

**Palomar Pomerado Health
Internal Audit and Compliance
Board Committee**

**Tuesday – February 17, 2009
8:00 a.m. – 10:00 a.m.**

**PPH Grand Office Bldg
456 E. Grand. Escondido
Conference Room - 1st floor**

A G E N D A



Call To Order

- Public Comments
- *Approval of Minutes – January 20, 2008

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ADJOURNMENT

Distribution Via Email: by Michele Gilmore, Secretary, including Ken Hugins-consultant

Linda Greer, Chairman	Janine Sarti, General Counsel	John Lilley, M.D.
Jerry Kaufman, M.A.P.T.	Bob Hemker, CFO	Lachlan Macleay, M.D,
Alan Larson, M.D.	Tom Boyle, Director Internal Audit	Bruce Krider, M.A., Alt
Michael Covert, CEO	Joanna Sainmervil, Admin Fellow	Nicole Dennis, BOD Secretary

NOTE: Asterisks indicate anticipated action; action is not limited to those designated items.

“In observance of the ADA, Americans with Disabilities Act, please notify us at (858) 675-5230, forty-eight hours prior to meeting so that we may provide reasonable accommodations”.

PALOMAR POMERADO HEALTH

Status of Director of Corporate Compliance Search

TO: Internal Audit & Compliance Committee

MEETING DATE: Tuesday February 17, 2009

FROM: Janine Sarti, Esq., General Counsel

BY: Michele Gilmore, Secretary to Committee

BACKGROUND:

Janine Sarti will report on the status of the search to fill the vacant position of Director of Corporate Compliance.

BUDGET IMPACT: None

STAFF RECOMMENDATION: INFORMATION

COMMITTEE QUESTIONS:

COMMITTEE RECOMMENDATION:

Motion:

Individual Action:

Information:

Required Time:

PALOMAR POMERADO HEALTH

Report on Compliance ad hoc Committee items to full BOD on 2/9/09

TO: Internal Audit & Compliance Committee

MEETING DATE: Tuesday February 17, 2009

FROM: Tom Boyle, Director of Internal Audit

BY: Michele Gilmore, Secretary to Committee

BACKGROUND:

Linda Greer will report on the recent ad hoc Corporate Compliance Committee items that were carried forward to the full BOD meeting on 2/9/09; revised Internal Audit & Compliance Committee Charter and the suggested change of title and level of Dir. of Compliance position (to be filled), and the Dir. of Internal Audit position.

BUDGET IMPACT: None

STAFF RECOMMENDATION: INFORMATION

COMMITTEE QUESTIONS:

COMMITTEE RECOMMENDATION:

Motion:

Individual Action:

Information:

Required Time:

PALOMAR POMERADO HEALTH

Status of Compliance Department Hotline

TO: Internal Audit & Compliance Committee
MEETING DATE: Tuesday February 17, 2009
FROM: Janine Sarti, Esq., General Counsel
BY: Michele Gilmore, Secretary to Committee

BACKGROUND:
Janine Sarti will report on the Compliance Department Hotline.

BUDGET IMPACT: None

STAFF RECOMMENDATION: INFORMATION

COMMITTEE QUESTIONS:

COMMITTEE RECOMMENDATION:

Motion:

Individual Action:

Information:

Required Time:

PALOMAR POMERADO HEALTH
Update on Internal Audit Services activities

TO: Internal Audit & Compliance Committee
MEETING DATE: Tuesday February 17, 2009
FROM: Tom Boyle, Director Internal Audit
BY: Michele Gilmore, Secretary to Committee

BACKGROUND:
Tom Boyle will report on Internal Audit Services activities.

BUDGET IMPACT: None

STAFF RECOMMENDATION: INFORMATION

Committee Questions:

COMMITTEE RECOMMENDATION:

Motion:

Individual Action:

Information:

Required Time:

PALOMAR POMERADO HEALTH
Report on Year End Audit & Management Letter

TO: Internal Audit & Compliance Committee

MEETING DATE: Tuesday February 17, 2009

FROM: Tom Boyle, Director Internal Audit

BY: Michele Gilmore, Secretary to Committee

BACKGROUND:

Deloitte & Touche will report on the fiscal year end Audit and management letter.

