Financial Audit of the Department of Human Services

A Report to the Governor and the Legislature of the State of Hawaii

Report No. 98-14
April 1998

THE AUDITOR
STATE OF HAWAII

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Conducted by

The Auditor
State of Hawaii
and
KPMG Peat Marwick LLP

Submitted by

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Foreword

This is a report of the financial audit of the Department of Human Services for the fiscal year July 1, 1996 to June 30, 1997. The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, which requires the State Auditor to conduct postaudits of all departments, offices, and agencies of the State and its political subdivisions. The audit was conducted by the Office of the Auditor and the certified public accounting firm of KPMG Peat Marwick LLP.

We wish to express our appreciation for the cooperation and assistance extended by officials and staff of the Department of Human Services.

Marion M. Higa
State Auditor

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Chapter 1

Introduction

This is a report of our financial audit of the Department of Human Services. The audit was conducted by the Office of the Auditor and the independent certified public accounting firm of KPMG Peat Marwick LLP. The audit was conducted pursuant to Section 23-4, Hawaii Revised Statutes, that requires the State Auditor to conduct postaudits of the transactions, accounts, programs, and performance of all departments, offices, and agencies of the State and its political subdivisions. In addition, Section 69 of Act 328, the Appropriations Act, Session Laws of Hawaii 1997, requires the Office of the Auditor to conduct a financial and management audit of the department. The Office of the Auditor issued its Report No. 97-18, *Management Audit of the Department of Human Services*, also in response to the requirement of the 1997 Appropriations Act.

Background

The Legislature created the Department of Social Services and Housing in 1959.[1] In 1987, the department's name was changed to the Department of Human Services.[2] Section 26-14, HRS, describes the department's responsibilities:

> The department shall administer programs designed to improve the social well-being and productivity of the people of the State. Without limit to the generality of the foregoing, the department shall concern itself with problems of human behavior, adjustment, and daily living through the administration of programs of family, child and adult welfare, economic assistance, health care assistance, rehabilitation toward self-care and support, public housing, and other related programs provided by law.

Organization

The department is headed by the director of human services. The director has overall responsibility for planning, directing, and coordinating the various programs. The programs expended almost $1.3 billion in FY1996-97, of which $519 million was in general funds. The department reorganized effective July 1, 1997. For the period under audit, however, the department was organized into staff offices and operating divisions as described here.

Staff offices

Six staff offices provided support services to the department.

The Administrative Services Office provided central accounting and fiscal management services.

The Information Systems Office was responsible for the planning, management, development, and maintenance of all matters relating to the department's information processing systems and applications.

The Personnel Office managed the department's personnel programs.

The Planning Office assisted and coordinated the budget preparation, implementation, and monitoring activities of all programs in the department.

The Administrative Appeals Office provided administrative proceedings and advised the director on matters pertaining to the department's administrative rules.

The Evaluation Office assisted in evaluating and assessing the department's capabilities in implementing and monitoring public programs and utilizing resources more effectively.

Operating divisions

Four operating divisions carried out the programs of the department.

The Family and Adult Services Division administered the programs for social services and economic assistance to eligible families and individuals.

The Med-QUEST Division had overall management of the plans, policies, regulations, and procedures of the department's medical assistance program.

The Vocational Rehabilitation and Services for the Blind Division administered programs of vocational rehabilitation, independent living rehabilitation, services for the blind, and disability determination, as provided in federal and state statutes, regulations, policies, and agreements between the State and federal government agencies.

The Self-Sufficiency and Support Services Division provided case management, educational, job training, job placement services and opportunities, child care services, children's health services, and extensive supportive services to preserve and strengthen eligible families, including adults and children, to help them achieve personal and economic self-sufficiency.

Other offices

Three additional offices were assigned to the department for administrative purposes.

The Executive Office on Aging was responsible for policy development for older adults including funding, monitoring, and evaluating programs and services.

The Office of Youth Services provided a continuum of prevention, rehabilitation, and treatment services and programs for youth at risk to prevent delinquency among juveniles.

The Hawaii Housing Authority administered and managed federal and state housing projects and rent subsidy programs.

Reorganization

Federal welfare reform prompted the department to reorganize. The department realigned the public assistance, social services, and employment and child care programs. Two of the department's divisions were combined and renamed the Benefit, Employment, and Support Services Division (BESSD) and the Social Services Division. The new benefits division absorbed the programs of the Family and Adult Services Division that handled eligibility determination and the Self-Sufficiency and Support Services Division that handled payment programs for employment and child care programs. The new Social Services Division absorbed the social services programs of the Families and Adult Services Division.

Furthermore, the planning office was eliminated and the planners were placed in each division. This decentralization of planning means the divisions are now responsible for planning while the director's office handles overall policy.

Objectives of the Audit

1. Assess the adequacy, effectiveness, and efficiency of the department's systems and procedures for the financial accounting, internal control, and financial reporting; and recommend improvements to such systems, procedures and reports; and to report on the financial statements of the department.

2. Ascertain whether expenditures and other disbursements have been made and all revenues and other receipts have been collected and accounted for in accordance with applicable federal and state laws, rules and regulations, and policies and procedures.

3. Ascertain the extent to which recommendations contained in Chapter 2 of the State Auditor's Report No. 94-5, *Financial Audit of the Department of Human Services for the Fiscal Year Ended June 30, 1993*, have been implemented.

4. Make recommendations as appropriate.

Scope and Methodology

We audited the financial records and transactions and reviewed the related systems of accounting and internal controls of the department for the fiscal year July 1, 1996 to June 30, 1997 to provide us with a basis to report on the fairness of the presentation of the combined financial statements. Included in our audit were all fund types and account groups except the general fixed assets account group. We also reviewed the department's transactions, systems, and procedures for compliance with applicable laws and regulations.

We examined the existing accounting, reporting, and internal control structure and identified deficiencies and weaknesses therein. We made appropriate recommendations for improvements including, but not limited to, the forms and records, the Financial, Accounting, and Management Information System (FAMIS) and the Hawaii Automated Welfare Information System (HAWI), and the accounting and operating procedures.

The independent auditors' opinion as to the fairness of the department's combined financial statements presented in Chapter 3 is that of KPMG Peat Marwick LLP. The audit was conducted from July 1997 through November 1997 in accordance with generally accepted government auditing standards.

Chapter 2

Serious Management Control Deficiencies Persist

Management controls are steps instituted by management to ensure that objectives are met and resources are safeguarded. This chapter presents our findings and recommendations on the management controls and financial accounting and internal control practices and procedures of the Department of Human Services of the State of Hawaii. We found several reportable conditions and other problems.

Summary of Findings

We found serious deficiencies in the department's management and internal control practices that we consider to be reportable conditions. Reportable conditions are significant deficiencies in the design or operation of an organization's management controls that could adversely affect its ability to record, process, summarize, and report financial data consistent with the assertions of management in the combined financial statements.

A material weakness is the worst possible reportable condition. A material weakness exists when management controls are such that misstatements in amounts that are material to the financial statements being audited may occur. Misstatements may not be detected within a timely period by employees in the normal course of performing their assigned functions. Our findings are summarized here as material weaknesses, other reportable conditions, and others.

The following matters are considered to be material weaknesses:

1. Controls over financial assistance to individuals continue to be weak. Required annual eligibility re-verifications are not performed; data entry is not checked for accuracy; required income and eligibility verification checks are not performed or documented on a consistent basis; and required supervisory reviews of client case files are not performed. Quality control reviews that could detect errors are not being performed. As a result, the department is paying out millions of dollars in error.

2. The department's welfare benefit overpayment recovery system is still deficient. The system's current capabilities should be enhanced to improve efficiency; an aged accounts receivable subsidiary ledger is not available; available reports are not requested or used; an analysis of collection effectiveness is not performed; and a significant number of welfare overpayment

cases are not pursued by the department due to staffing constraints. The department has not collected more than $40 million of identified overpayments.

Other reportable conditions are summarized as follows:

3. The Med-QUEST Division has failed to adequately pursue collection of amounts due from QUEST participants. More than $5 million in receivables remain uncollected—most of which may never be collected.

4. The Med-QUEST Division does not review the work of its fiscal agent. During the audit, we found Medicaid overpayments in excess of $500,000 due to errors by the fiscal agent.

5. The Med-QUEST Division has not executed contracts for 41 current Medicaid providers. These providers are providing services without the protection of a contract.

6. The department has serious problems with its information technology controls over the HAWI system. The department may not be able to comply with the federal requirement that the system be capable of processing Year 2000 data this year. The department's computer system back-up and disaster recovery procedures could be improved.

In addition to the reportable conditions described above, we found problems in the department's budgeting practices and in several other aspects of the internal control structure and its operation.

Material Weaknesses Reflect Continuing Serious Management Problems

We found an overall failure by management to address the material weaknesses even though they have been brought to its attention through prior audit reports. Despite the repeated findings communicated in its annual audit reports, the department has not made the changes that could save taxpayers millions of dollars annually. Also, despite the management's assertions of improvements in collecting overpayments, ***identified*** welfare overpayments increased in receivables by almost $5 million between FY1995-96 and FY1996-97.

Inadequate Internal Controls Over Financial Assistance to Individuals Constitute a Material Weakness

The department provides financial assistance to individuals under various state and federally funded programs. The larger programs are the Aid to Families with Dependent Children (now called Temporary Assistance to Needy Families), general assistance, food stamps, and the medical assistance programs. Eligibility determination and the amount of assistance is generally dependent upon the level of income, personal asset holdings, and family size. Management controls must ensure that information on the client's application and the annual reapplication are verified prior to approval to ensure that the clients are indeed eligible and that the proper amount of assistance is being provided.

During our audit, we found continued weaknesses in the following areas:

- Required annual re-verifications for medical assistance eligibility are not performed.
- Data entry is not checked for accuracy.
- Income and eligibility verification checks are not performed or documented on a consistent basis.
- Required supervisory reviews of client case files are not performed.
- Quality control reviews to detect errors have been stopped.

Required annual eligibility re-verifications not performed

Administrative rules for Medicaid and QUEST recipients require annual re-verification of participant eligibility. As part of our audit, we selected a sample of 21 medical assistance case files to determine whether the required re-verification was performed. In our sample of 21 cases, all the cases were not re-verified. Eleven of these cases had not been reviewed for eligibility since 1994. This means that ineligible recipients may be receiving medical benefits. In addition, Medicaid and QUEST clients may be responsible for a portion of their medical claims or premiums, depending on their income limits. Since annual re-verifications are not performed on a timely basis, Medicaid clients may not be paying their appropriate share of medical claims and QUEST clients may not be assessed their share of the QUEST premium.

Data entry not checked for accuracy

Data entries for new and ongoing financial and medical assistance are daily activities for the department. The Hawaii Automated Welfare Information System (HAWI) is the computerized program in which these data entries are made. Inaccurate information entered into the HAWI system has resulted in overpayments.

When the eligibility worker has completed entering the data, HAWI prints a "budget" screen. This printout summarizes significant information entered into the system. Currently, key data for both new applications and updates on ongoing cases is entered into the HAWI system. These entries are not checked for accuracy. Given the on-line nature of the HAWI system, an accuracy check should be performed and the check should be documented by the reviewer's signature on the "budget" screen printout that is maintained in the case folder. This data entry check is not being performed. Someone other than the eligibility worker entering the data should review the data after entry to ensure completeness and accuracy.

Required income and eligibility verification checks not performed or documented on a consistent basis

To prevent the paying of benefits to those who are not eligible, the department should verify information provided by applicants for various program benefits. Case workers are required to verify the information by checking various services. They are required to conduct wage and benefit matches with the Social Security Administration, the Internal Revenue Service, and the State Wage and Information Collection Agency of the Department of Labor. Following the department's administrative rules, they are required to document the information obtained. For new applications, the department's eligibility workers can access on-line data from the labor department wage agency and the unemployment insurance program.

During our audit, we found that the required reviews were not consistently performed or documented by the units. This problem was also pointed out in our prior financial audit report, Report No. 94-5, *Financial Audit of the Department of Human Services*, and the reports of independent contract auditors in each of the past three years.

Required supervisory reviews of client case files not performed

The Benefit Employment and Support Services Division (formerly the Family and Adult Services Division) requires that a supervisor review one client case file per income maintenance worker each month. The client case file review is to be a complete review for eligibility. All reviews are to be documented on *Form DHS 1295, Case Review Sheet - Integrated Management Evaluation*. The results of the review are to be reported monthly to the branch administrators or their designees. The purpose of the monthly report is to monitor compliance with the client case file review procedures. Based on two units tested, we found that supervisory reviews are not performed on a monthly basis.

Quality control reviews should not be reduced

State and federal rules require quality control review procedures to ensure that eligibility and the amount of assistance have been properly determined. These review procedures assist the department in determining error rates and in assessing whether the errors were clientcaused or agency-caused. Prior to October 1996, the department's Evaluation Office staff selected a random statistical sample of client case files for review in the Aid to Families with Dependent Children (AFDC), Medicaid, QUEST, and Food Stamps programs. Effective October 1996, the Evaluation Office staff stopped reviewing the AFDC program as it was no longer required to do so by federal regulations. Our review of 19 cases confirmed the Evaluation Office's review that disclosed 11 cases with identified overpayments amounting to $23,490 and 2 cases with identified underpayments amounting to $270.

The value of the these case reviews to help identify processing problems and overpayments has been proven. The reviews should be expanded, not eliminated. Without these reviews, the risk of undetected welfare overpayments is substantially increased. Further, the ability to obtain useful data such as error rates and reasons for such errors, and potential corrective actions to be taken, are hampered.

However, the department's recent elimination of quality control reviews of AFDC case files is just another reduced control over welfare assistance. The department has reduced controls for other programs in prior years. Eligibility reviews of general assistance case files have not been performed since FY1994-95 and foster care case file reviews have also been eliminated since FY1995-96. Based on payment errors found by the Evaluation Office, quality control reviews should not be reduced or eliminated.

Problems have repeatedly been dismissed by the department

Many of these problems have been pointed out to the department in annual audit reports and in our Report No. 94-5. The department at that time disagreed with our recommendations to improve various quality assurance checks. It did not believe that data entry should be checked for accuracy and disagreed with our recommendation to standardize eligibility documentation procedures. In its response to our report, the department cited its relatively low error rate to justify its maintaining the status quo.

In the June 30, 1995 audit report, the department stated that it did not implement the prior recommendation to verify data entry because of staffing shortages. In the June 30, 1996 audit report, the auditors again pointed out that data entry errors cost the State money—that even relatively small error rates can result in excess payments of about $1 million per month. The audit report pointed out that ***identified*** welfare overpayments totaled $37 million at June 30, 1996. The department responded that this amount was less than one percent of total benefits paid out over the same period.

In the year ended June 30, 1997, we found that ***identified*** welfare overpayments increased receivables by $4.7 million in one year to $41.7 million. These are significant amounts of taxpayer dollars no matter how they might be cast in terms of error rates. These resources could be better used to meet the needs of other state programs.

Problems With the Welfare Benefit Overpayment Recovery System Continue

At June 30, 1997, more than 30,000 recipients of public assistance (clients) have outstanding overpayments totaling $41.7 million. Overpayments have occurred in all of the department's public assistance programs.

Over the years, deficiencies in the welfare overpayment system have been brought to the department's attention. Some improvements have been made. The department's Automated Recovery System is used to monitor and collect known overpayments. The department now prepares a report that totals the identified overpayments due the State. It has also taken steps to improve the transfer of information between its HAWI and Automated Recovery System (ARS)—that is, its computer systems that enroll clients for public assistance and that monitor and collect known overpayments. However, significant improvements can still be made to the overpayment recovery system.

Aged accounts receivable subsidiary ledger not available

The department does not have a means of determining the status (in terms of clients, number of days and amounts) of outstanding welfare overpayments. It has no detailed subsidiary ledger that indicates the total dollar amount of outstanding overpayments to be collected, the individual clients owing the overpayment, and the length of time these overpayments have been outstanding. An aged accounts receivable ledger would enable the department to focus its efforts on those accounts most likely to yield reimbursement.

The department now has a report summarizing the total amount of welfare overpayments receivable recorded in the recovery system. This report, however, is not reviewed for accuracy or completeness and has been generated specifically for the purpose of the annual audit of the financial statements. It is not used as a functional management tool to monitor and collect welfare overpayments.

Useful reports not requested or used

The ARS is a database containing all known welfare overpayment information. The system can generate useful ad hoc reports based upon user specified criteria such as dollar thresholds and time periods. The department is not taking advantage of the system's capabilities to produce these types of reports to assist in its collection efforts. Specialized reports can be very helpful to the department in developing its follow-up and collection practices.

Analysis of collection effectiveness not performed

The department has no data summarizing the results of its collection efforts. As a result, the effectiveness of the collection policies and procedures cannot be analyzed to determine if departmental resources are effectively utilized in its collection efforts.

Significant number of welfare overpayment cases not pursued due to staffing constraints

Given the large number of clients and the department's limited resources to monitor the State's welfare system, it is very difficult to identify instances of welfare overpayment and to prove welfare fraud. Therefore, when such identification is made, it is imperative that the department pursue these instances as a deterrent to other clients, as well as collect these welfare overpayments on a timely basis.

The department's Investigation Office is responsible for investigating welfare overpayment cases and is involved in initiating court proceedings. The office's Case Control Section maintains overpayment case files and determines whether investigations should be initiated based upon the facts of the case. Investigations are conducted by the office's three investigating units. Due to staffing constraints, cases are generally pursued based on dollar amounts of the overpayments, overpayments made to repeat offenders and the probability of collection, which generally exceed $5,000. Consequently, a significant number of welfare overpayments have not been investigated and pursued by the department.

We were informed that the office lacks sufficient staff to effectively pursue all welfare overpayment cases. We also found that there are numerous vacant positions at the office. As a result, the investigating units had not initiated investigative action as of June 1997 for the approximately 725 cases assigned to them.

