

**GOVERNMENT OF THE DISTRICT OF COLUMBIA
OFFICE OF THE INSPECTOR GENERAL**

**NOT-FOR-PROFIT
HOSPITAL CORPORATION
UNITED MEDICAL CENTER**

**REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS**

FISCAL YEAR ENDED SEPTEMBER 30, 2011



**CHARLES J. WILLOUGHBY
INSPECTOR GENERAL**

GOVERNMENT OF THE DISTRICT OF COLUMBIA
Office of the Inspector General

Inspector General



May 14, 2012

The Honorable Vincent C. Gray
Mayor
District of Columbia
Mayor's Correspondence Unit, Suite 316
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

The Honorable Kwame R. Brown
Chairman
Council of the District of Columbia
John A. Wilson Building, Suite 504
1350 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear Mayor Gray and Chairman Brown:

As part of our contract for the audit of the District of Columbia's general purpose financial statements for fiscal year (FY) 2011, KPMG LLP (KPMG) submitted the enclosed final report on the Not-for-Profit Hospital Corporation's United Medical Center (UMC's) Internal Control Over Financial Reporting and on Compliance and Other Matters (OIG No. 12-1-06HW(a)).

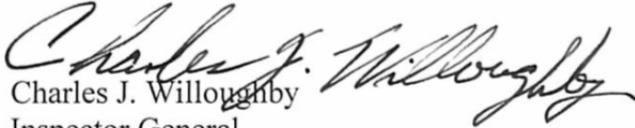
This report identified three deficiencies in internal control over financial reporting considered to be significant deficiencies: (1) inadequate resources and management review supporting the financial review process; (2) lack of access controls over information technology; and (3) valuation of accounts receivable. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. The results of KPMG's tests performed disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

KPMG set forth recommendations for correcting the identified internal control weaknesses and UMC management responses are noted. In some cases, corrective action has already been taken to remedy the noted deficiencies.

Mayor Gray and Chairman Brown
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If you have questions or need additional information, please contact Ronald W. King, Assistant
Inspector General for Audits, at (202) 727-2540.

Sincerely,


Charles J. Willoughby
Inspector General

Enclosure

CJW/ws

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Mayor Gray and Chairman Brown
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Washington, DC 20006

Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Directors
Not-for-Profit Hospital Corporation:

We have audited the financial statements of the Not-for-Profit Hospital Corporation, commonly known as United Medical Center (the Medical Center), a component unit of the District of Columbia, as of September 30, 2011 and for the year ended September 30, 2011, and have issued our report thereon dated February 15, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the Medical Center is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Medical Center's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Medical Center's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Medical Center's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in Attachment I to be significant deficiencies in internal control over financial reporting and are listed as items 2011-01, 2011-02 and 2011-03.



Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Medical Center's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Medical Center's responses to the matters identified in our audit are described in Attachment I. We did not audit the Medical Center's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of management, board of directors, others within the entity, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

February 15, 2012

2011-01. Inadequate Resources and Management Review Supporting the Financial Reporting Process.

Criteria

In order to comply with accounting standards and financial reporting requirements, entities need to maintain financial management systems that provide effective control over accountability for all funds, property, and other assets. In addition, the preparation of financial statements is the responsibility of management, including management's assertions that the financial statements are complete and accurate; that the rights and obligations recorded in the financial statements exist, belong to the entity, and are properly valued; and that the information presented in the financial statements is presented in accordance with generally accepted accounting principles. Pursuant to District and Federal Law, the District's Office of the Chief Financial Officer (OCFO) is directed to oversee and supervise the financial functions of the Medical Center, therefore, the financial reporting process is a collaborative effort between the OCFO and the CEO of the Medical Center.