BUDGET IMPACT: None

STAFF RECOMMENDATION: INFORMATION

Committee Questions:

COMMITTEE RECOMMENDATION:

Motion:

Individual Action:

Information:

Required Time:

PALOMAR POMERADO HEALTH
Date/Time/Location Of Next Meeting

TO: Internal Audit and Compliance Committee

MEETING DATE: Tuesday February 17, 2009

FROM: Tom Boyle, Director Internal Audit

BY: Michele Gilmore, Secretary to Committee

Background:

To discuss the date and time of the next meeting. It is currently scheduled for 8:00 am Tuesday, March 17, 2009 at the Grand Office 1st floor conference room – 456 E. Grand Ave., Escondido, CA.

Budget Impact: N/A

Staff Recommendation: INFORMATION

Committee Questions:

COMMITTEE RECOMMENDATION:

Motion:

Individual Action:

Information:

Required Time:

**PALOMAR POMERADO HEALTH
INTERNAL AUDIT AND COMPLIANCE COMMITTEE CHARTER**

I. Purpose.

The Internal Audit and Compliance Committee ("Committee") will assist the Board in the following items.

Provide review of:

- The integrity of PPH's financial statements.
- PPH's compliance with legal and regulatory requirements.
- The selection, performance, qualifications and independence of external auditors.
- The performance of PPH's internal audit function.

The Committee will ensure PPH's compliance program prevents and detects violations of law.

The Committee will strive to improve and promote PPH's internal audit and compliance policies, procedures and practices. The Committee will foster open communication among external and internal auditors, compliance, finance, senior Administration, and the Board. The Committee may obtain assistance from outside accounting, legal, or other consultants to resolve issues the Committee believes necessary to protect the organization. The Director of Corporate Compliance may also access outside legal counsel for certain sensitive compliance issues, with prior approval of the General Counsel or the Board Chair. It is expected these situations will occur in limited circumstances. PPH will provide funds to pay for the consultants.

The Committee Chair shall regularly report to, and review with the Board, any issues that arise with respect to the quality, operations, and integrity of PPH's internal audit and compliance functions.

II. Committee Membership.

A. Composition.

The Committee shall be composed of three independent board members. The Director of Internal Audit and the Compliance Officer will be committee members without vote. To maintain their independence, Committee members may not accept any fee for services from PPH, other than in the capacity as board members.

The Board will appoint Committee members and the Committee Chair. Members of the Committee are not required to be engaged in the accounting and auditing profession. However, it is preferred that at least one member of the Committee shall have past employment expertise in finance or accounting, requisite professional certification in accounting or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities or accounting or related financial management expertise. At the discretion of the Committee Chair, the Committee may select a member of the community to be an advisory member of the Committee. The Director of Internal Audit will provide ongoing training to Committee members to establish the required level of expertise.

Each member shall be knowledgeable in healthcare regulations or must become knowledgeable within a

reasonable period of time after appointment to the Committee. Members are not required to be engaged in the compliance profession and, consequently, some members may not have expertise in regulatory matters; however, the Compliance Officer will provide ongoing training to establish the required level of expertise.

B. Frequency of Meetings.

The Committee will meet at least once during each fiscal quarter, or more frequently as circumstances dictate and as necessary to fulfill its responsibilities. At the conclusion of each Committee meeting, the General Counsel, the Director of Internal Audit, and the Director of Corporate Compliance will each meet individually with the Committee, without Administration present, to discuss any issues or concerns. The Committee will also meet annually with the Director of Internal Audit, the Compliance Officer, external auditors, and Administration to discuss the annual Audit and Compliance Plans, and audited financial statements.

III. Duties and Responsibilities.

The Committee shall have the following responsibilities:

- 1.) Maintain meeting minutes.
- 2.) Annually review its charter and any Committee policies and recommend any changes to the Board or Governance Committee.
- 3.) Meet regularly with the Board which may include closed sessions.
- 4.) Review and discuss with Administration and the Director Internal Audit PPH's annual financial statements, all internal control reports and any relevant reports provided by external auditors.
- 5.) Appoint external auditors, with the approval of the Board. Oversee the work performed by the Internal Audit and Compliance departments for the purpose of preparing or issuing an audit or compliance report. Approve the overall audit scope and ensure audits are conducted in an efficient and cost-effective manner. Oversee the resolution of any issues between Administration and the Director of Internal Audit or the Compliance Officer.
- 6.) At least annually, obtain and review a report by the external auditors. The report shall include:
 - the external auditors' internal control procedures;
 - material issues arising the most recent internal control review, peer review, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more external audits carried out by the firm, and any steps taken to deal with any such issues.
- 7.) At least annually, obtain and review a report by a qualified independent authority, describing an assessment of the Director of Internal Audit and the Compliance Officer's independence, all relationships between the Director of Internal Audit and the Compliance Officer and PPH.
- 8.) Receive periodic reports on audit and compliance program's current policies and procedures, any changes to the compliance program, and the reasons behind the changes.