Reportable Conditions At the Med-QUEST Division Need Management Attention

Since our last financial audit, the department has begun its well publicized QUEST Demonstration Project and has reorganized to put all medical assistance programs under its new Med-QUEST Division. We audited the demonstration project, Report No. 96-19, *Audit of the QUEST Demonstration Project*, and found serious problems with its implementation.

In this financial audit, three reportable conditions are identified at the Med-QUEST Division. These problems involve the probable loss of millions of dollars of QUEST premium payments, hundreds of thousands of dollars of Medicaid overpayments, and a failure to protect the State's interests due to lapsed contracts with service providers. The State can ill afford these conditions to remain unchecked. These reportable conditions should be of paramount concern to the director of human services.

At Least $5 Million of QUEST Premiums Due From Individuals Remains Uncollected

The division paid premiums for persons participating in its QUEST, QUEST-P, or QUEST-Net insurance programs. In some instances, part of the premium cost is supposed to be borne by the client and the State is supposed to be reimbursed. The client's share of the premiums is determined by the division's income maintenance workers. The division's collection efforts of the client's shares of the premiums have been inadequate. The reported year-end accounts receivable balance for the three years that the project has existed are presented in Exhibit 2.1. In 1997, the amount considered uncollectible, $4.9 million, nearly equaled the amount receivable leaving only $94,000 considered collectible.

Exhibit 2.1
QUEST Premiums Receivable
June 30, 1995, 1996, and 1997

	1995	1996	1997
Premiums receivable	$382,184	$4,457,321	$5,033,044
Amount considered to be uncollectible	(0)	(2,252,198)	(4,938,742)
Amount considered to be collectible	$382,184	$2,205,123	$94,302

Source: Financial audit reports and working papers for June 30, 1995, 1996, and 1997

The division's records are inadequate to properly identify clients' account balances. The division maintains a detailed record of individual account balances due from clients. This detailed record reveals that $6.7 million of QUEST premium payments is owed. However, the division also maintains another aggregated report that shows the amount due at $5,033,000. The division cannot explain the $1.7 million difference, but believes that the $5 million is the more accurate figure. We were unable to determine the correct balance and so have presented the division's preferred amount here.

Regardless of the amount, the sharp growth in uncollected and uncollectible QUEST premiums represents an additional taxpayer subsidy. The division's failure to adequately follow up on past due accounts, its practice of continuing to pay premiums even when individuals do not pay their portion, and its poor recordkeeping all contribute to the problem of wasted tax revenues.

Fiscal Agent's Medicaid Overpayments Go Undetected

The division has contracted with a vendor to act as its fiscal agent and to make payments to physicians and hospitals for services provided to Medicaid patients. The contract requires the fiscal agent to review medical claims for propriety and accuracy and to pay the physicians and hospitals the proper amounts due them. The division then reimburses its fiscal agent for amounts paid to providers.

As part of our audit procedures, we tested the validity of amounts paid to the division's fiscal agent. We found errors made by the fiscal agent that had gone undetected by the division. We selected a sample of 30 large claims submitted by providers that the fiscal agent had processed and paid. Of these large claims, we found eight overpayments amounting to $202,000 and three underpayments amounting to $4,000. We were informed that the errors in claim payments were due primarily to discrepancies in the fiscal agent's instructions to its claim reviewers and clerical errors by the fiscal agent.

We informed the Med-QUEST Division staff of the results of our testing. As a result of the overpayments we found, the Med-QUEST Division requested that the fiscal agent perform a review of selected payments to acute care hospitals for service dates from January 1, 1995 to October 3, 1997. The fiscal agent's review in October 1997 disclosed that 25 claims were paid incorrectly and adjustments are currently in process. The overpayments amounted to $300,000. When added to the $202,000 we found, a total of more than $500,000 of overpayments was identified as a result of our audit, and not through the division's management of its fiscal agent.

The division does not review any of the fiscal agent's detailed reports of claims processed and paid. The fiscal agent submits a weekly statement to the division that summarizes all Medicaid benefits paid for the week. The fiscal agent also delivers the detailed support for the summary statement, including the detailed remittance advice and corresponding claims, directly to the State Archives. The division pays the fiscal agent directly based on the summary statement it receives with no review or independent testing on any of the supporting documentation delivered to the archives. The division has neglected its responsibility to test the accuracy of the summary statement before claims are processed for payment.

Contracts Have Not Been Obtained for Current Medicaid Providers

The division is responsible for the timely completion and execution of contracts with providers who provide mandated medical assistance to the public.

We found that the division is delinquent in executing contracts with Medicaid providers. Forty-one contracts with current Medicaid providers expired between July 1 and December 1, 1996 and had not been renewed as of November 1, 1997. The division continues to pay Medicaid providers for medical services despite their expired contracts. The division justifies this practice because it expects the contracts to be forthcoming.

This is not in the best interest of the State, the Medicaid provider, or the public. Properly executed contracts are essential to ensure that the type and scope of services are agreed upon, and the roles and responsibilities of the division and the department and the Medicaid providers are clearly delineated to avoid confusion or misunderstanding. It is essential that contracts be properly executed before any services are provided. Without the benefit of a contract, there is no assurance that services being provided are those that are required. Additionally, providing services without contractually defined roles and responsibilities puts both the State and Medicaid providers in jeopardy should any legal problems arise.

The division attributes the delay in executing contracts to several reasons. A change in contract format is needed due to changes in the procurement law. New contractual provisions require a tax clearance certificate, certificate of insurance, and corporate resolution. Statistics to be provided by the fiscal agent are needed to set formula rates for acute facilities.

But dealing with the procurement code and tax clearance requirements are management's responsibilities. Management should not contract with providers who fail to provide required certificates of insurance, corporate resolutions, or statistics.

Problems With the HAWI System Are Now a Reportable Condition

The department places heavy reliance on its HAWI system to record client information and to process and pay benefits. A system failure would seriously impact the department's ability to provide benefits to its clients. A serious problem facing the department is the ability of the HAWI system to recognize the Year 2000. Also, disaster recovery and system back-up procedures need to be improved.

Year 2000 problems loom

The Year 2000 is a significant concern that should be addressed as soon as possible. The problem arises from the fact that some computers operate on only the last two digits of a year and "00" is read as "1900" rather than "2000." Failure to adequately address the Year 2000 problem could result in costly and significant application program failures that could prevent the department from performing its normal processing activities. Immediate action by the department is essential because processes that depend on dates in the future may experience difficulties or failures well in advance of the actual Year 2000.

The HAWI system manager has determined that the HAWI system is not compliant with the Year 2000 requirements. Therefore, the system will not be capable of accurately processing data after December 31, 1999. In addition, the department was notified by the Department of Budget and Finance's Information and Communication Services Division that the operating system for the mainframe that runs the HAWI system is also not Year 2000 compliant. This means that the computer operating system will have to be upgraded along with the HAWI system software to be able to accurately process data.

The federal government is requiring that all states have their systems capable of processing Year 2000 data by October 1998 in order to process federal payments. However, the department does not have the resources to make the modifications needed to meet the federal requirements by October 1998.

The department has been appropriated funds to contract with a private company to make the necessary HAWI software revisions for Year 2000 compliance. However, as of December 1997, the department had not yet received approval from the attorney general or the governor to execute this contract. In addition, the department will be contracting with IBM, the proprietary vendor, to upgrade the operating system for HAWI. The funding for this contract has not been approved.

The department needs to make the Year 2000 compliance issue a top priority.

Data back-up procedures and disaster recovery could be enhanced

A back-up of all the data in the HAWI system going back to 1988 is performed daily and the tapes are transported to an off-site storage facility the following business day. There are no scheduled tests of this back-up data or procedures to ensure that complete back-ups are being obtained.

We were also informed that the mainframe system that runs the HAWI application is not protected from power interruptions by the use of a universal power supply. A universal power supply allows a mainframe system to be brought down (turned off) in a controlled fashion, while protecting the application and its data from loss or corruption. In addition to no protection of power supply, there is no back-up power source, such as a generator, that would allow the mainframe that runs HAWI to continue operating in the event of power service disruption.

Due to the department's heavy reliance on its HAWI system, any failure, be it processing or power supply, would seriously impact the department's ability to provide benefits to its clients. In FY1996-97, the department paid out over $404 million in benefits to approximately 118,612 clients.

Weaknesses in Internal Controls Are Found in Many Other Areas

In addition to the reportable conditions described above, we noted several other weaknesses involving the department's internal control structure and its operation that are summarized as follows:

1. Problems are noted in budgeting practices. There was no documentation for health care program forecasts and the foster care program forecasting model is not effective.

2. Minimal records are maintained by the Medicaid Investigation Unit. Management is unable to determine whether cases are properly and appropriately disposed of.

3. Cash receipts collected by and for the Med-QUEST Division are not submitted for deposit on a daily basis.

4. The Evaluation Office could be used to improve internal controls. Quality control checks could help pinpoint processing errors.

5. The department is not performing federally required contractor performance reviews on a timely basis.

6. Federal reporting deadlines are not met. Future federal funding could be jeopardized.

Some Problems Noted In Budgeting Practices

Because of legislative concerns over the budget submissions of the department, we reviewed the budget development practices of the Income Maintenance, Health Care, and Foster Care programs. The contract with KPMG required the firm to test the validity of data and assumptions used when preparing cost forecasts and the capability to provide reasonable estimates of future costs.

While we found that the cost forecasting and budgeting practices of the income maintenance programs appears to be reasonable, we found problems with the forecasts for health care and foster care.

No documentation supporting health care forecasts

We were unable to evaluate the Med-QUEST Division's forecasting and budgeting practices for the health care programs. There was no documentation of underlying data and assumptions used, nor any documentation of how the data and assumptions were brought together to develop a forecast.

The lack of forecast data is a serious concern for all. Health care payments now account for more than $600 million a year from federal and state sources and are expected to rise. Errors in forecasting can result in over- or under-budgeting of millions of dollars annually. The State simply no longer has the resources to afford these types of errors. Further, without reasonable forecasts, it is virtually impossible to evaluate the programs to ensure that the moneys were spent as needed and that the moneys spent produced the desired results.

Sound data needed to evaluate QUEST status

One of the federal requirements imposed on the QUEST project is that the federal share of program costs cannot exceed a limit. At the end of the demonstration project, any costs over the limit must be repaid to the federal government. The Med QUEST Division provided us with two different five-year comparisons of projected QUEST project costs within the federal limits. The first comparison was dated January 1997 and indicated the budget limit would be exceeded by $39 million. The second comparison was dated November 1997 and indicated the project costs would be under the budget limit by $5 million—a $44 million unexplained difference from the January comparison. Just as sound data is essential to evaluate cost forecasts, sound data is also essential for an evaluation of the status of this demonstration project. At this point, the division cannot say whether the project is under or over the federal limit.

Foster Care Program budgeting methodology should be enhanced

The foster care program uses a time series regression model to project future expenditures and formulate a budget. This regression model projects future expenditures based on historical costs only and does not consider other factors. The model does not consider fluctuations in the state's economy and the vast constant changes in legislative and regulatory laws that affect the program itself. This type of regression model omits influencing factors that may significantly impact budget projections.

The program also lacks the necessary data to develop good budget projections. Good projections for future funding needs are difficult to make without accurate information on client counts. Client count is influenced by five variables: (1) living arrangements, (2) legal status, (3) goals, (4) placement responsibility, and (5) services provided. Once these variables are defined, a measurement of a client count may be determined. However, defining these variables has been debated within the program for quite some time.

To illustrate the department's inaccurate budget requests, we reviewed the 1996 program budget and found that the requested emergency appropriation of $880,000 was based on a shortage as projected by the regression model. The emergency appropriation was not warranted since historical costs did not accurately reflect future program needs. The emergency appropriation was lapsed at the end of the fiscal year as a part of the approximate $1.2 million surplus. Again in 1997, the program over budgeted its requirements by the approximately $2.1 million that was lapsed. A better forecasting model that includes influencing factors and client count sensitive to variables could have prevented the excessive budget requests.

Minimal Records Are Maintained by the Medicaid Investigation Unit

The Med-QUEST Division has a Medicaid Investigation Unit that is responsible for the integrity review and investigation of the Medicaid program. The unit consists of one staff and is responsible for conducting investigations of alleged provider improprieties identified by the surveillance and utilization system. The unit receives and evaluates all complaints and reports regarding suspected fraud/abuse of the program. It studies federal and state program plan requirements and standards relating to Medicaid fraud and abuse. The unit also assists in interpreting and adopting new or amended rules and regulations.

Management should be able to evaluate whether reported cases are investigated in a timely and appropriate manner. However, minimal records are maintained on complaints received, action taken, and final case disposition. Without these records, management is unable to determine whether appropriate action is being taken on all complaints.

Cash Receipts Collected by and for the Med-QUEST Division Are Not Deposited Daily

The Med-QUEST Division collects more than $12 million annually in nursing facility taxes and other payments. We found that deposits were delayed up to 17 working days after the date of receipt.

Delays in depositing receipts into the state treasury occur because payments received by the administrative services office are forwarded to the Med-QUEST Division for deposit instead of being deposited directly upon receipt into the state treasury. We were informed that this practice is due to only the Med-QUEST Division being authorized to deposit funds into its appropriation. The administrative services office could simply make the deposit into the state treasury and forward the supporting documentation to the Med-QUEST Division for its records.

Evaluation Office Could Be Used to Improve Internal Controls

The department's Evaluation Office consists of program and management evaluation, financial evaluation, and quality control staff. The functional statements for the office states:

> The primary function of this office is to strengthen the department's program evaluation and assessment capabilities so that the department can make rational decisions with respect to implementing public programs; setting program levels; and using human resources, materials, and equipment more effectively.
>
> The management and evaluation staff evaluate department's programs and operations and provide consultation and technical management services relating to organization, procedures, work methods, and resource utilization.
>
> The Financial Audit Staff is responsible for the examination of financial transactions, records, and statements of the department and entities doing business with the department to attest to and ensure their legality, accuracy, and reliability. The staff also reviews the department's internal control systems to ensure that controls safeguard the department's assets against loss from waste, fraud, or error.

We previously pointed out that the department has reduced its quality assurance reviews. We also note that the Evaluation Office has not initiated any independent reviews of major programs such as QUEST, Medicaid, AFDC, Food Stamps, Vocational Rehabilitation, or Title XX of the Social Security Act. Such reviews would improve the department's ability to detect deficiencies in program budgeting, eligibility redeterminations, and welfare overpayments.

We also found that the Evaluation Office has not conducted a program evaluation, examination of financial transactions, or review of internal controls during the 1996 and 1997 fiscal years. Corrective action related to previous program evaluations and internal control reviews has not been performed as responsibility for implementation has not been clearly defined by the department.

Federally Required Contract Performance Reviews Are Not Performed in a Timely Manner

The department has not yet completed the reviews of subrecipients as required by the federal government. The department contracts with various agencies to provide certain federal grant funded programs. These contracted agencies are commonly referred to as subrecipients of federal funds. Federal regulations require program reviews of these subrecipients on a timely basis and corrective action plans to address any findings from audit reports performed by the subrecipients.

The department has yet to complete the program reviews for the fiscal year ended 1996 primarily because it has not received the federally required audit reports from six subrecipients. We also found that one subrecipient informed the department that it was not subject to federal reporting requirements as it is a for-profit organization. Although contractually required, the subrecipient did not plan to submit an audit report. Contracts require the submission of audit reports. They should be submitted and the department should be reviewing them in accordance with applicable federal guidelines.

Federal Reporting Deadlines Were Not Met

The department is responsible for submitting required financial reports in a timely manner. We found that the department failed to submit its financial reports for the fiscal years ending June 30, 1996 and 1995 within the required federal deadlines.

Federal regulations during the fiscal years ending June 30, 1996 and 1995 required the department to submit its audited financial statements within 30 days after completion of the audit, but no later than one year after the end of the audit period. We found that the June 30, 1996 and 1995 audit reports were dated June 27, 1997 and June 26, 1996, respectively. However, the department's responses which were included within the reports were dated July 31, 1997 and August 13, 1996, respectively. The financial reports were submitted in excess of thirteen months after the end of the audit period. As a result, the department has failed to meet reporting deadlines required by federal regulations for agencies receiving federal financial assistance.

Conclusion

The management of the Department of Human Services needs to act on its responsibility to the taxpayers who pay for the programs it manages. Failure to conduct sufficient quality assurance checks because errors fall within some "reasonable" rate is not acceptable. An annual increase in *identified* welfare overpayments of $4.7 million is not in the public's best interest.

The director of human services needs to address the serious fiscal problems at its Med-QUEST Division. The division must be required to conduct the required annual eligibility reverification of QUEST participants. Paying medical premiums without collecting amounts clients may owe cannot be allowed to continue. Payments to its fiscal agent must be better controlled for potential overpayments. Contracts with health care providers must be in place before providers provide services and payment is made.

More attention must be given to preventing overpayment. Proper controls are not impediments to effective program performance—they are essential to effective program management. Management must devote more attention to those controls.

Recommendations

1. We recommend that the governor, the director of finance, and the director of human services re-evaluate the current allocation of resources at the department of human services. In that evaluation, the following should be considered:

    a. The current level and cost of quality assurance controls;

    b. The annual savings that would result from improvements in quality assurance practices; and

    c. The redistribution of resources to effectuate savings from improved quality assurance practices and improved identification, monitoring and collection of overpayments.

2. The director of human services must exercise stronger oversight of the Med-QUEST Division. The director must take steps to ensure that the division:

    a. Minimizes the payment of QUEST premiums on behalf of clients who do not pay or will not pay their required share of the premiums and;

b. Collects all amounts due from QUEST clients;

c. Ceases the practice of paying its fiscal agent without reviewing supporting documentation;

d. Takes steps to review supporting documentation of past disbursements to its fiscal agent to identify potential Medicaid overpayments and pursue collection of those overpayments; and

e. Ceases the practice of allowing Medicaid payments to providers that do not have contracts to provide services to Medicaid patients.

