



Transmitted via e-mail

March 25, 2013

Mr. Cliff Allenby, Acting Director  
Department of State Hospitals  
1600 9th Street, Room 151  
Sacramento, CA 95814

Dear Mr. Allenby:

**Final Report—Department of State Hospitals' Implementation of Internal Control Recommendations**

Pursuant to the Budget Act of 2012, Chapter 21, Statutes of 2012, the Department of Finance, Office of State Audits and Evaluations (Finance), has completed its review of the Department of State Hospitals' (DSH) implementation of the recommendations presented in Finance's December 2007 Internal Control Review of the Department of Mental Health (DMH). On July 1, 2012, DMH was abolished and the responsibilities for the state hospitals transferred to the newly established DSH.

The enclosed report is for your information and use. DSH's response to the report results is incorporated into this final report. DSH agreed with our report results and we appreciate its willingness to implement corrective actions. The report is intended to assist management in improving its internal control. The report will be placed on our website.

We appreciate the assistance and cooperation of the DSH. If you have any questions regarding this report, please contact Kimberly Tarvin, Manager, or Rick Cervantes, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, CPA  
Chief, Office of State Audits and Evaluations

Enclosure

cc: Ms. Kathryn Radtkey-Gaither, Chief Deputy Director, Department of State Hospitals  
Mr. Mark Beckley, Deputy Director, Administrative Services, Department of State Hospitals  
Ms. Diane F. Boyer-Vine, Legislative Counsel, Office of Legislative Counsel  
Mr. Gregory Schmidt, Secretary of the Senate, Office of the Secretary of the Senate  
Ms. Amy Leach, Journal Clerk, California State Assembly, Office of the Chief Clerk

# Audit Report

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## Department of State Hospitals Implementation of Internal Control Recommendations

Prepared By:  
Office of State Audits and Evaluations  
Department of Finance

**MEMBERS OF THE TEAM**

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Final reports are available on our website at <http://www.dof.ca.gov>

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# BACKGROUND, SCOPE AND METHODOLOGY

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## BACKGROUND

Formerly a program of the Department of Mental Health (DMH), the Department of State Hospitals (DSH) was established in July 2012 to administer the state mental health hospital system, Forensic Conditional Release Program, Sex Offender Commitment Program, and the evaluation and treatment of judicially and civilly committed and voluntary patients.<sup>1</sup> DSH's mission is to provide evaluation and treatment in a safe and responsible manner, seeking innovation and excellence in hospital operations, across a continuum of care and settings.

During fiscal year 2011-12 the seven state hospitals served a combined average of 5,948 patients.<sup>2</sup> Throughout this report, we will refer to each state hospital as follows:

- DSH-Atascadero (ASH)
- DSH-Coalinga (CSH)
- DSH-Metropolitan (MSH)
- DSH-Napa (NSH)
- DSH-Patton (PSH)
- DSH-Salinas Valley (SVSH)
- DSH-Vacaville (VSH)

DSH management is responsible for establishing and maintaining an effective system of internal control, including documentation of the system, communicating the system requirements to employees, assuring the system is functioning as designed, and modifying the system as changes in conditions warrant.

## SCOPE

Pursuant to the Budget Act of 2012, Chapter 21, Statutes of 2012, the Department of Finance, Office of State Audits and Evaluations (Finance), determined whether the recommendations in Finance's 2007 Internal Control Review related to state hospitals were implemented as of June 30, 2012. For recommendations not fully implemented, the recommendations were prioritized based on fiscal and programmatic risks.

Cost efficiency was not considered when prioritizing risks because the recommendations related to procedures that would strengthen internal control and reduce the risk of errors or fraud may not necessarily increase cost efficiency. However, without a strong internal control system, the risk increases that significant errors and/or fraud may occur without timely detection which could significantly impact DSH's operations.

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<sup>1</sup> Excerpts from the Governor's Budget Summary 2013-14. DMH was abolished on July 1, 2012 and its responsibilities for the seven state hospitals transferred to the newly established DSH.

