

**segUNIVERSITY OF CALIFORNIA, DAVIS
AUDIT AND MANAGEMENT ADVISORY SERVICES**

**UC Davis Health System
Clinic Retail Sales
Internal Controls Review
Project #15-70**

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MANAGEMENT SUMMARY

Background

At the request of UC Davis Health System (UCDHS) management, Audit and Management Advisory Services (AMAS) conducted a review of internal controls over retail sales at UCDHS clinics. The request for the review originated because of management concerns regarding retail sales at clinics

Clinic retail sales encompass seven retail locations that are managed by three departments: Department of Ophthalmology (DOO), Department of Surgery (DOS) and Department of Otolaryngology (ENT).¹ DOO conducts sales at three Eye Clinic locations. DOS processes sales related to bariatric surgery at the Surgery Clinic (Cypress Building) and a Plastic Surgery Clinic (C-Street location). ENT collects sales at the Audiology Clinic and a Facial Plastics Clinic. The scope of the retail operations is depicted in the chart below:

Retail Locations	Account Type	FY15(1)	FY14	FY13	Change (%)
<i>Eye Clinic</i>	Gross Sales - all locations	\$ 1,129,202	\$ 1,033,245	\$ 785,278	44%
	Cost of Goods Sold	\$ 585,017	\$ 672,096	\$ 328,208	78%
	Net	\$ 544,185	\$ 457,489	\$ 457,070	19%
<i>DOS Clinics</i>	Gross Sales - Plastic Surgery	\$ 183,411	\$ 180,399	\$ 155,689	18%
	Cost of Goods Sold	\$ 130,610	\$ 134,754	\$ 128,974	1%
	Net	\$ 52,801	\$ 45,645	\$ 26,715	98%
	Gross Sales - Bariatrics	\$ 12,762	\$ 12,725	\$ 17,405	-27%
	Cost of Goods Sold	\$ 6,931	\$ 6,003	\$ 7,045	-2%
	Net	\$ 5,831	\$ 48,860	\$ 26,715	-78%
<i>ENT Clinic</i>	Gross Sales - Facial Plastics	\$ 175,779	\$ 174,035	\$ 206,457	-15%
	Cost of Goods Sold	\$ 83,962	\$ 70,340	\$ 113,980	-26%
	Net	\$ 91,818	\$ 103,696	\$ 92,477	-1%
	Gross Sales - Audiology (2)	\$ 356,501	\$ 1,051,677	\$ 943,908	-62%
	Cost of Goods Sold (3)	N/A	N/A	N/A	N/A
Total Gross Retail Sales		\$ 1,857,655	\$ 2,452,081	\$ 2,108,736	\$ 251,081.48
Note: (1) Projected amount based on current year-to-date activity in KFS as of May 2015.					
(2) Audiology revenues from sales are co-mingled with Self-Pay revenues reported under code OP25. Decrease in ENT-Audiology sales appears to be partially due to change in accounting practice to capture various revenues under additional codes in FY15, OP26 and OP28.					
(3) Cost of Goods Sold expense could not be readily determined.					

¹ Pharmacy retail sales were not included in the scope of our review.

The sales volume and complexity of retail sales transactions varied across the clinics. Sales activity ranged from approximately \$1,100,000 in fiscal year (FY) 2015 gross annual sales at the Eye Clinic consisting of thousands of transactions per month, to approximately \$13,000 in meal replacement sales at the Bariatric Surgery unit of the DOS, with a low volume of manual transactions.

Patient care services and retail sales activity are often closely linked and can occur in the same visit. For example, revenues arising from patient care services (such as a patient visit and sales of prescribed hearing devices) are recorded in Epic, while revenues from the sale of related items (such as hearing aid accessories) are recorded in the Clinic Charge Entry (CCE) system for retail sales. While the DOS and ENT clinics utilize CCE, and the Eye Clinic utilizes CompuLink to capture sales. Neither CCE nor CompuLink have a direct interface with the KFS general ledger.

Policies governing retail sales are currently under development at UCDHS.

Purpose and Scope

The objectives of our review were:

- To assess internal controls over the retail sales processes, including purchasing, receiving, inventory management, sales, cashiering and financial reporting; and
- To conduct a survey of the clinics with retail sales activity to analyze the existing practices and to assess the separation of duties.