3. The department should make it a priority to modify the HAWI system to be able to accurately process data for the Year 2000.

4. The department should take steps to improve internal controls in a number of other areas; specifically the department should:

   a. Develop and retain documentation of data and assumptions used to develop its health care program forecasts and modify the foster care program forecasting model to include projected case load information;

   b. Require its Medicaid Investigation Unit to maintain adequate records to ensure that cases are properly and appropriately disposed of;

   c. Ensure that cash receipts collected by and for the Med-QUEST Division are deposited on a daily basis;

   d. Use the Evaluation Office to conduct quality assurance reviews to improve internal controls; and

   e. Take steps to ensure that federally required contractor performance reviews are performed on a timely basis and federal reporting deadlines are met.

Chapter 3

Financial Audit

This chapter presents the results of the financial audit of the Department of Human Services, State of Hawaii (DHS), as of and for the fiscal year ended June 30, 1997. This chapter includes the independent auditors' report and the report on compliance and on internal control over financial reporting as they relate to DHS. It also displays financial statements of all fund types and account groups administered by DHS, together with explanatory notes, combining financial statements and supplemental information.

Summary of Findings

In the opinion of KPMG Peat Marwick LLP, based on their audit, except for the general fixed assets account group, the combined financial statements present fairly, in all material respects, the financial position of DHS as of June 30, 1997, and the results of its operations for the year then ended in conformity with generally accepted accounting principles. KPMG Peat Marwick LLP noted matters involving the internal control structure and its operation that they considered to be reportable conditions, including material weaknesses as defined in the report on compliance and on internal control over financial reporting based on an audit of financial statements performed in accordance with *Government Auditing Standards*. They also noted that their tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Independent Auditors' Report

The Auditor
State of Hawaii:

We have audited the following combined financial statements of the Department of Human Services, State of Hawaii:

> Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Unit, June 30, 1997 (Exhibit A);
>
> Combined Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit) - All Governmental Fund Types, Expendable Trust Funds and Discretely Presented Component Unit, For the year ended June 30, 1997 (Exhibit B);

Combined Statement of Revenues and Expenditures - Budget and Actual on a Budgetary Basis - General and Special Revenue Funds, For the year ended June 30, 1997 (Exhibit C);

These combined financial statements are the responsibility of the Department of Human Services, State of Hawaii's management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards 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 combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In accordance with the terms of our engagement, the scope of our audit did not include an audit of the general fixed assets account group. As a result, the balance sheet of the general fixed assets account group is included in the accompanying combined balance sheet of the Department of Human Services, State of Hawaii, for informational purposes only. It has been prepared from the Department of Human Services, State of Hawaii's fixed asset records without audit and we express no opinion on it.

As discussed in note 1 to the combined financial statements, the combined financial statements of the Department of Human Services, State of Hawaii, are intended to present the financial position and results of operations of only that portion of the funds and account groups of the State of Hawaii that is attributable to the transactions of the Department of Human Services, State of Hawaii.

In our opinion, except for the effects of such adjustment, if any, as might have been determined to be necessary had the scope of our audit included the general fixed assets account group, as discussed in the third paragraph above, the combined financial statements referred to above present fairly, in all material respects, the financial position of the Department of Human Services, State of Hawaii, as of June 30, 1997, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

As discussed in note 17, the Department of Human Services, State of Hawaii, is subject to liabilities arising from certain circumstances, including possible charges for medical services provided to Medicaid recipients. The ultimate outcome of these items cannot presently be determined. Accordingly, no provision for any liabilities that may result has been made in the accompanying combined financial statements.

As discussed in note 17, the State of Hawaii is a defendant in a lawsuit filed by the Office of Hawaiian Affairs (OHA) related to the inclusion of certain rental income received by the State of Hawaii through the Hawaii Housing Authority, State of Hawaii, in the determination of ceded land payments due to OHA.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 28, 1997 on our consideration of the Department of Human Services, State of Hawaii's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Our audit was made for the purpose of forming an opinion on the combined financial statements taken as a whole. The combining and individual fund financial statements (Schedule I through Schedule VII) and supplementary information (Schedule VIII through Schedule XIII) are presented for purposes of additional analysis and are not a required part of the combined financial statements. Such information has been subjected to the auditing procedures applied in our audit of the combined financial statements and, in our opinion, except for the effects of such adjustment, if any, as might have been determined to be necessary had the scope of our audit included the general fixed assets account group, as discussed in the third paragraph above, is fairly stated, in all material respects, in relation to the combined financial statements taken as a whole.

/s/ KPMG Peat Marwick LLP

Honolulu, Hawaii
November 28, 1997

Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Auditor
State of Hawaii:

We have audited the combined financial statements of the Department of Human Services, State of Hawaii, as of and for the year ended June 30, 1997, and have issued our report thereon dated November 28, 1997. In accordance with the terms of our engagement, the scope of our engagement did not include the audit of the general fixed asset account group as of June 30, 1997. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance
As part of obtaining reasonable assurance about whether the Department of Human Services, State of Hawaii's combined 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 and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*. However, we noted certain immaterial instances of noncompliance that we have reported to the Auditor, State of Hawaii, in Chapter 2 of this report.

Internal Control Over Financial Reporting
In planning and performing our audit, we considered the Department of Human Services, State of Hawaii's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the combined financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department of Human Services, State of Hawaii's ability to record, process, summarize and report financial data consistent with the assertions of management in the combined financial statements. The issues we consider to be reportable conditions are described in Chapter 2 of this report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider the items relating to the internal controls over financial assistance to individuals and the welfare benefit overpayment recovery system described in Chapter 2 of this report to be material weaknesses. We also noted other matters involving the internal control over financial reporting that we have reported to the Auditor, State of Hawaii, in Chapter 2 of this report.

This report is intended for the information of the Auditor, State of Hawaii, and the management of the Department of Human Services, State of Hawaii. However, this report is a matter of public record and its distribution is not limited.

/s/ KPMG Peat Marwick LLP

Honolulu, Hawaii
November 28, 1997

Description of Combined and Combining Financial Statements and Supplemental Information

The following is a brief description of the combined financial statements, the combining and individual fund financial statements and the supplementary information audited by KPMG Peat Marwick LLP, which are located at the end of this chapter.

Combined financial statements

Combined Balance Sheet - All Fund Types, Account Groups and Discretely Presented Component Unit (Exhibit A). This statement presents the assets, liabilities and equity of all fund types and account groups of the Department of Human Services, State of Hawaii (DHS), including its component unit, the Hawaii Housing Authority, at June 30, 1997.

Combined Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit) - All Governmental Fund Types, Expendable Trust Funds and Discretely Presented Component Unit (Exhibit B). This statement presents the revenues, expenditures and changes in fund balances (deficit) for all governmental fund types and expendable trust funds of DHS, including its component unit, the Hawaii Housing Authority, for the year ended June 30, 1997.

Combined Statement of Revenues and Expenditures - Budget and Actual on a Budgetary Basis - General and Special Revenue Funds (Exhibit C). This statement compares actual revenues and expenditures of DHS's general and special revenue funds on a budgetary basis to the budget adopted by the State Legislature for the year ended June 30, 1997.

Combining, individual fund financial statements

Combining Balance Sheet - General Fund (Schedule I). This schedule presents the assets, liabilities and fund balances (deficit) of the general fund of DHS at June 30, 1997.

Combining Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit) - General Fund (Schedule II). This schedule presents the revenues, expenditures and fund balances (deficit) of the general fund of DHS for the year ended June 30, 1997.

Combining Balance Sheet - Special Revenue Funds (Schedule III). This schedule presents the assets, liabilities and fund balances of the special revenue funds of DHS at June 30, 1997.

Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Special Revenue Funds (Schedule IV). This schedule presents the revenues, expenditures and fund balances of the special revenue funds of DHS for the year ended June 30, 1997.

Combining Balance Sheet - Trust and Agency Funds (Schedule V). This schedule presents the assets, liabilities and fund balances of the trust and agency funds of DHS at June 30, 1997.

Combining Statement of Revenues, Expenditures and Changes in Fund Balances - Expendable Trust Funds (Schedule VI). This schedule presents the revenues, expenditures and fund balances of the expendable trust funds of DHS for the year ended June 30, 1997.

Combining Statement of Changes in Assets and Liabilities - Agency Funds (Schedule VII). This schedule presents the changes in assets and liabilities of the agency funds of DHS for the year ended June 30, 1997.

Supplementary information - Hawaii Housing Authority combined financial statements

Combined Balance Sheet - All Fund Types and Account Groups (Schedule VIII). This statement presents the assets, liabilities and equity of all fund types and account groups of the Hawaii Housing Authority (HHA) at June 30, 1997.

Combined Statement of Revenues, Expenditures and Changes in Fund Balances - All Governmental and Fiduciary Fund Types (Schedule IX). This statement presents the revenues, expenditures and changes in fund balances for all governmental fund types and expendable trust funds of HHA for the year ended June 30, 1997.

Combined Statement of Revenues and Expenditures Ð Budget and Actual (Budgetary Basis) - General and Special Revenue Funds (Schedule X). This statement compares actual revenues and expenditures of HHA's general and special revenue funds on a budgetary basis to the budget adopted by the State Legislature for the year ended June 30, 1997.

Combined Statement of Revenues and Expenditures - Propriety Fund Types (Schedule XI). This statement presents the revenues and expenses of HHA's enterprise and internal service funds for the year ended June 30, 1997.

Combined Statement of Fund Equity - Propriety Fund Types (Schedule XII). This statement presents the changes in fund equity of HHA's enterprise and internal service funds for the year ended June 30, 1997.

Combined Statement of Cash Flows - Propriety Fund Types (Schedule XIII). This statement presents the cash flows of HHA's enterprise and internal service funds for the year ended June 30, 1997.

Notes to Combined Financial Statements

Explanatory notes which are pertinent to an understanding of the combined financial statements and financial condition of the funds administered by the Department of Human Services, State of Hawaii, are discussed in this section.

Note 1 - Financial reporting entity

General

The Hawaii State Government Reorganization Act of 1959 (Act 1, Second Special Session Laws of Hawaii 1959) created the Department of Social Services and Housing. In 1987, the name was changed to the Department of Human Services (DHS). DHS administers programs that are designed to improve the social well-being and productivity of people of the State of Hawaii (State).

DHS is part of the executive branch of the State. DHS's combined financial statements reflect only its portion of the fund type categories. The State Comptroller maintains the central accounts for all state funds and publishes financial statements for the State annually which includes the DHS's financial activities.

For financial reporting purposes, DHS includes all funds and account groups that are controlled by or dependent on DHS. Control or dependence on DHS was determined on the basis of statutory authority and monies flowing through DHS to each fund or account group. The accompanying combined financial statements reflect the financial position and results of operations of the following divisions of DHS:

Family and Adult Services Division. This division operates the income maintenance and social services programs. Services provided to eligible recipients under those programs include direct financial assistance, food stamps and social services. The division's operations are reported in the general, special revenue, and trust and agency funds.

Med-QUEST Division. This division operates the medical assistance program. Services provided to eligible recipients include medical assistance payments. The division's operations are reported in the general and special revenue funds.

Vocational Rehabilitation Division. This division provides for the rehabilitation needs of those disabled persons who cannot meet their vocational needs without assistance. The goal of those services, which are provided to mentally, physically and visually handicapped individuals, is to assist recipients toward employment and the enjoyment of full and independent lives. The division's operations are reported in the general, special revenue, and trust funds.

Self-Sufficiency and Support Service Division. This division provides case management services, educational, job training and job placement services, child care services and children's health services to preserve and strengthen eligible families and to enable them to achieve personal and economic self-sufficiency. The division's operations are reported in the general and special revenue funds.

Departmental Administration. Departmental administration includes management, accounting, data processing and other administrative services provided to DHS. Those operations are reported in the general, special revenue and agency funds.

Executive Office on Aging. This office is responsible for policy development of older adults including funding, monitoring and evaluating programs and services. Its operations are reported in the general and special revenue funds.

Office of Youth Services. This office is charged with developing and administering programs for preventing, rehabilitating and treating juvenile delinquency in the State. Its operations are reported in the general, special revenue and agency funds.

Definition of reporting entity

DHS has defined its reporting entity in accordance with Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*. This statement establishes standards for defining and reporting on the financial reporting entity. The basic criterion for including a potential component unit within the reporting entity is financial accountability. Other criteria include legal standing and fiscal dependency.

The financial reporting entity consists of the primary government, which is DHS, and its component unit, the Hawaii Housing Authority, State of Hawaii (HHA), for which DHS is financially accountable. HHA is included in DHS's reporting entity because of the significance of its operational and financial relationship with DHS.

The component unit column in the combined financial statements includes the financial data of DHS's discretely presented component unit, HHA. It is reported in a separate column to emphasize that it is legally separate from DHS.

Hawaii Housing Authority. HHA's mission is to provide safe and sanitary dwelling accommodations for low and moderate income residents of the State. To accomplish its objective, HHA provides assistance to low and moderate income families through rent supplement programs and the development and administration of state and federal rental housing projects. HHA issues its own separate audited general purpose financial statements which may be obtained at its administrative office.

Pursuant to Chapter 356, Hawaii Revised Statutes, HHA was created as a separate legal entity. HHA's Board of Commissioners consists of eight members, six of whom are public members appointed by the Governor. Two of the public members are appointed at large, and the remaining four are selected from each county. Not more than three of the public members can be members of the same political party. The last two voting members are the Director of Human Services and the Special Assistant to the Governor for Housing.

Note 2 - Summary of significant accounting policies

Basis of presentation

The financial transactions of DHS are recorded in individual funds and account groups which are reported by type in the combined financial statements and are described in the following sections. Each fund and account group is considered a separate accounting entity, thus related operations are accounted for with a separate set of self-balancing accounts. Account groups are used to establish accounting control and accountability for DHS's general fixed assets and general long-term obligations. Account groups are not funds as they do not reflect available financial resources and related liabilities. Financial resources are allocated to and are accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled.

The total columns on the accompanying combined financial statements are captioned "Memorandum Only" to indicate that they are presented only to facilitate financial analysis. Information in these columns do not purport to present financial position or results of operations of DHS in conformity with generally accepted accounting principles. Such data is not comparable to a consolidation. Interfund balances and transactions have not been eliminated.

DHS uses the following fund types, funds and account groups:

Governmental fund types:

General Fund. Accounts for all financial resources except those required to be accounted for in another fund. The annual operating budget, as authorized by the State Legislature, provides the basic framework within which the resources and obligations of the general fund are accounted.

Special Revenue Funds. Accounts for financial resources obtained from specific revenue sources and restricted to expenditures for specific purposes.

Capital Projects Fund. Accounts for financial resources obtained and to be used for the acquisition or construction of major capital facilities.

Fiduciary fund type:

Trust and Agency Funds. Accounts for transactions related to assets held by DHS in a trustee or agency capacity. These include expendable trust funds which account for assets held in trust to be expended for designated purposes and agency funds which account for the receipts and disbursements of various amounts collected by DHS in a custodial capacity.

Account groups:

General Fixed Assets Account Group. Accounts for all fixed assets of DHS acquired for use by DHS in the conduct of its general governmental operations.

General Long-Term Obligations Account Group. Accounts for the long-term portion of accrued vacation payable for governmental fund types.

Measurement focus and basis of accounting

Governmental Fund Types, Expendable Trust and Agency Funds. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds and expendable trust funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included in the combined balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.

DHS uses the modified accrual basis of accounting for the general, special revenue, capital projects, expendable trust and agency funds. Under the modified accrual basis of accounting, revenues and related current assets are recognized in the accounting period when they become both measurable and available to finance operations of the fiscal year or liquidate liabilities existing at year-end. Measurable means that the amount of the transaction can be determined. Available means that the amount is collected in the current fiscal year or soon enough after year-end to liquidate liabilities existing at the end of the fiscal year. Revenues susceptible to accrual include federal grants and funds appropriated by the State Legislature and allotted by the Governor. Expenditures are generally recorded when the related fund liabilities are incurred.

Cash and Short-Term Investments. Cash and short-term investments include cash in the State Treasury, cash in various Hawaii banks and time certificates of deposit with original maturities of three months or less.

HUD Annual Contributions. HHA receives annual contributions and subsidies from HUD for operating HHA's housing assistance payment programs and the development and operation of low income housing projects. HUD provides the annual debt service contributions used to meet principal and interest payments on notes and bonds. The debt service contributions related to principal and interest are recognized in the combined financial statements as net loss and contributed capital from housing operations. HHA also receives annual subsidies from HUD for housing assistance payments and operating deficits incurred in the operation of the programs. Annual subsidies are recognized as net loss and contributed capital from housing operations upon notification of approval from HUD. As explained in note 10, certain debt service contributions have been discontinued and the related debt has been forgiven or is subject to forgiveness.

Receivables. Receivables in the general and special revenue funds consist primarily of amounts due from recipients of welfare benefit overpayments. The amounts reported as net receivables consist primarily of cash repayments received subsequent to the balance sheet date.

Due from Other Governments. Due from other governments consists of that portion of appropriated or awarded revenues for which cash has not yet been received. Those amounts are due from the State and the federal government, respectively.

Investment. Investment in a U.S. Treasury bill is stated at amortized cost.

Inventory. Inventory for HHA consists principally of supplies for HHA-owned projects and administrative offices, and is stated at the lower of cost (first-in, first-out method) or fair value.

Net Property and Equipment. Property and equipment reported in the general fixed assets account group are recorded at cost. Those assets were acquired or constructed for general governmental purposes and were reported as expenditures in the funds that financed the assets at acquisition. No depreciation is provided on those assets.