<sup>2</sup> Excerpts from [www.dsh.ca.gov](http://www.dsh.ca.gov)

Our audit was limited to reviewing the implementation of the 2007 Internal Control Review recommendations. Because we did not evaluate any internal control processes other than those related to the 2007 Internal Control Review recommendations, other strengths or weaknesses may be currently present in the internal control system, but not addressed in this report. Inherent limitations in any internal control system include the risk that internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate over time.

## METHODOLOGY

To determine whether the recommendations in the 2007 Internal Control Review were implemented, we performed the following procedures:

- Interviewed key personnel at headquarters and state hospitals to obtain an understanding of the internal control and efforts to implement recommendations.
- Reviewed applicable internal policies and procedures and organization charts.
- Reviewed accounting and personnel records, contract files, and correspondence.
- Classified each recommendation as Implemented, In Progress, Not Implemented, or Not Applicable as defined below:

Status	Definition
Implemented	The recommendation was implemented.
In Progress	DSH performed activities as of December 2012, in an effort to implement the recommendation.
Not Implemented	DSH did not fully implement this recommendation.
Not Applicable	Either the recommendation relates to a DMH function not currently performed by DSH, or no transactions occurred related to the recommendation from July 1, 2011 through June 30, 2012.

- Prioritized the In Progress and Not Implemented recommendations for headquarters and the state hospitals based on fiscal and programmatic risk.

Except as discussed in the following paragraph, we conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In connection with our audit, there are certain disclosures required by generally accepted government auditing standards. Finance is not independent of DSH, as both are part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain management and accounting functions. These activities impair independence. However, sufficient safeguards exist for readers of this report to rely on the information contained herein.

The results of this audit are based on our review of documentation, other information made available to us, and interviews with staff and management.

Overall, DSH implemented 22 recommendations, is in progress of implementing 9 recommendations, has not implemented 46 recommendations, and 8 recommendations were no longer applicable to DSH operations. The recommendations not fully implemented with the highest programmatic and/or fiscal risk are presented below. However, Finance strongly encourages implementation of all the recommendations that relate to DSH operations to strengthen the internal control. For a detailed status of all the recommendations and the priority ranking, see Appendices A and B.

## Headquarters

### *Implementation Status*

The 2007 Internal Control Review included 38 recommendations that impacted Headquarters. Table 1 presents the implementation status of these recommendations.

**Table 1: Headquarters Recommendation Implementation Status**

Implemented	In Progress of Implementation	Not Implemented	Not Applicable	Total
14	8	10	6	38

### *Priority Ranking*

The top ten recommendations not fully implemented by headquarters with the highest programmatic and/or fiscal risks are presented below in Table 2.

**Table 2: Top 10 Headquarters Recommendations Not Fully Implemented**

Priority Ranking	Issue Number	Recommendation
1	1b	Improve and document the hospitals' budget projections and allocation methodologies by including appropriate cost drivers such as level of care, actual maintenance, and fixed costs.
2	1e	Determine accurate patient bed costs to ensure appropriate reimbursements from the counties and the California Department of Corrections and Rehabilitation (CDCR).
3	3e	Classify data to protect against unauthorized access.
4	3d	Locate an adequate recovery site for headquarters or properly equip Napa State Hospital to ensure successful recovery operations.

Priority Ranking	Issue Number	Recommendation
5	3b	Institute an Information Technology Risk Management Plan and update it on a regular basis.
6	6g	Compare the Sexually Violent Predator claimed costs to the patient approved plan of expenditures prior to payment.
7	5a	Develop contract monitoring best practices to ensure contract managers exercise due diligence when reviewing and approving status reports and claimed costs.
8	6f	Compare credit card charges to appropriate approvals and supporting documentation before payments are made. Report fraud to the Bureau of State Audits and Finance.
9	6a	Maintain a documented system of authorization and reassign incompatible duties to achieve the required separation.
10	3g	Modify database administrator's programming rights to ensure adequate separation of duties.

## Hospitals

### *Implementation Status*

The 2007 Internal Control Review included 47 recommendations that impacted one or more state hospitals. Table 3 presents the implementation status of those recommendations. If one or more hospitals did not fully implement the recommendation, the entire recommendation was considered not implemented. However, some of the state hospitals may have implemented, or are in the process of implementing the recommendation. See Appendix B for the status of each recommendation by individual state hospital.

