

**CENTER FOR INVESTIGATION, EDUCATIONAL AND MEDICAL SERVICE
FOR DIABETES OF PUERTO RICO**

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITOR'S REPORT**

JUNE 30, 2010 and 2009

MANAGEMENT DISCUSSION ANALYSIS

The Center for the Diabetes for Puerto Rico (The Diabetes Center) is a public corporation and a component unit of the Commonwealth of Puerto Rico, created by Law No. 166 approved on August 12, 2000. The purposes of the Diabetes Center are to perform studies, provide medical training, education, as well as outpatient and other related medical services to the diabetic population around the island and the neighbor countries. The Diabetes Center offers to the financial statements readers this narrative overview and analysis of the financial activities for the fiscal year ended June 30, 2010 and 2009.

Financial Highlights

- The total liabilities of the Diabetes Center at the close of the fiscal years ended June 30, 2010 and 2009 amounted to \$278,725 and \$263,677 each one, comprised of the accruals required under GASB No. 34 for payables, payroll taxes, rent payable, vacations and unearned in the amounts of \$61,685, \$152, \$21,016, \$113,603 and \$82,269, for 2010 and \$46,603, \$0, \$21,016, \$94,746 and \$101,312 for 2009. The assets exceeded its liabilities by \$2,589,710 and \$2,299,223, as reflected from the above analysis the Diabetes Center has the resources to meet its ongoing obligations.
- The Diabetes Center's total net change in assets increased by \$290,487 for 2010 and \$215,527 for 2009, the principal concept for the increase on 2010 is attributable to the control over expenditures, specifically over salaries and professional services.
- The Diabetes Center received a subsidy (legislature appropriation) by the Commonwealth of Puerto Rico of \$1,000,000 if those monies are not received the Center will operates with recurring losses and deficits.
- The Diabetes Center no longer maintains Certificates of Deposits with any financial institutions. Previous monies were used for their daily operations and acquisition of medical equipment.
- The Diabetes Center recognized intergovernmental transactions between the Medical Science School and the Center for monthly lease obligations in the amount of \$10,507, to the School Campus. At June 30, 2010 and 2009 the total outstanding debt of such commitment amounted to \$21,016. At the same time it recognized a receivable balance from the Medical Science School of \$65,463 for 2010 and \$22,159 for 2009, related to the rental of some space on the Diabetes Center facilities.
- Overall operating expenses reflect a decrease in relation to the last year and basically relates to the company new approach to reduce expenses an example of these are advertising accounts, continued education program and general and administrative.

Financial Analysis - continued

The financial statements are presented on the accrual basis of accounting. Under this method, revenues are recognized when earned and expenses are recorded when incurred. As allowed by Government Accounting Standard Board ("GASB") Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Accounting".

Capital Assets

The capital assets of the Diabetes Center are those assets that are used in the performance of its functions. The investment in capital assets for the fiscal year ended June 30, 2010 amounts to \$7,819. Major capital asset events during the prior fiscal year included the following:

- Additions of Equipment to Center's facilities in the amount of \$7,819.

REQUEST OF INFORMATION

This financial report is designed to provide a general overview of the Diabetes Center's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance Division of the Diabetes Center of Puerto Rico, Centro Medico Mail Station, P.O. Box 70344, PMB-87, San Juan, Puerto Rico 00936.

CENTER OF DIABETICS FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Statements of Activities and Changes in Net Assets