9.) Review and pre-approve both audit and non-audit services to be provided by the external auditors in accordance with the pre-approval policies and procedures. For services not requiring pre-approval under such policies and procedures, Administration shall inform the Committee of the nature of the project and the related fees with respect to such services provided by the external auditors. The Committee may delegate the authority to grant pre-approval to one or more members of the Committee with any such pre-approval reported to the Committee at its next regularly scheduled meeting.

10.) Review the integrity of PPH's financial reporting processes and the internal control structure.

11.) Review with Administration and external auditors, major issues regarding accounting principles and financial statement presentations, including any significant changes in PPH's selection or application of accounting principles, major issues as to the adequacy of PPH's internal controls and any special audit steps adopted in light of material control deficiencies.

12.) Review analyses prepared by Administration and external auditors, describing significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements.

13.) Review with Administration the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements of PPH.

14.) Review with Administration and the Compliance Officer and Director of Internal Audit any correspondence from or with regulatory agencies, any employee complaints or any published reports that raise material issues regarding PPH's financial statements, financial reporting process, internal audit controls or accounting policies.

15.) Require the CEO and CFO of PPH certify the financial reports as to the following: they have reviewed the report, the report does not contain any untrue statement of a material fact or a material omission, the financial statements fairly present the financial condition of the corporation, the certifying individuals have designed and evaluated systems of internal controls to make sure they that are aware of material information concerning the corporation's operation, the signers have disclosed to the auditors and the Committee any deficiencies in the controls as well as any fraud involving Administration or other key employees.

16.) Establish procedures for the receipt, retention and treatment of complaints received by PPH regarding regulatory, accounting, internal accounting controls or auditing matters. The Committee shall also establish procedures for the confidential and anonymous submission by employees regarding questionable matters.

17.) Consider the rotation of the lead audit partner and reviewing partner for PPH's independent audit firm every five (5) years.

18.) Commission periodic audits, as the Committee deems necessary, to monitor the implementation and integrity of the compliance program.

19.) Maintain audit and compliance records for seven (7) years.

20.) Review the appointment, termination, and replacement of the General Counsel, the Compliance Officer and the Director Internal Audit. Meet periodically with the Compliance Officer and Director of Internal Audit to discuss responsibilities, budget and staffing of PPH's internal audit and compliance functions and any issues the Compliance Officer and Director Internal Audit believes warrant Committee attention. The Committee shall discuss with the Compliance Officer and Director Internal Audit any significant material reports to Administration prepared by the Compliance Officer and Director Internal Audit and any responses from Administration.

21.) The Committee and the CEO must be in agreement on the performance appraisals of the General Counsel, the Director of Internal Audit, and the Director of Compliance. The performance appraisals for those positions will be prepared by the CEO and provided to the Committee for discussion and input. The CEO and the Committee chair will meet with the employee to discuss the performance appraisal. The Committee will receive a copy of the employee's written response to the performance appraisal. The Committee will also receive a copy of any other documentation regarding the employee's performance. The employee has the right at any time to access the Committee or the Board pertaining to issues relating to employment. At no time will any retribution or retaliation be tolerated against the employee for challenging an employment action or reporting an issue to the Board. The Committee will conduct compensation reviews of the General Counsel, the Director of Internal Audit, or the Director of Compliance. The Committee must agree upon changing any terms or conditions of employment for those positions including changes in severance agreements. The amount of severance for each of these positions shall be for one (1) year.

22.) Reserved.

23.) Direct special investigations for the Board.

24.) Keep current on changes in the laws and regulations affecting the Committee.

25.) Perform any other activities consistent with this Charter, PPH's Bylaws and governing law, to fulfill its responsibilities and duties.