**Table 3: Hospital Recommendation Implementation Status**

Implemented	In Progress of Implementation	Not Implemented	Not Applicable	Total
8	1	36	2	47

### *Priority Ranking*

The top fifteen recommendations not fully implemented by one or more hospital with the highest programmatic and/or fiscal risks are presented below in Table 4.

**Table 4: Top 15 Hospital Recommendations Not Fully Implemented**

Priority Ranking	Issue Number	Recommendation
1	1a	Institute timekeeping procedures to ensure attendance records are adequately prepared, certified, and retained for audit.
2	1b	Require overtime be reviewed and pre-approved by a designated supervisor and second level reviewer. The second level review should be performed outside the requestor's unit. For example, Central Staffing Services should perform a second review and provide final approval for level of care overtime requests. Ensure these reviews and approvals are adequately documented in personnel records.

<b>Priority Ranking</b>	<b>Issue Number</b>	<b>Recommendation</b>
3	1c.1	Conduct random overtime audits to reduce fraud and abuse.
4	4d	Develop an inventory system to safeguard pharmaceutical drugs.
5	1c.2	If suspected fraud is discovered, timely report the activity to the appropriate parties.
6	4a.2	Reassign incompatible duties to achieve the required separation.
7	4b.1	Secure assets such as the blank check stock, the check signing machine key, and the signature plate.
8	4c	Restrict system and application access rights to only those employees requiring it in the performance of their job duties.
9	6a	Compare Cal-Card and Voyager Fleet Card charges to appropriate approvals and supporting documentation before payments are made. Institute independent reviews of all expenditures, including gift card purchases, to ensure accuracy, propriety, and evidence of receipt.
10	6b	Ensure that only authorized employees use Cal-Card and Voyager Fleet Cards.
11	3c	Apply collection procedures promptly and systematically on delinquent accounts receivable balances. Ensure all collection efforts are made and documented to substantiate receivable write-off requests.
12	3a	Record account receivables timely and accurately.
13	3d	Write-off uncollectible accounts receivable.
14	2e	Document the contract bidding process and include the supporting documentation in the contract and purchase order files.
15	4e	Institute adequate inventory procedures, which should include the performance of physical inventories.

**Headquarters  
Recommendation Implementation Status and Priority Ranking**

<b>Issue Number</b>	<b>Recommendation</b>	<b>Status</b>	<b>Priority Ranking</b>
<b>Fiscal Integrity At Risk</b>			
1a	Develop organizational and programmatic budgets and an indirect cost allocation plan.	NA	
1b	Improve and document the hospitals' budget projections and allocation methodologies by including appropriate cost drivers such as level of care, actual maintenance, and fixed costs.	IP	1
1c	Ensure maintenance funding is adequate, develop criteria and methodologies to prioritize funding for hospitals, and perform onsite reviews of major special repair projects.	I	
1d	Develop standardized policies and procedures for hospital fiscal and administrative operations to ensure consistency. Non-adherence to policies should only be granted on an exception basis.	NI	15
1e	Determine accurate patient bed costs to ensure appropriate reimbursements from the counties and the CDCR.	IP	2
1f	Require Budget Office approval for all budget documents and institute fiscal monitoring practices to ensure expenditures are appropriately charged to the correct funding source.	I	
1g	Monitor hospital expenditures at the program element level and determine if a budget revision is necessary.	I	
<b>Inadequate Cash Flow Management</b>			
2a	Ensure accounting staff have the necessary information to perform their duties effectively and efficiently. Provide training on federal cost accounting principles and programs (e.g., the Office of Management and Budget Circular A-87 and Social Security Act program requirements).	NA	
2b	Develop policies and procedures for timely billing, collecting, and writing-off receivables and ensure all costs billed are proper and supported.	I	
2c	Reconcile billing amounts to source data.	NA	