AMAS conducted fieldwork including process walk-throughs, interviews and review of pertinent documents at all seven clinic locations. Clinic financial information for FY 2011 through FY 2015 was also reviewed.

Conclusions

The results of our review indicate there are significant weaknesses in internal controls over clinic retail sales operations.

At every clinic, there was a lack of separation of duties throughout the retail sales operation, including purchasing, receiving, and inventory management. Meaningful compensating controls such as reconciliation of purchasing and sales activity to inventory balances, and/or review of other management reports was not occurring due to perceived or actual system limitations with CompuLink and CCE. In the short term, UCDHS Management is committed to implementing additional controls to address the deficiencies identified in the audit. Long term solutions may include consolidating retail management and oversight functions and implementing a single point of sale system to establish a uniform approach to retail sales, billing and claims processing.

Under the existing operations, there continues to be a risk that errors or additional fraudulent activities could occur. Given the magnitude of the retail sales operations in relation to UCDHS operations as a whole, as well as non-financial risks that may exist, management must weigh the costs versus benefits of providing additional resources to address the lack of separation of duties over retail sales at the clinic locations. At a minimum, management must ensure that appropriate reporting capabilities exist to allow for sufficient oversight over retail sales activities.

Our detailed observations and recommendations for each clinic, organized by topic, are contained in the remainder of this report.

Observations and Management Corrective Actions (MCAs)

Observation	Criteria	MCAs
A.1. Purchasing-Separation of Duties		
<p>Poor controls over the purchasing function and lack of appropriate separation of duties increases the risk of unauthorized purchases and irregular activity. Separation of duties issues relating to the purchasing function were noted at all locations.</p> <p><u>Eye Clinics (All):</u> There is a lack of separation of duties between the following:</p> <ul style="list-style-type: none"> • Vendor orders (all opticians and designated managers) • Receipt of goods (all opticians and designated managers) • Validation of invoices for payment (all opticians and designated managers) • Addition/deletion of items from CompuLink inventory (designated managers) • Processing of returns (designated managers) <p>Additionally, access to the Eye Clinic purchasing and billing system, CompuLink, is not properly segregated between purchasing and receiving.</p> <p>Although some compensating controls have been implemented, such as the designated managers maintaining custody of a Manual Order Book to help track patient-specific orders and deliveries, there are no effective preventive controls that would mitigate the risk</p>	<p>PPM 350-21 <i>“Purchasing, receiving, and financial reports reviewing duties must be separated so that one person’s work routinely serves as a complementary check on another person’s work, and no one person has complete control of a purchase transaction...”</i></p>	<p>Eye Clinic Management will take steps to ensure an appropriate separation of duties exists. In the current environment, this will require the following actions:</p> <ul style="list-style-type: none"> a. Eye Clinic will outsource the buying function to a third party vendor, Vision West, to manage the inventory ordering and invoice processing for multiple vendors by January 15, 2016: <ol style="list-style-type: none"> 1. An accounting staff who is not part of the vendor ordering process will validate receipt when shipments come in, and log items into inventory. 2. An accounting staff will have a “Read Only” access to systems to validate invoices against receiving records. b. Eye Clinic will establish a process to track monthly purchase activity detail in CompuLink and compare purchases to invoices paid to

<p>posed by the lack of separation of duties and help stop unauthorized purchases.</p>		<p>review for any irregular activity by October 15, 2015.</p>
<p><u>DOS Clinics (All):</u> The same individuals who are authorized to contact vendors and place orders are also responsible for verifying receipts of goods and posting purchasing card (P-card) transactions in KFS. Supporting documents for invoices paid did not include evidence of receipt verification process.</p>	<p>PPM 350-21 <i>See excerpt above.</i></p>	<p>DOS Management has initiated steps to ensure an appropriate separation of duties, including taking the following actions:</p> <ul style="list-style-type: none"> c. DOS will separate the vendor ordering function from receipt verification and accounting by October 15, 2015. d. DOS will ensure that the receiving records are maintained and included with invoice support by October 15, 2015.
<p><u>ENT – Facial Plastics</u> The same individuals who are authorized to contact vendors to obtain a quote or to place an order have the ability to receive goods and sign-off on the invoice indicating receipt. The same individual authorized to set up vendor files is also responsible for contacting vendors, processing invoices for payment (including verifying receipt), and receiving vendor rebate checks.</p>	<p>PPM 350-21 <i>See excerpt above.</i></p>	<p>ENT Management has initiated steps to ensure an appropriate separation of duties, including taking the following actions as of July 31, 2015:</p> <ul style="list-style-type: none"> e. ENT Facial Plastics has separated the functions of placing orders and receiving by designating one person to contact vendors and place orders, and another person to verify receiving documents.