Years ended June 30, 2010 and 2009

Revenues:		
Patient service revenues, net (note 8)	\$ 60,462	\$ 62,611
Other operating revenues (note 10)	<u>49,931</u>	<u>34,050</u>
Total revenues	<u>110,393</u>	<u>96,661</u>
Operating expenses:		
Salaries and employee benefits	426,282	372,066
Depreciation expense	46,725	126,521
Rent (note 6)	126,093	126,093
Advertising expense	-	-
Donation grants expense	-	2,848
Professional services		
Accounting	38,220	37,168
Legal	9,900	21,600
Medical	17,317	83,634
Investigations	-	-
Programmers	22,485	23,603
Otros	45,090	-
Medical insurance expense	26,189	26,323
Insurance expense	23,815	28,781
Cost of sales - nutristore	10,062	18,204
Continued Education Programs	2,071	1,000
Bad debts expenses	7,023	7,839
General and administrative	<u>100,844</u>	<u>53,262</u>
Total expenses	<u>902,116</u>	<u>928,942</u>
Operating (loss) before non-operating revenues	(791,723)	(832,281)
Non-operating revenues:		
Legislature appropriations by the Commonwealth of Puerto Rico (notes 1 and 9)	1,000,000	1,000,000
Legislature special fund resolution (notes 1 and 9)	-	-
Rent income	43,305	43,305
Interest income	<u>198</u>	<u>863</u>
Total non-operating revenue	<u>1,043,503</u>	<u>1,044,168</u>
Net income	251,780	211,887
Net assets, beginning of year (note 11)	<u>2,080,888</u>	<u>1,869,001</u>
Net assets, end of year	<u>\$ 2,332,668</u>	<u>\$ 2,080,888</u>

See notes to financial statements.

P R T R A S T

CENTER OF DIABETES FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements
June 30, 2010 and 2009

Note 1 – Organization and Summary of Significant Accounting Policies

Organization

The Center for Investigative, Educational & Medical Service for Diabetes of Puerto Rico (the "Diabetes Center") is a public corporation and a component unit of the Commonwealth of Puerto Rico, created by Act No. 166 approved on August 12, 2000. The purposes of the Diabetes Center are to perform studies, provide medical training, education, as well outpatient and other related medical services to the diabetic population around the island, the neighbor countries.

The Financial Reporting Entity

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as applicable to governmental units. The Diabetes Center is accounted for as a discretely presented component unit of the Commonwealth.

The Diabetes Center adopted the provision of GASB Statement No. 34 "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments" (GASB No. 34), GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis – for State and Local Governments: Omnibus" (GASB No. 37) and GASB Statement No. 38, "Certain Financial Statement Note Disclosures" (GASB No. 38) effective July 1, 2002. GASB No. 34 established financial and reporting standards for all state and local governments and related entities. The most important effects of the adoption of GASB No. 34 relates to the inclusion of management's discussion and analysis in the Diabetics Center's financial statements, a change required by GASB No. 34. The adoption of GASB No. 38 modifies, rescinds and establishes certain financial statement disclosure requirements.

Measurement Focus, Basis of Accounting and Financial Presentation

The financial statements are presented on the accrual basis of accounting. Under this method, revenues are recognized when earned and expenses are recorded when incurred. As allowed by Governmental Accounting Standard Board ("GASB") Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Accounting".

CENTER OF DIABETES FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements (continued)
June 30, 2010 and 2009

Impairment of Long-Lived Assets

Management reviews property and equipment for possible impairment whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. If there is an indication of impairment, management prepares an estimate of future cash flows (undiscounted and without interest charges) expected to result from the use of the asset until its eventual disposition.

If these cash flows are less than the carrying amount of the asset, an impairment loss is recognized to write down the assets to its estimated fair value. No indications of impairment are evident as a result of such review.

Compensated Absences

Compensated absences are accrued when earned by the employees. Employees may carry-forward their compensated absences as permitted by statute and may settle them in a cash payment from the Diabetes Center, if employment has ceased.

Legislature Appropriations

The Commonwealth of Puerto Rico granted to the Diabetes Center annual appropriations of \$1,000,000 for their fiscal year ended on June 30, 2010 and 2009. For their operations and capital expenses as a subsidy for their actual deficit operations. Such appropriations are recorded as revenue as realized in the period stated in the grant.

Recent Accounting Developments

GASB Statement No. 39 "Determining Whether Certain Organizations Are Component Units" provides additional guidance to determine whether certain organizations for which the primary government is not financially accountable should be reported as component units based on the nature and significance of their relationship with the primary government. The impact of this statement on the Diabetes Center's financial statements has not yet been determined.

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CENTER OF DIABETES FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Financial Statements (continued)
June 30, 2010 and 2009

Note 4 – Account Receivable from Restricted Donation Grants – (Continued)

In addition, there is a pending inter fund transfer between unrestricted cash funds and the restricted cash funds as of June 30, 2010 and 2009 of \$33,305, which represents of monies deposited on the unrestricted funds accounts when it should be deposited on the restricted fund.