Issue Number	Recommendation	Status	Priority Ranking
2d	Use the approved indirect billing rate and adjust the Treatment Authorization Appeal Review fees annually to ensure adherence to full cost recovery principles.	NA	
<b>Reporting Structure of Information Security Officer is Ineffective</b>			
3a	To emphasize the importance of the Information Security Officer's (ISO) role, revise the reporting structure of the ISO to provide Director accessibility and consider modifying the position to have a "confidential" designation.	I	
3b	Institute an Information Technology (IT) Risk Management Plan and update it on a regular basis.	IP	5
3c	Complete and submit all reports in accordance with the State Administrative Manual and Statewide Information Management Manual requirements.	IP	14
3d	Locate an adequate recovery site for headquarters or properly equip Napa State Hospital to ensure successful recovery operations.	IP	4
3e	Classify data to protect against unauthorized access.	NI	3
3f	Restrict consultant access to files necessary for contracted tasks and promptly modify or remove access upon completion of the contract.	NA	
3g	Modify database administrator's programming rights to ensure adequate separation of duties.	NI	10
3h	Remove separated employees from the CALSTARS Security File and modify employee access to ensure fiscal data integrity.	I	
<b>Project Management Practices Do Not Meet Minimum Requirements</b>			
4	Develop and document policies and procedures for IT functions. Institute minimum project management practices to support successful projects.	I	
<b>Inadequate Contract Development and Monitoring</b>			
5a	Develop contract monitoring best practices to ensure contract managers exercise due diligence when reviewing and approving status reports and claimed costs.	NI	7
5b	Ensure critical policies and procedures are documented, revised periodically, and are communicated to employees timely.	IP	16
5c	Form evaluation panels to ensure the objectivity of bid ranking.	I	
5d	Develop standardized contract provisions to include personnel service costs, contract budgets, positions/titles, maximum hourly rates, fringe benefits, overhead, and hours.	I	

Issue Number	Recommendation	Status	Priority Ranking
5e	Ensure all contract language includes details, such as a schedule of tasks, deliverables, progress reports, and corresponding deadlines.	I	
5f	Document provisions for reporting and disposition of training contract revenue.	NA	
<b>Inadequate Safeguarding of Assets</b>			
6a	Maintain a documented system of authorization and reassign incompatible duties to achieve the required separation.	IP	9
6b	Ensure the signature plate is removed from the check signing machine after checks are signed and safeguarded.	I	
6c	Develop and communicate policies and procedures for critical processes.	IP	17
6d	Review all postings to the general ledger.	I	
6e	Require the preparer and reviewer to sign and date reconciliations.	I	
6f	Compare credit card charges to appropriate approvals and supporting documentation before payments are made. Report fraud to the Bureau of State Audits and Finance.	NI	8
6g	Compare the Sexually Violent Predator claimed costs to the patient approved plan of expenditures prior to payment.	NI	6
6h	Prepare accurate and complete property registers and include the required details for each item including the property identification tag number, serial number, and cost information.	NI	12
6i	Reconcile the property register with the general ledger quarterly.	NI	13
6j	Conduct a physical inventory of all property and reconcile the results with the property register and general ledger.	NI	11
<b>Financial Statement Preparation Needs Improvement</b>			
7a	Institute a year-end work plan with reasonable deadlines that includes a review of accrual transactions and encumbrance balances for validity.	I	
7b	Ensure proper disclosures are made in the year-end statements.	NI	18

**Legend:**

I = Implemented

NI = Not Implemented

IP = In Progress

NA = Not Applicable

Risk Ranking: Highest Risk = 1

Lowest Risk = 18

**Hospitals  
Recommendation Implementation Status and Priority Ranking**

Issue	Prior Recommendation	MSH	PSH	ASH	NSH	CSH	VSH	SVSH	Priority Ranking
<b>Inadequate Personnel Practices</b>									
1a	Institute timekeeping procedures to ensure attendance records are adequately prepared, certified, and retained for audit.	NI	NI	NI	NI	NI	I	I	1
1b	Require overtime be reviewed and pre-approved by a designated supervisor and second level reviewer. The second level review should be performed outside the requestor's unit. For example, Central Staffing Services should perform a second review and provide final approval for level of care overtime requests. Ensure these reviews and approvals are adequately documented in personnel records.	NI	I	I	I	I	NI	I	2
1c.1	Conduct random overtime audits to reduce fraud and abuse.	NI	I	NI	I	NI	NI	NI	3
1c.2	If suspected fraud is discovered, timely report the activity to the appropriate parties.	NA	NI	NA	NA	NI	NA	NI	5
1d	Complete exit clearance procedures correctly and include all pertinent documents in the separated employee files.	NI	NI	NI	NI	NI	I	I	25
1e	Institute payroll procedures to ensure correct classification of employees.	I	I	I	I	I	I	I	
<b>Acquisition Controls Need Improvement</b>									
2a.1	Ensure payments are made with properly executed contracts.	I	I	I	I	I	I	NA	

