COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

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May 7, 2012

TO: Supervisor Zev Yaroslavsky, Chairman
Supervisor Gloria Molina
Supervisor Mark Ridley-Thomas
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: Wendy L. Watanabe
Auditor-Controller

SUBJECT: **DEPARTMENT OF HEALTH SERVICES' COMMUNITY HEALTH PLAN FINANCIAL AUDIT FOR THE YEARS ENDED JUNE 30, 2010, AND 2011**

Attached is the independent auditor's report on the financial statements of the Department of Health Services' (DHS) Community Health Plan (CHP) for the years ended June 30, 2010, and 2011. The audit was performed by Simpson & Simpson, Certified Public Accountants (Simpson).

California law requires the CHP and other managed care plans to submit annual financial statements that have been audited by an independent Certified Public Accountant to the State Department of Managed Health Care. The statements must be accompanied by an opinion on the fairness of the financial statement presentation. Simpson's opinion indicates that the financial statements present fairly CHP's financial position and operating results, as of, and for, the years ended June 30, 2010, and 2011. We confirmed CHP's audited financial statements have been submitted to the State Department of Managed Health Care, as required.

Simpson's report noted that, on March 29, 2011, your Board approved transitioning all of CHP's health plan operations to L.A. Care, and authorized DHS and the Chief Executive Officer to negotiate the transfer. The transfer has begun and will be completed by October 1, 2012.

Internal Control Review

Simpson indicated that, in completing their audit, they noted no matters involving CHP's internal controls for the year ended June 30, 2011. Simpson also reviewed the internal control matters noted in their prior audits, including security over CHP's Novell network system; the need to replace CHP's outdated Patient Management System; and CHP's ability to handle increased growth. CHP management indicated that implementation of some of the recommendations from the prior management letters were on hold due to the restructuring of CHP's operations.

Simpson discussed their report with CHP management. The details of Simpson's review of CHP's internal controls are included in the management letter, which will be sent to your Board separately.

Please call me if you have any questions, or your staff may contact Robert Campbell at (213) 253-0101.

WLW:JLS:RGC

Attachment

c: William T Fujioka, Chief Executive Officer
Mitchell H. Katz, M.D., Director, DHS
John Krattli, Acting County Counsel
Public Information Office
Audit Committee

Attachment

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN

Financial Statements for the
Years Ended June 30, 2011 and 2010
with Independent Auditor's Report

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
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INDEPENDENT AUDITOR'S REPORT

To the Board of Supervisors of
the County of Los Angeles

We have audited the accompanying balance sheets of the Los Angeles County Department of Health Services Community Health Plan (CHP) as of June 30, 2011 and 2010 and the related statements of income and changes in fund balances, and cash flows for the years then ended. These financial statements are the responsibility of CHP's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CHP as of June 30, 2011 and 2010 and the results of its operations, changes in its fund balances and its cash flows for the years then ended in conformity with generally accepted accounting principles in the United States of America.

As discussed in Note 11 to the financial statements, on March 29, 2011, the Los Angeles County Board of Supervisors approved the transition of all lines of CHP's business to L.A Care, and subsequently authorized the Director of Health Services to negotiate a Transition And Safety Net Support Agreement between Los Angeles County and L.A. Care. The execution of this agreement will effectively result in the discontinuance of CHP's health plan operations. The terms of the agreement have not been finalized as of the date of this report.

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In accordance with *Government Auditing Standards*, we have also issued a report dated December 23, 2011, on our consideration of the CHP's internal control over financial reporting and on 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* and should be considered in assessing the results of our audit.

Los Angeles, California
December 23, 2011

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Balance Sheet
June 30

ASSETS	**2011**	**2010**
Current assets:		
Cash and cash equivalents	$ 28,405,499	$ 21,802,272
Receivables (Note 3)	38,304,119	45,217,527
Prepaid expenses	2,273,266	1,965,404
Total current assets	68,982,884	68,985,203
Noncurrent assets:		
Long-term investments	303,504	303,504
Total noncurrent assets	303,504	303,504
TOTAL ASSETS	69,286,388	69,288,707
LIABILITIES AND FUND BALANCE		
Current liabilities:		
Accrued capitation	19,071,349	17,623,663
Claims payable (Note 4)	12,492,649	22,049,488
Accounts payable	3,599,204	2,385,204
Accrued salaries and related benefits	2,553,162	2,555,649
Amount due to Los Angeles County (Note 5)	9,165,400	7,968,403
Other liability (Note 6)	3,951,629	3,141,511
Total current liabilities	50,833,393	55,723,918
Fund balance:		
Restricted	4,868,625	4,650,952
Unrestricted	13,584,370	8,913,837
Total fund balance	18,452,995	13,564,789
TOTAL LIABILITIES AND FUND BALANCE	$ 69,286,388	$ 69,288,707

