

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

AUDITED FINANCIAL REPORT

**FOR THE YEARS ENDED
DECEMBER 31, 2008, 2007, 2006, 2005, 2004 AND 2003**

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Table of Contents

	<u>Page</u>
FINANCIAL SECTION	
Independent Auditor’s Report.....	1-2
Statement of Net Assets – Modified Cash Basis	3-4
Statement of Revenues, Expenses and Changes in Net Assets – Modified Cash Basis	5-6
Notes to Financial Statements.....	7-11
OTHER REPORT	
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	12-13

FINANCIAL SECTION



INDEPENDENT AUDITOR'S REPORT

Board of Directors
County of Mendocino Health Plan
Ukiah, California

We have audited the accompanying financial statements of the County of Mendocino Health Plan (Health Plan), an internal service fund of the County of Mendocino, California, as of and for the years ended December 31, 2008, 2007, 2006, 2005, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the management of the County of Mendocino Health Plan. Our responsibility is to express opinions 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 of material misstatement. An audit includes consideration of 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 the Health Plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the Health Plan prepares its financial statements on the modified cash basis, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

As discussed in Note 1, the financial statements present only the County of Mendocino Health Plan internal service fund, and are not intended to present fairly the financial position – modified cash basis of the County of Mendocino, California, and the changes in its financial position – modified cash basis in conformity with the basis of accounting described in Note 1.

Board of Directors
County of Mendocino Health Plan
Ukiah, California

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position – modified cash basis of the County of Mendocino Health Plan as of December 31, 2008, 2007, 2006, 2005, 2004 and 2003, and the respective changes in financial position – modified cash basis for the years then ended in conformity with the basis of accounting described in Note 1.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 3, 2009, on our consideration of the County of Mendocino Health Plan'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* and should be considered in assessing the results of our audit.

Gallina LLP

Roseville, California
August 3, 2009

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Statement of Net Assets - Modified Cash Basis
December 31, 2008, 2007, 2006, 2005, 2004, and 2003

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Liabilities			
Current Liabilities:			
Due to County of Mendocino	\$ 990,738	\$ 1,451,986	\$ 491,139
Total current liabilities	<u>990,738</u>	<u>1,451,986</u>	<u>491,139</u>
Noncurrent liabilities:			
Benefit claims liability	<u>1,980,869</u>	<u>1,835,531</u>	<u>1,662,013</u>
Total noncurrent liabilities	<u>1,980,869</u>	<u>1,835,531</u>	<u>1,662,013</u>
 Total Liabilities	 <u>2,971,607</u>	 <u>3,287,517</u>	 <u>2,153,152</u>
Net Assets (Deficits)			
Unrestricted	<u>(2,971,607)</u>	<u>(3,287,517)</u>	<u>(2,153,152)</u>
 Total Liabilities and Net Assets	 <u>\$ --</u>	 <u>\$ --</u>	 <u>\$ --</u>

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

continued

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Statement of Net Assets - Modified Cash Basis
December 31, 2008, 2007, 2006, 2005, 2004, and 2003

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Liabilities			
Current Liabilities:			
Due to County of Mendocino	\$ 426,894	\$ 936,921	\$ 1,036,703
Total current liabilities	<u>426,894</u>	<u>936,921</u>	<u>1,036,703</u>
Noncurrent liabilities:			
Benefit claims liability	<u>1,384,818</u>	<u>1,800,000</u>	<u>1,380,000</u>
Total noncurrent liabilities	<u>1,384,818</u>	<u>1,800,000</u>	<u>1,380,000</u>
 Total Liabilities	 <u>1,811,712</u>	 <u>2,736,921</u>	 <u>2,416,703</u>
Net Assets (Deficits)			
Unrestricted	<u>(1,811,712)</u>	<u>(2,736,921)</u>	<u>(2,416,703)</u>
 Total Liabilities and Net Assets	 <u>\$ --</u>	 <u>\$ --</u>	 <u>\$ --</u>

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

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Statement of Revenues, Expenses,
and Changes in Fund Net Assets
Modified Cash Basis