<p><u>ENT - Audiology</u> The same individuals authorized to place orders with vendors can receive items shipped directly to the Clinic.</p> <p>Orders are tracked in an Excel spreadsheet accessible to the audiologists. The Director approves invoices based upon the information contained in the spreadsheet. The same spreadsheet is also used to track inventory.</p>		<ul style="list-style-type: none"> f. ENT Facial Plastics has separated the functions of setting up vendor files, contacting vendors, and processing of invoices including verifying receipt, and receiving vendor rebate checks. g. ENT Audiology has separated ordering and receiving by designating one employee responsible for ordering, and a separate employee for receiving. h. ENT Audiology will restrict access to manual records of purchasing/receiving/inventory to appropriate individuals by October 15, 2015.
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Observation	Criteria	MCAs
A.2. Purchasing-Returned Merchandise		
<p>There is no process in place to match returns with vendor credits. Coupled with separation of duties issues in tracking movement of inventory noted at A.1., this poses increased risk of theft and inappropriate recording and accounting for returns. Additionally, vendor credits may be missed.</p> <p><u>Eye Clinics (All):</u> There is no process in place to match vendor returns with vendor credits recorded in KFS to help identify outstanding returns without vendor credits.</p> <p><u>ENT-Audiology:</u> Returns are manually tracked in Excel. There is no process in place to match returns with the vendor credits in KFS to help identify outstanding returns without vendor credits.</p>	<p>UCDHS Policy 2256 <i>“Return of Merchandise to Vendors”. Segregate purchasing from receiving and processing returns. Ensure that all returned goods are accounted for through a reconciliation between returned goods records and vendor credits.”</i></p>	<p>a. Eye Clinic will outsource the buying function to a third party vendor, Vision West, and returns will be logged and compared to CompuLink and KFS accounting records by January 15, 2016.</p> <p>b. ENT Audiology has initiated a process to reconcile returns logs to KFS accounting records as of July 31, 2015.</p>

Observation	Criteria	MCAs
A.3. Purchasing-Accounts Payable		
<p>Invoices were processed with insufficient supporting documentation to validate that the items were actually received.</p> <p>The retail sales clinics did not follow the UCDHS Centralized Purchasing process due to the unique patient services and patient care-related merchandise, such as lenses or hearing devices, for example, that required special care by medical staff ordering items.</p> <p>Shipments were delivered directly to the clinic managers who placed or authorized orders. Additionally, the DOS and ENT clinics used KFS to process purchase orders and recorded the sales transactions in the School of Medicine accounts, with payments processed by UCD campus Accounts Payable Division.</p> <p>Our review of invoices for all seven retail locations found insufficient supporting documentation to verify that receipt of the goods was verified prior to issuing payment. The risk of erroneous or fraudulent purchases and/or payments increases when there is no review process to independently compare receiving records to purchase orders and invoices.</p>	<p>UCOP Accounting Manual D-371-36 <i>“Payment of Vendor Invoices – Departmental Approval Method. Invoices should be compared to the original purchase authorization document to ensure that the order number is valid. Confirmation that the invoiced goods or services were received should be obtained by accounts payable prior to issuing a payment, e.g., a departmental certification acknowledging receipt may be recorded on the invoices or a copy of the receiving document on-line. “</i></p>	<p>a. Eye Clinic will outsource the purchasing function to Vision West and will ensure that the receiving records are compared to invoices prior to paying invoices, by January 15, 2016.</p> <p>b. ENT has taken steps to ensure that the receiving records are maintained and included with invoice support as of July 31, 2015.</p> <p>c. DOS has taken steps to ensure that the receiving records are maintained and included with invoice support as of July 31, 2015.</p>