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

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Statement of Income and Changes in Fund Balance
For the Fiscal Years Ended June 30

	2011	2010
REVENUES		
Capitation premiums	$ 306,512,144	$ 284,744,845
OPERATING EXPENSES		
Cost of health care services:		
Capitation premiums	219,117,285	202,199,954
Medical services	16,382,915	21,130,754
Pharmacy	25,931,136	20,478,488
Medical supplies	62,921	112,133
Total cost of health care services	261,494,257	243,921,329
General and administrative:		
Salaries and employee benefits	12,912,883	13,369,155
Professional and consulting services	6,919,650	4,487,147
Rent	1,389,430	1,224,865
Office expense	4,363,511	6,127,681
Communications	1,578,001	807,277
Miscellaneous	-	413
Total general and administrative expenditures	27,163,475	26,016,538
Total operating expenses	288,657,732	269,937,867
OPERATING INCOME	17,854,412	14,806,978
OTHER REVENUES		
Interest income	336,964	242,958
Other revenues	75,134	1,559,599
Total other revenues	412,098	1,802,557
Net income	18,266,510	16,609,535
FUND BALANCE, beginning of year	13,564,789	17,274,611
Transfer to LA County (Note 7)	(13,378,304)	(20,319,357)
FUND BALANCE, end of year	$ 18,452,995	$ 13,564,789

The accompanying notes are integral part of these financial statements.

LOS ANGELES COUNTY
DEPARTMENT OF HEALTH SERVICES
COMMUNITY HEALTH PLAN
Statement of Cash Flows
For the Fiscal Years Ended June 30

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 18,266,510	$ 16,609,535
Adjustments to reconcile change in net income to net cash used by operating activities		
Changes in operating assets and liabilities:		
Decrease/(Increase) in receivables	6,913,408	(9,579,974)
Decrease in prepaid expense	(307,862)	(312,401)
Decrease/(Increase) in accrued capitation	1,447,686	(2,033,600)
(Decrease)/Increase in claims payable	(9,556,839)	8,651,445
Increase/(Decrease) in accounts payable	1,214,000	(567,761)
(Decrease) in accrued salaries and related benefits	(2,487)	(407,920)
Increase/(Decrease) in amount due to Los Angeles County	1,196,997	(2,793,019)
Increase in other liability	810,118	1,857,617
Net cash provided by operating activities	19,981,531	11,423,922
CASH FLOWS FROM FINANCING ACTIVITIES		
Transfer to Los Angeles County	(13,378,304)	(20,319,357)
Net cash used by financing activities	(13,378,304)	(20,319,357)
Net increase/(decrease) in cash and cash equivalents	6,603,227	(8,895,435)
Cash and cash equivalents, beginning of the year	21,802,272	30,697,707
Cash and cash equivalents, end of the year	$ 28,405,499	$ 21,802,272

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

NOTE 1 – ORGANIZATION AND NATURE OF BUSINESS

The Community Health Plan (CHP) is the Medi-Cal health maintenance organization (HMO) owned and operated by the Los Angeles County Department of Health Services (DHS). It is a federally qualified HMO and is licensed as a prepaid full service health care service plan by the State of California Department of Managed Health Care under the Knox-Keene Health Care Service Plan Act of 1975. CHP provides health care services at low or no cost through the State's Medi-Cal Managed Care and Healthy Families Program and the Personal Assistance Services Council - Service Employees International Union (PASC-SEIU) Homecare Worker Health Care Plan (See Note 11).

Medi-Cal Managed Care

CHP is one of five Plan Partners contracting with L.A. Care Health Plan, the Local Health Initiative for Medi-Cal Managed Care in Los Angeles County. CHP has over 1300 primary care physicians, over 1,500 pharmacies, including the chain of Rite-Aid stores, and more than a thousand specialists in the Medi-Cal provider network. Under the Medi-Cal program there is no cost to the member for covered services and no co-payments. Effective January 1, 2012, all Medi-Cal enrollees will be transitioned to L.A Care Health Plan (See Note 11).

