Mangum Regional Medical Center

(A Component Unit of the Town of Mangum, Oklahoma)

Financial Statements
and
Independent Auditor's Report

December 31, 2017

REDW LLC
CPAs | Advisors

Mangum Regional Medical Center
(A Component Unit of the Town of Mangum, Oklahoma)

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Independent Auditor's Report

Board of Trustees
Mangum Regional Medical Center
Mangum, Oklahoma

Report on the Financial Statements

We have audited the accompanying financial statements of Mangum Regional Medical Center (the "Medical Center"), a component unit of the Town of Mangum, Oklahoma, as of and for the six-month period ended December 31, 2017, and the related notes to the financial statements, which collectively comprise the Medical Center's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

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Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Medical Center as of December 31, 2017, and the changes in its financial position and its cash flows for the six-month period then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Notes 8 and 9 to the financial statements, the Medical Center is a defendant in an ongoing lawsuit concerning the line of credit that was executed in the name of the former management company Alliance Health Southwest Oklahoma, LLC (AHSO). As of the date of this report no likelihood of outcome can be estimated. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Management has omitted the management's discussion and analysis information that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. Our opinion on the basic financial statements is not affected by this missing financial information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated August 17, 2020, on our consideration of the Medical Center's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Medical Center's internal control over financial reporting and compliance.

REDW LLC

Phoenix, Arizona
August 17, 2020

Financial Statements

Mangum Regional Medical Center
(A Component Unit of the Town of Mangum, Oklahoma)
Balance Sheet
December 31, 2017

Assets		
Current assets		
Cash	$	133,205
Patient accounts receivable, net		2,673,217
Inventories		235,404
Prepaid expenses and other		34,012
Total assets	$	3,075,838
Liabilities		
Current liabilities		
Accounts payable	$	2,637,956
Accrued expenses		148,391
Estimated amounts due to third-party payors		3,299,318
Current portion of long-term debt		514,485
Total liabilities		6,600,150
Net Position (Deficit)		
Unrestricted		(3,524,312)
Total liabilities and net position (deficit)	$	3,075,838

The accompanying notes are an integral part of these financial statements.

Mangum Regional Medical Center
(A Component Unit of the Town of Mangum, Oklahoma)
Statement of Revenues, Expenses and Changes in Net Position
For the Six-Months Ended December 31, 2017

Operating Revenues	
Net patient service revenue	$ 3,368,732
Other	12,274
Total operating revenues	3,381,006
Operating Expenses	
Purchased services and professional fees	2,609,253
Salaries, wages and benefits	2,057,042
Supplies and other	762,024
Other operating	165,688
Utilities	86,196
Travel and meals	88,603
Insurance	60,804
Repairs and maintenance	48,029
Rental expense	100,726
Total operating expenses	5,978,365
Operating loss	(2,597,359)
Nonoperating Revenues and Expenses	
Interest expense	(54,574)
Estimated third-party payor expense	(3,835,292)
Extinguishment of contested line of credit	3,028,734
Other nonoperating expense	(65,821)
Total nonoperating expenses	(926,953)
Excess of expenses over revenues and change in net position	(3,524,312)
Net position, beginning of period	-
Net deficit, end of period	$ (3,524,312)

The accompanying notes are an integral part of these financial statements.

Mangum Regional Medical Center
(A Component Unit of the Town of Mangum, Oklahoma)
Statement of Cash Flow
For the Six-Months Ended December 31, 2017

Cash flows from operating activities	
Receipts from patients and third-party payors	$ 3,994,833
Payments to suppliers and contractors	(4,753,294)
Payments to employees	(2,609,253)
Other receipts, net	12,274
Net cash used for operating activities	(3,355,440)
Cash flows from noncapital financing activities	
Cash received from contested line of credit	3,028,734
Cash received from valid note payables	530,075
Payments on note payable	(15,590)
Interest paid	(54,574)
Net cash provided by noncapital financing activities	3,488,645
Net increase in cash	133,205
Cash, beginning of period	-
Cash, end of period	$ 133,205
Reconciliation of operating loss to net cash used for operating activities	
Operating loss	$ (2,597,359)
Adjustments to reconcile operating loss to net cash used for operating activities	
Changes in assets and liabilities	
Patient accounts receivable	(2,673,217)
Inventories	(235,404)
Prepaid expenses and other	(34,012)
Accounts payable	2,572,135
Accrued expenses	148,391
Estimated amounts due to third-party payors	(535,974)
Net cash used for operating activities	$ (3,355,440)

The accompanying notes are an integral part of these financial statements.