Note 5 – Property and Equipment

Property and equipment at June 30, 2010 and 2009:

	<u>Estimated Useful Lives</u>		
Furniture and equipment	3 to 10 yrs	\$ 828,424	\$ 820,605
Automobiles	5 to 10 yrs	20,993	20,993
Leasehold Improvements	30 yrs	903,214	903,214
		<u>1,752,631</u>	<u>1,744,812</u>
Less accumulated depreciation		(835,477)	(818,858)
Less accumulated amortization – leasehold		<u>(226,183)</u>	<u>(196,076)</u>
Total		<u><u>\$ 690,971</u></u>	<u><u>\$ 729,878</u></u>

Note 6 – Rent Payable

The Diabetes Center rents its facilities through operating lease agreement in which the latest expires in March 2011, with an auto-renewal clause for five (5) more years. Rent expense under such lease agreements for the year ended June 30, 2010 and 2009 amounted to approximately \$126,100.

As of June 30, 2010 and 2009 it has an outstanding balance payable to the landlord of \$21,016. Future minimum lease payments as of June 30, 2010 are as follows:

<u>Year ending June 30,</u>	<u>Amounts</u>
2011	<u>\$94,568</u>

2010

CENTER OF DIABETES FOR PUERTO RICO
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Notes to Financial Statements (continued)
June 30, 2010 and 2009

Note 11 - Prior Period Adjustment

Certain error, resulting in the both the overstatement and understatement of previously reported assets and expenses of prior years, were corrected during 2009 resulting in the following changes to retained earnings as of December 31, 2009:

Retained earnings as previously reported	\$1,907,908
Understatement of several operating expenses	<u>(38,907)</u>
Retained earnings as adjusted	<u>\$1,869,001</u>

Note 12 – Reclassifications

Certain reclassifications have been made to prior year financial statements to conform to the current year presentation.



CENTER OF DIABETICS FOR PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

Operating Expenses - General and Administrative

Years ended June 30, 2010 and 2009

Medical supplies	\$ 23,318	\$ -
Credit Cards Payments	1,720	3,075
Office expenses	4,535	6,144
Telephone expenses	7,916	11,802
Postage and mailing expenses	494	328
Auto expenses	149	227
Equipment rental expense	7,710	8,402
Maintenance expense	40,204	5,783
Pension plan expense	3,909	3,843
Parking of employees	6,426	5,647
Miscellaneous expenses	<u>4,463</u>	<u>8,011</u>
Total general and administrative expenses	<u>\$ 100,844</u>	<u>\$ 53,262</u>

**The Board of Directors
Center for Investigation, Educational and Medical Service for
Diabetics of Puerto Rico**

Dear Sirs:

In planning and performing our audit of the financial statements of the Center for Investigation, Educational and Medical Service for Diabetics of Puerto Rico (the Center) for the year ended June 30, 2010, on which we have issued our report dated December 12, 2010, we considered its internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurances on the internal control. However, we noted certain matters involving the internal control and its operations that we consider being reportable conditions under standards establish by American Institute of Certified Public Accountants. Reportable conditions involve matters coming to attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Corporation's ability to record, process, summarize, and report financial data consistent with the assertion of management in the financial statements. The reportable conditions that we noted are described in exhibit 1.

Our consideration of the internal control would not necessarily disclose all matters in the internal controls that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control elements does not reduce to a relative low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Of the reportable conditions, the following are, in our judgment, material weaknesses:

a) Failure to maintain an accurate and reliable accounting system:

1 – Receivables from patients and third-party payors.

EXHIBIT 1

1. Condition

The main objective of internal accounting control is to segregate accounting duties such that an individual who has access to assets (cash receipts, signed checks, equipment, etc.) does not also have access to the accounting records that control the assets. Proper segregation of duties provides reasonable assurance that an individual would be prevented from removing an asset from the Center and concealing that activity by altering the related accounting records.

Cause of Condition

In growing entities like the Center, there are usually a limited number of personnel available for accounting duties; accordingly, an appropriate segregation of responsibilities is not practical in many areas. As the Center adds additional personnel, accounting duties can be further segregated to improve internal controls. Until duties can be adequately segregated, however, a critical element in the Center's internal control system is the close involvement of senior management in the day-to-day operations and close review of accounting activities and interim financial reports.