26.) Ensure implementation of an annual customer satisfaction survey for the internal audit and compliance functions. The Director of Internal Audit and Compliance Officer will make quarterly reports to the Committee regarding the percent of implemented audit recommendations, areas where the audit and compliance functions can reduce costs, avoid risks, and enhance revenue.

27.) Periodically review PPH's ethics and compliance training program to determine the scope and effectiveness of the program and assess the return on its investment.

28.) Periodically review the compliance program's procedures for the receipt, retention, and treatment of complaints to ensure the procedures require actions that are responsive, corrective, and confidential.

29.) Receive periodic reports from the Compliance Officer on the implementation of the compliance program, including PPH's efforts to educate its employees on compliance issues, promote adherence to applicable laws and regulations, and investigate any alleged compliance violations reported

through the compliance program.

- 30.) Make any recommendations the Committee believes necessary and appropriate to the Board regarding changes to the compliance program.
- 31.) Periodically review, along with the Compliance Officer, or seek credible reports on specific risk exposures, the steps taken to monitor and mitigate exposure, and the compliance program's ability to identify such exposures.
- 32.) Periodically review, or seek credible reports on, the effectiveness of PPH's Compliance Program and how Administration measures the program's effectiveness.
- 33.) Review, in conjunction with the Director of Internal Audit, any known significant disputes between Administration and PPH's internal or external auditors concerning matters of regulatory and corporate compliance, as well as Administration's responses to those disputes.
- 34.) Monitor any audits or examinations by governmental or other regulatory agencies as applicable.
- 35.) Perform any other actions consistent with this Charter, Bylaws, or as the Board deems necessary.

IV. Outsourcing of Certain Investigations.

The Committee may utilize an independent investigator to review certain situations which may impair the objectivity of audit or compliance staff. This outsourcing will occur after the General Counsel consults with the Committee and Board, and the Board directs the General Counsel to hire an outside investigator. The following are examples of situations where the investigation may be outsourced. These situations are examples only and are not meant to limit the circumstances where an independent investigator may be used.

-Irregularities in travel and entertainment expenses incurred by Board and senior leadership. On an annual basis, the Director of Internal Audit will meet with the Internal Audit and Compliance Committee, and certify to the Committee that all travel expenses of the Board, CEO, and the Executive Management Team were appropriate.

-Allegations against senior leadership, including, but not limited to, inappropriate conduct, fraud, sexual harassment, and misappropriation of funds.

-Independent review of key decisions where PPH does not have sufficient staff to conduct the review, or where there may be a conflict of interest with current staff.

-Audit of governance activities/processes.

V. Scope of Authority.

The Board delegates to the Committee its power and authority to perform the duties and responsibilities under this Charter. The Committee may carry out any other responsibilities and duties delegated to it by the

Board. Administration is responsible for the preparation, presentation and integrity of PPH's financial statements as well as PPH's financial reporting process, accounting policies and procedures, internal accounting controls and disclosure controls and procedures. The independent auditor is responsible for conducting an annual audit of PPH's financial statements, and expressing an opinion as to the conformity of such annual financial statements with generally accepted accounting principles. The Compliance Officer is responsible for conducting an annual evaluation of PPH's Compliance Program, and expressing an opinion as to the conformity of the program with regulatory requirements. Each member of the Committee shall be entitled to rely on the integrity of those persons within PPH and of the professionals and experts from which the Committee receives information and, absent actual knowledge to the contrary, the accuracy of the financial and other information provided to the Committee by such persons, professionals or experts. It shall be within the purview of the Committee to request Internal Audit staff review subjects to be audited as appropriate.

VI. Reporting Relationships.

The General Counsel, the Director of Internal Audit, and the Compliance Officer shall have dual reporting relationships to both the CEO and the Committee. This is further described in the attached chart.

December 18, 2008



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October 31, 2008

The Audit Committee of Palomar Pomerado Health
15255 Innovation Drive Suite 202
San Diego, California 92128-3410
The Management of Palomar Pomerado Health
15255 Innovation Drive Suite 202
San Diego, California 92128-3410

Dear Members of the Audit Committee and Management:

In planning and performing our audit of the financial statements of Palomar Pomerado Health ("PPH") as of and for the year ended June 30, 2008 (on which we have issued our report dated October 31, 2008), in accordance with auditing standards generally accepted in the United States of America, we considered PPH's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of PPH's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of PPH's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, in connection with our audit, we have identified, and included in the attached Appendix, certain matters involving PPH's internal control over financial reporting that we consider to be significant deficiencies under standards established by the American Institute of Certified Public Accountants.