For the Years Ended December 31, 2008, 2007, 2006, 2005, 2004, and 2003

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Operating Revenues:			
County contributions	\$ 9,682,862	\$ 8,660,427	\$ 7,920,402
Employee contributions	<u>3,335,486</u>	<u>2,339,688</u>	<u>2,189,839</u>
 Total Operating Revenues	 <u>13,018,348</u>	 <u>11,000,115</u>	 <u>10,110,241</u>
Operating Expenses:			
Health care benefits	11,692,252	11,251,255	9,453,237
Claims liability change	145,338	173,518	277,195
Wellness program	151,513	82,855	161,908
Administrative costs			
Salaries and benefits	121,734	69,522	84,441
Insurance	57,640	51,376	47,074
Third party administrative and other professional services	481,592	456,243	411,126
Other	<u>10,834</u>	<u>8,486</u>	<u>7,156</u>
 Total Operating Expenses	 <u>12,660,903</u>	 <u>12,093,255</u>	 <u>10,442,137</u>
Operating Income (Loss)	<u>357,445</u>	<u>(1,093,140)</u>	<u>(331,896)</u>
Non-Operating Revenues (Expenses):			
Contribution from County of Mendocino	--	--	--
Investment expense	<u>(41,535)</u>	<u>(41,225)</u>	<u>(9,544)</u>
 Total Non-Operating Revenues (Expenses)	 <u>(41,535)</u>	 <u>(41,225)</u>	 <u>(9,544)</u>
Change in net assets	315,910	(1,134,365)	(341,440)
Net assets (deficits), beginning of year	<u>(3,287,517)</u>	<u>(2,153,152)</u>	<u>(1,811,712)</u>
Net assets (deficits), end of year	<u>\$ (2,971,607)</u>	<u>\$ (3,287,517)</u>	<u>\$ (2,153,152)</u>

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

continued

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Statement of Revenues, Expenses,
and Changes in Fund Net Assets
Modified Cash Basis

For the Years Ended December 31, 2008, 2007, 2006, 2005, 2004, and 2003

	2005	2004	2003
Operating Revenues:			
County contributions	\$ 7,717,135	\$ 7,764,473	\$ 6,838,663
Employee contributions	2,188,801	2,176,532	2,420,302
Total Operating Revenues	9,905,936	9,941,005	9,258,965
Operating Expenses:			
Health care benefits	8,741,283	9,166,536	10,021,822
Claims liability change	(415,182)	420,000	33,000
Wellness program	157,994	133,423	193,300
Administrative costs			
Salaries and benefits	58,359	65,502	45,608
Insurance	58,923	59,362	73,197
Third party administrative and other professional services	355,882	400,553	481,834
Other	9,790	6,898	7,863
Total Operating Expenses	8,967,049	10,252,274	10,856,624
Operating Income (Loss)	938,887	(311,269)	(1,597,659)
Non-Operating Revenues (Expenses):			
Contribution from County of Mendocino	--	--	3,170,000
Investment expenses	(13,678)	(8,949)	(32,797)
Total Non-Operating Revenues (Expenses)	(13,678)	(8,949)	3,137,203
Change in net assets	925,209	(320,218)	1,539,544
Net assets (deficits), beginning of year	(2,736,921)	(2,416,703)	(3,956,247)
Net assets (deficits), end of year	\$ (1,811,712)	\$ (2,736,921)	\$ (2,416,703)

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

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Notes to Financial Statements
For the Years Ended December 31, 2008, 2007, 2006, 2005, 2004 and 2003

Note 1: **Summary of Significant Accounting Policies**

A. Reporting Entity

The County of Mendocino provides health care benefits to eligible employees. The County of Mendocino Health Plan (Health Plan) is fully self-insured by the County and is available to current employees.

The Health Plan is reflected in the County of Mendocino Annual Financial Report as an internal service fund and is administered by the Human Resources Department of the County. The Health Plan also provides life, accidental death, vision, and dental coverage.

Employees are eligible if they are full-time employees or are employed in a permanently allocated position in County service. Employee and employer (the County) contributions are intended to be, respectively, 25% and 75% of Health Plan expenses. The County's contribution to the Health Plan is paid out of current available resources and is funded on a pay-as-you-go basis. Employee contribution amounts are determined by plan choice and spouse or dependent coverage. The amount of the contributions is determined annually by Mercer Health and Benefits, hired as a third-party health plan consultant/actuary.