Effect of Condition

Improper implementation of internal controls could result in risk errors or fraud.

Recommendation

There are certain procedures, described below, which can be implemented currently by your existing personnel to improve internal control.

Cash Receipts:

To improve internal control, the employee who opens mail and restrictively endorse all checks, should prepare a daily log of all cash receipts.

Check Signatures:

The Center policy should enforced to be limit at a more practical amount (e.g., \$1,000 and over) for two authorized signatures or it could implement the use of two signature from management personnel at Center's facilities and with the bank being made aware of the policy.

Management's Response

Center has present evidence that these issues have been resolved or corrective actions being implemented. Condition corrected.

2. Condition

A comprehensive accounting policies and procedures manual should be a readily accessible reference to accounting personnel to ensure that accounting policies and procedures are known and followed. Such a manual also benefits the Center during turnover of key accounting individuals. With thoroughly documented policies and procedures, the learning period of new employees is reduced and management may have increased assurance that accounting policies and procedures are consistently followed during the transition period.

Cause of Condition

An accounting policies and procedures manual for accessible reference to accounting personnel should be available to ensure that accounting policies and procedures are known and properly followed.

Effect of Condition

Unreliable financial information and misclassification of transactions, as well as possible internal control override.

Recommendation

The Center should prepare and implement an accounting policies and procedures manual to document significant policies on each area of service and documentation. Upon completion, the manual should be distributed to key accounting personnel and be approved by the Board of Directors.

Management's Response

Condition accepted by the Center, but the Accounting Manual has been prepared, it's waiting for the Board and Management approval to become effective.

3. Condition

The Center has not established systematic collection procedures for account receivable balances (private patients and third party payors).

Cause of Condition

They have not in place a systematic collection policy to be followed for the collections of outstanding account receivable balances.

Effect of Condition

Accounts receivable not properly valued and recorded at their net realizable value at year end.

Recommendation

Systematic collection procedures should be established specifying procedures to be followed in connection with past due receivables and collections efforts to third party payors.

3. Condition – continued

Management's Response

Accepted

4. Condition

The Center has implemented a medical / billing software to improve service, data gathering, billing of service and recordkeeping; however, during the course of our audit we have noted the following items that indicate a strong need for increased management attention regarding the collection process, recordkeeping and aging of accounts receivable.

- Year-end account receivable balance is not reconciled with accounting records and general ledger.
- System doesn't provide appropriate information for audit trail and recordkeeping of patients' outstanding balance.
- System does not provide information of contractual allowance adjustment for each patient service transaction. Neither provides a year-end balance or reconciliation process of contractual allowance.
- Collection efforts prior to writing off account receivables varied greatly from account to account.
- A policy to determine an adequate allowance for doubtful accounts or credit adjustments based on historic data and current status of the accounts receivable aging does not exist.
- An analysis to evaluate the appropriate allowance for doubtful accounts or credit adjustments is not performed on a regular basis.

Cause of Condition

Collection process, recordkeeping and aging of accounts receivable are not properly followed and recognized on Center financial records.

Effect of Condition

- Year-end account receivable balance not reconciled with accounting records and general ledger.
- No appropriate information for audit trail and recordkeeping of patients' outstanding balance.
- System does not provide information of contractual allowance adjustment for each patient service transaction. Neither provides a year-end balance or reconciliation process of contractual allowance.
- Collection efforts prior to writing off account receivables varied greatly from account to account.
- No policy to determine an adequate allowance for doubtful accounts or credit adjustments.
- No analysis to evaluate appropriate allowance for doubtful accounts or credit adjustments.

Recommendation

We recommend to strengthen the account receivable accounting information and collection process the following:

- Service orders numbers should be required for each service provided, without respect of a recurrence service or continuance process from previous visit.

4. Condition – continued

Recommendation

- System should provide for audit trail and examination each service provided by fiscal year, monthly period, insurance carrier, patient accounting balance record, etc.
- Systematic collection procedures should be established based on dollar amount and age of the receivable. Collection efforts should begin as quickly after the due date as is practical.
- Correspondence with customers should be documented and customer difference should be resolved or reconciled as quickly as possible.

