusions. It is also important to note that this report provides management with information about the condition of risks and internal controls at one point in time. Future changes in environmental factors and actions by personnel may significantly and adversely impact these risks and controls in ways that this report did not and cannot anticipate.