B. Basis of Presentation and Accounting

The accompanying financial statements of the Health Plan have been prepared on the modified cash basis of accounting. Under that basis, revenues and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. That basis differs from generally accepted accounting principles primarily because the Health Plan has not recognized capital assets and related depreciation expense; accounts receivable from members and contributors and accounts payable to vendors and their related effects on changes in net assets in the accompanying financial statements.

All activities of the Health Plan are accounted for within an internal service fund of the County. Internal service funds are used to account for operations that provide services to other departments or agencies of the government, or to other governments, on a cost-reimbursement basis.

Internal service funds distinguish operating revenues and expenses from non-operating items. Principal operating revenues consist of charges to the general fund of the County of Mendocino and participating employees. Operating expenses include the cost of services and administrative expenses. All revenue and expenses not meeting this definition are reported as non-operating revenues and expenses.

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Notes to Financial Statements (continued)
For the Years Ended December 31, 2008, 2007, 2006, 2005, 2004 and 2003

Note 1: **Summary of Significant Accounting Policies** (continued)

B. Basis of Presentation and Accounting (continued)

The Health Plan has elected under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, to apply all applicable GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board, the Accounting Principles Board or any Accounting Research Bulletins issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The GASB periodically updates its codification of the existing Governmental Accounting and Financial Reporting Standards which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes GAAP for governmental units.

C. Net Assets

Net assets comprise the various net earnings from operating and non-operating revenues, expenses and contributions of capital. Under the modified cash basis, net assets are classified as restricted and unrestricted net assets. Restricted net assets consists of net assets for which constraints are placed thereon by external parties, such as lenders, grantors, contributors, laws, regulations and enabling legislation, including self-imposed legal mandates. Unrestricted net assets consists of all other net assets not included in restricted net assets.

When both restricted and unrestricted resources are available for use, it is the Health Plan's policy to use restricted resources first, then unrestricted resources as they are needed.

D. Estimates

The preparation of financial statements in conformity with the modified cash basis, a comprehensive basis of accounting other than generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates.

Note 2: **Cash and Investments**

Cash balances at year end are reported on the Statement of Net Assets – Modified Cash Basis as Due to County of Mendocino.

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Notes to Financial Statements (continued)
For the Years Ended December 31, 2008, 2007, 2006, 2005, 2004 and 2003

Note 2: Cash and Investments (continued)

The Health Plan maintains a portion of its cash and investments with the Mendocino County Treasurer in an investment pool. On a quarterly basis the Treasurer allocates interest to participants based upon their average daily balances. Required disclosure information regarding categorization of investments and other deposit and investment risk disclosures can be found in the County's financial statements. The County of Mendocino's financial statements may be obtained by contacting the County of Mendocino Auditor-Controller's office at 501 Low Gap Road, Room 1080, Ukiah, CA 95482.

Required disclosures for the Health Plan's deposit and investment risks at December 31, 2008, 2007, 2006, 2005, 2004 and 2003 were as follows:

	2008	2007	2006	2005	2004	2003
Credit risk	Not available	Not available	Not available	Not available	Not available	Not available
Custodial risk	Not available	Not available	Not available	Not available	Not available	Not available
Concentration of credit risk	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable	Not applicable
Interest rate risk	Not available	Not available	Not available	Not available	Not available	Not available

Investments held in the County's investment pool are available on demand and are stated at cost plus accrued interest, which approximates fair value.

The Health Plan also maintains an external bank account used by the third party administrator to pay medical claims. Balances for this account are not included in the accompanying financial statements. The funds are available for their designated purpose immediately.

Note 3: Contribution from County of Mendocino

In 2003, the County of Mendocino transferred \$3,170,000 to the Health Plan to address a significant deficit in the fund. This transfer was not intended to be repaid by the Health Plan, and was also not intended to be repeated in the future.

Note 4: Deficit Net Assets

The Health Plan has had deficit net assets each year under audit, primarily as a result of the benefit claims liability as well as rising costs of health insurance benefits. The Health Plan operates on a pay-as-you-go basis, and also intends to establish a reserve account to provide adequate funding for the outstanding benefit claims liability.