Observation	Criteria	MCAs
A.4.Purchasing-Purchasing Cards		
<p>Merchandise for resale was purchased using P-cards at DOS clinics. P-card transactions were not appropriately reviewed for support.</p> <p><u>DOS Clinics (All):</u> All merchandise for retail sales is currently purchased using P-Cards. PPM 350-21, "Departmental Purchasing Delegations" states that purchasing cards cannot be used by UCDHS departments.</p> <p>Further, the P-card transactions were not appropriately reviewed by an independent reviewer. Without independent reviews of P-card purchases, there is a risk that the purchases were not properly authorized and/or received.</p>	<p>PPM 350-21 <i>"The purchasing card is a corporate charge card used for the sole purpose of purchasing noninventorial supplies authorized for departmental purchases (DaFIS order types M3, U3, OV, and D3). Purchasing cards cannot be used by UCDHS departments."</i></p> <p>PPM 350-22 <i>"The [purchasing] card holder is responsible for collecting and forwarding source documents to the account manager...within 5 days of receipt. The account manager is responsible for ensuring that expenditures are properly authorized... and establishing a process that ensures there is evidence that items purchased were properly received."</i></p>	<p>a. UCDHS Financial Services and UCDCMC Clinical Operations will review the purchasing card policy and determine whether the policy requires an amendment to reflect the existing practices by April 15, 2016.</p> <p>b. Provided that the amended policy allows DOS to continue using Purchasing cards, DOS will ensure appropriate separation of duties and an independent review of expenditures by April 15, 2016.</p>

Observation	Criteria	MCAs
B.1.Inventory Management		
<p>Due to the nature of clinic retail activities, it was not practical to restrict physical access to inventory only to individuals authorized to issue products. However, inventory tracking and reporting processes that could serve as compensating controls were limited or insufficient.</p> <p>Eye Clinic (All): The capabilities of CompuLink to track inventory changes such as inventory adjustments and deletions have not been fully explored, and there is currently no management reporting in this area.</p> <p>The estimated value of inventory at year-end is over \$50,000, including frames and lenses, but the inventory on hand value was not confirmed and reported to Financial Services at year-end.</p> <p>ENT Clinics (All): CCE does not have the capability to track inventory activity, including adjustments, changes and deletions.</p> <p>The total estimated value of inventory at year-end for the two ENT clinics is over \$50,000.</p> <p>DOS Clinics (All): CCE does not have the capability to track inventory activity, including adjustments, changes and deletions.</p>	<p>UCDHS Policy 2278 <i>“A major departmental supply inventory has a combined inventory value of new (or reusable) and unissued materials available for resale that exceeds \$50,000...The Department heads...shall ensure that ..appropriate records are kept and maintained to facilitate effective administrative control of quantities and values of stock on hand.”</i></p> <p>PPM 350-60 <i>“The department head maintaining supply inventories...maintains appropriate records to facilitate effective administrative control of quantities and values of stock on hand, establishes safeguards to protect supply inventories from theft or other loss..., verifies</i></p>	<p>a. Eye Clinic has initiated a process for generating CompuLink inventory management reports showing inventory adjustments, deletions and additions, and will ensure management review on a regular basis to monitor for irregular activity as of July 31, 2015.</p> <p>b. Eye Clinic will determine inventory on hand value and evaluate whether the amount meets the \$50K threshold inventory reporting requirement by October 15, 2015. The inventory count will be conducted by an individual independent of the day-to-day inventory management process.</p> <p>c. Eye Clinic will ensure the year-end inventory values are reported to Financial Services by July 15, 2016, if applicable.</p> <p>d. ENT will determine inventory on hand value and evaluate whether the amount meets the \$50K threshold inventory reporting requirement by August 15, 2016.</p>

