AUDIT COMMITTEE OF THE 
BOARD OF DIRECTORS

MONDAY, SEPTEMBER 9, 2019 
2:00 p.m. meeting

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I. CALL TO ORDER

II. PUBLIC COMMENTS

  5 minutes allowed per speaker, with a cumulative total of 15 minutes per group
  For further details and policy see Request for Public Comments notices available in the meeting room

III. INFORMATION ITEMS

  A. None

IV. OLD BUSINESS

  A. None

V. MINUTES

  *A. None

VI. NEW BUSINESS

  *A. Election of a Chairperson of the Audit Committee

VII. PRESENTATIONS

  A. Audit Entrance Presentation – (Addendum A – Pp5-13) 
     Aldrich CPAs & Advisors LLP

  B. Scheduling of a Date/Time/Location for the Next Audit Committee Meeting

VIII. COMMITTEE MEMBER COMMENTS/FUTURE AGENDA ITEMS

  Scheduling of a Date/Time/Location for the Next Audit Committee Meeting

IX. FINAL ADJOURNMENT

Next Meeting: TBD

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If you have a disability, please contact us 72 hours prior to scheduled meeting time by calling 760-740-6383 to arrange reasonable accommodations
TO: Audit Committee of the Palomar Health Development Board

MEETING DATE: Monday, September 9, 2019

FROM: Carlos A. Bohorquez, Chief Financial Officer

Background: The Bylaws of Palomar Health Development, Inc. ("Health Development") {ARTICLE IV, Section 4.12, as amended January 27, 2015} authorize the Board of Directors ("the Board") to create one or more Board committees. In November 2018, the Board formally created a two-person Audit Committee, comprised of “the two Palomar Health-appointed Directors of the Board not appointed Chairperson of the Board”.

Further, ARTICLE IV, Section 4.13 requires that regular and special meetings and actions of Board Committees shall be governed by the provisions of this Article IV applicable to meetings and actions of the Board.

ARTICLE IV, Section 4.07 requires that the Board elect officers at its Annual Organizational Meeting: “One member shall be elected as Chairperson, one as Vice-Chairperson and one as Secretary. The Board may also appoint the Treasurer at the Annual Organizational Meeting.” In order to adapt Section 4.07 for pertinence to this two-person Board Committee, a Chairperson and a Vice-Chairperson should be elected.

Budget Impact: N/A

STAFF RECOMMENDATION: Staff recommends that a Chairperson and a Vice-Chairperson be elected for the Audit Committee of the Health Development Board.

Motion: X

Individual Action:

Information:

Required Time:
TO: Audit Committee of the Palomar Health Development Board

MEETING DATE: Monday, September 9, 2019

FROM: Carlos A. Bohorquez, Chief Financial Officer

Background: The external auditing firm of Aldrich CPAs & Advisors LLP has been retained to perform an audit of the FYE June 30, 2019, financial reports of Palomar Health Development, Inc. Representatives from the firm will present the planned scope of the audit at the meeting (Addendum A).

Budget Impact: Budgeted
Scheduling the Date for the Remaining Meeting Of the Audit Committee for Calendar Year 2019

TO: Audit Committee of the Palomar Health Development Board

MEETING DATE: Monday, September 9, 2019

FROM: Carlos A. Bohorquez, Chief Financial Officer

Background: The Bylaws of Palomar Health Development, Inc. ("Health Development") {ARTICLE IV, Section 4.03, as amended January 27, 2015} provide guidelines for the regular meetings of the Health Development Board ("the Board"). Further, ARTICLE IV, Section 4.13 requires that regular and special meetings and actions of Board Committees shall be governed by the provisions of Article IV applicable to meetings and actions of the Board. The provisions of Article IV applicable to the Audit Committee are that there shall be two meetings each calendar year.

The Audit Committee was created by the Board for the specific purposes of: 1) Reviewing the intended actions of the external auditor prior to the fiscal year-end audit; and, 2) Previewing the final results of the audit before presentation to the Board. This initial meeting of the Audit Committee was organized based on the external auditor’s scheduled commencement of the audit of the FYE June 30, 2019, financial statements. A second meeting of the Audit Committee will need to be scheduled for review of the draft audit results prior to their presentation to the Board at its next regularly scheduled meeting (Wednesday, December 11, 2019). Date options for that meeting will be provided at the meeting.

Budget Impact: N/A

STAFF RECOMMENDATION: Staff recommends that the Board set the date, time and place for the Audit Committee meeting for review of the draft audited financial statements for FYE June 30, 2019.

