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MODOC MEDICAL CENTER

**COUNTY OF MODOC,
CALIFORNIA**

MANAGEMENT LETTER

JUNE 30, 2008

_____, 2011

To the Board of Supervisors,
And the Management of Modoc Medical Center
County of Modoc, California

Ladies and Gentlemen:

We have audited the basic financial statements of the Modoc Medical Center (Medical Center) for the year ended June 30, 2008 and have issued our report thereon dated _____, 2011. In planning and performing our audit of the basic financial statements of the Medical Center, we considered internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements. An audit does not include examining the effectiveness of internal control and does not provide assurance on internal control. We have not considered internal control since the date of our report. During our audit we noted certain matters involving internal control and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies and are summarized as follows:

CURRENT YEAR MANAGEMENT LETTER COMMENTS

HOSPITAL AUXILIARY

CONTROL DEFICIENCY:

In prior years, the County of Modoc Board of Supervisors, acting as the Board of Directors of Modoc Medical Center, approved the creation of the Modoc Medical Center Hospital Auxiliary (formally known as the Alturas Hospital Auxiliary). According to its by-laws, the objective of the authority is to promote and advance the welfare of Modoc Medical Center and its patients through ways and means approved or proposed by the Administration. In addition, it states that all funds will be used for the needs and objectives of the Auxiliary.

In prior fiscal years, the Auxiliary has received donations from the general public for capital improvements for the Medical Center. These funds have been reported in the Modoc Medical Center's financial statements as restricted cash and investment assets. The funds are held in separate trust funds with the County of Modoc. Once the Medical Center incurs qualifying capital expenditures, the funds are transferred from the trust funds to the operating account to cover the cost of purchased equipment and improvements. We also noted the Auxiliary operates the gift shop on the Medical Center premises. The proceeds of which are contributed to the Medical Center through the purchase of capital equipment. We noted the Auxiliary maintains a separate bank account. The balance at June 30, 2008 was approximately \$14,530. The operations of the Auxiliary is not conducted by the Medical Center and is not accounted for in the Medical Center's financial statements.

We noted the current by-laws do not clearly define how members of the Auxiliary are appointed. However, any changes to the Auxiliary's by-laws are approved by the Board of Supervisors.

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In accordance with GASB 39, *Determining Whether Certain Organizations Are Component Units*, certain organizations warrant inclusion as part of the financial reporting entity because of the nature and significance of their relationship with the primary government, including their ongoing financial support of the primary government or its other component units. A legally separate, tax-exempt organization should be reported as a component unit of a reporting entity if *all* of the following criteria are met:

1. The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
2. The primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization.
3. The economic resources received or held by an *individual organization* that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to that primary government.

We noted as of June 30, 2008, the Medical Center has not conducted a formal evaluation to determine whether the Auxiliary is a component unit of the Medical Center, and thus determine whether its operations should be consolidated with the Medical Center for financial reporting purposes.

RECOMMENDATION:

We recommend that the Medical Center perform an analysis to determine if the operating of the Auxiliary should be consolidated with that of the Medical Center. GASB 14, *The Financial Reporting Entity* and GASB 39, *Determining Whether Certain Organizations Are Component Units*, provide several checklists that can assist with documenting the determination.

MANAGEMENT'S RESPONSE

Management will use the checklists provided in GASB 14 and GASB 39 to determine if the Auxiliary's operations should be consolidated with the financial reporting of the hospital. If consolidation is decided, then periodic posting of the organization's activity will be included in the hospital's general ledger. If consolidation is not deemed warranted, then the hospital will only record transactions that directly affect the hospital's activities when they are incurred.

SAFEGUARDING ASSETS - PETTY CASH

CONTROL DEFICIENCY:

The accessibility to petty cash should be limited to authorized individuals in order to ensure appropriate controls over the use of the funds. The application of the above procedures would ensure better control over petty cash.

As a result of our audit, we noted the Medical Center does not maintain adequate controls over the accessibility of the petty cash. Multiple employees not responsible for the administration of the petty cash fund in the accounting office have access to the code for the lock box containing the petty cash. We noted all members of the Accounting staff have the combination to the lock box.

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RECOMMENDATION:

We recommend that the Medical Center implement a stronger internal control to limit the accessibility to petty cash to authorized individuals in order to ensure appropriate controls over the use of the funds.

MANAGEMENT'S RESPONSE:

Management will assign one person with primary responsibility to keep petty cash in a secured location only accessible to them. If they are unavailable, they will assign temporary custody, also to be kept in a secured location.