Management's Response

Accepted

5. Condition

The Center's patient accounts receivable is significantly aged, resulting in higher collection delinquency.

Cause of Condition

No proper procedures of collections, analysis and follow-up of outstanding balances.

Effect of Condition

No proper accounting system and unreliable aging of accounts receivable.

Recommendation

To improve collections, we recommend the following:

- Close attention should be given to collection of past- due accounts. Proper follow-up should be given to collection efforts after services are provided and insurance carries determine deductible payment for medical services.
- Consideration should also be given to implement insurance carriers negotiate rates, as well as contractual allowance adjustment implemented to identify patient deductibles and proper outstanding balance for collections efforts.

Management's Response

Accepted

6. Condition

The Center's accounting software system does not have the capability of accumulating accounts receivable by customer, nor retaining information relating to payment history, unusual credit adjustments or terms, or historical services by patient tie-in with billing amounts and outstanding balance. Significant time is spent by accounting personnel to manually accumulate this information.

6. Condition – continued

Cause of Condition

No proper accounting system software in place, specifically one used for a health care institution.

Effect of Condition

Significant time spent by accounting personnel to manually accumulate this information and risk of misstatements.

Recommendation

The Center should enhance their current accounting software system or acquire a new more accounting oriented system, to aforementioned capabilities should be considered and included.

We recommend the possible evaluation of subcontracting the billing and collection functions to an outsider with extensive experience and knowledge in the field of healthcare system and third-party payors insurance plans.

Management's Response

Accepted

7. Condition

An inventory system should be implemented to strengthen Center's inventory control. To make the inventory system effective and reliable, the Center must be willing to dedicate the resources and personnel.

Cause of Condition

No personnel assigned to maintain, control and recording of inventory cost and financial balance.

Effect of Condition

Inventory balance is not properly recognize and misappropriation risk.

Recommendation

- Establish and monitor proper inventory reporting procedures. These procedures should include recording of inventory receipts and relief of inventory. Physical inventory counts should be conducted quarterly to maintain control until implementation of the system.
- Train personnel in the proper use of the inventory system and segregate items from property and equipment.

Management's Response

Accepted

8. Condition

The financial information supplied to the Board of Directors should be improved.

Cause of Condition

No finance director or controller in place, as well as to the misunderstanding of the accounting and financial information importance.

Effect of Condition

Lack of financial information and understanding by the Board of Directors members.

Recommendation

We recommend that the following information be included in the Board package at least quarterly.

- Trend analysis of receivable aging and discussion of significant past due amounts.
- Trended schedule of inventories by category, related reserves and results of cycle counts.
- Schedule of marketable securities and cash account reconciliations.
- Trended schedule of significant accrued liabilities.
- Summarized status information on significant open professional service contracts, including explanations for significant changes.
- Consolidated balance sheet and income statement, both trended by month and comparative year to date.
- Consolidated income statement with budget comparisons for month (or quarter) and year, including explanations for significant changes.

Management's Response

Accepted

9. Condition and Recommendation

The Center should strongly consider the implementation of a Finance and Accounting Division. This is an important division within an organization, even more for an institution experiencing remarkable operational and financial changes. A finance position should be an executive officer at the policy-making level responsible to top management, expected to attend most executive and policy-making meetings and to submit the necessary reports and analyses relating to the financial condition of the Center.

9. Condition – continued

The basic functions and duties of a Finance/Accounting Division should include:

- Establishment and maintenance of a logical and integrated plan of financial operations. This would include, among other things, preparations of budgets, reporting, accounting systems and determination of long-term financing needs and possible sources, etc.
- Establishment of complete and adequate system of financial reporting so as to supply all segments of management with the information (both financial and statistical) required to make informed business judgments.
- Maintenance of the accounting records. This would include, among other things, critically reviewing the existing records and record keeping methods and applying sound accounting principles and practices within the accounting records.
- Establishment and maintenance of a sound system of controls. This would include the overall accounting system and control of paper flow as well as specific budget control of expenses, accounting, cash flow and operations.
- Assignment of duties and supervision of work habits within the accounting department.

Management's Response

Accepted

Sincerely,


Fernandez Valdivia & Company, PSC