Condition

During our audit of the fiscal year 2011 financial statements, we noted deficiencies in the control environment surrounding financial accounting and reporting. This year represented the first full year of operations for the Medical Center since its involuntary foreclosure of and acquisition by the District of Columbia Government (the District) in July 2010. During fiscal year 2011, the Medical Center continued to experience turnover in supervisory and key operational accounting personnel. In particular, the position of the Director of Patient Financial Services was vacant from mid-March through September 1, 2011. As a result, there was not adequate oversight of the business office for six months of the fiscal year. In addition, in early August the Medical Center's Chief Financial Officer (CFO) left that position (remaining as Executive Vice President of Operations). The Controller and interim CFO positions were held by the same individual for almost two months during the current year under audit. This was also the first year that the Medical Center assumed operations of the skilled nursing facility. The preparation and review of the Medical Center's financial statements is a complex task, necessarily requiring significant time and numerous coordinated processes to ensure the completeness and accuracy of the information presented therein and that the accounting conclusions and financial statement amounts are subject to appropriate review and are properly supported by written documentation. As there are many sources of information outside the accounting system, the extent of analysis over that information results in a financial reporting process that is highly complex and susceptible to errors. This resulted in a significant number of adjustments being identified during the audit. Specifically, we noted the following:

Overall Control Environment Surrounding the Financial Reporting Process:

We noted significant improvement as compared to the prior stub period's audit. However, in conducting our year-end audit procedures, we noted instances where there were errors in the underlying documentation and calculations, missing or inadequate documentation, inconsistent application of control procedures and a lack of understanding of certain accounting principles and key processes supporting the year-end financial statements. Furthermore, we noted reconciling differences and inaccuracies within the draft financial statements and supporting

schedules. Consequently, several adjustments were proposed and recorded during the audit process to correct the year-end financial statements and footnote disclosures. The following significant control exceptions were noted:

- *Accounting for Cash and Cash Equivalents* – We noted that controls were not in place and operating effectively to ensure the proper classification of outstanding checks at year end.
- *Revenue and the Valuation of Accounts Receivable*– We noted that management’s estimate of the allowance for uncollectible accounts receivable and the contractual allowance contained errors in the underlying aging model support. Additionally, the allowance recorded related to the skilled nursing facility did not reflect sufficient reserves for unbilled Medicare amounts, nor did it take into consideration that inaccurate per diem rates for the Medicaid Pending accounts were used to bill for the skilled nursing facility services.
- *Accounting for Capital Assets and Grant Revenues* – We noted that the Medical Center continues to track its fixed asset purchases, disposals and related depreciation manually using excel spreadsheets. This manual process resulted in an adjustment to depreciation expense in the current year. Additionally, there were purchases of capital assets and related grant revenues that were not recorded in the proper period.

Cause

The conditions noted above are the result of the following:

- Accounting department personnel turnover that continued into 2011;
- Ineffective management review of certain account balances and supporting documentation;
- Lack of effective communication across all business, accounting, legal and risk management functions; and
- A lack of technically astute accounting and business office personnel who are able to critically evaluate accounting methodologies and transactions to ensure policies and procedures are in accordance with applicable industry and accounting principles.

Effect

Significant adjustments and/or expanded disclosures were required to ensure the Medical Center’s financial statements were fairly stated as of and for the year ended September 30, 2011.

Recommendation

Although management has made some progress in this area, we recommend that management continue to refine the process used to support the financial reporting process, including the notes to the audited financial statements, all significant adjustments, and account reconciliations. The process should allow for supervisory review; the review process should be timely and include an evaluation of the reasonableness of individual financial statement line items by an individual with sufficient accounting and financial reporting experience and knowledge of the Medical Center’s core business processes to detect inconsistencies and errors. Specific focus should be

placed on achieving proper accounting cutoff and valuation of all balance sheet accounts as well as the accuracy of the financial statements and footnotes. Furthermore, we suggest that management develop a process to ensure that all responsible accounting areas are properly resourced to provide accurate and timely information to support amounts recorded in the Medical Center's financial statements.

We further recommend that the accounting department develop clear two-way lines of communication with Risk Management, in-house counsel, Patient Financial Services, and other Business office departments to ensure areas of potential financial risk are known and appropriately addressed in the Medical Center's financial statements.