<p>Although the total inventory value of merchandise for resale appear less than \$50,000, the inventory management processes could be improved.</p>	<p><i>inventory counts on an annual basis..., approves stock adjustments over \$250 per transaction, supported by written explanation of adjustments, retains physical inventory worksheets for five years”.</i></p>	<p>The inventory count will be conducted by an individual independent of the day-to-day inventory.</p> <ul style="list-style-type: none"> e. ENT will ensure the year-end inventory values are reported to Financial Services by August 15, 2016, if applicable. f. DOS will ensure that physical inventory counts are periodically conducted with the independent verification to validate the actual amounts on hand by January 15, 2016. g. UCDCM Management and UCDCM Financial Services will review and revise HPP2278 to include the retail clinic responsibility to report annual inventory as part of UCDCM major supplies inventories by January 15, 2016.
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Observation	Criteria	MCAs
<p>C.1. Accounting-Management Reporting & Oversight</p> <p>All clinics making retail sales currently do not have a management reporting process in place to provide full fiscal oversight over retail operations.</p> <p>None of the clinics monitor retail sales activity to the extent that they have a clear understanding overall or at the clinic level of:</p> <ul style="list-style-type: none"> • Gross Sales • Cost of Goods Sold, including beginning inventory, cost of goods purchased and ending inventory • Net revenues • Profit margin <p><u>Eye Clinic (All):</u> The capabilities of CompuLink to generate information regarding retail sales activity have not been fully explored by the Eye Clinic. Assessing the reporting capabilities may require follow-up with the software vendor.</p> <p><u>ENT and DOS (All):</u> CCE may not have the capability to provide all of the information necessary to generate the management reports. However, some basic information (e.g., sales and cost of goods purchased for resale) can be obtained from KFS.</p> <p>ENT - Audiology currently co-mingles revenue from retail sales with patient revenues (self-pay code OP25) when recording in KFS, and tracks purchases and inventory manually in Excel. No reporting was available to accurately determine total sales and related expenses.</p>	<p>Accounting Manual-H576-67: Hospitals: Reporting Requirements</p> <p><i>“Within any enterprise, there’s an imperative need for statistical and financial information...for the purposes of decision making by its management and other interested parties... Each hospital must maintain records to support its monthly accruals so that the data in its monthly reports can be reconciled to the data recorded in the University General Ledger.”</i></p>	<p>a. Eye Clinic has initiated a management reporting process in CompuLink for the following as of July 31, 2015</p> <ul style="list-style-type: none"> • Gross Sales • Cost of Goods Sold, including beginning inventory, cost of goods purchased and ending inventory • Net revenues <p>b. Eye Clinic will utilize CompuLink and KFS data to begin providing reporting and fiscal oversight for retail operations by January 15, 2016</p> <p>c. ENT-Audiology has requested a separate object code for retail sales and supplies. Until the code(s) is established, retail sales will be tracked in a spreadsheet to be implemented by November 15, 2015.</p> <p>d. ENT-Audiology will utilize a spreadsheet to track retail sales (prior to CCE replacement) to be implemented by November 15, 2015.</p>

		e. DOS will work with Financial Services to develop and implement a means of monitoring retail sales activity to the extent possible prior to CCE replacement by January 15, 2016
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Observation	Criteria	MCAs
C.2. Accounting-Reconciliations		
<p>The lack of procedures to reconcile CompuLink to KFS increases the risk of errors and/or fraudulent activity occurring and being undetected, resulting in inaccurate accounting data and unreliable financial information.</p> <p>Eye Clinic: The Eye Clinic does not have procedures in place to reconcile daily deposits and insurance billings recorded in CompuLink to revenue in KFS.</p> <p>In March 2014, an approximate \$18,000 discrepancy between monthly sales per CompuLink and revenues posted in KFS during the same time period was not identified and/or resolved due to the lack of such procedures.</p> <p>There was also no process to reconcile insurance billings for frames and lenses processed in CompuLink and the actual collections received. As a result, the total accounts receivable amounts recorded in CompuLink were not properly recorded in KFS to ensure the monthly accrual reporting.</p>	<p>UCOP Accounting Manual H-576, Medical Centers</p> <p><i>“Each medical center must reconcile its accounting records monthly to the University General Ledger at the campus.”</i></p> <p><i>“While the detail of the individual patient accounts must be maintained in the medical center’s accounts receivable system, the total accounts receivable is reconciled monthly to the University General Ledger control account.”</i></p>	<p>a. Eye Clinic will establish a process to reconcile daily collection deposits per CompuLink records and KFS by January 15, 2016.</p> <p>b. Eye Clinic will establish a process to reconcile insurance billings and collections received in KFS on a monthly basis by January 15, 2016.</p> <p>c. Eye Clinic will establish a process to ensure that all monthly accounts receivable amounts are properly recorded in KFS based on the CompuLink data by January 15, 2016.</p>