Mangum Regional Medical Center
(A Component Unit of the Town of Mangum, Oklahoma)
Notes to Financial Statements
December 31, 2017

1) Nature of Operations and Summary of Significant Accounting Policies

<u>Nature of Operations and Reporting Entity</u>
Mangum Regional Medical Center (the "Medical Center") is an 18-bed critical access hospital located in the heart of Mangum, Oklahoma. The Medical Center is a component unit of the Town of Mangum. The Medical Center earns revenue by providing inpatient, outpatient and emergency care services to patients, as well as operating a rural health clinic.

<u>Basis of Accounting and Presentation</u>
The accompanying financial statements of the Medical Center have been prepared on the accrual basis of accounting using the economic resources measurement focus. Revenues, expenses, gains, losses, assets and liabilities from exchange and exchange-like transactions are recognized when the exchange transaction takes place, while those from government-mandated nonexchange transactions (principally, municipal appropriations) are recognized when all applicable eligibility requirements are met. Operating revenues and expenses include exchange transactions and program-specific, government-mandated nonexchange transactions. Government-mandated nonexchange transactions that are not program-specific (such as municipal appropriations), investment income and interest on capital assets-related debt are included in nonoperating revenues and expenses. The Medical Center first applies restricted net position when an expense or outlay is incurred for purposes for which both restricted and unrestricted net position are available.

<u>Use of Estimates</u>
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

<u>Cash Equivalents</u>
The Medical Center considers all liquid investments with original maturities of three months or less to be cash equivalents. At December 31, 2017, the Center did not have any cash equivalents.

Risk Management
The Medical Center is exposed to various risks of loss from torts; theft of, damage to and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters. Settled claims did not exceed this commercial coverage in the six-months ended December 31, 2017.

Patient Accounts Receivable
Patient accounts receivable is presented at net subsequent receipts collected for services rendered from third-party payers, patients and others.

Supplies
Supply inventories are stated at the lower of cost, determined using the first-in, first-out method, or market.

Compensated Absences
The Medical Center's policies permit most employees to accumulate vacation benefits that are realized as paid time off. Expense and the related liability are recognized as vacation benefits are earned whether the employee is expected to realize the benefit as time off. Compensated absence liabilities are computed using the regular pay in effect at the balance sheet date, plus an additional amount for compensation-related payments, such as Social Security and Medicare taxes, computed using rates in effect at that date.

Net Patient Service Revenue
The Medical Center has agreements with third-party payers that provide for payments to the Medical Center at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payers and others for services rendered and includes estimated retroactive revenue adjustments and a provision for uncollectible accounts. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such estimated amounts are revised in future periods as adjustments become known.

Income Taxes
As an essential government function of the Town of Mangum, the Medical Center is generally exempt from federal and state income taxes under Section 115 of the Internal Revenue Code and a similar provision of state law.

Pronouncements Issued But Not Yet Effective

GASB has issued the following pronouncements that may affect future financial position, results of operations, cash flows, or financial presentation of the Medical Center upon implementation. The Medical Center has not fully determined the effect these pronouncements will have on the financial statements.

GASB Statement No	GASB Accounting Standard	Effective Fiscal Year
83	*Certain Asset Retirement Obligations*	2020
84	*Fiduciary Activities*	2020
86	*Certain Debt Extinguishment Issues*	2018
87	*Leases*	2022
88	*Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*	2020
89	*Accounting for Interest Cost Incurred before the End of a Construction Period*	2021
90	*Majority Equity Interests, an Amendment of GASB Statements No. 14 and No. 61*	2020
91	*Conduit Debt Obligations*	2022
93	*Replacement of Interbank Offered Rates*	2022
94	*Public-Private and Public-Public Partnerships and Availability Payment Arrangements*	2023

2) Net Patient Service Revenue

The Medical Center has agreements with third-party payers that provide for payments to the Medical Center at amounts different from its established rates. These payment arrangements include:

- **Medicare** – The Medical Center, as a critical access hospital, is reimbursed for inpatient and outpatient services provided to Medicare program beneficiaries on a cost reimbursement methodology. The Medical Center is reimbursed at tentative rates with final settlement determined after submission of annual cost reports by the Medical Center and audits thereof by the Medicare administrative contractor. The Medical Center's Medicare cost reports have been audited by the Medicare administrative contractor through the year ended December 31, 2015.