Views of Responsible Officials

During fiscal year 2011, management and staff made significant strides toward improving the timeliness and overall quality of the financial reporting process. For example, accounting procedures covering the month-end close process, reconciliation of balance sheet accounts on a monthly basis and production of timely monthly and year-end financial statements were enhanced. The financial statement reporting package was revamped to include more information on cash collections, patient volumes, payor mix and statistical analysis. These changes improved the overall quality of financial information reported; however, there remains room for improvement to our systems and processes. The following areas were noted as control deficiencies during the annual audit and management's response to remediate the deficiencies is provided:

- *Accounting for Cash and Cash Equivalents* – Outstanding checks were improperly classified as a current liability. This practice has been changed and now outstanding checks are properly classified in cash and cash equivalents on the financial statements.
- *Revenue and Valuation of Accounts Receivable* – The valuation of accounts receivable is complex and incorporates contractual allowances and bad debt provisions based upon management's standard algorithm at 9/30/2011. That includes management's policy of reserving 100% of all accounts receivable related to patient responsibility, also known as "Self Pay". Beyond our standard algorithm, we reserve all accounts receivable outstanding over 120 days. As a point of reference, Medicare and Medicaid allow care providers 6 months to submit a claim per their timely filing guidelines. Management's 100% reserve of all accounts over 120 days plus the 100% of self pay reserve and its normal reserves presents a conservative net receivable balance. Nevertheless, management and OCFO staff accepted KPMG's recommendation to increase bad debt reserves on the Hospital and Skilled Nursing Facility receivables and recorded the additional provision on bad debts.

Per diem rates used for Medicaid Pending accounts in the Skilled Nursing Facility will be updated and reviewed quarterly to ensure that they are kept current.

- *Accounting for Capital Assets and Grant Revenues* – The Medical Center has access to all of its detailed property and equipment asset records. These records are maintained on a spreadsheet because the Medical Center does not have a Fixed Asset Accounting System. Management and staff of the OCFO will implement a procedure to test the accuracy of depreciation expense on a monthly basis to ensure that the expense is reported correctly on the financial statements. Capital Assets purchased using grant funds will be recognized in the appropriate period when purchased and recorded in accordance with generally accepted accounting principles.

- *Staffing of Accounting Areas* – Management and staff are in agreement that there is a need to evaluate the adequacy of staffing levels and skill sets in all accounting and business office areas. A staffing plan is being developed that emphasizes recruiting experienced accounting and business office staff. Existing staff will be required to attend training seminars to improve/update technical proficiency in GAAP, non-profit accounting, billing office procedures and practices.

2011-02. Lack of Access Controls over Information Technology

Criteria

National Institute of Standards and Technology (NIST) Special Publication (SP) 800-12 indicates that from time to time it is necessary to review user account management on a system (access controls). The Medical Center's policies require performance of procedures with respect to backup storage and recovery, and application incident response (backup and incident response controls). NIST SP 800-53 indicates that monitoring procedures are necessary to identify and remedy inappropriate or unusual activity in job processing that should include timely identification of failures, and implementation and documentation of remedial actions (application job processing controls).

Condition

In support of our financial statement audit, we tested the design and implementation of selected general information technology (IT) controls related to the Meditech application for the purpose of establishing reliance thereon and thereby reducing the amount of substantive testing required. During the performance of these tests, we identified certain logical access controls that were not designed and/or functioning effectively.

Specifically we noted the following in our testing of logical access controls:

- We were informed by Medical Center management and representatives of Medical Information Technology, Inc. (Meditech) that as many as over 3,000 Meditech employees may have write-level or greater remote access to the Medical Center's instance of the Meditech HCIS and its supporting database and operating system. Although Meditech remote user access to the HCIS is tracked in audit logs available on Meditech's customer portal, the Medical Center management does not proactively review the logs on a periodic basis to determine whether Meditech user remote access has been authorized by the Medical Center's Information Technology Department.
- Password parameters for the Meditech supporting database and operating systems have not been set to enforce password complexity, minimum password length, password expiration, password history and account lockout.

Cause

To a large degree, these logical access processes are constrained by a lack of resources; however, we believe it is important that management prioritize its efforts to implement process changes to strengthen these controls.

Effect

Controlling access to the information systems is a primary management mechanism to help ensure that only authorized users may access financial systems and users have only the capabilities they need to perform their roles. Unauthorized access could lead to manipulation of financial data and a subsequent financial statement misstatement.