Property and equipment reported in HHA's proprietary fund types are recorded at cost, net of accumulated depreciation. Interest costs incurred during construction are capitalized. Depreciation and amortization has been provided over the estimated useful lives of those assets using the straight-line method. The estimated useful lives are as follows:

Structure and improvements	10-40 years
Equipment, furniture and fixtures	3-10 years
Vehicles	71/2 years

Depreciation and amortization recognized on assets acquired or constructed from grants or contributions is transferred to and deducted from contributed capital, to the extent that contributed capital is available.

Other Assets. Other assets for the special revenue fund consists of food stamp coupons to be used in the Food Stamps Program. Food stamp coupons are stated at the face value of the coupons held at various financial institutions and offset by deferred revenue.

Accumulated Vacation and Sick Leave. Employees are credited with vacation at a rate of 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment. Such accumulated vacation has been recorded as accrued wages and employee benefits payable in the general long-term obligations account group and HHA's proprietary fund types at the balance sheet date. Sick leave is not convertible to pay upon termination of employment and is recorded as an expenditure when taken.

Due to Individuals. Due to individuals consists primarily of assets held by DHS in a trustee capacity for children under foster care or at the Hawaii Youth Correctional Facility.

Encumbrances. Encumbrances are recorded obligations in the form of purchase orders and contracts and are recorded in the governmental fund types. DHS records encumbrances at the time purchase orders or contracts are awarded and executed. Encumbrances outstanding at year-end are reported as reservations of fund balances since they do not constitute expenditures or liabilities.

Reservations of Fund Balances. Portions of the governmental fund type fund balances are reserved for encumbrances outstanding at year-end. Those amounts are generally liquidated in the subsequent fiscal year.

Appropriations. An authorization granted by the State Legislature permitting a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year.

Grants. Federal grants and assistance awards made on the basis of entitlement periods are recorded as intergovernmental receivables and revenues when entitlement occurs. All other federal reimbursement-type grants are recorded as intergovernmental receivables and revenues when the related expenditures or expenses are incurred.

Intrafund and Interfund Transactions. Significant transfers of financial resources between activities included within the same fund are offset within that fund. Transfers of revenues from funds authorized to receive them to funds authorized to expend them have been recorded as operating transfers in the combined financial statements.

Employees' Retirement System. Contributions to the Employees' Retirement System of the State of Hawaii (System) include current service costs and amortization of the accrued unfunded liability over a period of 50 years from July 1, 1964. The State's policy is to fund its required contribution annually.

Risk Management. Liabilities related to certain types of losses (including torts, theft of, damage to, or destruction of assets, errors or omissions, natural disasters and injuries to employees) are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

Use of Estimates. The preparation of combined financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and other debits and liabilities and other credits, as well as disclosure of contingent assets and liabilities at the date of the combined financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Note 3 - Budgeting and budgetary control

The budget of DHS is a detailed operating plan identifying estimated costs and results in relation to estimated revenues. The budget includes (1) the programs, services and activities to be provided during the fiscal year, (2) the estimated revenues available to finance the operating plan and (3) the estimated spending requirements of the operating plan. The budget represents a process through which policy decisions are made, implemented and controlled. Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated periodically throughout the fiscal year. Amounts reflected as budgeted revenues in the combined statement of revenues and expenditures - budget and actual on a budgetary basis - general and special revenue funds are those estimates as compiled by DHS and reviewed by the Department of Budget and Finance. Budgeted expenditures are derived primarily from acts of the State Legislature and from other authorizations contained in the State Constitution, the Hawaii Revised Statutes (HRS) and other specific appropriation acts in various Session Laws of Hawaii.

All expenditures of those appropriated funds are made pursuant to the appropriations in the biennial budget as amended by subsequent supplemental appropriations. Budgetary control is maintained at the departmental level. Budget revisions and interdepartmental transfers may be effected with certain executive and legislative branch approvals.

The general fund and certain special revenue funds have legally appropriated annual budgets. The final legally adopted budget in the combined statement of revenues and expenditures - budget and actual on a budgetary basis - general and special revenue funds represent the original appropriations, transfers and other legally authorized legislative and executive changes.

To the extent not expended or encumbered, general fund and special revenue funds appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The State Legislature specifies the lapse dates and any other contingencies which may terminate the authorization for other appropriations. Known lapses occurring in the fiscal year of appropriation, if any, are included in the amended budgets, and are netted against revenues in the combined statement of revenues and expenditures - budget and actual on a budgetary basis - general and special revenue funds. Appropriations which lapse in a year subsequent to the fiscal year of appropriations do not affect current fiscal year budgets and are, therefore, excluded from that statement.

A comparison of budgeted and actual revenues and expenditures of the general and special revenue funds are presented in the combined statement of revenues and expenditures - budget and actual on a budgetary basis - general and special revenue funds. Differences between revenues and expenditures reported on the budgetary basis and those reported in accordance with generally accepted accounting principles (GAAP) are mainly due to (1) encumbrances of purchase order and contract obligations, (2) program accruals and deferrals and (3) unbudgeted revenues and expenditures. These differences represent a departure from GAAP.

A summation of the difference between revenues and expenditures reported on the budgetary basis and those reported in accordance with GAAP for the general and special revenue funds for the year ended June 30, 1997 is as follows:

	General	Special Revenue
Excess of revenues and other financing sources over (under) expenditures and other financing uses - actual on a budgetary basis	$12,503	$(7,060,896)
Reserved for encumbrances	8,459,891	4,013,352
Expenditures for liquidation of prior fiscal year encumbrances and reservations	(3,948,231)	(23,273,586)
Receivables - other	(2,335,539)	8,521
Accruals related to federal reimbursements for program expenditures	(19,546,222)	16,585,399
Vouchers and contracts payable	37,745,516	(237,529)
Accrued medical assistance payable	11,040,398	11,040,398
Excess of revenues and other financing sources over expenditures and other financing uses - GAAP basis	$31,428,316	$1,075,659

Note 4 - Cash and short-term investments

Cash and short-term investments consisted of the following at June 30, 1997:

	DHS	HHA
Cash in State Treasury	$37,165,253	$17,880,536
Cash in banks	344,864	282,586
Time certificates of deposit	---	1,550,000
Cash on hand	22,274	19,534
	$37,532,391	$19,732,656

The State maintains a cash pool that is available for all funds. Each fund type's portion of this pool (reported as cash in State Treasury) is displayed in the combined balance sheet as cash and short-term investments. Those funds are pooled with funds from other state agencies and departments and deposited in approved financial institutions by the Director of Finance. At June 30, 1997, information relating to the insurance and collateral of cash deposits was not available since such information is determined on a statewide basis and not for individual departments. Cash deposits are covered by federal deposit insurance or are collateralized by government securities held in the name of the State by third party custodians.

DHS and HHA also maintain cash in banks which are held separately from cash in State Treasury. At June 30, 1997, the carrying amounts of total bank deposits for DHS and HHA were $344,864 and $282,586, respectively. The corresponding bank balances for DHS and HHA, which are represented were $363,552 and $1,187,566, respectively. Those deposits not covered by federal deposit insurance are also fully collateralized by government securities held in the name of the State by third party custodians.

Note 5 - Other receivables

Other receivables of DHS, net of an allowance for doubtful accounts, consisted of the following at June 30, 1997:

	General	Special Revenue
Welfare benefit overpayments	$18,542,280	$23,148,334
QUEST premiums receivable	5,033,044	----
Social Security Interim Assistance Loans	568,000	----
Others	324,661	----
	24,467,985	23,148,334
Less allowance for doubtful accounts:		
Welfare benefit overpayments	18,221,280	22,854,334
QUEST premiums receivable	4,938,742	----
	23,160,022	22,854,334
Other receivables, net	$1,307,963	$294,000

Other receivables of HHA, net of an allowance for doubtful accounts, consisted of the following at June 30, 1997:

Tenant lease rent	$1,683,145
Other	483,302
	2,166,447
Less allowance for doubtful tenant lease rent accounts	1,449,199
Other receivables, net	$717,248

Note 6 - Note receivable

HHA's note receivable consists of a $426,100 uncollateralized promissory note receivable from a developer bearing interest at 9 percent. On January 1, 2010, HHA has the option to acquire certain improvements constructed by the developer. If HHA does not exercise the option, the entire principal balance and accrued interest as of January 1, 2010 will be repaid over a period of 15 years in monthly installments necessary to fully amortize the outstanding amount of this note.

Note 7 - Net property and equipment

Changes in DHS's general fixed assets account group (unaudited) for the year ended June 30, 1997 were as follows:

	Balance at July 1, 1996	Additions	Disposals	Balance at June 30, 1997
Buildings and improvements	$659,664	$----	$----	$659,664
Equipment, furniture and fixtures	22,903,150	490,644	136,752	23,257,042
	$23,562,814	$490,644	$136,752	$23,916,706

HHA's net property and equipment consisted of the following at June 30, 1997:

Land	$28,314,672
Structures and improvements	295,345,594
Equipment, furniture and fixtures	8,377,463
Vehicles	523,574
Construction in progress	60,434,075
	392,995,378
Less accumulated depreciation	127,155,642
Net property and equipment	$265,839,736

Construction in progress at June 30, 1997 consists primarily of construction costs relating to various housing projects.

Note 8 - General long-term obligations

The general long-term obligations account group of DHS is used to account for the long-term portion of the obligation for accrued vacation payable. The obligation for accrued employee benefits payable by DHS and HHA changed during the fiscal year ended June 30, 1997, as follows:

	DHS	HHA
Balance at July 1, 1996	$9,566,663	$252,368
Net increase	705,924	15,303
Balance at June 30, 1997	$10,272,587	$267,671

Note 9 - Nonimposed employee fringe benefits

Payroll fringe benefits costs of DHS's employees funded by state appropriations (general fund) are assumed by the State and are not charged to DHS's operating funds. These costs, totaling $13,731,000 for the year ended June 30, 1997, have been reported as general fund revenues and expenditures.

Note 10 - HUD collateralized liabilities

HUD collateralized liabilities of HHA consisted of the following at June 30, 1997:

U.S. government loans, bearing interest at the existing rates charged to HUD by the U.S. Treasury (8% to 10% at June 30, 1997), indefinite maturities	$6,132,554
Federal Financing Bank note, due in decreasing annual payments, maturing at various dates through 2016 and bearing interest at 6.6%	9,738,968
USGI, Inc. mortgage note, bearing interest at 7.5%, principal and interest due monthly, maturing January 1, 2018, collateralized by the Banyan Street Manor Project	1,428,803
State of Michigan Department of Treasury mortgage note, bearing interest at 7.5%, principal and interest due monthly, maturing May 2018, collateralized by the Wilikina Apartment Project	2,938,456
Housing bonds payable	17,596,000
HUD collateralized liabilities	$37,834,781

In accordance with the provisions of the "Consolidated Omnibus Budget Reconciliation Act of 1985" (Act), HUD no longer makes annual contributions for debt service on the U.S. government loans in anticipation of pending debt forgiveness meeting certain criteria.

At June 30, 1997, approximately $6,133,000 of outstanding U.S. government loans meet the criteria for forgiveness by HUD; accordingly, HHA expects that this debt will be forgiven upon action by HUD.

HHA continues to recognize the outstanding principal balance due on U.S. government loans until such time that the debt is actually forgiven. Related interest is accrued and expensed in the period incurred. Accrued interest directly related to the outstanding U.S. government loans amounted to approximately $3,101,000 at June 30, 1997, of which approximately $1,072,000 was incurred during the current fiscal year. The accrued interest is also expected to be forgiven; accordingly, HUD annual contributions receivable is being recognized to the extent of accrued interest payable at June 30, 1997.

HHA issued housing bonds pursuant to Chapter 356, HRS, to provide permanent financing for low-income housing projects. These bonds are the obligation of HHA and not of the Federal Low-Rent Program specifically or the State in general. The first five issues are callable after 10 years and the remaining issues are callable after 15 years from the date of issue. The housing bonds require annual level debt service payments and are collateralized by HUD's annual contribution for debt service and the excess of project revenues over related expenses. Housing bonds payable at June 30, 1997 consisted of the following:

Bond issue	Issue Date	Last Maturity Date	Interest Rate	Principal Balance
4th	August 1, 1957	August 1, 1998	3.000%	$81,000
5th	August 1, 1958	August 1, 1998	3.500	159,000
6th	August 1, 1959	August 1, 1998	3.500	171,000
7th	August 1, 1961	August 1, 2002	3.125	125,000
8th	August 1, 1964	August 1, 2005	3.375	2,815,000
9th	August 1, 1964	August 1, 2005	3.625	575,000
10th	August 1, 1965	August 1, 2006	3.625	1,340,000
11th	August 1, 1966	August 1, 2007	3.625	765,000
12th	August 1, 1966	August 1, 2007	4.500	1,625,000
13th	August 1, 1968	August 1, 2009	5.125	1,580,000
14th	August 1, 1970	August 1, 2009	5.750	8,360,000
		Housing bonds payable		$17,596,000

The approximate maturities of bonds and notes payable are as follows:

Year ending June 30:	
1998	$8,091,000
1999	2,001,000
2000	1,849,000
2001	1,880,000
2002	1,954,000
Thereafter	22,059,781
	$37,834,781

Note 11 - Mortgage payable

Kekuilani Gardens Project (Kekuilani), a low income housing project purchased by HHA in December 1996, entered into a mortgage agreement in December 1996 in the amount of $5,213,614 with the U.S. Department of Agriculture and Rural Development. The mortgage loan bears interest at 7.25% and is collateralized by the Kekuilani Gardens Project. Principal and interest are payable in monthly installments of $11,509 and matures on December 1, 2046. At June 30, 1997, the mortgage payable balance was $5,209,173.

Kekuilani also entered into an interest credit and rental assistance agreement in December 1996 with the U.S. Department of Agriculture Rural Development which reduces Kekuilani's principal and interest payments. During the period, Kekuilani realized approximately $106,000 of interest credit reducing the interest expense from $157,000 to $51,000.

In addition, Kekuilani entered into a mortgage agreement in December 1996 in the amount of $696,267 with the Rental Housing Trust Fund Commission. The mortgage loan bears interest at 1.00% and is collateralized by the Kekuilani Gardens Project. Principal and interest are payable in monthly installments of $1,475 and matures on January 1, 2047. At June 30, 1997, the mortgage payable balance was $690,517.

The approximate maturities of mortgage payable are as follows:

Year ending June 30:	
1998	$21,000
1999	23,000
2000	24,000
2001	25,100
2002	26,200
Thereafter	5,780,390
	$5,899,690

Note 12 - Lease commitments

Operating leases

DHS leases office facilities on a long-term basis. Those leases expire on various dates from 1997 through 2022. Certain leases include renewal and escalation clauses.

HHA leases land and improvements under a sublease agreement expiring in the year 2008.

Future minimum lease rentals under these noncancelable operating leases at June 30, 1997 are as follows:

Fiscal year ending June 30:	DHS	HHA
1998	$1,749,000	$185,000
1999	1,550,000	185,000
2000	943,000	185,000
2001	576,000	185,000
2002	349,000	185,000
Thereafter	8,949,000	1,186,800
	$14,116,000	$2,111,800

Total rent expense for DHS and HHA for the year ended June 30, 1997 amounted to approximately $ 1,944,000 and $185,000, respectively.

Land lease

Banyan Street Manor Project (Banyan Street), a low income residential housing project of HHA, entered into a lease agreement which commenced October 1973 with the City and County of Honolulu for the land on which the building is situated and all improvements thereon for a term of 55 years. Banyan Street has the option to purchase the fee simple interest in the land at any time after October 5, 1993 for a specified percentage of the fair market value at the time of purchase. Annual rentals are at a nominal amount for the entire term of the lease. Lease rent has been prepaid for the entire term.

Note 13 - Contributed capital

The contributed capital of the HUD Subsidized Programs of HHA includes HUD annual contributions for the payment of principal on debt incurred to finance development and modernization of HHA-owned housing projects.

Note 14 - Fund balance deficits and accumulated deficit

At June 30, 1997, DHS's general and special revenue funds had deficits in the unreserved fund balances aggregating to approximately $58,687,000 and 1,299,000, respectively. Those deficits resulted primarily from the fact that under GAAP, expenditures are recorded on the accrual basis when incurred, while revenues are recognized only when the funds are measurable and available.

Note 15 - Retirement benefits

Employees' retirement system

Substantially all eligible employees of DHS and HHA are members of the System, a cost-sharing multiple-employer public employee retirement plan covering eligible employees of the State and counties. The System provides retirement benefits as well as death and disability benefits. Prior to June 30, 1984, the plan consisted of only a contributory option. In 1984, legislation was enacted to add a new noncontributory option for members of the System who are also covered under social security. Persons employed in positions not covered by social security are precluded from the noncontributory option. The noncontributory option provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory option or to elect the new noncontributory option and receive a refund of previous employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory options, respectively.

Prior to June 30, 1997, required employer contributions to the System were based upon the frozen initial liability method and included amortization of the accrued unfunded liability over a period of 50 years beginning July 1, 1964. Effective June 30, 1997, the entry age normal actuarial cost method is used to calculate the total employer contribution required. Under this method, the total employer contribution is comprised of the "normal cost" plus the level annual payment required to amortize the unfunded actuarial accrued liability over the remaining period of 19 years from July 1, 1997. The employer normal cost is the level percentage of payroll contribution required to pay all benefits. Actuarial gains and losses resulting from differences between the actual and assumed experience are reflected in the employer unfunded accrued liability. The State's policy is to fund its required contribution annually.

Ten-year historical trend information showing the System's progress in accumulating sufficient assets to pay benefits when due is presented in the System's annual report.