Medicare cost report receivables (liabilities) are as follows:

	Amount	Status
2016	$ (1,397,906)	Filed, pending audit
2017 (January - June)	(2,437,386)	Filed, pending audit
2017(July - December)	535,974	Filed, pending audit
	$ (3,299,318)	

- **Medicaid** – The Medical Center is reimbursed for services rendered to patients covered by the state Medicaid program at prospectively determined rates per discharge and fee schedules with no retroactive adjustments. Those payment rates vary according to a patient classification system that is based on clinical, diagnostic and other factors.

Approximately 73% percent of net patient service revenue is from participation in the Medicare and state-sponsored Medicaid programs for the six-months ended December 31, 2017. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation and change. As a result, it is reasonably possible that recorded estimates will change materially in the near term.

The Medical Center has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment to the Medical Center under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined daily rates.

3) Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Medical Center's deposits may not be returned to it. The Medical Center does not have a policy for custodial credit risk. The bank balances of deposits were $418,978 at December 31, 2017. At December 31, 2017, $254,391 of the total bank balances was insured by the Federal Deposit Insurance Corporation (FDIC) and the remaining balance of $164,587 was uninsured.

4) Patient Accounts Receivable

Patient accounts receivable at December 31, 2017, represents all cash collections on receivable balances. These amounts consisted of:

Medicare	$ 1,207,122
Medicaid	215,525
Other third-party payers	1,203,547
Patients	47,023
	$ 2,673,217

5) Medical Malpractice Claims

The Medical Center purchases medical malpractice insurance under a claims-made policy on a fixed premium basis. Accounting principles generally accepted in the United States of America require a health care provider to accrue the expense of its share of malpractice claims costs, if any, for any reported and unreported incidents of potential improper professional service occurring during the year by estimating the probable ultimate costs of the incidents. Based upon the Medical Center's claims experience, no such accrual has been made. It is reasonably possible that this estimate could change materially in the near term.

6) Note Payable

The following is a summary of notes payable transactions for the Medical Center for the year ended December 31 2017:

	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Promissory note 1	$ -	$ 205,300	$ (15,590)	$ 189,710	$ 189,710
Promissory note 2	-	324,775	-	324,775	324,775
	$ -	$ 530,075	$ (15,590)	$ 514,485	$ 514,485

The promissory note 1 is to Blackhawk Mangum, LLC entered on October 30, 2017, in the amount of $205,300. The monthly payments are $9,474 at an annual interest rate of 10% with a single final balloon payment of $108,655 on the first day of November 2018.

The note was used for the inventories obtained from the previous Medical Center operator.

The promissory note 2 is to Praxeo Health LLC entered on July 10, 2017, in the amount of $309,000. The monthly payments were due to start on November 1, 2017; however, no payments were made until 2018, at which time the note was paid in full. The annual interest rate of 12% caused the note balance to increase to $324,775 as of December 31, 2017. The note was used to meet payroll obligations during its first few months of operation.

7) Medical Center Operations

In July 2017, the Town of Mangum executed a contract with Alliance Health Southwest Oklahoma, LLC (AHSO) to manage and operate the Medical Center with the understanding that AHSO would have sole financial responsibility until the Medical Center was profitable. AHSO was responsible for day-to-day operations including employment of all staff necessary to operate the Medical Center, as well as identify a CEO. The AHSO partnership consisted of three individuals who also were principal officers of other related party entities. Throughout the latter six months of 2017, AHSO entered into a variety of contracted services such as, but not limited to, IT, equipment leases and employee staffing with its related party entities. Additionally, AHSO procured a line of credit to use for daily operations. AHSO was listed as the signor on this line of credit, not the Medical Center. One other additional loan was executed without proper approval from the Town of Mangum or in the Medical Center’s name. This loan to Praxeo Health LLC, while not properly executed, was subsequently paid by the Medical Center in 2018. On December 10, 2018, the agreement between the Medical Center and AHSO was terminated and the Town of Mangum began legal proceedings to ensure no liability exists for the obligations that were not lawfully approved and/or ratified in the name of the Medical Center. The line of credit that was not properly authorized in the name of the Medical Center has been removed from the financial statements as of December 31, 2017, and characterized as an extinguishment of contested debt in nonoperating revenue on the statement of revenues, expenses and changes in net position. See additional details regarding subsequent events related to this line of credit in note 8 below.