Observation	Criteria	MCAs
C.3. Accounting-Controls Over Sales Price		
<p>Sales price discounts and adjustments need better monitoring.</p> <p>Eye Clinic (All): Currently all opticians have the capability of modifying sales prices in CompuLink. Additionally, when processing certain sales, opticians must make manual adjustments of billing rates due to a known system error in the CompuLink and VSP interface. Allowing opticians to make adjustments to sales prices and billing rates creates a risk of inaccuracies and irregular activity.</p> <p>ENT and DOS Clinics (All): A CCE system function to discount sales allows staff to manually enter the discount amounts. The same individuals are also responsible for daily collections and daily reconciliations of their own deposits. If unmonitored, this poses a risk of inappropriate activity.</p> <p>DOS-Plastic Surgery also does not charge a shipping fee for sales shipped to patient's address.</p>	<p>BUS 49, Policy for Cash and Cash Equivalents Received.</p> <p><i>“The Business Unit head is responsible for establishing procedures that ensure that at all times....technology resources involved in processing cash and cash equivalents...are protected from loss, corruption, or compromise to confidentiality.”</i></p>	<p>a. Eye Clinic will contact the CompuLink vendor and request correction of the VSP billing rate issue in the CompuLink system by October 15, 2015.</p> <p>b. Eye Clinic has initiated a process to review and approve, and monitor, price adjustments on a regular basis as of July 31, 2015.</p> <p>c. ENT-Audiology will establish a process to review the discounts and price adjustments on a regular basis, by January 15, 2016.</p> <p>d. DOS will establish a process to review the discounts and price adjustments reports on a regular basis, by October 15, 2015.</p> <p>e. DOS will consider the cost versus benefit of establishing a shipment fee by December 31, 2015.</p>

Observation	Criteria	MCAs
D.1. Other/ Limited Staff Operations		
<p>Limited staff operations pose greater risk of irregular activity, financial loss and abuse.</p> <p>The Eye Clinic Folsom Optical Shop opened in March 2015 and is currently managed by one designated manager who is responsible for all aspects of the retail sales. The same individual performs such incompatible duties as:</p> <ul style="list-style-type: none"> ✓ Purchasing and receiving ✓ Purchasing and verifying receipt of merchandize to authorize invoice payment ✓ Adding/deleting inventory in the system on a daily basis and physical inventory counts ✓ Cashiering/sales, daily cash settlement and the preparation of daily deposits <p>Although the Eye Clinic Management implemented some mitigating controls such as an independent review of daily deposit records and comparison to the daily collections report generated in CompuLink, a risk of irregular activity, potential fraud and abuse is increased if additional controls are not in place.</p>	<p>PPM 330-11 <i>“Departmental financial administrative duties shall be separated so that one person’s work routinely serves as a complementary check on another’s work, and no one person has complete control of a financial transaction. When separation is considered impracticable for non-payroll activities, i.e. due to limited departmental staff, the variance from the standard must be documented in writing and approved by the Associate Vice Chancellor – Finance/Controller.”</i></p>	<p>a. Eye Clinic has designated one staff (a contact lens technician) to work with the optician to ensure separation of duties at the Folsom location, as of July 31, 2015.</p>

APPENDIX A – SUMMARY OF ISSUES BY LOCATION

	Ambulatory Care Center Satellite Office/ Cadillac Dr. Satellite Office/ Folsom Plastic Surgery Surgery Clinic/ Bariatrics ENT/ Facial Plastics ENT/ Audiology						
Summary of Issues	Eye Clinic			DOS		ENT	
Purchasing NOT separated from receiving.	X	X	X	X	X	X	X
Returns NOT tracked/matched with vendor credits.	X	X	X				X
Vendor invoices not validated against pre-authorized orders and records of receipt.	X	X	X	X	X	X	X
P-cards used to purchase inventory.				X	X		
Insufficient physical security (access not restricted to designated employees authorized to make sale).	X	X	X	X	X	X	X
No process to monitor inventory changes, incl. deletions, modifications and other adjustments.	X	X	X	X	X	X	X
No process to monitor sales data, including beginning/ending inventory, cost of goods sold.	X	X	X	X	X	X	X
No reconciliation between daily deposits per subsidiary systems (i.e. CompuLink) and KFS.	X	X	X				
No reconciliation between billings in CompuLink and KFS.	X	X	X				
Cashiering controls/ price discounts.	X	X	X	X	X	X	X
Other/ limited staff operations/ separation of duties.			X				