Measurement of assets and actuarial valuations are made for the entire System and are not separately computed for individual participating employers such as DHS and HHA. The disclosures required by Governmental Accounting Standards Board Statement No. 5 are presented in the System's Comprehensive Annual Financial Report (CAFR). The following data is provided as of June 30, 1996 for the entire System from the disclosures contained in the CAFR for the year then ended, the most recent available information:

Pension benefit obligation	$7,292,592,400
Net assets available for benefits (at cost)	6,063,074,600
Unfunded pension benefit obligation	$1,229,517,800

The pension benefit obligation is a standardized measure of the present value of pension benefits, adjusted for the effects of projected salary increases, estimated to be payable in the future as a result of employee service to date.

The entire System's actuarially determined employer contribution requirements were met at June 30, 1997.

In November 1994, the GASB issued Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, which establishes a financial reporting framework for defined benefit plans that distinguishes between two categories of information: (a) current financial information about plan assets and financial activities and (b) actuarially determined information, from a long-term perspective, about the funded status of the plan and the progress being made in accumulating sufficient assets to pay benefits when due. The System adopted the provisions of this statement effective July 1, 1996.

In November 1994, the GASB also issued Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, which establishes standards for the measurement, recognition, and display of pension expenditures and related liabilities, assets, note disclosures and, if required, supplementary information in the financial reports of state and local governmental employers. The State anticipates adopting the provisions of this statement effective July 1, 1997.

Post-retirement health care and life insurance benefits

In addition to providing pension benefits, the State provides certain health care and life insurance benefits to all employees who retire from DHS and HHA on or after attaining age 62 with at least 10 years of service or age 55 with at least 30 years of service under the noncontributory option and age 55 with at least 5 years of service under the contributory option. Retirees credited with at least 10 years of service excluding sick leave credit qualify for free medical insurance premiums; however, retirees with less than 10 years must assume a portion of the monthly premiums. All disability retirees who retired after June 30, 1984, with less than 10 years of service, also qualify for free medical insurance premiums. Free life insurance coverage and dental coverage for dependents under age 19 are also available. Retirees covered by the medical portion of Medicare are eligible to receive a reimbursement of the basic medical coverage premiums. Contributions are based upon negotiated collective bargaining agreements, and are funded by the State as accrued. DHS's and HHA's share of the post-retirement health care and life insurance benefits expense for the year ended June 30, 1997 were approximately $ 2,841,000 and $406,000, respectively.

Effective July 1, 1996, certain changes were made to the postretirement medical benefits offered to employees hired after June 30, 1996. The State will pay 50% of the monthly medical insurance premiums for these retirees with at least 10 years of service but less than 15 years, 75% with at least 15 years of service but less than 25 years, and 100% with 25 or more years of service.

Note 16 - Risk management

DHS and HHA are exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets; errors and omissions; natural disasters; and injuries to employees.

Torts

DHS and HHA are involved in various actions, the outcome of which, in the opinion of management, will not have a material adverse effect on DHS's and HHA's financial position. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State's general fund, except as described in note 17.

Property and liability insurance

The State has purchased property damage insurance for losses that may occur for substantially all state facilities, including those of DHS and HHA. The policies provide for coverage of $100,000,000 per occurrence with a $250,000 deductible. The deductible for windstorm coverage is 2.5% of loss subject to a $250,000 minimum and $2,500,000 maximum per occurrence. Included in the property damage insurance is earthquake and flood coverage whose limit of loss per occurrence is $50,000,000 with a deductible of 5% of loss subject to the $250,000 deductible. In addition, the State has a $10,000,000 public employee faithful performance insurance policy with a $50,000 deductible. The State also has a personal injury and property damage liability, including automobile and public errors and omissions, insurance policy with an annual aggregate of $23,000,000 per occurrence, subject to a $2,000,000 deductible. Claims under $10,000 are handled by the risk management office of the Department of Accounting and General Services. Losses not covered by property and liability insurance are paid from legislative appropriations of the State's general fund.

Workers' compensation policy

The State is self-insured for workers' compensation. Expenditures for workers' compensation are appropriated annually from the State's general fund. DHS is covered by the State's self-insured Workers' Compensation Program for medical expenses of injured employees. However, temporary wage loss replacement benefits to these employees are paid by DHS. Liabilities for temporary wage loss replacement benefits are established if information indicates that it is probable that liabilities have been incurred as of fiscal year-end and the amounts of those benefits can be reasonably estimated. These liabilities include an amount for benefits that have been incurred but not reported. In the opinion of management, DHS has adequately reserved for such benefits. HHA has a retrospectively rated workers' compensation insurance policy. Based on available claim experience information, the minimum premium accrued for financial statement reporting purposes approximates the HHA's ultimate workers' compensation cost.

Note 17 - Commitments and other contingencies

Accumulated sick leave

Sick leave for all full-time employees accumulates at the rate of one and three-quarters working days for each month of service without limitation. It may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a state employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the System. Accumulated sick leave at June 30, 1997 amounted to approximately $ 30,378,000 and $3,730,000 for DHS and HHA, respectively.

Deferred compensation plan

The State has a deferred compensation plan which enables state employees to defer a portion of their compensation. The Department of Human Resources Development has the fiduciary responsibility of administering the plan. Deferred compensation is not available to employees until termination, retirement, death or an unforeseeable emergency. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) solely the property and rights of the State (without being restricted to the provisions of benefits under the plan), subject to the claims of the State's general creditors. Participants' rights under the plan are equal to those of the State's general creditors in an amount equal to the fair value of the deferred account balance for each participant. Deferred compensation payable at June 30, 1996, the most recent available information, for all entities of the State amounted to $462,531,000. The deferred compensation payable for DHS and HHA at June 30, 1996 is not readily available.

Medicaid program

DHS reimburses providers of medical services provided to Medicaid recipients under a Prospective Payment System (PPS). Under PPS, standard costs and rates are negotiated between DHS and the State's Medicaid providers in advance. PPS allows providers to file for standard cost and rate adjustments up to five years subsequent to the rendering of those services. The amount of future adjustments, if any, to be made for services provided through June 30, 1997 cannot be determined at this time. Any adjustments would be funded from future appropriations.
In December 1994, the U.S. Department of Health and Human Services, Health Care Financing Administration (HCFA), informed DHS of a possible disallowance associated with the State's nursing facility tax program. Under this program, nursing facilities are assessed a 6 percent tax on all nursing facility income. The nursing facility tax program contains an income tax credit to private pay patients.

HCFA is contending that the income tax credit associated with this nursing facility tax violates the hold harmless provisions contained in Section 1903 (w)(4)(A) of the Social Security Act and 42 CFR 433.68 (f), which specifies that a hold harmless provision exists when the state imposing the tax provides for a payment to taxpayers and the amount of such payment is positively correlated either to the amount of such tax or the difference between the amount of the tax and the amount of payment under the state plan.

DHS has appealed the possible disallowance of approximately $19,350,000 to $38,700,000 as of June 30, 1997. As of November 28, 1997, the appeal remains pending and the final outcome of this appeal cannot be determined at this time.

DHS is also subject to liabilities arising from charges for medical services provided to Medicaid recipients.

QUEST program

In July 1993, HCFA approved the Hawaii Health QUEST Demonstration Project under the authority of Section 1115 of the Social Security Act. The Medicaid waiver project was approved for the period April 1, 1994 to March 31, 1999. Special terms and conditions of the waiver limit the federal share of program costs over the five-year demonstration period to Medicaid expenditures that the federal government would have incurred for certain groups under the former Medicaid program (referred to as the federal limit). Any program costs that exceed the federal limit will be borne by DHS.

While the ultimate liability, if any, in the disposition of this matter is presently difficult to estimate, it is management's belief that the outcomes are not likely to have a material adverse effect on DHS's financial position. Accordingly, no provision for any liability that might result has been made in the accompanying combined financial statements.

Ceded lands

OHA et al., v. State of Hawaii, Civil No. 94-0205-01 (1st Circuit)
The lands transferred to the United States by the Republic of Hawaii at Hawaii's annexation to the United States in 1898 are commonly referred to as the ceded lands. Upon Hawaii's admission to the Union in 1959, title to ceded lands still held by the United States and to lands which the United States acquired by exchanges for ceded lands after 1898 was conveyed by the United States to the State. Section 5 of the Admission Act expressly provided that those lands were to be held by the State as a public trust. Certain rental housing projects of HHA are situated on parcels of land which are to be held by the State as a public trust under Section 5.

In 1978, the State Constitution was amended to expressly specify that the lands conveyed to the State as a public trust by the Admission Act were to be held by the State as a public trust for native Hawaiians and the general public, and to establish OHA to administer and manage the proceeds and income derived from the pro rata portion of the lands held by the State for the betterment of native Hawaiians.

On January 14, 1994, OHA filed suit against the State alleging that the State failed to properly account for and fully pay the pro rata share of proceeds and income derived from the lands of public trust established by the Admission Act and the 1978 amendments to the State Constitution. OHA seeks an accounting of all proceeds and income, funds and revenues derived from the lands since 1978, and restitution or damages amounting to 20% of the proceeds and income derived from (a) the lands since November 7, 1978, (b) the lands since June 16, 1980, and (c) the lands under Act 304, Session Laws of Hawaii 1990, as well as interest thereon. The State has denied all of OHA's substantive allegations, and asserted its sovereign immunity from suit and other jurisdictional and claim-barring defenses.

In May 1996, OHA filed four motions for partial summary judgment as to the State's liability to pay OHA 20% of monies from four specific sources, including rental housing projects of HHA situated on public trust lands. The State opposed those four motions. The State also filed a motion to dismiss on sovereign immunity grounds.

On October 24, 1996, the Circuit Court of the First Circuit of the State of Hawaii (First Circuit Court) denied the State's motion to dismiss and granted OHA's four motions for partial summary judgment. The State has filed an interlocutory appeal to the Hawaii Supreme Court from both orders. All other proceedings, including the trial previously scheduled to begin on November 18, 1996, have been stayed pending the Hawaii Supreme Court's disposition of the appeal.

OHA's complaint and motions do not specify the State's alleged failures, nor do they state the dollar amount of the claims. The First Circuit Court's October 24, 1996 order granting OHA's motions for partial summary judgment did not determine the amounts owing. The basis and methodology for calculating any such amount are being disputed. OHA has not provided complete information for its claims for the period from 1981 through 1991, and has provided no information as to its claims for the period from 1991 to the present. The expert witness retained by OHA in this case has estimated that the State's potential liability for the four sources specified in OHA's summary judgment motions for the years 1981 through 1991 (but not thereafter) to be not less than $178,000,000, of which approximately $9,200,000 is related to gross rental income derived by HHA. The Airline Committee of Hawaii, *amicus curiae* in the Circuit Court and Supreme Court proceedings, has estimated the potential liability of the State with respect to airport related proceeds and income, under a worst case analysis, to be as great as $1.2 billion.

On June 30, 1997, the Governor approved Act 329, Session Laws of Hawaii 1997. The purpose of this Act was to achieve a comprehensive, just and lasting resolution of all controversies relating to the proper management and disposition of the lands subject to public trust, and of the proceeds and income which the lands generate. The Act establishes a task force which is allowed until January 1999 to identify and consider all issues and controversies relating to the public trust, and to prepare recommendations for the State Legislature to implement through legislation. It also fixes the amount of proceeds and income OHA will receive during the two year period at $15.1 million per year, and requires the completion, continued maintenance, and use of a comprehensive inventory of the public trust lands.

OHA et al. v. HHA, et al., Civil No. 95-2682-07 (1st Circuit)
On July 27, 1995, OHA filed another suit against HHA and the Director of Finance to secure additional compensation and an itemized accounting of the sums previously paid to OHA for five specifically identified parcels of ceded lands, which were transferred to HHA for rental housing projects. Discovery is ongoing and no trial date has been set.

The State's potential liability, if any, therefore, may be determined either (1) by the ruling by the Hawaii Supreme Court on the State's interlocutory appeal and, if such ruling is adverse to the State, the conclusion of any subsequent trial and related appeals, or (2) by legislation enacted as a result of the process set out in Act 329. Given all of the above, and the uncertain timing of any final disposition of the case, the State is not able to predict either the ultimate outcome of the case, or the magnitude of its potential liability, if any, with any reasonable certainty. A legislative resolution or judicial decision adverse to the State could have a material adverse effect on the State's financial condition.

A legislative resolution or judicial decision adverse to the State could have a material adverse effect on HHA's financial condition if an adverse resolution or decision against the State includes liability for gross rental income derived by HHA from rental housing projects situated on lands in the public trust and the liability is imposed upon HHA. Given all of the above, no estimate of loss has been made in the accompanying combined financial statements.

Exhibit A

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES

Combined Balance Sheet – All Fund Types, Account Groups
and Discretely Presented Component Unit

June 30, 1997

Assets and Other Debits	Governmental Fund Types: General	Governmental Fund Types: Special Revenue	Governmental Fund Types: Capital Projects	Fiduciary Fund Type: Trust and Agency	Account Groups: General Fixed Assets (Unaudited)	Account Groups: General Long-Term Obligations	Total Primary Government (Memorandum Only)	Component Unit – Hawaii Housing Authority	Total Reporting Entity (Memorandum Only)
Cash and short-term investments (note 4)	$ 11,420,384	$ 24,853,058	$ 100,533	$ 1,158,416	$ —	$ —	$ 37,532,391	$ 19,732,656	$ 57,265,047
Receivables:									
HUD annual contributions (note 10)	—	—	—	—	—	—	—	3,881,639	3,881,639
Other (note 5)	1,307,963	294,000	—	—	—	—	1,601,963	717,248	2,319,211
Due from other funds	—	3,352,157	—	—	—	—	3,352,157	7,219,847	10,572,004
Due from other governments	—	21,346,776	—	—	—	—	21,346,776	12,553	21,359,329
Note receivable (note 6)	—	—	—	—	—	—	—	426,100	426,100
Investment in U.S. government security	—	—	—	—	—	—	—	1,850,000	1,850,000
Inventory	—	—	—	—	—	—	—	580,003	580,003
Prepayments to landlords	—	—	—	—	—	—	—	1,246,058	1,246,058
Restricted deposits and funded reserves	—	—	—	—	—	—	—	5,858,610	5,858,610
Net property and equipment (note 7)	—	—	—	—	23,916,706	—	23,916,706	265,839,736	289,756,442
Other assets:									
Food stamp coupons	—	94,836,095	—	—	—	—	94,836,095	—	94,836,095
Other	—	—	—	—	—	—	—	385,264	385,264
Resources to be provided in future years for retirement of general long-term obligations	—	—	—	—	—	10,272,587	10,272,587	267,671	10,540,258
Total assets and other debits	$ 12,728,347	$ 144,682,086	$ 100,533	$ 1,158,416	$ 23,916,706	$ 10,272,587	$ 192,858,675	$ 308,017,385	$ 500,876,060

Exhibit A, Continued

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES

Combined Balance Sheet – All Fund Types, Account Groups and Discretely Presented Component Unit

June 30, 1997

	Governmental Fund Types			Fiduciary Fund Type	Account Groups				
Liabilities, Equity and Other Credits	**General**	**Special Revenue**	**Capital Projects**	**Trust and Agency**	**General Fixed Assets (Unaudited)**	**General Long-Term Obligations**	**Total Primary Government (Memorandum Only)**	**Component Unit – Hawaii Housing Authority**	**Total Reporting Entity (Memorandum Only)**
Liabilities:									
Vouchers and contracts payable	$ 3,378,508	$ 2,079,774	$ 50,000	$ 764	$ —	$ —	$ 5,509,046	$ 4,795,237	$ 10,304,283
Accrued wages and employee benefits payable (note 8)	216,256	3,477,509	—	—	—	10,272,587	13,966,352	1,581,998	15,548,350
Accrued interest (note 10)	—	—	—	—	—	—	—	3,931,010	3,931,010
Due to individuals	—	—	—	82,002	—	—	82,002	—	82,002
Due to other agencies	—	766,254	—	—	—	—	766,254	—	766,254
Due to other funds	3,352,157	—	—	—	—	—	3,352,157	7,219,847	10,572,004
Due to other governments	—	—	—	—	—	—	—	1,060,526	1,060,526
Due to State of Hawaii	15,201,415	—	—	—	—	—	15,201,415	—	15,201,415
Deferred revenue	—	94,836,095	—	—	—	—	94,836,095	—	94,836,095
Accrued medical assistance payable	40,807,602	40,807,602	—	—	—	—	81,615,204	—	81,615,204
HUD collateralized liabilities (note 10)	—	—	—	—	—	—	—	37,834,781	37,834,781
Mortgage payable (note 11)	—	—	—	—	—	—	—	5,899,690	5,899,690
Other liabilities	—	—	—	837,951	—	—	837,951	2,027,074	2,865,025
Total liabilities	62,955,938	141,967,234	50,000	920,717	—	10,272,587	216,166,476	64,350,163	280,516,639
Equity and other credits:									
Investment in general fixed assets	—	—	—	—	23,916,706	—	23,916,706	22,654,569	46,571,275
Contributed capital (note 13):									
Federal	—	—	—	—	—	—	—	243,214,292	243,214,292
State of Hawaii	—	—	—	—	—	—	—	77,628,797	77,628,797
Other	—	—	—	—	—	—	—	423,900	423,900
	—	—	—	—	23,916,706	—	23,916,706	343,921,558	367,838,264
Less depreciation and amortization on property and equipment acquired or constructed from grants and contributions	—	—	—	—	—	—	—	111,214,755	111,214,755
	—	—	—	—	23,916,706	—	23,916,706	232,706,803	256,623,509
Retained earnings	—	—	—	—	—	—		3,231,836	3,231,836
Fund balances (deficit):									
Reserved for encumbrances	8,459,891	4,013,352	50,533	—	—	—	12,523,776	1,808,697	14,332,473
Reserved for homeless project and other	—	—	—	237,699	—	—	237,699	420,950	658,649
Unreserved (note 14)	(58,687,482)	(1,298,500)	—	—	—	—	(59,985,982)	5,498,936	(54,487,046)
Total equity and other credits	(50,227,591)	2,714,852	50,533	237,699	23,916,706	—	(23,307,801)	243,667,222	220,359,421
Commitments and contingencies (notes 8, 10, 11, 12, 15, 16 and 17)									
Total liabilities, equity and other credits	$ 12,728,347	$ 144,682,086	$ 100,533	$ 1,158,416	$ 23,916,706	$ 10,272,587	$ 192,858,675	$ 308,017,385	$ 500,876,060

See accompanying notes to combined financial statements.