Motion: X

Individual Action:

Information:

Required Time:
ADDENDUM A

Palomar Health Development, Inc.

Meeting with the Audit Committee and Management

For the Year Ended June 30, 2019
September 9, 2019

To the Audit Committee and Management
Palomar Health Development, Inc.

Dear Committee Members and Management,

We are pleased to discuss with you our audit service plans for Palomar Health Development, Inc. (PHD) for the year ended June 30, 2019.

The purpose of this discussion is to provide you with the required communications regarding the auditor’s responsibility, the scope of the audit, and the timing of the audit.

We would also like to discuss current year developments at PHD, as well as the risk factors, professional and regulatory changes, and other factors that will be included in our planning for the audit and that will impact the performance of our audit.

We welcome any questions or input you may have about this audit service plan. We look forward to working with you again this year and consider PHD to be an important client for our audit practice.

Very truly yours,

[Signature]

Andy Maffia, CPA
Aldrich CPAs + Advisors LLP
SCOPE OF SERVICES

We are engaged to audit the financial statements of PHD for the year ending June 30, 2019. Professional standards require that we provide you with the following information related to our audit.

As stated in our engagement letter dated July 22, 2019, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested.

Our audit will be conducted in accordance with auditing standards generally accepted in the United States of America. These standards include the requirement that our audit procedures include:

- Obtaining an understanding of PHD and its environment, including internal control, sufficient to assess the risks of material misstatement in the financial statements and to design the nature, timing, and extent of further audit procedures.
- Walkthroughs of the procedures used in significant accounting and transaction cycles to determine the effectiveness of the design of the controls.
- An assessment of the risks of material misstatement of the financial statements based on that understanding. Material misstatements may result from:
  - Errors
  - Fraudulent financial reporting
  - Misappropriation of assets
  - Violations of laws or governmental regulations that are attributable to PHD or to acts by management or employees acting on behalf of PHD.

We generally communicate our significant findings at the conclusion of the audit; however, some matters could be communicated sooner, particularly if significant difficulties are encountered during the audit where assistance is needed to overcome the difficulties or if the difficulties may lead to a modified opinion. We will also communicate any internal control related matters that are required to be communicated under professional standards.

Management is responsible for the fair presentation in the statements of financial position, activities and changes in net assets, functional expenses, and cash flows in conformity with generally accepted accounting principles. Management is responsible for adopting sound internal control policies, establishing and maintaining effective internal control, and preventing and detecting fraud. Our audit of the financial statements does not relieve you or management of your responsibilities.
SCOPE OF SERVICES, CONTINUED

Our services include:

- Financial statement audit and opinion on PHD’s financial statements as of June 30, 2019.
- As considered necessary under professional standards, and based on our judgment, a management letter commenting upon the internal controls of PHD, fiscal management practices, and other observations resulting from the audit.
- A letter to the Board of Directors and Audit Committee, identifying significant accounting policies, management judgments and accounting estimates, audit adjustments and other matters discussed during the audit.
- Meetings with the Board of Directors and/or Audit Committee prior to and at the conclusion of the audit, and at other times, as deemed appropriate.
- Completion of the information returns (form 990)

CLIENT SERVICE TEAM

Aldrich uses a client service team to bring a broad range of competencies to our engagements. We will assign a client service team that will lead our services and the additional staff needed for your requirements. The client service team will include:

- Andy Maffia, Partner – Responsible for all professional services
- Elsa Romero, Partner – Responsible for tax and consulting services

All members will be actively involved and available for the duration of the assigned services, and additional staff members will be assigned and available as needed. All staff have significant experience with not-for-profit organizations. Should there be any management staff changes we will discuss them with you prior to implementation.

SERVICE TIMELINE

We will work with management to determine a detailed timeline for our audit procedures. Our general timing is as follows:

- Pre-audit meeting with the Audit Committee and management to obtain further understanding of PHD and develop a work plan, including discussion of the audit plan: September 9, 2019
- Planning and interim fieldwork (at Aldrich’s offices): The week of October 28, 2019
- Complete fieldwork: The week of November 4, 2019
- Delivery of audit report draft to PHD: TBD
- Presentation of the audit results to the Audit Committee: TBD
- Completion of the information returns (990): TBD
SIGNIFICANT AUDIT AREAS AND ISSUES

We will focus our audit efforts on the following significant areas:

- Cash
- Grants receivable
- Revenue recognition cycle
- Net asset restrictions
- Payroll and related liabilities
- Functional expense allocations
- Controls associated with significant transaction cycles, including revenues, expenditures, and payroll