Recommendation

We recommend that Medical Center management coordinate with MEDITECH to obtain an understanding of the following: (1) The number and user account identifiers of MEDITECH employees provided remote access to the Medical Center's instance of the HCIS and the levels of access and (2) controls that MEDITECH has placed into operation to help ensure only authorized MEDITECH users have access to the Medical Center's instance of the HCIS. Further, we recommend that the Medical Center establish and implement a formalized process in which management performs a periodic review of logs of MEDITECH remote user access and traces back selected activities back to supporting authorization documentation authorization (e.g., a documented request to access the system). This review should be documented to indicate who performed the review, the date the review was performed and, for exceptions noted during the review, any Medical Center follow up and final disposition. Finally, Medical Center management should periodically monitor control performer adherence to the review process to help ensure it is properly completed and documented on a going forward basis. We recommend that Medical Center management coordinate with MEDITECH to reconfigure existing password configuration settings at the operating system and database level, where applicable, in accordance with the Medical Center's Password Management Policy. Finally, we recommend that management monitor adherence to the policy on a periodic basis. As it relates to review of Meditech user access, we recommend that management continue to perform the control activities put in place in remediation of the deficiency noted above. Further, we recommend that management monitor the effectiveness of these controls on a regular and periodic basis.

Views of Responsible Officials

The Medical Center Information Technology Department (UMC IT) is committed to the process of continuous improvement of its privacy and security practices. This includes the introduction of new enabling technologies and updating of policies and procedures. Technology is in a rapid state of change, and threats to our environment are equally dynamic. Therefore, we are engaged in a continuous cycle of improving our interior and perimeter security. Controlling access to operating systems, databases and system applications is paramount to ensuring overall security of our system. The following access controls are currently in place and will be updated to include improved documentation on user reviews and acceptance of properly authorized change request forms:

- Management has a policy that requires audit reviews be performed of user access levels. The purpose of our policy is to prevent unauthorized use or access that is not consistent with job responsibilities. The Medical Center IT staff performs routine reviews of user access to determine compliance with our policies. It has not been our practice to prepare supporting documents of these reviews. In the future, we will develop documentation consistent with actions taken to ensure compliance of this policy.
- Management's statement to auditors was that Meditech's access to our system is prompted by a request from the organization for help. This request is either via a task entered on Meditech's website, or a call or email to a specific Meditech support person requesting assistance. All Meditech users' access is captured in an audit trail log on Meditech's website. It is also captured in the OPS module within Meditech. Both areas contain information regarding who accessed the system, the date and time on which the system was accessed, and the reason the system was accessed. This information is retained in the OPS module for 14 days only. Management previously was not documenting the reviews;

however, the Medical Center has started documenting within the helpdesk log that reviews are occurring. In addition, there were no incidents found through the audit examination where Meditech accessed the UMC HCIS system without being requested.

- The Medical Center password parameters require a double key entry, with a minimum password length that is encrypted. Passwords are required to be changed every 180 days and auto expire after 90 days. After three failed attempts, there is a 60 second timeout. These requirements are already set at the parameter level. Management is not aware of the Meditech password management parameters for managing remote access to their clients, such as the Medical Center. The Meditech remote support is covered by a software service warranty agreement between the Medical Center and Meditech. In our opinion, patient health information is properly protected and to our knowledge KPMG examination did not reveal compromises. We have in place the controls necessary to detect unauthorized access into the Medical Center Meditech licensed software applications.

2011-03. Valuation of Accounts Receivable

Criteria

The Medical Center records patient service revenue at the estimated net realizable amount from patients, third party payors and others for services rendered. Additionally, patient's accounts receivable are recorded net of estimated contractual allowances and amounts estimated to be uncollectible. The contractual allowance percentages and the allowance for uncollectible accounts is a significant estimate recorded based on management's judgment.