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Notes to Financial Statements (continued)
For the Years Ended December 31, 2008, 2007, 2006, 2005, 2004 and 2003

Note 5: Insurance

The Health Plan maintains insurance coverage to address a variety of risks. The Health Plan participates in the CSAC Excess Insurance Authority excess liability insurance program. "All risk" coverage for physical loss and damage, including flood and earthquake, is maintained through participation in the CSAC Excess Insurance Authority. The Health Plan is entirely self-insured for unemployment claims. Settlement amounts did not exceed commercial insurance coverage for the years presented. Insurance limits for the various plans and coverage are summarized below for the years ending December 31:

	2008	2007	2006	2005	2004	2003
Worker's compensation:						
Primary	\$125,000 per occurrence	\$125,000 per occurrence	\$125,000 per occurrence	\$125,000 per occurrence	\$125,000 per occurrence	\$125,000 per occurrence
Excess	Up to \$5,000,000	Up to \$5,000,000	Up to \$5,000,000	Up to \$5,000,000	Up to \$5,000,000	Up to \$5,000,000
General liability and automobile:						
Self-insured	Up to \$150,000	Up to \$150,000	Up to \$150,000	Up to \$150,000	Up to \$150,000	Up to \$150,000
Excess	\$150,000 - \$10,000,000	\$150,000 - \$10,000,000	\$150,000 - \$10,000,000	\$150,000 - \$10,000,000	\$150,000 - \$10,000,000	\$150,000 - \$10,000,000
All risk:						
Self-insured	Up to \$10,000	Up to \$10,000	Up to \$10,000	Up to \$10,000	Up to \$10,000	Up to \$10,000
Excess	\$10,000 - \$600,000,000	\$10,000 - \$600,000,000	\$10,000 - \$600,000,000	\$10,000 - \$600,000,000	\$10,000 - \$600,000,000	\$10,000 - \$600,000,000
Hospital malpractice:						
Self-insured	Up to \$5,000	Up to \$5,000	Up to \$5,000	Up to \$5,000	Up to \$5,000	Up to \$5,000
Excess	\$5,000 - \$21,500,000	\$5,000 - \$21,500,000	\$5,000 - \$21,500,000	\$5,000 - \$21,500,000	\$5,000 - \$21,500,000	\$5,000 - \$21,500,000
Health insurance:						
Self-insured	Up to \$175,000 per occurrence	Up to \$175,000 per occurrence	Up to \$175,000 per occurrence	Up to \$175,000 per occurrence	Up to \$175,000 per occurrence	Up to \$175,000 per occurrence
Stop loss - individual	\$175,000 - \$2,000,000 lifetime maximum	\$175,000 - \$2,000,000 lifetime maximum	\$175,000 - \$1,000,000 lifetime maximum	\$175,000 - \$1,000,000 lifetime maximum	\$175,000 - \$1,000,000 lifetime maximum	\$175,000 - \$825,000 lifetime maximum
Stop loss - aggregate	125% of expected claims, maximum \$1 million	125% of expected claims, maximum \$1 million	125% of expected claims, maximum \$1 million	125% of expected claims, maximum \$1 million	125% of expected claims, maximum \$1 million	N/A

Note 6: Benefit Claims Liability

Benefit claims liability represents the liability for current unfiled claims and those claims that have been filed but not yet approved for payment. Mercer Health and Benefits, a third party consultant, annually prepares the liability estimate used in financial reporting. Liability for unpaid claims is subject to change due to future re-estimations of claims, inflation, and changes in laws and regulations.

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Notes to Financial Statements (continued)

For the Years Ended December 31, 2008, 2007, 2006, 2005, 2004 and 2003

Note 6: **Benefit Claims Liability** (continued)

Changes in the balance of claims liabilities for the years ended December 31, 2008, 2007, 2006, 2005, 2004, and 2003 for benefits are approximately as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Claims liability, January 1	\$ 1,835,531	\$ 1,662,013	\$ 1,384,818	\$ 1,800,000	\$ 1,380,000	\$ 1,347,000
Current year claims and changes in estimates	9,435,056	9,494,839	8,072,875	6,720,347	8,309,310	8,978,203
Benefit claim payments	<u>(9,289,718)</u>	<u>(9,321,321)</u>	<u>(7,795,680)</u>	<u>(7,135,529)</u>	<u>(7,889,310)</u>	<u>(8,945,203)</u>
Claims liability, December 31	<u>\$ 1,980,869</u>	<u>\$ 1,835,531</u>	<u>\$ 1,662,013</u>	<u>\$ 1,384,818</u>	<u>\$ 1,800,000</u>	<u>\$ 1,380,000</u>