CONTROL OVER MAILING DISBURSEMENTS

CONTROL DEFICIENCY:

Signed checks are returned from the County Auditor's office for mailing to the accounts payable department where the checks were initiated. This represents a lack of segregation of duties which could possibly result in the misappropriation of County funds.

RECOMMENDATION:

We recommend that the Medical Center implement stronger internal controls to ensure signed checks are mailed by someone other than the accounts payable clerks who prepare the checks and initiate the warrant requests. Segregating the duties of preparing and mailing checks to vendors can improve controls over cash and reduce the possibility of the misappropriation of funds.

MANAGEMENT'S RESPONSE:

Management has a policy in place that prevents the Accounts Payable clerk from picking up completed checks from the County. Checks are now in the custody of other staff that copy checks to add to AP bundles and prepare for mailing. The check register also provided by the County is provided to the AP Clerk to log cash used on the cash log and post payments made to the AP system.

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CONTROLS OVER PROCUREMENT

CONTROL DEFICIENCY:

As a result of our audit procedures over the Medical Center’s procurement policies and procedures, we noted the following control deficiencies:

- It was noted that occasionally an invoice is received with no identifiable invoice number. In these circumstances, the Medical Center’s accounting system allows the A/P Clerk to leave the invoice number blank. As a result, this can result in the duplicate payment of an invoice going undetected in the system. Generally, these duplicate payments are caught by County review or vendor notification.
- We noted that there was no formal policy or procedure in place to ensure that there is adequate funding available to purchase items for the Medical Center for the fiscal year 2007-2008.
- The Medical Center’s purchasing procedures are informal and not in compliance with the formal purchasing policy. We noted for purchases over the \$5,000 threshold, the purchasing agent for the Medical Center generally makes purchases based on the recommendation of the originating department, as long as it is within a reasonable range for the pricing of the item. Additionally, it was noted that there is not a justification for sole-source submitted in these instances.
- We noted New Vendor forms are not required for creating a new vendor entry into the HealthLands system. In addition, management does not perform a periodic review of vendors list.

RECOMMENDATION:

We recommend that the Medical Center implement stronger policies and procedures to ensure the risk of entering a duplicate invoice is mitigated. We also recommend that the Medical Center review its current purchasing policies to ensure they comply with Countywide purchasing policies, including policies covering bidding, purchasing selection criteria, and the proper documentation of sole source purchase justifications.

MANAGEMENT’S RESPONSE:

Management is in the process of creating unique invoice numbers by generating a range of numbers to sequentially assign to invoices as needed. Doing so, will eliminate duplicated invoice numbers. Currently if a new vendor is added through purchasing, the CFO signs a credit application. Management will further controls to include a New Vendor Request Form to be completed for all new vendors. The form will be authorized by the CEO, CFO, or Controller prior to setting up in Healthland. Management will periodically review the vendor list and compare to known activity.

In regard to cash management, policies have changed to only present invoices for payment if there is sufficient cash in the hospital fund from the beginning of the month to cover the expenditures.

A procurement checklist is in progress to ensure completeness procedures to comply with the policy in place. Purchasing is not allowed to proceed with purchases without a completed and authorized checklist.

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INVENTORY VALUATION

CONTROL DEFICIENCY:

As a result of our audit procedures over inventory, we noted the Medical Center does not have a procedures designed to verify the current valuation of supplies inventory at June 30. We noted several instances where the value of the recorded inventory could not be fully supported through supporting invoices.

RECOMMENDATION:

We recommend that the Medical Center implement procedures to ensure inventory is properly valued at the lower of cost or market at June 30, in accordance with GAAP.

MANAGEMENT'S RESPONSE:

Management feels the supplies in the Purchasing and Patient Nutritional Services are fairly stated. However, we do agree that controls need to be strengthened in the remaining areas. Efforts have been made to train staff that maintain those inventories that are noted in addition to reorganizing the entire Central Supply department. Also, new tracking systems are in progress to monitor incoming and outgoing supplies from those departments. The tracking on the spreadsheet include vendor name, product number, cost and quantity to provide count sheets for physical counts.

PATIENT CHARGES

CONTROL DEFICIENCY:

Through testing of controls over patient files, we noted one exception related to lack of supporting procedures in the patient files for the charge selected. We noted no physician order, lab order, or pharmacy order for the charge selected.

RECOMMENDATION:

We recommend that the Medical Center review its current policies and procedures to ensure they are properly designed and implemented to ensure patient charges are fully supported, and that the supporting documentation is maintained in the patient billing file.