Condition

During our year-end audit procedures, we gained an understanding of management's methodology in estimating both the contractual allowance and allowance for bad debt for the hospital and the skilled nursing facility which comprise "The Medical Center". Management calculated the estimated contractual allowance for its gross patient accounts receivable based on the 12 month rolling data for patient charges, receipts and adjustments for fiscal year 2011. From this data, management only used those patient accounts that have a net zero balance, i.e. accounts fully collected and/or adjusted for as of year-end, to calculate the estimated contractual allowance percentages. These percentages are calculated separately by inpatient and outpatient and by payor, and applied to the accounts receivable balances. Management applied these calculated percentages to the aging categories other than the greater than 120 day category. We noted that management applied a flat rate of 100% reserve on all balances that had aged greater than 120 days. Management reserves as bad debt, 100% of all self-pay accounts receivable. Self-pay denotes those patient accounts where the liability for payment rests with the individual. We note that it is the Medical Center's practice to only reserve in its allowance for bad debts the self-pay accounts receivable.

The Medical Center assumed operations of the skilled nursing facility effective October 1, 2010. Therefore, management was unable to use past collection history in developing the percentages utilized for the contractual allowance and bad debt amounts for amounts due for skilled nursing services. Thus, management used its judgment to determine an estimate for the contractual allowance percentages and the allowance for bad debts.

We noted during our review of the valuation of accounts receivable for the hospital, that there was an error in the aging model such that the contractual allowance was understated when applying management's methodology of reserving all amounts greater than 120 days at 100%. Furthermore, we noted a deterioration in the quality of the accounts receivable balance in that there was a significant increase in those amounts due in the over 120 day aging category. With regards to the skilled nursing facility, we noted that the estimate of the allowance for bad debts did not adequately consider the amounts that were yet to be billed to Medicare.

As a result of the above items, KPMG proposed and management recorded an adjustment to increase the allowance for bad debts as of September 30, 2011.

Cause

The conditions noted above resulted from the lack of management's consideration of all available information in recording its contractual allowance and allowance for bad debts as well

as the precision level of management's review of all the schedules supporting the allowance calculations.

Effect

A significant adjustment was proposed and recorded to increase the allowance for bad debts as of September 30, 2011.

Recommendation

We recommend that management strengthen its controls over the process to estimate contractual allowances and provisions for bad debts to ensure that there is proper consideration of all available information, including changes in external conditions, which could impact management's current reserve methodology to ensure that accounts receivables are properly valued at year end. Additionally, management should ensure that there is a proper level of review over all reports and schedules utilized in management's reserve methodology and that such review is at a detailed level of precision to detect errors or misstatements. Lastly, management should enhance the controls around their accounts receivable collection process to ensure that amounts due to the Medical Center are collected in a timely manner.

Views of Responsible Officials

The valuation of accounts receivable is complex and incorporates contractual allowances and bad debt provisions based upon management's standard algorithm at September 30, 2011. That includes management's policy of reserving 100% of all accounts receivable related to patient responsibility, also known as "Self Pay". Beyond our standard algorithm, we reserve all accounts receivable outstanding over 120 days. As a point of reference, Medicare and Medicaid allow care providers 6 months to submit a claim per their timely filing guidelines. Management's 100% reserve of all accounts over 120 days plus the 100% of self pay reserve and its normal reserves presents a conservative net receivable balance.

Management's algorithm is updated each quarter throughout the fiscal year. The Medical Center calculates the algorithm by performing a look-back analysis on gross patient accounts receivable data for the previous 12 months. Patient charges, receipts and adjustments are accumulated for past 12 months. From this data, only those patient accounts that have a net zero balance are used, i.e. accounts fully collected and/or adjudicated by third party insurance payor, to calculate the estimated contractual allowance percentages. These percentages are calculated separately for inpatient, outpatient and by payor, and applied to the Accounts Receivable balances to determine contractual allowance reserves. This calculation is performed routinely and takes into account available information resulting from external conditions (payments received on accounts) to properly estimate contractual allowance reserves for the period under review.

Because the patient accounting system is continuously updated throughout day with patient charges, payments and adjustments, the information on the aging report reflects a point in time, and will vary based on the date and time the report is downloaded. To ensure that the aging report is accurate as of the end of the financial period under review, the following controls have been implemented:

- Reviewed several months of aging reports and changed the practice on how the reports are downloaded and compiled.

- Assigned first level review responsibility of the report to the Assistant Director of the Business Office.
- Assigned second level review responsibility of the report to the accounting staff, Controller and CFO.