Note 7: **Employees Retirement Plan (Defined Benefit Pension Plan)**

As an internal service fund of the County of Mendocino, employees of the Health Plan participate in the County's multiple employer defined benefit pension plan, the Mendocino County Retirement Association. Employees of the Health Plan contributed to the plan as follows:

<u>Year Ended December 31,</u>	<u>Amount</u>
2008	\$11,240
2007	6,958
2006	9,120
2005	6,285
2004	6,163
2003	3,864

The Mendocino County Retirement Association issues a separate annual financial report. Copies of the report may be obtained from the Auditor-Controller's Office of the County of Mendocino.

OTHER REPORT



GALLINA LLP

CERTIFIED PUBLIC ACCOUNTANTS

**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***

Board of Directors
County of Mendocino Health Plan
Ukiah, California

We have audited the financial statements of County of Mendocino Health Plan (Health Plan), an internal service fund of the County of Mendocino, as of and for the years ended December 31, 2008, 2007, 2006, 2005, 2004 and 2003, and have issued our report thereon dated August 3, 2009. 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 Health Plan's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of the Health Plan's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Health Plan's internal control over financial reporting.

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 significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Health Plan'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 Health Plan's financial statements that is more than inconsequential will not be prevented or detected by the Health Plan's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Health Plan's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be 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.

Board of Directors
County of Mendocino Health Plan
Ukiah, California

Compliance and Other Matters

As part of obtaining reasonable assurance about whether County of Mendocino Health Plan'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 certain matters that we reported to management of the Health Plan in a separate letter dated August 3, 2009.

This report is intended solely for the information and use of the County of Mendocino Health Plan's management, others within the entity, and federal and state agencies and is not intended to be and should not be used by anyone other than these specified parties.

Gallina LLP

Roseville, California
August 3, 2009

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Management Report

**For the Years Ended December 31, 2008,
2007, 2006, 2005, 2004, and 2003**

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Management Report
For the Years Ended December 31, 2008, 2007, 2006, 2005, 2004, and 2003

Table of Contents

	<u>Page</u>
Introduction.....	1-2
Required Communication	3-5
 <u>Current Year Recommendations</u>	
Cash in Bank	6



GALLINA LLP
CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
County of Mendocino Health Plan
Ukiah, California

In planning and performing our audit of the basic financial statements of the County of Mendocino Health Plan (Health Plan) for the fiscal years ended December 31, 2008, 2007, 2006, 2005, 2004, and 2003, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on internal control.

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 significant deficiency is a control deficiency, or a 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.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls.

During our audit we became aware of other matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions regarding those matters. We previously reported on the Health Plan's internal control in our report dated August 3, 2009. This letter does not affect our report dated August 3, 2009 on the financial statements of the County of Mendocino Health Plan.

Board of Directors
County of Mendocino Health Plan
Ukiah, California

County of Mendocino Health Plan's management has provided responses to the comment described in the memorandum that accompanies this letter. We did not audit the Health Plan's responses and accordingly, we express no opinion on it.

This report is intended for the use of management, the Board of Directors, and the County of Mendocino Health Plan, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

We thank the Health Plan's staff for its cooperation during our audit.

Gallina LLP

Roseville, California
August 3, 2009

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Management Report
Required Communication
as of December 31, 2008, 2007, 2006, 2005, 2004, and 2003

We have audited the financial statements of the County of Mendocino Health Plan for the years ended December 31, 2008, 2007, 2006, 2005, 2004, and 2003 and have issued our reports thereon date August 3, 2009. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards and Government Auditing Standards

As stated in our engagement letter dated May 7, 2009, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

As part of our audit, we considered the internal control of the Health Plan. Such considerations were solely for the purpose of determining our audit procedures and not to provide assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the Health Plan's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter dated May 7, 2009.