Exhibit B

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES

Combined Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit) – All Governmental Fund Types, Expendable Trust Funds and Discretely Presented Component Unit

For the year ended June 30, 1997

	Governmental Fund Types			Fiduciary Fund Type			
	General	Special Revenue	Capital Projects	Expendable Trust	Total Primary Government (Memorandum Only)	Component Unit-Hawaii Housing Authority	Total Reporting Entity (Memorandum Only)
Revenues:							
State allotted appropriations	$ 537,089,729	$ —	$ 10,333	$ —	$ 537,100,062	$ 8,381,381	$ 545,481,443
Intergovernmental	—	697,753,261	—	—	697,753,261	22,558,800	720,312,061
Other (note 9)	13,731,000	25,641,167	—	93,350	39,465,517	728,736	40,194,253
Total revenues	550,820,729	723,394,428	10,333	93,350	1,274,318,840	31,668,917	1,305,987,757
Other financing sources - operating transfers in	12,503	—	—	—	12,503	28,703	41,206
Total revenues and other financing sources	550,833,232	723,394,428	10,333	93,350	1,274,331,343	31,697,620	1,306,028,963
Expenditures:							
Assured standard of living	447,445,048	661,153,473	—	—	1,108,598,521	—	1,108,598,521
Services to individuals, families and veterans	51,600,627	42,406,428	—	—	94,007,055	—	94,007,055
Vocational rehabilitation	2,193,594	9,944,553	—	24,747	12,162,894	—	12,162,894
Overall program support for social services	18,165,647	8,805,869	—	—	26,971,516	—	26,971,516
Housing	—	—	—	—	—	29,871,467	29,871,467
Capital outlays	—	—	959,800	—	959,800	1,085,010	2,044,810
Total expenditures	519,404,916	722,310,323	959,800	24,747	1,242,699,786	30,956,477	1,273,656,263
Other financing uses – operating transfers out	—	8,446	—	—	8,446	1,178,904	1,187,350
Total expenditures and other financing uses	519,404,916	722,318,769	959,800	24,747	1,242,708,232	32,135,381	1,274,843,613
Excess of revenues and other financing sources over (under) expenditures and other financing uses	31,428,316	1,075,659	(949,467)	68,603	31,623,111	(437,761)	31,185,350
Other changes in fund balances – net loss and contributed capital from housing operations	—	—	—		—	67,718,442	67,718,442
Excess of revenues and other financing sources, over (under) expenditures, other financing uses and other changes in fund balances	31,428,316	1,075,659	(949,467)	68,603	31,623,111	67,280,681	98,903,792
Fund balances (deficit) at July 1, 1996	(81,655,907)	1,639,193	1,000,000	16,103	(79,000,611)	153,731,972	74,731,361
Residual equity transfer in	—	—	—	152,993	152,993	—	152,993
Fund balances (deficit) at June 30, 1997 (note 14)	$ (50,227,591)	$ 2,714,852	$ 50,533	$ 237,699	$ (47,224,507)	$ 221,012,653	$ 173,788,146

See accompanying notes to combined financial statements.

Exhibit C

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES

Combined Statement of Revenues and Expenditures – Budget and Actual on a Budgetary Basis – General and Special Revenue Funds

For the year ended June 30, 1997

	General Fund			Special Revenue Funds		
	Budget	Actual on a Budgetary Basis	Variance Favorable (Unfavorable)	Budget	Actual on a Budgetary Basis	Variance Favorable (Unfavorable)
Revenues:						
State allotted appropriations	$ 554,931,020	$ 538,055,429	$ (16,875,591)	$ —	$ —	$ —
Intergovernmental	—	—	—	541,776,401	505,378,692	(36,397,709)
Other revenues	—	—	—	17,697,360	25,641,167	7,943,807
Total revenues	554,931,020	538,055,429	(16,875,591)	559,473,761	531,019,859	(28,453,902)
Other financing sources – operating transfer in	—	12,503	12,503	—	—	—
Total revenues and other financing sources	554,931,020	538,067,932	(16,863,088)	559,473,761	531,019,859	(28,453,902)
Expenditures:						
Assured standard of living	482,263,616	474,569,273	7,694,343	492,735,466	482,060,465	10,675,001
Services to individuals, families, and veterans	52,833,814	47,975,166	4,858,648	43,595,860	35,913,066	7,682,794
Vocational rehabilitation	3,040,024	1,451,689	1,588,335	9,197,333	8,631,829	565,504
Overall program support for social services	16,793,566	14,059,301	2,734,265	13,945,102	11,466,947	2,478,155
Total expenditures	554,931,020	538,055,429	16,875,591	559,473,761	538,072,307	21,401,454
Other financing uses – operating transfers out	—	—	—	—	8,447	(8,447)
Total expenditures and other financing uses	554,931,020	538,055,429	16,875,591	559,473,761	538,080,754	21,393,007
Excess of revenues over (under) expenditures and other financing uses	$ —	$ 12,503	$ 12,503	$ —	$ (7,060,895)	$ (7,060,895)

See accompanying notes to combined financial statements.

Schedule I

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES

Combining Balance Sheet – General Fund

June 30, 1997

Assets	Family and Adult Services Division	Med-QUEST Division	Vocational Rehabilitation Division	Self-Sufficiency and Support Service Division	Departmental Administration	Executive Office on Aging	Office of Youth Services	Total
Cash and short-term investments	$ 5,592,253	$ 1,932,586	$ 444,099	$ 1,173,163	$ 217,909	$ 551,639	$ 1,508,735	$ 11,420,384
Receivables – other	1,213,661	94,302	—	—	—	—	—	1,307,963
Total assets	$ 6,805,914	$ 2,026,888	$ 444,099	$ 1,173,163	$ 217,909	$ 551,639	$ 1,508,735	$ 12,728,347
Liabilities and Fund Balances (Deficit)								
Liabilities:								
Vouchers and contracts payable	$ 1,343,059	$ 918,423	$ 178,582	$ 130,404	$ 139,682	$ 142,475	$ 525,883	$ 3,378,508
Accrued wages and employee benefits payable	84,105	69,309	2,594	5,416	10,005	118	44,709	216,256
Due to other funds	(8,708,943)	16,570,981	(1,538,238)	(2,865,914)	(105,729)	—	—	3,352,157
Due to State of Hawaii	9,029,268	1,662,266	1,538,238	2,865,914	105,729	—	—	15,201,415
Accrued medical assistance payable	—	40,807,602	—	—	—	—	—	40,807,602
Total liabilities	1,747,489	60,028,581	181,176	135,820	149,687	142,593	570,592	62,955,938
Fund balances (deficit):								
Reserved for encumbrances	3,844,765	1,835,177	327,195	1,037,343	68,222	409,046	938,143	8,459,891
Unreserved	1,213,660	(59,836,870)	(64,272)	—	—	—	—	(58,687,482)
Total fund balances (deficit)	5,058,425	(58,001,693)	262,923	1,037,343	68,222	409,046	938,143	(50,227,591)
Total liabilities and fund balances (deficit)	$ 6,805,914	$ 2,026,888	$ 444,099	$ 1,173,163	$ 217,909	$ 551,639	$ 1,508,735	$ 12,728,347

See accompanying independent auditors' report.

Schedule II

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES

Combining Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit) – General Fund

For the year ended June 30, 1997

	Family and Adult Services Division	Med-QUEST Division	Vocational Rehabilitation Division	Self-Sufficiency and Support Service Division	Departmental Administration	Executive Office on Aging	Office of Youth Services	Total
Revenues:								
State allotted appropriations	$ 172,418,189	$ 335,749,628	$ 1,317,944	$ 7,884,644	$ 6,111,117	$ 4,922,163	$ 8,686,044	$ 537,089,729
Other	7,870,300	1,550,700	827,000	1,223,000	1,449,000	28,000	783,000	13,731,000
Total revenues	180,288,489	337,300,328	2,144,944	9,107,644	7,560,117	4,950,163	9,469,044	550,820,729
Other financing sources – operating transfers in	—	—	—	—	—	—	12,503	12,503
Total revenues and other financing sources	180,288,489	337,300,328	2,144,944	9,107,644	7,560,117	4,950,163	9,481,547	550,833,232
Expenditures:								
Assured standard of living	141,052,309	302,952,079	—	3,440,660	—	—	—	447,445,048
Services to individuals, families and veterans	31,683,760	—	—	5,471,721	—	4,541,117	9,904,029	51,600,627
Vocational rehabilitation	—	—	2,193,594	—	—	—	—	2,193,594
Overall program support for social services	5,503,825	5,000,604	—	—	7,661,218	—	—	18,165,647
Total expenditures	178,239,894	307,952,683	2,193,594	8,912,381	7,661,218	4,541,117	9,904,029	519,404,916
Excess of revenues and other financing sources over (under) expenditures	2,048,595	29,347,645	(48,650)	195,263	(101,101)	409,046	(422,482)	31,428,316
Fund balances (deficit) at July 1, 1996	3,009,830	(87,349,338)	311,573	842,080	169,323	—	1,360,625	(81,655,907)
Fund balances (deficit) at June 30, 1997	$ 5,058,425	$ (58,001,693)	$ 262,923	$ 1,037,343	$ 68,222	$ 409,046	$ 938,143	$ (50,227,591)

See accompanying independent auditors' report.

Schedule III

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES

Combining Balance Sheet – Special Revenue Funds

June 30, 1997

Assets	Family and Adult Services Division	Med-QUEST Division	Vocational Rehabilitation Division	Self-Sufficiency and Support Service Division	Departmental Administration	Executive Office on Aging	Office of Youth Services	Total
Cash and short-term investments	$ 7,991,341	$ 13,909,726	$ 1,475,774	$ 546,944	$ 403,276	$ 7,100	$ 518,897	$ 24,853,058
Receivables – other	294,000	—	—	—	—	—	—	294,000
Due from other funds	(8,195,811)	16,540,939	(2,021,328)	(2,865,914)	(105,729)	—	—	3,352,157
Due from other governments	3,350,462	14,369,195	1,362,882	2,569,095	(106,999)	(7,100)	(190,759)	21,346,776
Other assets – food stamp coupons	94,836,095	—	—	—	—	—	—	94,836,095
Total assets	$ 98,276,087	$ 44,819,860	$ 817,328	$ 250,125	$ 190,548	$ —	$ 328,138	$ 144,682,086
Liabilities and Fund Balances								
Liabilities:								
Vouchers and contracts payable	$ 802,122	$ 471,988	$ 270,689	$ 121,702	$ 85,135	$ —	$ 328,138	$ 2,079,774
Accrued wages and employee benefits payable	1,771,219	1,474,778	103,089	128,423	—	—	—	3,477,509
Due to other agencies	766,254	—	—	—	—	—	—	766,254
Deferred revenue	94,836,095	—	—	—	—	—	—	94,836,095
Accrued medical assistance payable	—	40,807,602	—	—	—	—	—	40,807,602
Total liabilities	98,175,690	42,754,368	373,778	250,125	85,135	—	328,138	141,967,234
Fund balances:								
Reserved for encumbrances	538,482	538,804	816,492	925,273	187,407	19,913	986,981	4,013,352
Unreserved	(438,085)	1,526,688	(372,942)	(925,273)	(81,994)	(19,913)	(986,981)	(1,298,500)
Total fund balances	100,397	2,065,492	443,550	—	105,413	—	—	2,714,852
Total liabilities and fund balances	$ 98,276,087	$ 44,819,860	$ 817,328	$ 250,125	$ 190,548	$ —	$ 328,138	$ 144,682,086

See accompanying independent auditors' report.

Schedule IV

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES

Combining Statement of Revenues, Expenditures and Changes in Fund Balances – Special Revenue Funds

For the year ended June 30, 1997

	Family and Adult Services Division	Med-QUEST Division	Vocational Rehabilitation Division	Self-Sufficiency and Support Service Division	Departmental Administration	Executive Office on Aging	Office of Youth Services	Total
Revenues:								
Intergovernmental	$ 313,772,175	$ 341,040,880	$ 13,081,968	$ 20,927,488	$ 1,524,210	$ 4,809,770	$ 2,596,770	$ 697,753,261
Other	386,192	24,174,814	1,080,161	—	—	—	—	25,641,167
Total revenues	314,158,367	365,215,694	14,162,129	20,927,488	1,524,210	4,809,770	2,596,770	723,394,428
Expenditures:								
Assured standard of living	282,653,261	361,403,839	4,028,479	13,067,894	—	—	—	661,153,473
Services to individuals, families and veterans	26,912,763	227,219	—	7,859,594	—	4,810,082	2,596,770	42,406,428
Vocational rehabilitation	—	—	9,944,553	—	—	—	—	9,944,553
Overall program support for social services	4,589,180	2,687,961	—	—	1,528,728	—	—	8,805,869
Total expenditures	314,155,204	364,319,019	13,973,032	20,927,488	1,528,728	4,810,082	2,596,770	722,310,323
Other financing uses – operating transfers out	—	—	9,500	(742)	—	(312)	—	8,446
Total expenditures and other financing uses	314,155,204	364,319,019	13,982,532	20,926,746	1,528,728	4,809,770	2,596,770	722,318,769
Excess of revenues over (under) expenditures and other financing uses	3,163	896,675	179,597	742	(4,518)	—	—	1,075,659
Fund balances (deficit) at July 1, 1996	97,234	1,168,817	263,953	(742)	109,931	—	—	1,639,193
Fund balances at June 30, 1997	$ 100,397	$ 2,065,492	$ 443,550	$ —	$ 105,413	$ —	$ —	$ 2,714,852

See accompanying independent auditors' report.

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES

Combining Balance Sheet – Trust and Agency Funds

June 30, 1997

	Expendable Trust Funds							Agency Funds		
Asset	McInerny Foundation	Donations for Sight Conservation	Youth Residential Program	Recruitment of Foster Parents	Geist Foundation Grant	Donation for Social Services	Donation for Aging Program	Special Deposits	Temporary Deposits	Total
Cash and short-term investments	$ 431	$ 11,389	$ 1,002	$ 4,715	$ 63,893	$ 125,141	$ 31,892	$ 82,002	$ 837,951	$ 1,158,416
Liabilities and Fund Balances										
Liabilities:										
Vouchers and contracts payable	$ —	$ 110	$ —	$ —	$ 654	$ —	$ —	$ —	$ —	$ 764
Due to individuals	—	—	—	—	—	—	—	82,002	—	82,002
Other liabilities	—	—	—	—	—	—	—	—	837,951	837,951
Total liabilities	—	110	—	—	654	—	—	82,002	837,951	920,717
Fund balances – reserved for homeless project and other	431	11,279	1,002	4,715	63,239	125,141	31,892	—	—	237,699
Total liabilities and fund balances	$ 431	$ 11,389	$ 1,002	$ 4,715	$ 63,893	$ 125,141	$ 31,892	$ 82,002	$ 837,951	$ 1,158,416

See accompanying independent auditors' report.

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES

Combining Statement of Revenues, Expenditures and
Changes in Fund Balances – Expendable Trust Funds

For the year ended June 30, 1997

	McInerny Foundation	Donations for Sight Conservation	Youth Residential Program	Recruitment of Foster Parents	Geist Foundation Grant	Donation for Social Services	Donation for Aging Program	Total
Revenues – other	$ —	$ 3,633	$ —	$ —	$ 80,588	$ 120	$ 9,009	$ 93,350
Expenditures – vocational rehabilitation	—	2,083	226	—	17,349	342	4,747	24,747
Excess of revenues over (under) expenditures	—	1,550	(226)	—	63,239	(222)	4,262	68,603
Fund balances at July 1, 1996	431	9,729	1,228	4,715	—	—	—	16,103
Residual equity transfers in	—	—	—	—	—	125,363	27,630	152,993
Fund balances at June 30, 1997	$ 431	$ 11,279	$ 1,002	$ 4,715	$ 63,239	$ 125,141	$ 31,892	$ 237,699

See accompanying independent auditors' report.

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES

Combining Statement of Changes in Assets
and Liabilities – Agency Funds

For the year ended June 30, 1997

		Balance at July 1, 1996		Additions		Deductions		Balance at June 30, 1997
Special deposits fund:								
Assets – cash	$	209,018	$	32,717	$	(159,733)	$	82,002
Liabilities – due to individuals	$	209,018	$	32,717	$	(159,733)	$	82,002
Temporary deposits fund:								
Assets – cash	$	3,257,679	$	211,125	$	(2,630,853)	$	837,951
Liabilities – other liabilities	$	3,257,679	$	211,125	$	(2,630,853)	$	837,951
Total – all agency funds:								
Assets – cash	$	3,466,697	$	243,842	$	(2,790,586)	$	919,953
Liabilities:								
Due to individuals	$	209,018	$	32,717	$	(159,733)	$	82,002
Other liabilities		3,257,679		211,125		(2,630,853)		837,951
Total liabilities	$	3,466,697	$	243,842	$	(2,790,586)	$	919,953

See accompanying independent auditors' report.