Issue	Prior Recommendation	MSH	PSH	ASH	NSH	CSH	VSH	SVSH	Priority Ranking
2a.2	Ensure payments are made with approved purchase orders.	I	I	NI	I	I	I	I	21
2b	Begin the contract amendment process prior to the contract expiration date to ensure adequate time to obtain the necessary approvals.	NI	NI	I	I	NI	I	NA	22
2c	Include all the necessary information, such as a clear scope and adequate budget detail, in all contracts.	NI	I	I	I	I	I	NA	19
2d	Ensure contract logs are accurate and complete.	NI	I	I	NI	NI	I	NA	36
2e	Document the contract bidding process and include the supporting documentation in the contract and purchase order files.	NI	I	I	NI	NI	I	I	14
2f	Combine contracts and purchases from the same vendor to avoid the appearance of circumvention of state policies. For contracts over \$10,000, follow the standard agreement contract requirements. For contracts over \$50,000, obtain Department of General Services (DGS) approval.	I	I	I	NI	I	I	I	20
<b>Ineffective Accounting and Oversight of Accounts Receivable</b>									
3a	Record account receivables timely and accurately.	I	I	I	NI	IP	I	I	12
3b	Review postings and the accounts receivable ledger for accuracy.	IP	I	I	IP	IP	I	I	28
3c	Apply collection procedures promptly and systematically on delinquent accounts receivable balances. Ensure all collection efforts are made and documented to substantiate receivable write-off requests.	IP	IP	IP	IP	IP	I	NI	11
3d	Write-off uncollectible accounts receivable.	IP	IP	IP	IP	IP	I	NI	13
3e	Update lease agreements on a regular basis to include current reimbursable operating costs. Obtain the necessary approvals from DGS or the Legislature, if necessary.	NI	I	I	NI	I	NA	NA	18

Issue	Prior Recommendation	MSH	PSH	ASH	NSH	CSH	VSH	SVSH	Priority Ranking
<b>Inadequate Safeguarding of Assets</b>									
4a.1	Maintain a documented system of authorization.	NI	I	NI	I	I	I	I	30
4a.2	Reassign incompatible duties to achieve the required separation.	NI	NI	NI	I	NI	NI	NI	6
4b.1	Secure assets such as the blank check stock, the check signing machine key, and the signature plate.	I	I	NI	I	I	NI	I	7
4b.2	Maintain a record of undeliverable salary warrants and persons authorized to pickup warrants.	I	I	I	I	I	NI	I	33
4c	Restrict system and application access rights to only those employees requiring it in the performance of their job duties.	I	I	NI	NI	NI	NI	NI	8
4d	Develop an inventory system to safeguard pharmaceutical drugs.	NI	NI	I	NI	NI	NA	NA	4
4e	Institute adequate inventory procedures, which should include the performance of physical inventories.	I	I	IP	NI	NI	NI	NI	15
4f	Ensure property acquisitions and dispositions are adequately prepared, approved, and timely recorded in the property ledger and accounting records.	NI	I	NI	NI	NI	NI	NI	16
4g	Conduct quarterly fixed asset reconciliations and annual real property reconciliations.	NI	I	NI	NI	NI	NI	NI	17
<b>Incomplete or Outdated Employee Housing Rental Agreements</b>									
5a.1	Ensure rental agreements are prepared, enforced, and include necessary terms such as rent amounts.	I	I	I	NI	NA	NA	NA	24
5a.2	Update the rental agreements to ensure the appropriate rent is charged.	NI	NI	NI	NI	NA	NA	NA	23
5b	Require all employees to pay the appropriate rent and cleaning deposits.	I	I	I	I	NA	NA	NA	
5c	Report fringe benefits correctly and timely to the State Controllers Office.	I	I	I	NI	NA	NA	NA	34