The year ended June 30, 2019 is the year in PHD which the nonprofit reporting standard, ASU 2016-14, is required to be implemented. This standard will result in additional disclosures in the financial statements and we will be working with management on the accounting changes and the required disclosures and will review those with you in the closing meeting. The following are the areas that will be impacted:

- Footnotes regarding the new standard and its impact on the financial statements
- Change in the presentation and reporting requirements for net assets and endowments
- Required liquidity disclosures
- Change in reporting of investment expenses
- Increased disclosure and reporting regarding functional expenses

FRAUD CONSIDERATIONS

Our professional standards require us to consider the risk of fraud. As it relates to our audit, fraud includes the misappropriation of assets or fraudulent financial reporting. Procedures we will perform relating to fraud considerations include:

- Reviewing internal controls for susceptibility to fraud.
- Considering the control environment and pressures/incentives to commit fraud.
- Questioning employees at various levels within PHD regarding fraud.
- Our professional standards also require us to make inquiries of the board of directors, or a representative thereof, related to fraud concerns.

PEER REVIEW

Our firm recently completed our routine peer review in accordance with standards issued by the American Institute of Certified Public Accountants (AICPA) for the year ended April 30, 2017. These standards subject a variety of our engagements to review by an independent, third-party group to ensure they are being conducted in accordance with various applicable auditing and attest standards. We have provided you with the most recent copy of the peer review report at the end of this letter.
PROFESSIONAL AND REGULATORY CHANGES
The following items relate to changes throughout the not-for-profit environment for the benefit of audit committee and management:

State of Nonprofits
The NFP sector continues to play a large role in the world economy with more than 1.5 million nonprofits registered with the IRS. According to Giving USA, all 9 sectors of recipient organizations identified (religion; education; human services; giving to foundations; health; public-society benefit; arts, culture, and humanities; international affairs; and environment and animals) experienced growth in the amount of giving received in 2016; and individuals led the way, increasing their giving by 3.9 percent in 2016. Trends continue to show that donor-advised funds are increasingly popular, with contributions into donor-advised funds growing to $23.3 billion in 2017, according to the National Philanthropic Trust's 2017 Donor-Advised Fund Report. With the adoption of new individual federal tax legislation in 2018, donor-advised funds may become more popular as individuals consider clustering their donations, giving every other year to take advantage of the higher standard tax deductions in off-giving years.

Baby boomers (those born between approximately 1946 and 1964) are retiring in staggering numbers and are expected to continue to do so over the next decade. As this large demographic exits the workforce, Nonprofits likely will be faced with leadership gaps and potential instability in their leadership positions. Succession planning has never been more top-of-mind as a key risk for boards and executive teams, especially in the nonprofit industry, given the mission-driven activities, personal relationships, and fundraising responsibilities of many nonprofit executives. To ensure the continued growth and success of the organization, the board must ensure that this transition is handled timely and correctly.

Several accounting rule changes that nonprofits should consider disclosing as pending accounting pronouncements will be effective in the near future. Nonprofits should plan to invest substantive time to determine impacts and prepare for the adoption of these standards. Important considerations include appropriate implementation timing; proper accounting; effects on process, controls, and software; and financial statement format and disclosure impacts.

Given the significance of these changes, nonprofit accounting and auditing professionals will need a thorough understanding of the requirements of each new standard and will need to plan ahead for the applicable changes, including any necessary adjustments to systems, controls, and communications with internal and external stakeholders. Also, nonprofit auditors may be called upon for assistance with the impact assessments and implementation of new standards and should make sure that independence is not impaired by any assistance that is provided.

Cybersecurity
In 2017 there was a 30% increase in data breaches reported according to the Identity Theft Resource Center. 63% of nonprofits reported at least one data breach in the last year, with healthcare and educational institutions incurring the most breaches to date for nonprofits. Most breaches were due to hacking, email phishing, or malware. In January 2017, a nonprofit was hacked, and all the agency's data was stripped, encrypted, and taken for ransom. The hackers demanded funds before they would return the data, and when the organization did not make the payment, the hackers posted sensitive donor information online. Months after the incident, the nonprofit was still in the process of carefully re-entering donor information and reported that its ability to obtain grant funding was affected by the data loss.
PROFESSIONAL AND REGULATORY CHANGES, CONTINUED

Awareness training is an important first step in any security program. It can be particularly effective when provided for all new hires, as well as annually for all employees. In addition, nonprofits may wish to employ other methods, such as a monthly email reminder or awareness posters in the break room, to frequently remind end users about safe computing habits. Each organization also needs to ensure that they have the right technology to protect them as well. These systems should be tested annually by an independent and qualified third party to make sure they work properly.