We have also identified, and included in the attached Appendix, other control deficiencies involving PPH's internal control over financial reporting as of June 30, 2008 that we wish to bring to your attention.

The definitions of a control deficiency and a significant deficiency are also set forth in the attached Appendix.

Although we have included management's written response to our comments in the attached Appendix, such responses have not been subjected to the auditing procedures applied in our audit and, accordingly, we do not express an opinion or provide any form of assurance on the appropriateness of the responses or the effectiveness of any corrective actions described therein.

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

Yours truly,

SECTION I — SIGNIFICANT DEFICIENCIES

We consider the following deficiencies in PPH's internal control over financial reporting to be a significant deficiency:

Financial Reporting Process — Review of Reconciliations and Financial Statements

Observation: Although management has taken steps to implement new policies and procedures, and has hired a new accounting manager to address issues raised in the prior years, we noted areas that still require improvements. The year-end reviews of several general ledger accounts were not properly or timely performed resulting in several audit adjustments. Examples of these areas include the following:

- Construction in progress (“CIP”) accounts - projects that remained open at year end were not adequately reviewed to ensure that all items were appropriately capitalized at year end. An immaterial amount of items were found to be inappropriately capitalized in fiscal year 2008. Additionally several invoices had not been accrued in fiscal year 2007. This resulted in a prior year error identified in the current year of approximately \$3.5 million.
- Certain invoices related to fiscal year 2008 had not been accrued in the accounts payable account as of year-end. Additionally, the pension expense accrual was not trued up at year end to reflect the actual liability balance.
- Certain other adjustments were identified that related to misclassification between long term and short term assets and liabilities such as for the Premier receivable balance, reclassification from assets to liabilities for the interest rate swap liability, identification of credit balances existing in asset accounts such as accounts receivable, and year end close entries of subsidiary ledgers to the general ledgers for the Foundation and Health Development.
- There was no documentation that the payroll suspense account reconciliation was approved by management.

Recommendation: Although employee turnover and the recent layoffs were part of the reason for the above issues noted, PPH should implement formal preparation and review procedures for the reconciliations of all significant general ledger accounts, and also require sign-off by the preparer and reviewer upon completion, particularly for high risk areas such as the payroll suspense accounts mentioned above. Formal procedures will enhance the accuracy of financial information and facilitate the improvement of segregation of duties. PPH should also consider performing many of these prior to year-end to facilitate a timelier year-end close.

In particular for CIP, PPH management reviews all CIP projects at the time the projects are completed and transferred for appropriate capitalization. However, this review is not performed at fiscal year end and the risk remains that there may be items recorded in CIP that should be expensed rather than capitalized under generally accepted accounting standards. PPH should perform a review of all open projects at year end, or more frequently, to ensure that CIP amounts are properly recorded. For accounts payable and CIP, management should ensure that a process is in place to capture invoices that are received after year end. Those invoices should be evaluated for materiality and to the extent they total to material amounts they should be accrued as part of a post-closing adjustment. Additionally, management should perform a review of accrued liabilities at year end to ensure they are reconciled and appropriately reflect the amounts owed.

Management's Response: Management acknowledges the audit recommendation in following closing procedures and agrees that processes regarding reconciliements will be strengthened to ensure appropriate reviews and approvals are obtained on a timely basis.

Financial Operations and the Project Managers are to conduct, at a minimum, annual reviews of open CIP accounts as stated per current procedures. Coordinated efforts between Finance, Project Management, and Facilities will be made to ensure that CIP accounts follow generally accepted accounting principles ("GAAP"). To this end, a newly created position of Project Accountant – Facilities Master Plan has been approved by Executive Management.

Additional procedures have been established and implemented to identify and accrue the open payables in accordance with GAAP.

Accounting for Significant Non-Routine Transactions

Observation: PPH continues to enter into complex transactions, which require knowledge of specific accounting guidance and literature. The dissolution of the Escondido Surgery Center Partnership ("ESC"), and the investment in PDP Pomerado LLC were two significant non-routine transactions that were identified in fiscal year 2008. The potential accounting impact of these items was not evaluated in a timely manner. The dissolution of the ESC triggered a requirement for a fair value analysis of the assets acquired and liabilities assumed to be performed. The investment in PDP Pomerado, LLC took place in April 2006, however was not identified and accounted for until fiscal year 2008.