Qualitative Aspects of Accounting Practices

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Health Plan are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2008, 2007, 2006, 2005, 2004, and 2003. We noted no transactions entered into by the Health Plan during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transactions occurred.

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Management Report
Required Communication
as of December 31, 2008, 2007, 2006, 2005, 2004, and 2003

Significant Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate affecting the financial statements was:

- Management's estimate of the benefit claims liability is derived from actuarial valuations obtained from experts. We agreed the benefit claims liability reported in the financial statements to those reported in actuarial reports dated June 30 of each year being audited.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit other than those that are trivial, and communicate them to the appropriate level of management.

Management passed on the following adjustment:

- To record year end balance of external cash account in the following amounts:

<u>Year</u>	<u>Balance</u>
2008	\$ 12,776
2007	12,883
2006	(51,469)
2005	5,380
2004	(38,809)
2003	(31,938)

Management has determined that the effects of the passed adjustment is immaterial to the financial statements taken as a whole. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, in the financial statements as a whole.

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Management Report
Required Communication
as of December 31, 2008, 2007, 2006, 2005, 2004, and 2003

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated August 3, 2009.

Management Consultations with Other Independent Auditors

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Health Plan's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Management Report
Current Year Recommendations
as of December 31, 2008, 2007, 2006, 2005, 2004, and 2003

CASH IN BANK

Criteria

All bank accounts belonging to the Health Plan should be recorded on the general ledger and all related activity should be properly recorded.

Condition

The Health Plan has an external bank account used by its third party administrator to pay medical claims. However, this external bank account is not reported on the general ledger.

Cause

The external bank account is not recorded on the general ledger.

Effect or Potential Effect

By not recording the external bank account on the general ledger, the Health Plan could mislead observers about the financial condition of the Health Plan.

Recommendation

We recommend that the Health Plan work with the Auditor-Controller's Office to incorporate the external bank account and properly record activity between it and the County Treasury on the general ledger.

Management Response

Management of the Health Plan will consider implementing these recommendations.

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Management Report

**For the Years Ended December 31, 2008,
2007, 2006, 2005, 2004, and 2003**

DRAFT 7/31/2009

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Management Report
For the Years Ended December 31, 2008, 2007, 2006, 2005, 2004, and 2003

Table of Contents

	<u>Page</u>
Introduction.....	1-2
Required Communication	3-5
<u>Current Year Recommendations</u>	
Cash in Bank	6

Board of Directors
County of Mendocino Health Plan
Ukiah, California

In planning and performing our audit of the basic financial statements of the County of Mendocino Health Plan (Health Plan) for the fiscal years ended December 31, 2008, 2007, 2006, 2005, 2004, and 2003, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on internal control.

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 significant deficiency is a control deficiency, or a 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.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls.

During our audit we became aware of other matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions regarding those matters. We previously reported on the Health Plan's internal control in our report dated {DATE}. This letter does not affect our report dated {DATE} on the financial statements of the County of Mendocino Health Plan.

Board of Directors
County of Mendocino Health Plan
Ukiah, California

County of Mendocino Health Plan's management has provided responses to the comment described in the memorandum that accompanies this letter. We did not audit the Health Plan's responses and accordingly, we express no opinion on it.

This report is intended for the use of management, the Board of Directors, and the County of Mendocino Health Plan, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

We thank the Health Plan's staff for its cooperation during our audit.

Roseville, California
{DATE}

**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

Management Report
Required Communication
as of December 31, 2008, 2007, 2006, 2005, 2004, and 2003

We have audited the financial statements of the County of Mendocino Health Plan for the years ended December 31, 2008, 2007, 2006, 2005, 2004, and 2003 and have issued our reports thereon date {DATE}. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards and Government Auditing Standards

As stated in our engagement letter dated May 7, 2009, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

As part of our audit, we considered the internal control of the Health Plan. Such considerations were solely for the purpose of determining our audit procedures and not to provide assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the Health Plan's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter dated May 7, 2009.

Qualitative Aspects of Accounting Practices

Significant Accounting Policies

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INTERNAL SERVICE FUND**

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**COUNTY OF MENDOCINO HEALTH PLAN
INTERNAL SERVICE FUND**

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Current Year Recommendations
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Recommendation

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Management Response

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