Additionally, the Medicare number used for reimbursement is tied to the Medical Center, not the operator of the facility. The cost reports for 2016 and the first six months of 2017 had not been completed or filed prior to July 2017. Once the cost reports were completed, it was determined that estimated third party-payor liabilities in the amount of $3,835,292 existed for services prior to July 1, 2017 (see Note 2). The related expense is presented as a nonoperating expense on the statement of revenues, expenses and changes in net position.

8) Contingencies

Litigation

In the normal course of business, the Medical Center is, from time to time, subject to allegations that may or do result in litigation. Some of these allegations are in areas not covered by commercial insurance, for example, allegations regarding employment practices or performance of contracts. The Medical Center evaluates such allegations by conducting investigations to determine the validity of each potential claim. Based upon the advice of legal counsel, management records an estimate of the amount of ultimate expected loss, if any, for each. Events could occur that would cause the estimate of ultimate loss to differ materially in the near term.

Contested Line of Credit

On September 6, 2019, First National Bank of Vinita filed a lawsuit against the Medical Center related to the line of credit that was executed in the name of the former management company AHSO. The lawsuit alleges that approximately $1.88 million of credit extended to AHSO is the legal responsibility of the Medical Center despite the fact that the agreement was not properly approved by the Medical Center’s board or in the name of the Medical Center. As of the date of issuance of this report the likelihood of outcome cannot be estimated.

MedSurg Consulting, LLC and Surgery Center of Altus, LLC v Medical Center

On January 9, 2019, a motion was filed against the Medical Center regarding some equipment that was leased and remained on the Medical Center campus after the former management company left. Medsurg claims the Medical Center owes approximately $734,000, which represents the balance remaining on the leased equipment. On March 28, 2019, a cross-petition was filed by the Medical Center against the Surgery Center of Altus and several other AHSO related entities in relation to the ongoing litigation. As of the date of issuance of this report the Medical Center legal team believe these motions have a high likelihood of resolution in the Medical Center’s favor.

9) Subsequent Events

At the time of this report's release, citizens and the economies of the United States and other countries have been impacted by the coronavirus (COVID-19) pandemic. The World Health Organization declared a Public Health Emergency on January 30, 2020. The evolution of the virus, the extent of its economic impact and the results of steps taken and yet to be taken by governments and financial institutions are unknown. Governments and businesses may face supply chain disruptions, labor shortages, revenue declines, an increase in bad debts, reduced cash flow, difficulties meeting loan covenants, goodwill and inventory impairment, credit difficulties, and other financial implications. The significance and the duration of the pandemic's financial impact are indeterminable. These financial statements do not consider the potential financial implications of the pandemic.

On March 27, 2020, President Trump signed into law the "Coronavirus Aid, Relief, and Economic Security (CARES) Act." The CARES Act, among other things, includes provisions relating to refundable payroll tax credits, deferment of employer side social security payments, net operating loss carryback periods, alternative minimum tax credit refunds, modifications to the net interest deduction limitations, increased limitations on qualified charitable contributions, and technical corrections to tax depreciation methods for qualified improvement property. It also appropriated funds for the SBA Paycheck Protection Program loans that are forgivable in certain situations to promote continued employment, as well as Economic Injury Disaster Loans to provide liquidity to small businesses harmed by COVID-19. There is no assurance that the Medical Center is eligible for these funds or will be able to obtain them.

In May, June and July of 2020, the Medical Center received a total of $4,257,659 from the Provider Relief Fund of the CARES Act. This funding supports healthcare-related expenses or lost revenue attributable to COVID-19 and ensures uninsured Americans can get testing and treatment for COVID-19. Providers who have been allocated a payment must sign an attestation confirming receipt of the funds and agree to certain terms and conditions regarding the use of the funds.

The Medical Center continues to examine the impact that the CARES Act may have on its business. Currently, the Medical Center is unable to determine the ultimate impact that the CARES Act will have on its financial condition, results of operations, or liquidity.