Healthy Families Program

CHP contracts with the State Managed Risk Medical Insurance Board (MRMIB) to participate as a Healthy Families Program provider. The Healthy Families Program provides comprehensive health, dental and vision coverage to children in families with incomes at or below 250% of the Federal Poverty Level. Since the program began in 1998, Community Health Plan has been designated the Community Provider Plan for Los Angeles County for the provision of health coverage. Effective September 30, 2012, the MRMIB contract will end and the Healthy Families enrollees will not transition to L.A Care Health Plan (See Note 11).

PASC-SEIU Homecare Worker Health Care Plan

Effective April 1, 2002, the PASC-SEIU Homecare Worker Health Care Plan was implemented to provide health services to eligible In-Home Supportive Services (IHSS) Workers. The plan provides IHSS Workers access to a provider network comprised of Los Angeles County Department of Health Services facilities and contract providers. Effective February 1, 2012, all In-Home Supportive Services Health enrollees will be transitioned to L.A Care Health Plan (See Note 11).

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

As a managed health care organization, CHP derives the majority of its revenues from capitation premiums received for providing prepaid health services and prepares its financial statements in accordance with the AICPA Audit and Accounting Guide for "Health Care Organizations." The following is a summary of significant accounting policies used in the preparation of the accompanying consolidated financial statements. Such policies are in accordance with accounting principles generally accepted in the United States of America and have been consistently applied. The preparation of financial statements in conformity with generally accepted accounting principles 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 for each reporting period. The significant estimates made in the preparation of CHP's financial statements relate to the assessment of the carrying value of claims payable and contingent liabilities. While management believes that the carrying value of such assets and liabilities is adequate as of June 30, 2011 and 2010, actual results could differ from the estimates upon which the carrying values were based.

Basis of Presentation - Fund Accounting

The accounts of the County are organized on the basis of funds and account groups, each of which is a separate accounting entity. Each fund is accounted for through a separate set of accounts that comprise its assets, liabilities, fund equity, revenues and expenditures or expenses, as appropriate. CHP, **an enterprise activity**, is reported under the general fund of the County of Los Angeles. General fund is used to account for all financial resources except those required to be accounted for in another fund. Resources or expenditures not restricted for a particular purpose are accounted for in the general fund.

Accounting Standards

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting, CHP has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989.

Concentration of Source of Revenues

CHP received approximately 58% of its premium revenues under service agreements with L.A. Care Health Plan for both fiscal years ended June 30, 2011 and 2010.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents

Cash and cash equivalents consist of CHP's equity portion of the Los Angeles County cash and investment pool. Funds received by CHP are deposited into the cash and investment pool for which the County Treasury is the depository. Funds deposited in the pool are similar in nature to demand deposits, (i.e., funds may be deposited and withdrawn at any time without prior notice or penalty). Interest earned on the pooled funds is accrued in a pooled interest apportionment fund and is allocated based on the average daily cash balances of the fund. The average annual interest rates earned on CHP's deposits during fiscal years ended June 30, 2011 and 2010 were approximately 1.29% and 1.16%, respectively. As of June 30, 2011 and 2010, substantially all investments in the County investment pool were U.S. government securities, bankers' acceptances and negotiable certificates of deposit.

Long-Term Investments

Long-term investments consist of restricted investments on deposit with the California Department of Managed Health Care (DMHC). These investments consist of U.S. Treasury securities, and due to their restricted nature, are classified as long-term without regard to contractual maturity. Market values approximate carrying values as of June 30, 2011 and 2010.

Claims Reimbursement Receivable

Claims reimbursement receivable are claims for capitated services paid by CHP that are reimbursable from the contracted medical groups and hospitals. Management believes that uncollectible amounts, if any, will not be material to the financial statements.

Accrued Capitation

CHP pays capitation premiums to the contracted medical groups and hospitals in arrears on a per member per month basis. Accrued capitation consists of capitation payments due the contracted medical groups and hospitals.

Claims Payable

The liability for claims payable includes adjudicated claims, claims pending adjudication and a provision for incurred but not reported claims. The amount payable for the claims pending adjudication is reduced by an allowance for denied claims estimated based on paid/denied ratio of claims closed during the year. The provision for incurred but not reported claims is estimated using a lag study based upon historical data including the period between the date services are rendered and the date claims are received and paid and denied claim activity. The estimate for incurred but not reported claims is made on an accrual basis and adjusted in future periods as required.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Any adjustments to the prior period estimates are included in the current period. Such estimates are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided. While the ultimate amount of claims and losses paid are dependent on future developments, management is of the opinion that the recorded reserves are adequate to cover such costs. These liabilities are reduced by estimated amounts recoverable from contracted health care providers.