Schedule VIII

STATE OF HAWAII
HAWAII HOUSING AUTHORITY

Combined Balance Sheet – All Fund Types and Account Groups

June 30, 1997

Assets and Other Debits	Governmental Fund Types: General	Governmental Fund Types: Special Revenue	Governmental Fund Types: Capital Projects	Proprietary Fund Types: Enterprise	Proprietary Fund Types: Internal Service	Fiduciary Fund Type: Trust and Agency	Account Groups: General Fixed Assets	Account Groups: General Long-Term Obligations	Total (Memorandum Only)
Assets:									
Cash and short-term investments	$ 1,385,434	$ 4,998,159	$ 922,153	$ 11,200,028	$ 804,009	$ 422,873	$ —	$ —	$ 19,732,656
Receivables:									
HUD annual contributions	—	—	—	3,881,639	—	—	—	—	3,881,639
Tenant, net of allowance of $1,449,199	—	—	—	233,946	—	—	—	—	233,946
Other	—	16,870	—	465,498	934	—	—	—	483,302
Due from other funds	—	1,729,057	—	5,490,790	—	—	—	—	7,219,847
Due from HUD	—	12,553	—	—	—	—	—	—	12,553
Note receivable	—	—	—	426,100	—	—	—	—	426,100
Investment in U.S. government security	—	—	—	1,850,000	—	—	—	—	1,850,000
Tenant security deposits	—	—	—	62,926	—	—	—	—	62,926
Inventory	—	—	—	580,003	—	—	—	—	580,003
Prepayments to landlords	—	1,246,058	—	—	—	—	—	—	1,246,058
Restricted deposits and funded reserves	—	—	—	5,858,610	—	—	—	—	5,858,610
Deferred costs	—	—	—	101,521	—	—	—	—	101,521
Other	—	—	—	220,817	—	—	—	—	220,817
Property and equipment:									
Land	—	—	—	26,799,262	—	—	1,515,410	—	28,314,672
Structures and improvements	—	—	—	282,273,839	—	—	13,071,755	—	295,345,594
Equipment, furniture and fixtures	—	—	—	6,499,156	917,779	—	960,528	—	8,377,463
Vehicles	—	—	—	—	517,456	—	6,118	—	523,574
Construction in progress	—	—	—	53,333,317	—	—	7,100,758	—	60,434,075
	—	—	—	368,905,574	1,435,235	—	22,654,569	—	392,995,378
Less accumulated depreciation and amortization	—	—	—	125,978,251	1,177,391	—	—	—	127,155,642
Net property and equipment	—	—	—	242,927,323	257,844	—	22,654,569	—	265,839,736
Other debits – amount to be provided for retirement of general long-term obligations	—	—	—	—	—	—	—	267,671	267,671
Total assets and other debits	$ 1,385,434	$ 8,002,697	$ 922,153	$ 273,299,201	$ 1,062,787	$ 422,873	$ 22,654,569	$ 267,671	$ 308,017,385

STATE OF HAWAII
HAWAII HOUSING AUTHORITY

Combined Balance Sheet – All Fund Types and Account Groups

June 30, 1997

Liabilities, Equity and Other Credits	Governmental Fund Types: General	Governmental Fund Types: Special Revenue	Governmental Fund Types: Capital Projects	Proprietary Fund Types: Enterprise	Proprietary Fund Types: Internal Service	Fiduciary Fund Type: Trust and Agency	Account Groups: General Fixed Assets	Account Groups: General Long-Term Obligations	Total (Memorandum Only)
Liabilities:									
Accounts payable	$ 329,284	$ 5,400	$ 165,227	$ 4,295,326	$ —	$ —	$ —	$ —	$ 4,795,237
Accrued expenses:									
Interest	—	—	—	3,931,010	—	—	—	—	3,931,010
Wages and employee benefits	—	—	—	1,314,327	—	—	—	267,671	1,581,998
Other	—	—	—	703,471	—	—	—	—	703,471
Due to HUD	—	1,053,246	—	7,280	—	—	—	—	1,060,526
Due to other funds	4,379	1,445,115	—	5,770,353	—	—	—	—	7,219,847
Security deposits	—	—	—	898,602	—	—	—	—	898,602
HUD collateralized liabilities	—	—	—	37,834,781	—	—	—	—	37,834,781
Mortgage payable	—	—	—	5,899,690	—	—	—	—	5,899,690
Note payable	—	—	—	171,327	—	—	—	—	171,327
Other	—	—	—	251,751	—	1,923	—	—	253,674
Total liabilities	333,663	2,503,761	165,227	61,077,918	—	1,923	—	267,671	64,350,163
Equity and other credits:									
Investment in general fixed assets	—	—	—	—	—	—	22,654,569	—	22,654,569
Contributed capital:									
Federal	—	—	—	243,032,648	181,644	—	—	—	243,214,292
State of Hawaii	—	—	—	77,316,574	312,223	—	—	—	77,628,797
Other	—	—	—	423,900	—	—	—	—	423,900
	—	—	—	320,773,122	493,867		22,654,569	—	343,921,558
Less depreciation and amortization on property and equipment acquired or constructed from grants and contributions	—	—	—	110,732,121	482,634	—	—	—	111,214,755
			—	210,041,001	11,233	—	22,654,569	—	232,706,803
Retained earnings	—	—	—	2,180,282	1,051,554	—	—	—	3,231,836
Fund balances:									
Reserved for continuing appropriations	1,051,771	—	756,926	—	—	—	—	—	1,808,697
Reserved for homeless project expenditures	—	—	—	—	—	420,950	—	—	420,950
Unreserved	—	5,498,936	—	—	—	—	—	—	5,498,936
Total equity and other credits	1,051,771	5,498,936	756,926	212,221,283	1,062,787	420,950	22,654,569	—	243,667,222
Commitments and contingencies									
Total liabilities, equity and other credits	$ 1,385,434	$ 8,002,697	$ 922,153	$ 273,299,201	$ 1,062,787	$ 422,873	$ 22,654,569	$ 267,671	$ 308,017,385

See accompanying independent auditors' report.

Schedule IX

STATE OF HAWAII
HAWAII HOUSING AUTHORITY

Combined Statement of Revenues, Expenditures and Changes in Fund Balances – All Governmental and Fiduciary Fund Types

For the year ended June 30, 1997

	Governmental Fund Types			Fiduciary Fund Type	
	General	Special Revenue	Capital Projects	Expendable Trust	Total (Memorandum Only)
Revenues:					
Intergovernmental – HUD annual contributions	$ —	$ 22,558,800	$ —	$ —	$ 22,558,800
State allotted appropriations	7,391,381	—	990,000	—	8,381,381
Interest and other	—	728,736	—	—	728,736
Total revenues	7,391,381	23,287,536	990,000	—	31,668,917
Other financing source – operating transfers in	28,703	—	—	—	28,703
Total revenues and other financing source	7,420,084	23,287,536	990,000	—	31,697,620
Expenditures:					
Housing assistance payments	2,077,622	19,381,857	—	—	21,459,479
Homeless services	3,632,298	—	—	—	3,632,298
Personal services	475,153	1,640,057	—	—	2,115,210
Administration	211,166	1,451,272	—	—	1,662,438
Capital outlays	—	—	1,080,890	4,120	1,085,010
Security	499,621	53,878	—	—	553,499
Repairs and maintenance	22,529	219,802	—	—	242,331
Other	42,610	162,285	1,317	—	206,212
Total expenditures	6,960,999	22,909,151	1,082,207	4,120	30,956,477
Other financing use – operating transfers out to enterprise funds	377,198	801,706	—	—	1,178,904
Total expenditures and other financing use	7,338,197	23,710,857	1,082,207	4,120	32,135,381
Revenues and other financing source in excess of (under) expenditures and other financing use	81,887	(423,321)	(92,207)	(4,120)	(437,761)
Fund balances at July 1, 1996	969,884	5,922,257	849,133	425,070	8,166,344
Fund balances at June 30, 1997	$ 1,051,771	5,498,936	756,926	420,950	7,728,583

See accompanying independent auditors' report.

Schedule X

STATE OF HAWAII
HAWAII HOUSING AUTHORITY

Combined Statement of Revenues and Expenditures –
Budget and Actual (Budgetary Basis) – General and Special Revenue Funds

For the year ended June 30, 1997

	General Fund Budget	General Fund Actual (Budgetary Basis)	General Fund Variance Favorable (Unfavorable)	Special Revenue Budget	Special Revenue Actual (Budgetary Basis)	Special Revenue Variance Favorable (Unfavorable)
Revenues:						
Intergovernmental – HUD annual contributions	$ —	$ —	$ —	$ 15,874,607	$ 14,937,791	$ (936,816)
State allotted appropriations	7,567,395	7,414,906	(152,489)	—	—	—
Total revenues	7,567,395	7,414,906	(152,489)	15,874,607	14,937,791	(936,816)
Other financing source – operating transfers in	—	28,703	28,703	—	—	—
Total revenues and other financing source	7,567,395	7,443,609	(123,786)	15,874,607	14,937,791	(936,816)
Expenditures:						
Homeless services	4,178,188	4,159,970	18,218	—	—	—
Rental assistance services	2,381,870	2,277,323	104,547	15,874,607	14,937,791	936,816
Rental housing services	1,007,337	1,006,316	1,021	—	—	—
Total expenditures	7,567,395	7,443,609	123,786	15,874,607	14,937,791	936,816
Excess of revenues and other financing source over expenditures	$ —	$ —	$ —	$ —	$ —	$ —

See accompanying independent auditors' report.

STATE OF HAWAII
HAWAII HOUSING AUTHORITY

Combined Statement of Revenues and Expenses – Proprietary Fund Types

For the year ended June 30, 1997

	Enterprise	Internal Service	Total (Memorandum Only)
Operating revenues:			
Rental	$ 18,774,859	$ 128,994	$ 18,903,853
Other	658,361	—	658,361
Total operating revenues	19,433,220	128,994	19,562,214
Operating expenses:			
Personal services	9,425,172	—	9,425,172
Depreciation and amortization	9,029,805	119,464	9,149,269
Utilities	6,968,785	—	6,968,785
Repairs and maintenance	3,531,065	—	3,531,065
Payments in lieu of taxes	735,725	—	735,725
Insurance	276,658	—	276,658
Other	2,509,436	524	2,509,960
Total operating expenses	32,476,646	119,988	32,596,634
Operating income (loss)	(13,043,426)	9,006	(13,034,420)
Nonoperating revenues and expenses:			
Interest expense	(2,997,467)	—	(2,997,467)
HUD accrued contribution for interest	2,570,308	—	2,570,308
HUD operating subsidy	7,248,751	—	7,248,751
Interest income	578,038	26,852	604,890
Total net nonoperating revenues	7,399,630	26,852	7,426,482
Operating transfers in from:			
General fund	377,198	—	377,198
Special revenue funds	801,706	—	801,706
Total operating transfers	1,178,904	—	1,178,904
Net income (loss)	$ (4,464,892)	$ 35,858	$ (4,429,034)

See accompanying independent auditors' report.

STATE OF HAWAII
HAWAII HOUSING AUTHORITY

Combined Statement of Fund Equity – Proprietary Fund Types

For the year ended June 30, 1997

	Enterprise			Internal Service			
	Contributed Capital	Retained Earnings	Total Fund Equity	Contributed Capital	Retained Earnings	Total Fund Equity	Total (Memorandum Only)
Balances at July 1, 1996	$ 146,859,785	$ (2,321,086)	$ 144,538,699	$ 44,864	$ 982,065	$ 1,026,929	$ 145,565,628
Net income (loss)	—	(4,464,892)	(4,464,892)	—	35,858	35,858	(4,429,034)
Transfer of depreciation and amortization on property and equipment acquired or constructed from grants and contributions to contributed capital	(8,966,260)	8,966,260	—	(33,631)	33,631	—	—
Contributions:							
Federal	345,365	—	345,365	—	—	—	345,365
HUD annual contributions	61,325,878	—	61,325,878	—	—	—	61,325,878
State of Hawaii	10,476,233	—	10,476,233	—	—	—	10,476,233
Balances at June 30, 1997	$ 210,041,001	$ 2,180,282	$ 212,221,283	$ 11,233	$ 1,051,554	$ 1,062,787	$ 213,284,070

See accompanying independent auditors' report.

STATE OF HAWAII
HAWAII HOUSING AUTHORITY

Combined Statement of Cash Flows – Proprietary Fund Types

For the year ended June 30, 1997

	Enterprise	Internal Service	Total (Memorandum Only)
Cash flows from operating activities:			
Operating income (loss)	$ (13,043,426)	$ 9,006	$ (13,034,420)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	9,029,805	119,464	9,149,269
Loss on disposal of fixed assets	—	524	524
Provision for uncollectible accounts	607,027	—	607,027
Decrease (increase) in assets:			
HUD grants receivable	89,211	—	89,211
Tenant and other receivables	(504,650)	—	(504,650)
Due from other funds	(376,777)	46,195	(330,582)
Inventory	(54,222)	—	(54,222)
Other assets	(2,173)	—	(2,173)
Increase (decrease) in liabilities:			
Accounts payable	(756,388)	—	(756,388)
Accrued expenses	211,264	—	211,264
Due to HUD	7,280	—	7,280
Due to other funds	510,721	(5,531)	505,190
Other liabilities	(93,016)	—	(93,016)
Total adjustments	8,668,082	160,652	8,828,734
Net cash provided by (used in) operating activities	(4,375,344)	169,658	(4,205,686)
Cash flows from noncapital financing activities:			
HUD operating subsidy received	7,248,751	—	7,248,751
Operating transfer in from special revenue fund	600,000	—	600,000
Operating transfers in from general funds	377,198	—	377,198
Net cash provided by noncapital financing activities	8,225,949	—	8,225,949
Cash flows from capital and related financing activities:			
Payments for capital acquisition	(31,761,010)	(52,090)	(31,813,100)
Principal payments on mortgage loan	(99,319)	—	(99,319)
Proceeds from loans	6,894,224	—	6,894,224
Payments of interest	(425,735)	—	(425,735)
Receipts from capital grants	25,070,444	—	25,070,444
Operating transfers in from special revenue funds	201,706	—	201,706
Net cash used in capital and related financing activities	$ (119,690)	$ (52,090)	$ (171,780)

STATE OF HAWAII
HAWAII HOUSING AUTHORITY

Combined Statement of Cash Flows – Proprietary Fund Types, Continued

	Enterprise	Internal Service	Total (Memorandum Only)
Cash flows from investing activities:			
Receipts of interest	$ 544,687	$ 26,878	$ 571,565
Purchase of time certificates of deposit	(400,000)	—	(400,000)
Net increase in restricted deposits and funded reserves	(1,088,202)	—	(1,088,202)
Net cash provided by (used in) investing activities	(943,515)	26,878	(916,637)
Net increase in cash and cash equivalents	2,787,400	144,446	2,931,846
Cash and cash equivalents at July 1, 1996	7,512,628	159,563	7,672,191
Cash and cash equivalents at June 30, 1997	$ 10,300,028	$ 304,009	$ 10,604,037
Reconciliation of cash and cash equivalents to cash and short-term investments:			
Cash and cash equivalents	$ 10,300,028	$ 304,009	$ 10,604,037
Time certificates of deposit with original maturities greater than three months	900,000	500,000	1,400,000
Cash and short-term investments at June 30, 1997	$ 11,200,028	$ 804,009	$ 12,004,037

Schedule of noncash investing, capital and financing activities:

During the current fiscal year, the Federal Low-Rent Program had a reduction in accrued interest on HUD collateralized debt and a reduction in HUD collateralized debt of $29,061,113 and $34,758,220, respectively, which was forgiven by HUD.

During the current fiscal year, the Enterprise Funds acquired $10,629,377 of certain capital assets that were contributed to the Funds by federal and state agencies.

During the current fiscal year, the Kekuilani Garden Project accrued $13,000 of interest expense which was converted to mortgage payable.

See accompanying independent auditors' report.

Notes

Chapter 1

1. Act 1, State Government Reorganization Act, Session Laws of Hawaii, Second Special Session of 1959.

2. Act 339, SLH, Regular Session of 1987.

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Human Services on March 27, 1998. A copy of the transmittal letter to the department is included as Attachment 1. The department's response is included as Attachment 2.

The department generally concurs with our findings and recommendations. It states that at the time of the audit review, the department was already developing and implementing corrective actions. However, it noted that staffing constraints and limited resources make some of the recommendations difficult to implement.

The department generally agrees with our finding that controls over financial assistance are weak. It recognizes the need to disenroll those who are ineligible for medical assistance programs and has a major effort underway to aggressively attack the overdue and currently due eligibility reviews. The department also recognizes the need for the review of client data entry and income and eligibility verification checks, and for supervisory reviews of client case files and quality control reviews. The department will try to make improvements in these areas with available resources and staffing.

The department also concurs with our finding that the welfare benefit overpayment system is still deficient. It recognizes the inefficiencies of its computerized Automated Recovery System (ARS) and will continue to work on enhancements to include an aging of accounts receivable and other specialized reports to aid in follow-up and improved collection practices. The department states that it has improved in the collection of total overpayments. While we recognize the collection efforts of the department, we believe it still needs to do a better job at *preventing* overpayments, which in FY1996-97 increased by over $4.7 million.

The department also agrees with our finding that the fiscal agent contracted to make Medicaid payments for the Med-QUEST Division overpaid physicians and hospitals in excess of $500,000. It conducted its own investigation and identified claims that were manually priced in error. The department noted that the overpaid amounts have been recovered and that it plans to incorporate an annual claims review audit requirement in the next Request for Proposal for a new fiscal agent.

In addition, the department agrees with our finding on the failure to timely complete and execute contracts with Medicaid providers. However, it feels that the protection of a contract is unnecessary since these facility providers complete and sign a Medicaid provider application that specifies the provider responsibilities and agreements. The department will consult with the attorney general to determine whether contracts for facilities may be replaced with an application/contracting process.

Furthermore, the department concurs with our findings on the problems with the HAWI system. It states that it is in the process of obtaining approvals to hire consultants to help upgrade its operating systems and applications software to become Year 2000 compliant. In addition, the department states that the system backup and recovery process has performed successfully on several occasions though not tested on a regular basis, and that funds are lacking for a disaster recovery plan as requested by DAGS.