Supplemental Schedule

Independent Auditor's Reports on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Trustees
Mangum Regional Medical Center
Mangum, Oklahoma

We have audited, 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, the financial statements of Mangum Regional Medical Center (the "Medical Center"), a component unit of the Town of Mangum, Oklahoma, as of and for the six-month period ended December 31, 2017, and the related notes to the financial statements, which collectively comprise the Medical Center's basic financial statements, and have issued our report thereon dated August 17, 2020.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Medical Center's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the Medical Center's internal control.

A *deficiency in internal control* 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 a combination of deficiencies, in internal control, 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

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Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings and responses as items 2017-001 through 2017-004 that we consider to be material weaknesses.

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 Findings

The Medical Center's responses to the findings identified in our audit are described in the accompanying schedule of findings and responses. The Medical Center's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Medical Center's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Medical Center's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

REDW LLC

Phoenix, Arizona
August 17, 2020

Mangum Regional Medical Center
(A Component Unit of the Town of Mangum, Oklahoma)
Schedule of Findings and Responses
For the Six-Month Period Ended December 31, 2017

2017–001 — Enhancement of Board Oversight (Material Weakness)

Criteria: The Board of Trustees has a fiduciary responsibility to ensure sound judgment and business decisions are employed as well as oversight of enterprise and fraud risks for the Medical Center. This oversight should include frequent reviews of internally developed financial statements as well as established policies and authority levels detailing who can enter into agreements in the name of the Medical Center. Specific focus should also be made to better understand all related party relationships and their effectiveness in the delivery of products or services.

Condition: During 2017, at the request of the former management company Alliance Health Southwest Oklahoma, LLC (AHSO), several debts were entered into and a variety of related party companies were utilized for professional services. No documentation supported the conclusion that the related party companies provided the most advantageous benefit to the Medical Center. As a result, the AHSO management agreement was subsequently terminated and the Town of Mangum had to aggressively defend the Medical Center to release the organization from any potential liability.

Cause: AHSO was able to enter into agreements without the knowledge and/or consent of the Board as there were no established policies ratified until November 2017. Additionally, the policies that were created primarily concerned human resources related activities and not financial or governance policies.

Effect: The financial statements required significant adjustments to remove liabilities that were disputed.

Auditor's Recommendations: The Medical Center should work to develop and approve policies surrounding contract execution, related party relationships and monitoring activities. These policies should be reviewed and formally approved by the Board of Trustees as outlined in the Bylaws. Additionally, the Board of Trustees should consider enhancing board oversight. The American Institute of Certified Public Accountants and the Chartered Institute of Management Accountants jointly issued a report titled *Governing for Performance: New Directions in Corporate Governance*. The report describes the characteristics of highly effective boards and outlines the related factors that should be combined to achieve board effectiveness. Specifically, it states the organizations and their boards should focus primarily on strategy and risk oversight, boardroom behaviors, and the relationship between the board and management. It also states that frameworks and tools such as the CIMA Strategic Scorecard, the board's charter, and COSO Enterprise Risk Management Framework can help organizations and their boards address these issues effectively.

2017–001 — Enhancement of Board Oversight (Material Weakness) — continued

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Management's Response: In December 2018 the Board of Trustees entered into a new management contract agreement with Cohesive Healthcare Management and Consulting (Cohesive). Cohesive is not authorized to sign any contracts on the behalf of the Medical Center. All contracts go to the board for approval and are then signed by the Board Chair. The board is also presented financial statements and policies/procedures for the Medical Center for their approval.

2017-002 — Patient Accounts Receivable and Allowances (Material Weakness)

Criteria or Specific Requirement: Accounts receivable aging reports should be produced at least monthly to support the evaluation and collectability of accounts receivable balances. Each payor class should be evaluated based on past collection history and a reserve for uncollectible accounts should be established for both contractual allowances and bad debt. Periodic adjustments to these reserves should be approved by management in light of billing and collection performance.

Condition: Management has not developed a formal process to periodically update the estimate for the allowance for doubtful patient accounts receivable.

Cause: Management has not developed an allowance model as a result of the very recent takeover of the Medical Center and its lack of historical information available.

Effect: A material audit adjustment was required to adjust the ending balances to the actual cash receipts collected. The net accounts receivable balance was decreased by $1,888,592.