Issue	Prior Recommendation	MSH	PSH	ASH	NSH	CSH	VSH	SVSH	Priority Ranking
5d	Require waivers of liabilities from guests. (Note Special Order 213.02 effective October 31, 2007 states that housing is strictly for state employees.)	NA	NA	NA	NI	NA	NA	NA	37
<b>Accounting Controls Need Improvement</b>									
6a	Compare Cal-Card and Voyager Fleet Card charges to appropriate approvals and supporting documentation before payments are made. Institute independent reviews of all expenditures, including gift card purchases, to ensure accuracy, propriety, and evidence of receipt.	NI	I	NI	NI	NI	I	I	9
6b	Ensure that only authorized employees use Cal-Card and Voyager Fleet Cards.	NI	I	I	I	I	I	NI	10
6c	Update accounting records promptly by posting checks and cash receipts.	I	I	I	I	I	I	NI	26
6d	Maintain supporting documents for travel and salary advances, ensure that salary advances do not exceed the employee's net salary, and document the reason for the advance.	I	I	I	NI	I	I	I	27
6e	Prepare reconciliations and include preparation dates and necessary signatures. Promptly reconcile, investigate, and close any reconciling items.	I	I	I	NI	I	I	I	29

Issue	Prior Recommendation	MSH	PSH	ASH	NSH	CSH	VSH	SVSH	Priority Ranking
<b>Weak Controls over Trust Accounting</b>									
7a	Obtain approval from Finance, Fiscal Systems and Consulting Unit, for bank accounts outside the State Treasury System.	NA							
7b	Prepare a listing or transfer receipts for checks and money orders transferred between employees.	I	I	I	I	I	NA	NA	
7c	Record funds in the accounting records on a timely basis and perform reconciliations. Identify and timely clear reconciling items.	I	I	I	NI	NI	NA	NA	31
7d	Post receipts to the Client Benefit Fund.	NA							
7e	Review canteen charges for propriety prior to payment.	I	I	I	I	I	NA	NA	
7f	Obtain and document patient approval prior to establishing other accounts or transferring funds.	NA	I	I	I	I	NA	NA	
7g	Timely remit discharged patient trust monies. Verify their addresses via certified mail.	I	I	I	I	I	NA	NA	
7h	Close inactive special purpose trust accounts and develop an annual expenditure plan for such trust accounts.	NI	I	I	NI	NI	NA	NA	35
7i	Establish an adequate hold policy for checks and money orders received for patients.	I	I	I	I	I	NA	NA	
<b>Financial Statement Preparation Needs Improvement</b>									
8	Properly report accrued expenditures in the year-end financial statements.	I	I	NI	I	I	NI	I	32

**Legend:**

I = Implemented  
 NI = Not Implemented  
 IP = In Progress  
 NA = Not Applicable

Risk Ranking: Highest Risk = 1  
 Lowest Risk = 37



**EXECUTIVE OFFICE**

1600 Ninth Street, Room 150  
Sacramento, CA 95814



March 13, 2013

**David Botelho, Chief  
Office of State Audits and Evaluations  
Department of Finance  
915 L Street  
Sacramento, CA 95814**

Dear Mr. Botelho:

The Department of State Hospitals has received the Office of State Audits and Evaluations (OSAE) report on the Implementation of Internal Control Recommendations. The department agrees with the findings presented in this report and agrees with the methodology utilized to evaluate the department's internal control practices.

We recognize and appreciate that this review was large in scope and comprehensive in regard to our fundamental internal controls in Sacramento, five state hospitals and two psychiatric programs. The recommendations will be evaluated by our management team as the recommendations presented in the report have the potential to improve the department's internal control practices. The recommendations will be monitored and implemented through a Corrective Action Plan that the department has developed.

On behalf of the Department of State Hospitals, thank you for this important review of departmental internal control practices. We are also appreciative of your continued support to help the department improve its accountability through the professionalism and expertise provided by your staff.

Sincerely,

*Original signed by:*

**CLIFF ALLENBY**  
Acting Director