MANAGEMENT'S RESPONSE:

The Utilization Review department is currently reviewing 100% of patient files from the hospital to ensure charge capture and supporting documentation. Items noted are addressed in the monthly Revenue Cycle meetings or Medical Staff meetings as deemed necessary.

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STORING BACK-UP COPIES OF ELECTRONIC DATA FILES OFF-SITE

CONTROL DEFICIENCY:

While conducting the audit and obtaining an understanding of the Medical Center's information management process, we noted that back-up copies of the electronic data files are not stored at off-site locations. The Medical Center currently has adopted a security policy to maintain back-up copies of electronic data files in the accounting department that is in a building adjacent to the main hospital building. However, the tapes are not stored in a secure fire-protected environment and access to back up files are semi-restricted in the IT Supervisors office. Storing back-up copies of the electronic data files offsite would help protect the data and allow the Medical Center to function in case of a disaster.

We also noted the IT facilities that currently house the Medical Center's servers is not adequately ventilated and security cameras do not monitor access to the room.

RECOMMENDATION:

We recommend that the Medical Center follow the policy of storing back-up copies of electronic data. Storing back-up copies of the electronic data files offsite would help protect the data and allow the Medical Center to function in case of a disaster. We also recommend that the facilities storing the computer servers is properly ventilated to prevent loss of data.

MANAGEMENT'S RESPONSE:

Management will work on a policy to partner with the County to store tapes offsite in a fire-safe environment. If the relationship does not produce a cooperative effort, the hospital will find alternative locations to securely store the electronic data.

Plans have already been made to move the location of the servers from the hospital to a ventilated, climate controlled area in the Accounting building.

FORMAL USER ACCOUNT AUDIT PROCEDURES

CONTROL DEFICIENCY:

While conducting the audit over the Medical Center's information technology management process, we noted the Medical Center does not have formal procedures for performing periodic audits of its user account profiles and, at the time of our review, a report itemizing user profiles was not readily available for monitoring.

RECOMMENDATION:

We recommend that management implement policies and procedures to develop more stringent auditing policies and procedures to ensure that user rights are appropriately assigned. For example, department managers should be required to review user access profiles on an annual basis to ensure user access is consistent with job responsibilities.

MANAGEMENT'S RESPONSE:

Management will periodically distribute employee access lists to managers to validate.

FORMAL DISASTER PLAN

CONTROL DEFICIENCY:

The Medical Center does not have a formal written disaster recovery plan to document how it would recover if a disaster struck the computer system. The objective of developing and maintaining a formal disaster plan is to minimize the disruption of the Medical Center's operations in the event of a disaster or breakdown. A comprehensive and efficient disaster planning serves to mitigate any unforeseen disruption in the Company's operations related to disasters or breakdowns.

RECOMMENDATION:

We recommend the Medical Center develop a formal, documented plan which should include the following items:

- Objectives of the plan
- Location of, and access to, off-site storage
- A listing of all data files that would have to be obtained from the off-site storage location
- Identification of a back-up location (name and telephone number) with similar or compatible equipment for emergency processing (management should make arrangements for such back-up with another company, a computer vendor, or a service center; the agreement should be in writing)
- The individual to be responsible for the overall implementation of the disaster plan
- The assignment of responsibilities to appropriate IT personnel and the specific procedures to be performed by these individuals and their subordinates; and
- Priority of critical applications and reporting requirements during the emergency period

Additionally, the Medical Center should test the plan to determine whether it will be workable in an emergency situation and whether the Medical Center has considered all significant points relative to disaster planning.

MANAGEMENT'S RESPONSE:

Management will have IT incorporate the above recommendations into its current policies and procedures.

STATUS OF PRIOR YEAR MANAGEMENT LETTER COMMENTS

None reported.

**NEW FINANCIAL REPORTING AND AUDITING STANDARDS EFFECTIVE FOR FISCAL YEAR
2008/2009**

INFORMATIONAL ONLY

GOVERNMENTAL ACCOUNTING STANDARD No. 51

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This statement establishes accounting and financial reporting standards for many different types of assets that may be considered intangible assets, including easements, water rights, timber rights, patents, trademarks, and computer software. This statement is not effective until June 30, 2010.

GOVERNMENTAL ACCOUNTING STANDARD No. 53

In June 2008, The GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This Statement is intended to improve how state and local governments report information about derivative instruments—financial arrangements used by governments to manage specific risks or make investments—in their financial statements. The Statement specifically requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The guidance in this Statement also addresses hedge accounting requirements. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2009, with earlier application encouraged.

GOVERNMENTAL ACCOUNTING STANDARD No. 54

In March 2009, The GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. This statement is not effective until June 30, 2011.