Fund Balance

Fund balances are reported as restricted when constraints placed on its use are either: (1) externally imposed by creditors, grantors, contributors or laws or regulations of other governments, or (2) imposed by law through constitutional provisions or enabling legislation. CHP's restricted fund balance consists of the amounts required to satisfy the deposit and tangible net equity requirements of the Department of Managed Health Care as of June 30, 2011 and 2010 (see Note 7 and 12).

Premium Revenues

CHP's premium revenues are capitation payments received for plan enrollees on a per member per month basis. Premiums are recognized as revenue in the month in which the members are entitled to service.

Cost of Health Care Services

CHP contracts with various medical groups to provide professional care to its members on a capitated, or fixed per member per month fee basis. Capitation contracts generally include a provision for stop-loss and non-capitated services for which CHP is liable. Additionally, CHP contracts with certain hospitals to provide hospital care to enrolled members on a capitation basis.

The cost of health care services is recognized in the period in which services are provided and includes an estimate of the cost of services which have been incurred but not yet reported. Such costs include capitation payments to contracted medical groups and hospitals for primary care, specialty and hospital services and the cost of non-capitated medical services, pharmacy and medical supplies.

Fair Value of Financial Instruments

The estimated fair value amounts of cash equivalents and long-term investments approximate their carrying amounts in the financial statements and have been determined by CHP using available market information and appropriate valuation methodologies. The carrying amounts of cash equivalents approximate fair value due to the similarity in its nature to demand deposits. The fair values of long-term investments are estimated based on quoted market prices and dealer quotes for similar investments.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Tax

As an operating division of the County, CHP is exempt from State and Federal income taxes.

NOTE 3 – RECEIVABLES

Receivables are comprised of interest receivable, capitation premiums receivable, Quality Improvement Funding receivable and claims reimbursement receivable from health care service providers. As of June 30, 2011 and 2010, receivables consisted of the following:

	2011	2010
Capitation premiums receivable	$ 21,220,345	$ 21,746,555
Claims reimbursement receivable	14,416,564	22,233,299
Interest receivable	62,352	41,514
Quality Improvement Funding receivable	876,602	-
Other receivable	1,728,256	1,196,159
	$ 38,304,119	$ 45,217,527

NOTE 4 – CLAIMS PAYABLE

Claims payable are comprised of claims payable, claims pending adjudication and a liability for claims incurred but not yet received, reduced by management's estimate of the amount that will be denied and the amount that will be recoverable from contracted providers. As of June 30, 2011 and 2010, claims payable consisted of the following:

	2011	2010
Claims payable/pending adjudication	$ 46,074,110	$ 28,791,002
Claims incurred but not received	8,619,605	19,507,999
Claims payable	164,573	82,441
Less: Allowance for denied claims	(42,365,639)	(26,331,954)
	$ 12,492,649	$ 22,049,488

NOTE 5 – AMOUNT DUE TO LOS ANGELES COUNTY

Cash disbursements for CHP are made from the general fund of Los Angeles County Department of Health Services (DHS). CHP transfers funds periodically to the general fund from its County cash and investment pool to reimburse the general fund or to fund its projected cash disbursements. The amount due to Los Angeles County consists of the amount owed to the DHS general fund and the amount due other County funds for services such as telephone, rent and information system support. As of June 30, 2011 and 2010, the amount due to Los Angeles County consisted of the following:

NOTE 5 – AMOUNT DUE TO LOS ANGELES COUNTY (Continued)

	2011	2010
Amount due to Los Angeles County funds	$9,165,400	$7,968,403

NOTE 6 – OTHER LIABILITY

Other liability is comprised of claims settlements, pay-for-performance, and incentive payment to Department of Health Service passed through CHP. As of June 30, 2011 and 2010, other liabilities consisted of the following:

	2011	2010
Claims Settlements	$ 2,395,256	$ 520,855
Pay-for-Performance Program	1,556,373	2,532,706
Incentive Payment	-	87,950
	$ 3,951,629	$ 3,141,511

NOTE 7 – TRANSFER TO LOS ANGLES COUNTY

CHP transfers funds in excess of 150% of the total net equity to the general fund of DHS. During the fiscal years ended June 30, 2011 and 2010, the total transfer to DHS amounted to $13,378,304 and $20,319,357, respectively.

NOTE 8 – RETIREMENT PLAN

The County's retirement plan covers CHP's employees and provides for monthly pension payments to eligible employees upon retirement. Salaries and employee benefits expense includes a provision for the retirement plan cost, as well as vacation and sick pay, which is estimated based on a percentage of salaries expense. The actual cost of the retirement plan, actuarial present value of accumulated retirement plan benefits, and net assets available for retirement plan benefits are not separately identifiable for CHP.