Auditor's Recommendation: Management should perform routine analysis to develop a methodology for estimating an allowance for doubtful accounts based on historical trends, and assess accounts receivable on a monthly basis. The estimation should include an analysis by payor class for contractual adjustments and by age for the allowance for doubtful accounts. Adjustments should be recorded on a monthly basis to ensure that the financial statements presented to the board are accurate.

Management's Response: Since Cohesive has become the management company, they have implemented a process of estimating collectible accounts receivable based on historical receipts. An estimated adjustment is made on a monthly basis. Management is provided with a key performance indicator report from the billing company that provides historical charges, collections, and adjustments by payer for each month. This data is utilized to update the rate of estimated reserves on a quarterly basis. After year-end a look back analysis will also be performed to validate the estimates.

2017-003 — Enhance Internal Controls (Material Weakness)

Criteria or Specific Requirement: Organizations must develop, evaluate and utilize internal controls to ensure the integrity of financial and accounting information, promote accountability, and prevent fraud.

Condition: The Medical Center lacked many internal controls around key financial and accounting functions. Specifically, the following deficiencies were identified:

- No segregation between the preparer and reviewer functions or no review function was in place for cash, inventory, accounts payable, accrueds and journal entries creation and posting
- Journal entries lacked supporting documentation to help substantiate their appropriateness and accuracy
- Agreements or contracts were modified and no amendments or revisions were documented
- Access to employees' rates of pay was not properly restricted and the employee responsible for processing payroll received the signed checks for disbursement
- Cash collected at the Medical Center from co-pays or other revenue streams was not properly monitored or reconciled at the time of payment

Cause: Management had not fully developed a sound internal control structure.

Effect: These deficiencies, or a combination of these deficiencies, indicate that there was a reasonable possibility that a material misstatement of the Medical Center's financial statements would not be prevented or detected on a timely basis. The inability to detect or prevent material errors from occurring erodes the public trust and perception of the Medical Center and could prevent future business opportunities.

Auditor's Recommendation: The Medical Center should review its business processes and ensure internal controls are developed, documented via policy and implemented sufficient to address the above identified areas.

Management's Response: Management has implemented the following controls to address the areas identified above:

- The Medical Center's Controller reconciles key balance sheet accounts on a monthly basis. Financial statements are reviewed on a monthly basis by Cohesive Finance along with review of the allowance calculations and Due to Medicare.
- Since 2017, there has been turnover in the accounting department. The Controller who has been in place since December 2018, keeps supporting documentation for all manual journal entries.

2017-003 — Enhance Internal Controls (Material Weakness) — continued

Management's Response — continued:

- All contracts and amendments must be approved by the board. These agreements are reviewed and approved by Cohesive before they go to the board for approval. The executed agreements and amendments are maintained by the Administrator and/or Controller.
- Payroll has been outsourced to Paycom. The only people who have access to the system are Cohesive HR personnel and the HR representative on site at the hospital. Pay rate changes and new hires must be approved by Cohesive before they can be modified in the system.
- Point-of-sale cash collections are now receipted at time of payment and the cash posting team reconciles all receipts to the daily bank activity.

2017-004 — **Reconcile Accounts to Supporting Documents (Material Weakness)**

Criteria or Specific Requirement: Reconciliations of all significant accounts should be performed on a monthly basis.

Condition: The Medical Center did not accrue for Paid-Time-Off (PTO) balances as of December 31, 2017.

Cause: Management had not developed standardized monthly close processes which resulted in overlooking a significant liability balance.

Effect: An entry to increase liabilities and related expenses by $73,292 was needed to properly reflect PTO accruals as of December 31, 2017.

Auditor's Recommendation: The Medical Center should adopt a policy requiring monthly reconciliation of all balance sheet accounts to their subsidiary ledgers in order to ensure that accuracy of the monthly financial statements and underlying subsidiary ledgers. Balance sheet reconciliations quickly identify errors and needed corrections. If reconciliations are performed infrequently, errors and adjustments can occur, resulting in the need for significant corrections when the reconciliations are performed. Any reconciling differences should be corrected before the books are closed for the month-end.

Management's Response: Since 2017, key accruals and balance sheet reconciliations are occurring on a monthly basis by the hospital Controller.