Recommendation: Management should evaluate all significant transactions to ensure all accounting entries associated with the transactions are adequately posted to the financial statements in a timely manner. The above noted transactions were complex accounting transactions, and a process should be implemented to ensure the finance department is made aware of these transactions on a timely basis resulting in the appropriate and timely reporting in PPH's financial statements.

Management's Response: Finance Department will review Board minutes on a monthly basis to anticipate any significant business transactions that would require accounting treatment. Communication effectiveness between Administration and Finance will be reviewed for improvement.

SECTION II — OTHER CONTROL DEFICIENCIES

We identified the following other control deficiencies involving PPH's internal control over financial reporting as of June 30, 2008 that we wish to bring to your attention:

Password Configuration

Observation: Password configuration for Lawson and Cerner are not in line with PPH's password standards. The Apache portal which enables access to Lawson does not provide for any password configuration, and password complexity is not enabled for the Network Domain as it may cause technical issues and jeopardize some applications on the network (like Softmed and SSI). Additionally, the maximum password age is set at 180 days on Cerner and on the Network Domain. Further, password configuration for the Oracle and DB2 databases are not in line with PPH's password standards. There are no password settings configured within Oracle and, only minimum length (6 characters) and lockout (25 attempts) settings were configured on DB2. Weak password configuration may result in users creating weak passwords, which in-turn may result in unauthorized access to key financial and non-financial information. This may compromise the confidentiality and integrity of the financial and non-financial information. Given the regulatory requirements to maintain confidentiality of patient information and integrity of the financial information, any such instances may result in substantial liability and loss of reputation to PPH.

Recommendation: Management should implement stronger password controls over the Lawson and Cerner applications and over Oracle and DB2 databases and take appropriate steps to enable the “complexity” password setting. In addition, management should consider setting the maximum password age to a lower value as current best practices recommends a password age of 30-90 days long.

Management’s Response: Information Technology (“IT”) management will review the password configuration capabilities of the systems indicated. Modifications will be made as allowable by the systems. For those systems which complexity is limited, it will be noted as such. We have considered lowering our password age but believe the 180 days is best suited for our environment and staff. We anticipate completing modifications within 60 days.

Administrative Access to Cerner and Lawson

Observation: The following was noted with regard to the Cerner database and the operating system access:

- A large number of users (approximately 180) had inappropriate administrative access to Cerner.
- The Unix Administrators list, which lists all personnel with administrator access, included terminated employees and inactive contractors.

In addition, administrative access to databases was not restricted appropriately. A terminated employee user identification had administrative access to the Cerner database and an Internal Audit Manager had administrative access to the Lawson database.

If access is not appropriately restricted, unauthorized access to the system may occur resulting in loss of integrity and confidentiality of financial and non-financial information. Unauthorized use of user identifications relating to terminated users and inactive contractors may not enable accountability for inappropriate usage, if any.

Recommendation: Management should review the existing administrative access lists and perform a periodic access-list review over users with access to the Oracle and DB2 databases, the Cerner Application, and over Unix users to ensure ongoing appropriateness of the administrative access.

Management’s Response: IT management will review the administrator access list and take appropriate action against accounts. Any accounts that require special privileges will be noted. We will update our procedures and processes to ensure adequate on-going review. We anticipate completing modifications within the next 60 days.

SECTION V — OTHER MATTERS

Our observation concerning another matter related to best practices involving internal control over financial reporting that we wish to bring to your attention is as follows:

Periodic Review of Supplier Master File

Observation: There is no evidence that the supplier master file has been recently reviewed for any suppliers that have not been used for a significant period of time and which should be marked for deletion by the system.

Recommendation: Management should implement formal procedures in regards to regular reviews of the supplier master file for any suppliers that are no longer used so that these records are appropriately deleted. This will reduce the risk that inactive suppliers are accidentally used.

Management's Response: The Master Supplier Review procedure was developed and published 06/30/08 mandating annual review. Accounts Payable ("AP") has included this review in the 2008 calendar year-end task list.

SECTION VI — DEFINITIONS

The definitions of a control deficiency and a significant deficiency that are established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, are as follows:

A control deficiency 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 misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that even if the control operates as designed, the control objective is not always met. A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control over financial reporting.

* * * * *