NOTE 9 – REGULATORY REQUIREMENTS

CHP, as a California licensed health service plan, is regulated by the State of California Department of Managed Health Care (DMHC). Title 28 of the Code of California Regulations requires that CHP maintain certain deposits assigned to the Director of the DMHC and comply with certain minimal capital or tangible net equity requirements. Management believes that as of June 30, 2011 and 2010, CHP met its regulatory requirements.

NOTE 10 – CONTINGENCIES

The County has agreed to fund CHP's losses, if any, and to cover CHP under its self-insured medical malpractice program when medical services are provided at a County facility. In addition, the County has agreed to cover CHP under its self-insured workers' compensation program. These coverages are provided to CHP at no cost.

NOTE 11 – CHP'S DISCONTINUATION OF ITS OPERATIONS-TRANSISTION AND SAFETY NET SUPPORT AGREEMENT WITH L.A. CARE HEALTH PLAN

On March 29, 2011 the Los Angeles County Board of Supervisors (Board) approved the Director's of DHS recommendation that all lines of the CHP business be transferred from CHP to L.A. Care and that L.A. Care assume all health plan functions. This transition is to occur gradually over the subsequent year and will eventually result in CHP's discontinuation as a managed care health plan.

On November 8, 2011 the Board authorized the Director of Health Services to execute an agreement with L.A. Care to structure a long term financial relationship between L.A. Care and the County of Los Angeles and to provide for the orderly transfer of health plan operations from CHP to L.A. Care, effective on the date of Board's approval through December 31, 2021.

As of the date of this report, the Director of Health Services is still in negotiations with L.A. Care to finalize the transition agreement. The primary value of CHP to DHS over the years has been the revenue it brings in for patients who receive their care in the DHS system. Thus, in negotiating the long term agreement, the parties will focus on the elements which will provide the basis for ongoing funding for DHS.

The financial terms for the financial support from L.A. Care Health Plan to DHS are confidential and not subject to disclosure. These provisions are protected as proprietary and also subject to Section 1457 of the Health and Safety Code, among other confidential provisions and public record exemptions. The agreement will include the following provisions:

1. Mutual indemnification between the parties,
2. The County will retain financial and other legal responsibilities as appropriate prior to the transition date. L.A. Care will assume financial and other legal health plan responsibilities thereafter,
3. Each party will maintain certain recordkeeping responsibilities as appropriate,
4. The parties will establish payment to the County of any of its CHP accounts receivables that exist following the transition date(s).

Additionally, this transition will include a separate agreement between DHS and L.A. Care which will establish DHS as a contracted provider for the CHP members to be transitioned to L.A. Care.

CHP has the preferred community provider plan designation for Healthy Family Enrollees for the contract year beginning October 1, 2011. Thus, these enrollees cannot be transitioned to L.A. Care

and CHP must continue as an operating Knox-Keene licensed health plan through September 30, 2012. On this date, CHP will cease to be the designated Community Provider Plan for the Healthy Families Program.

NOTE 12 – RESTRICTED FUND BALANCE

As a result of CHP's transition the restricted fund balance will be held until May 2013, to ensure that all claims and other liabilities are paid when due. The remaining restricted funds will be transferred to DHS (See Note 11).

NOTE 13 – SUBSEQUENT EVENTS

The CHP has evaluated events or transactions that occurred subsequent to June 30, 2011 through December 23, 2011, the date the accompanying financial statements were available to be issued, for potential recognition or disclosure in the financial statements and determined no subsequent matters require disclosure or adjustment to the accompanying financial statements.

SIMPSON & SIMPSON
CERTIFIED PUBLIC ACCOUNTANTS

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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 Supervisors of
County of Los Angeles

We have audited the financial statements of the **Los Angeles County Department of Health Services Community Health Plan** (CHP) as of and for the fiscal years ended June 30, 2011 and 2010, and have issued our report thereon, dated December 23, 2011. 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

In planning and performing our audit, we considered the CHP's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the CHP's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the CHP's internal control over financial reporting.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the CHP'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*.

We noted no certain matters that we reported to management of the CHP for fiscal year ending June 30, 2011. However, management updated the status of previous matters in a separate letter dated December 23, 2011.

This report is intended solely for the information and use of the County of Los Angeles, management, and the State of California Department of Managed Health Care and is not intended to be and should not be used by anyone other than these specified parties.

Simpson & Simpson

Los Angeles, California
December 23, 2011

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