In 2019 Aldrich added a new division to our company, Aldrich Technology. Aldrich Technology offers independent security assessments to our nonprofit clients. Through an assessment process, we discover the threats and vulnerabilities that expose data, systems, and infrastructure, and we design defenses that provide critical protection. Our approach is tailored to meet each client's individual needs to manage risk, and ensure ongoing protection in a constantly changing environment.

Nonprofit Reporting Project and the 990

With the implementation of the nonprofit reporting standards there will now be differences between the financial statements and the 990 informational return. Form 990 filers will have to determine how to navigate these differences until the IRS updates the form to line up with the reporting standards. The largest issue will be in the reporting of net asset categories as the 990 will still have the prior classification of unrestricted, temporarily restricted, and permanently restricted. There are also questions related to endowments that will contain the old language. The AICPA has requested that the IRS update the form to align with the changes as well as requesting the IRS issue guidance on how the form should be completed in the interim. We will keep you posted as we learn more on this.

Revenue from Contracts with Customers

In May 2014, the revenue recognition standard was issued. The implementation date for nonprofit entities is for years beginning after December 15, 2018. This standard replaces virtually all existing revenue recognition guidance and affects all entities that enter into contracts with customers. There are two options for implementation allowed: retrospective for each period presented or to apply retrospectively but report the cumulative effect in the opening balance of net assets. Comparative periods would not have to be restated. There is also the option to only present one year which would eliminate the comparative presentation. Each organization should have an understanding of the standard and how it will impact their organization. They will also need an implementation plan that may require work in advance to ensure that contracts are designed correctly.

In response to this standard a task force was created to address the specific concerns of the nonprofit organizations. ASU 2018-08 was issued in June 2018 to provide guidance on the accounting and reporting of grants and contributions. This guidance will assist nonprofit organizations in evaluating if a transaction is an exchange transaction or a contribution. Clarification was also added to determine if a contribution is conditional or unconditional and how each of these should be recorded.

This update is effective for transactions in which an entity is either a public business entity or an NFP that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market and serves as a resource recipient, the entity should apply the amendments in this Update on contributions received to annual periods beginning after June 15, 2018, including interim periods within those annual periods. All other entities should apply the amendments for transactions in which the entity serves as the resource recipient to annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019.
PROFESSIONAL AND REGULATORY CHANGES, CONTINUED

For transactions in which an entity is either a public business entity or an NFP that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market and serves as a resource provider, the entity should apply the amendments in this Update on contributions made to annual periods beginning after December 15, 2018, including interim periods within those annual periods. All other entities should apply the amendments for transactions in which the entity serves as the resource provider to annual periods beginning after December 15, 2019, and interim periods within annual periods beginning after December 15, 2020. We have provided two webinars on this topic that are available for viewing if desired.

Other Standard updated that might impact Palomar Health Development, Inc.:

- **Lease Accounting**: The new standard for lease accounting was issued and is effective for nonprofits for years beginning after December 15, 2019, earlier application is permitted.
- **Tax Reform**: Congress passed major tax reform in December of 2017. This reform impacts NFP's primarily in the area of unrelated business income. We have provided articles and webinars on the impact and can provide copies and the link to the webinar upon request.
Report on the Firm’s System of Quality Control

September 6, 2017

To the Shareholders of Aldrich CPAs + Advisors LLP
and the Peer Review Committee of the Oregon Society of CPAs

We have reviewed the system of quality control for the accounting and auditing practice of Aldrich CPAs + Advisors LLP (the firm) in effect for the year ended April 30, 2017. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants (Standards). A summary of the nature, objectives, scope, limitations of, and the procedures performed in a System Review as described in the Standards may be found at www.aicpa.org/prsummary. The summary also includes an explanation of how engagements identified as not performed or reported in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.

Firm’s Responsibility

The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported in conformity with professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

Peer Reviewer’s Responsibility

Our responsibility is to express an opinion on the design of the system of quality control and the firm’s compliance therewith based on our review.

Required Selections and Considerations

Engagements selected for review included engagements performed under Government Auditing Standards, including compliance audits under the Single Audit Act and audits of employee benefit plans.

As a part of our peer review, we considered reviews by regulatory entities as communicated by the firm, if applicable, in determining the nature and extent of our procedures.

Opinion

In our opinion, the system of quality control for the accounting and auditing practice of Aldrich CPAs + Advisors LLP in effect for the year ended April 30, 2017, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of pass, pass with deficiency(ies) or fail. Aldrich CPAs + Advisors LLP has received a peer review rating of pass.

[Signature]
Certified Public Accountants