GOVERNMENTAL ACCOUNTING STANDARD No. 57

In December 2009, the GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. This statement addresses issued related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer other postemployment benefit (OPEB) plan. This statement is effective for periods beginning after June 15, 2011.

GOVERNMENTAL ACCOUNTING STANDARD No. 58

In December 2009, the GASB issued Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies*. This statement provides accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. This statement is effective for periods beginning after June 15, 2009.

STATEMENT ON AUDITING STANDARDS (SAS) NO. 117

COMPLIANCE AUDITS

The AICPA's Auditing Standards Board (ASB) has issued Statement on Auditing Standard 117, which supersedes SAS No. 74, *Compliance Auditing Considerations in Audits of Governmental Entities and Recipients of Governmental Financial Assistance*. This standard addresses the application of GAAS to a compliance audit. It is effective for compliance audits for fiscal periods ending on or after June 15, 2010. Early implementation is permitted.

STATEMENT ON AUDITING STANDARDS (SAS) NO. 118

OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

The AICPA's Auditing Standards Board (ASB) has issued Statement on Auditing Standards 118, *Other Information in Documents Containing Audited Financial Statements*. This standard addresses the auditor's responsibility in relation to other information in documents containing audited financial statements and the auditor's report thereon. In the absence of any separate requirement in the particular circumstances of the engagement, the auditor's opinion on the financial statements does not cover other information, and the auditor has no responsibility for determining whether such other information is properly stated. This standard establishes the requirement for the auditor to read the other information of which the auditor is aware because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information. It is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early application is permitted.

STATEMENT ON AUDITING STANDARDS (SAS) NO. 119

SUPPLEMENTARY INFORMATION IN RELATION TO THE FINANCIAL STATEMENTS AS A WHOLE

The AICPA's Auditing Standards Board (ASB) has issued Statement on Auditing Standards 119, *Supplementary Information in Relation to the Financial Statements as a Whole*. This standard addresses the auditor's responsibility when engaged to report on whether supplementary information is fairly state, in all material respects, in relation to the financial statements as a whole. The information covered by this standard is presented outside the basic financial statements and is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. It is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early application is permitted.

STATEMENT ON AUDITING STANDARDS (SAS) NO. 120

REQUIRED SUPPLEMENTARY INFORMATION

The AICPA's Auditing Standards Board (ASB) has issued Statement on Auditing Standards 120, *Required Supplementary Information*. This standard addresses the auditor's responsibility with respect to information that a designated accounting standard setter requires to accompany an entity's basic financial statements. In the absence of any separate requirements in the particular circumstances of the engagement, the auditors' opinion on the basic financial statements does not cover required supplementary information. It is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early application is permitted.

AMERICAN RECOVERY AND REINVESTMENT ACT – 2009

On February 13, 2009, Congress passed the American Recovery and Reinvestment Act (the Act). The Act of Congress was based largely on proposals made by President Obama and is intended to provide a stimulus to the U.S. economy in the wake of the economic downturn. The measures are nominally worth \$787 billion. The Act includes federal tax relief, expansion of unemployment benefits and other social welfare provisions, and domestic spending in education, health care, and infrastructure, including the energy sector. The Act also includes numerous non-economic recovery related items that were either part of longer-term plans or desired by Congress.

As a result of the Act, State and Local governments can qualify for significant financial aid. This financial aid will be subjected to a high level of accountability and transparency. Grant and loan awards will be subject to Single Audit in accordance with OMB Circular A-133. Management will be subjected to significant responsibilities upon receipt of Recovery Act funds. Management should consider the following when administering the use of these funds:

- That control procedures in place over federal expenditures are appropriate, working properly, and designed to prevent unallowable expenditures.
- Whether additional controls and system requirements will be needed to ensure that Recovery Act funds are able to be separately identified and tracked.
- If applicable, whether new controls will need to be established to meet the stringent reporting requirements back to federal agencies.
- If Recovery Act funds will be passed down to subrecipients, that controls are in place to ensure appropriate subrecipient monitoring and also whether any new controls will need to be established related to new subrecipient reporting responsibilities.

To the Board of Supervisors,
And the Management of Modoc Medical Center
_____, 2011
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Our audit procedures are designed primarily to enable us to form an opinion on the financial statements, and therefore may not bring to light all weaknesses in policies or procedures that may exist. We aim, however, to use our knowledge of the Medical Center gained during our work to make comments and suggestions that we hope will be useful to you.

We would be pleased to discuss these comments and recommendations with you at any time.

This report is intended solely for the information and use of the Board of Supervisors, medical center management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Rancho Cucamonga, California
_____, 2011