Finally, the department agrees with our findings related to weaknesses in the department's internal controls and has begun corrective actions. It states that 1) improvements in documentation of data and assumptions used for the health care program forecast have been made for the current biennium, 2) the Medicaid Investigation Unit is now maintaining detailed records on all complaints received, including actions taken and final case dispositions, 3) new procedures were recently implemented to insure timely deposits of cash receipts for the Med-QUEST Division, 4) corrective actions related to previous program evaluations and internal control review are being implemented, and 5) the financial reviews of its subrecipients for the fiscal year ended June 30, 1996 have been completed.

We made a few editorial changes to our draft report for the purposes of clarity, consistency, and style.

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917

MARION M. HIGA
State Auditor

(808) 587-0800
FAX: (808) 587-0830

March 27, 1998

COPY

The Honorable Susan M. Chandler, Director
Department of Human Services
Queen Liliuokalani Building
1390 Miller Street
Honolulu, Hawaii 96813

Dear Dr. Chandler:

Enclosed for your information are three copies, numbered 6 to 8 of our draft report, *Financial Audit of the Department of Human Services*. We ask that you telephone us by Tuesday, March 31, 1998, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Monday, April 6, 1998.

The Governor and presiding officers of the two houses of the Legislature have also been provided copies of this draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Marion M. Higa

Marion M. Higa
State Auditor

Enclosures

ATTACHMENT 2

BENJAMIN J. CAYETANO
GOVERNOR

SUSAN M. CHANDLER, M.S.W., Ph.D.
DIRECTOR

KATHLEEN G. STANLEY
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES

P.O. Box 339
Honolulu, Hawaii 96809-0339

April 3, 1998

RECEIVED
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OFC. OF THE AUDITOR
STATE OF HAWAII

The Honorable Marion M. Higa
State Auditor
Office of the Auditor
465 S. King Street
Honolulu, Hawaii 96813-2917

Dear Mrs. Higa:

Thank you for the opportunity to review and comment on the draft report, Financial Audit of the Department of Human Services, prepared by your office. The department is in general agreement with the findings and recommendations of the report. At the time of the audit review, the department was already developing and implementing corrective actions. However, it should be noted that staffing constraints and limited resources make some of the recommendations difficult to implement.

In the hope of contributing to a broader understanding of the findings, we would like to offer the following:

- A key problem is the recovery of overpayments. The department will redouble its efforts in this area, and is prepared to improve collections to the degree that staffing will allow. Although we are proud of the fact that we have been rated first in the nation in accuracy, we also recognize that any payments to ineligible clients are unacceptable.

- It is important to understand that the overpayment total cited in the audit report is an amount accumulated since 1984, and that federal law has limited the department's recovery abilities for much of that period.

- The department recognizes that there are funds that can be recovered with increased capabilities and has coordinated with the Department of the Attorney General to request staff to be assigned specifically to pursuing collection of overpayments.

- We have asked the 1998 Legislature for additional staffing to strengthen the eligibility and eligibility reverification capabilities of the Med-QUEST Division and to support the Med-QUEST information systems.

We agree with the auditor's recommendations and:

- We will work with the Governor and the Director of Finance to re-evaluate the current allocation of resources at the Department of Human Services ;
- The department will exercise stronger oversight of the Med-QUEST Division;
- The department will make it a priority to modify the HAWI system to be able to accurately process data for the Year 2000; and
- The department will take steps to improve internal controls.

We recognize that the Auditor's Office is valuable in helping us to move toward our shared goal: a department that runs with maximum efficiency as it continues to provide its essential services to the people of Hawaii. The department appreciates that the Auditor has acknowledged the progress being made since the last audit and has reported the department's high accuracy rate for the financial assistance and food stamp programs, first in the nation in financial assistance and second in food stamp, respectively. The Department of Human Services administers over $800 million in assistance annually. We are proud of our record to date and we recognize the need for constant improvement.

Attached are the department's comments on the audit report's findings that explain more fully the department's actions in addressing the problems described in your report.

Sincerely,

Susan M. Chandler

Susan M. Chandler, M. S. W., Ph.D.
Director

Attach.

RESPONSES TO LEGISLATIVE AUDITOR'S FINDINGS

FINDING #1: Controls over financial assistance.

A. Performance of required annual re-verification for medical assistance eligibility.

Response:

As stated in our response to the December 1997 Management Audit, the Med-QUEST Division (MQD) is very cognizant of the need to disenroll those who are ineligible for the program. The department has a major effort underway to aggressively attack both the overdue and currently due eligibility reviews. Med-QUEST has changed its policies and has removed the requirement that clients come into the office for personal interviews. Eligibility re-verifications of Aged, Blind and Disabled (ABD) clients have been conducted. In addition, a new schedule of eligibility reviews has begun with the oldest overdue reviews being conducted first. Within these, the department will focus on those clients most likely to have earnings. Thus the highest cost cases and those most likely to become ineligible will be given first priority.

While the number of cases with overdue eligibility reviews is large, the department has been bringing the number down. The neighbor islands have made great strides and the reviews are current. The problem remains only on Oahu. To further assist in this initiative, the department is transferring a vacant position from a neighbor island branch office to Oahu.

Additionally, the Med-QUEST Division has instituted a Hawaii Automated Welfare Information (HAWI) system change to automatically insert a plan end date in the system whenever a case is closed. This will ensure that the plans are quickly and properly notified when a person becomes ineligible.

The Executive Supplemental Budget for FY 99 includes requests for 23 Income Maintenance Worker (IMW) positions. These additional positions will enable the division to reduce the number of overdue reviews on Oahu.

Re-verifications for the financial assistance programs and the food stamp program are completed annually and on a timely basis. All cases receiving financial assistance or food stamps (and who are medically eligible) remain eligible, even without a separate medical review if the financial and or food stamp review was completed.

B. Accuracy of data entries.

Response:

The HAWI system limits clerical staff to registration of applications only. Authorization of payments is limited to trained IMW staff as a security measure. Similarly, the Action History retained by the system will identify staff who authorized payments or entered data on the client's record and serves as an audit trail.

All data entry by new staff is checked and authorized by a supervisor. New IMW staff are not able to authorize payments until their supervisor determines that they are competent to do eligibility determination and then they are given security clearance.

The HAWI system has several built in checks. It does all computations and several computer matches. These are of themselves checks for accuracy. Also, quality control reviews have never identified any overpayment as a result of an erroneous data entry. Moreover, the department does not have sufficient staff to check 100% of data entries. In this time of government downsizing and reduced funding, it is not an appropriate expenditure to increase the size and cost of our line staff.

C. Performance and documentation of required income and eligibility verification checks.

Response:

Income and eligibility verification checks are performed on a consistent basis though they may not be documented on a consistent basis. At the point of application and at each eligibility review, cross-checks are made with the Department of Labor and Industrial Relations, and the Departments of Motor Vehicles and Real Property. We are also in the process of developing an on-line access with the Social Security Administration which will become part of our required application and eligibility review verification process. This should be in place by June 1998 and will allow staff to verify social security status and benefits at any time. Automatic system initiated reviews are completed at regular intervals with the Social Security Administration, the Internal Revenue Service, the U.S. Department of Labor and the Veteran's Administration. These reviews are done automatically and do not require that the worker initiate the review. Because of security requirements, these reports may not be filed in the case record.

The department has standardized documentation requirements. Unfortunately, it is difficult to enforce a standard that was developed to service 175 cases per worker when the staff is handling 300 cases on average.

D. Performance of required supervisory reviews of client case files.

Response:

Although some of our supervisors are not doing the required review of one case per worker per month, all of our supervisors are doing reviews of cases. Supervisors review all new cases coming into the unit and cases being returned to the unit. They also review 100% of the cases completed by new workers. These reviews result in a much greater review rate than required.

Additionally, the program office has initiated a case review process that reviews approximately 120 cases per year, randomly selected from the units. This review is part of the management evaluation process.

E. Quality control reviews.

Response:

The quality control staff of the Evaluation Office temporarily discontinued reviews of the Aid to Families with Dependent Children (AFDC) now called Temporary Assistance to Needy Families (TANF) program during the months October 1996 to June 1997. During this period, staff was assigned special projects for the Med-QUEST Division (MQD) and the Benefit, Employment and Support Services Division (BESSD). They resumed quality assurance reviews and monitoring activities for the TANF program effective July 1997, and continue to conduct such activities on an ongoing basis. Even though the Federal government no longer requires such reviews and quality control reports, the DHS conducts them to help identify program errors and causes of errors, reduce error levels, and ensure against errors and overpayments.

The quality control staff continues to sample and review client case files for the TANF, Food Stamp, and Medicaid programs. It should be noted that Hawaii has exceptionally low error rates for its assistance programs. For financial assistance, we were number 14 in the nation in 1992, number five in 1993 and number one in 1994. This is the last year for which the federal government has issued national data. The Hawaii Food Stamp program has consistently ranked number one or number two in the nation from 1990 through 1996.

It is important to understand that a majority of our overpayments do not come from errors but from notice requirements. Because we are required by law to give adequate notice before decreasing benefits and to pay "aid paid pending a fair hearing" most or our overpayments are generated because we are following the law and with the full knowledge of the worker. These overpayments cannot be prevented.

FINDING #2: Welfare benefit overpayment recovery system.

The department's Automated Recovery System (ARS) contains information on the cumulative balances of all financial assistance program overpayment claims. The major programs for which overpayment claims are established and maintained within the ARS, are the Aid to Families with Dependent Children, Food Stamp, General Assistance, Aid to Aged, Blind and Disabled, and Medicaid. It should be noted that the total overpayment balance of approximately $41.7 million as of June 30, 1997, represents a cumulative total of all claims established in the ARS since 1984 with the general fund portion about $18.5 million. The conversion of the manual accounts receivable system to the ARS was completed in August 1984. The department estimates that a substantial portion of this cumulative balance is uncollectible. Payments often cannot be recovered due to bankruptcy, hardship, or the client is deceased or incarcerated. In addition, the cost to collect certain claims (staff time, court fees) would exceed the benefits derived (actual recovery).

To date, the DHS has effected write-offs of uncollectible accounts amounting to $834,000 for the Food Stamp and General Assistance programs. The department is presently pursuing the write-off of additional accounts under the AFDC program, having received permission to do so as a result of the new federal welfare reform law. AFDC overpayment claims account for approximately one-third of the total balance.

The department recognizes the inefficiencies of the ARS, and has been continually attempting to improve the system within the limited internal resources available. In October 1996, the department completed the automated interface between HAWI and the ARS, resulting in the automatic posting of recoupment transactions from HAWI to the ARS. This was a major project that required a substantial amount of time and effort by in-house staff and took several years to successfully complete. Also, in October 1996, the migration of the ARS from the dated IBM System 36 mini-computer to the new IBM AS-400 computer was accomplished, significantly increasing system capacity and improving the ability to more efficiently maintain the ARS. The system presently has the capability to generate overpayment information and reports in the desired sorts and formats on a more timely basis.

The ARS required substantial systems modification and enhancements. The following briefly describes the major systems enhancements completed by the department, since fiscal year 1994:

- system modification for the state tax intercept program; completed June 1995;
- implementation of automated claims establishment (Form 1484); completed October 1995;
- implementation of HAWI recoupment interface; completed October 1996;
- systems modification for new ARS billing form; completed November 1996;
- implementation of write-off process for Food Stamp uncollectible claims; completed December 1996;

- implementation of write-off process for General Assistance uncollectible claims; completed February 1997;
- implementation of Federal Tax Refund Offset program; completed April 1997;
- automated posting of recoupment transactions prior to interface; completed March 1998.

A. Aged accounts receivable subsidiary ledger.

Response:

As a result of these system improvements and enhancements, especially the automated updating of account balances and the facilitated access to ARS data, the department is presently assessing the types of internal reports required to effectively monitor and manage the overpayment balances. This would include an aged accounts receivable report, based on aging the accounts within the ARS. Although, aging reports have been generated on an ad hoc basis, the department plans to produce aging and delinquent account reports regularly as a part of the process in monitoring overpayments. Such reports are planned to be in production by July 1998. The department agrees that these reports can serve as an essential management tool in managing overpayments.

B. Automated Recovery System (ARS) reports.

Response:

It should be noted that the department has been actively working with the Department of the Attorney General (AG) since January 1997 to arrange for AG assistance and expertise in pursuing delinquent account collections. These efforts culminated in the completion of a December 1997 Memorandum of Understanding between the director of human services and the attorney general, establishing a collections unit comprised of AG staff on a pilot basis. In addition, the AG has submitted a supplemental budget request for seven permanent positions to be dedicated to DHS overpayment collection activities. In order to maximize the effectiveness of such resources, this unit will be physically located within the DHS and will work directly with the DHS staff and systems, such as the ARS. Under such an arrangement, the department will work with the AG staff in reviewing all the necessary overpayment account information and reports, and implement the processes that would maximize recoveries. For instance, it is planned that formal delinquency notices on AG stationery would be sent to selected groups of accounts in which the potential to receive payment would be the greatest. The ARS will be able to generate such a list of accounts based on criteria, as established by the department and the AG. The department will be utilizing the capability of the ARS to generate specialized reports, and using this information, develop the most effective follow-up and collections practices.

C. Overpayment collection efforts.

Response:

Presently, the department has reports available that summarize the total receipts for all overpayment accounts. For example, the calendar year 1997 report shows total receipts of almost $3.8 million, comprised of $881,000 in check and cash payments, $2,500,000 in recoupments, and $390,000 through tax intercepts. The department plans to produce such information on a regular basis in order to more closely monitor the status of collections and assess the effectiveness of collection practices.

Although the DHS currently has very limited resources dedicated to pursuing the collection of overpayments, the department has continued to increase the amounts collected, as illustrated below.

Calendar Year	**Total Collections**
1994	$2,957,270
1995	3,558,861
1996	3,733,815
1997	3,768,548

The department plans to implement a project focused on increasing collections of delinquent balances that will involve the redirection of existing Investigation Office (INVO) staff in addition to support from the Attorney General's Office.

D. Investigation and pursuit of welfare overpayment cases.

Response:

The department concurs the INVO lacks sufficient staff to effectively pursue all welfare overpayment cases and there are numerous vacant positions. We also concur there are a number of welfare overpayments pending investigation but disagree with the finding that "a significant number of welfare overpayment cases are not investigated and pursued by the department." In 1997, the INVO received 3,423 fraud complaints. The report identified 725 cases or 21% in which an investigator had not initiated action as of June 1997. These are pending cases which reflect the department's inability to take action on a timely basis. This does not mean the department will not complete an investigation or recovery action.

All fraud complaints go through an initial screening or preliminary investigation to determine whether the case is to be forwarded to the Income Maintenance Worker to complete an overpayment claim and/or stop payment or be assigned to the INVO staff for further investigation. The audit addresses cases assigned to the INVO staff for criminal investigation and fails to consider other options utilized by the department to address fraud or intentional program violations. Cases may be referred to the Administrative Appeals Office for an Administrative Disqualification Hearing (ADH), clients may waive their right to an ADH and accept a sanction, or an overpayment claim can be established. When the ADH hearings officer rules in favor of the department or clients waive their right to an ADH, clients are barred from participation in the program for one year for the first violation, two years for the second violation, and permanently for the third violation.

In 1997, there were 721 cases considered appropriate for administrative resolution. There were 97 cases in which administrative resolution was not completed: 42 cases lacked sufficient evidence to proceed and in 55 cases we were unable to locate the individual to serve notice. Of the remaining 624 cases, 483 cases waived their rights to a hearing which totaled $1,353,567 in overpayments, 138 cases were found unfavorable for the client at the ADH which totaled $219,537 in overpayments, and three cases were found in favor of the client at the ADH which totaled $25,861 in overpayments.

There were 73 cases totaling $1,508,615 in overpayments referred for criminal prosecution in 1997. However, successful prosecution action was completed in 57 cases totaling $1,464,646 in overpayments. The ADH process is used extensively as a case referred for criminal prosecution requires extensive investigative resources.

The department does not concur with the statement "due to staffing constraints, only cases with overpayments exceeding $5,000...are generally pursued for prosecution." There may be some confusion related to criminal prosecution versus civil remedy. The Department of the Attorney General at one time set a $5,000 minimum requirement to pursue a civil suit to recover overpayments. However, due to the lack of adequate investigative resources, the staff is more selective in investigating cases to be referred for criminal prosecution.

The combined ADH and prosecution cases account for approximately 40% of the total dollar value of new overpayment claims established in 1997. The remaining 60% of claims were established by the Income Maintenance Workers as recoupment or closed cases to be billed.

Finally, the department does not concur with the statement the INVO office lacks guidance to effectively pursue all welfare overpayment cases. The department lacks staffing resources to complete both investigations and aggressively pursue recovery of overpayments on a timely basis. We are considering various approaches to better utilize the existing staff resources to increase recovery.

FINDING #3: QUEST premiums due from individuals.

Response:

The Med-QUEST Division (MQD) disagrees with the auditor's findings that the department has not pursued collection amounts for premiums from QUEST participants and that the department is ignoring the rules of eligibility for the QUEST demonstration project.

The department has always attempted to collect on past due premiums from recipients by sending monthly invoices on balances owed. The MQD is reluctant to write off the balances because many recipients cannot make full payment on their balances, but do in fact make minimal payments to the department.

Many of the balances that have no activity are written off under the Hawaii Administrative Rules (HAR) process and the MQD is continuing to write off balances of bankrupt QUEST participants.

If a recipient does not pay any portion of the outstanding premiums for a period of more than 60 days, the eligibility worker is notified by the MQD finance office to begin the disenrollment process. All of the procedures followed for this process are within the administrative rules.

FINDING #4: Fiscal agent's Medicaid overpayments.

Response:

The Med-QUEST Division agrees with the auditor's finding of excess overpayments of $500,000 due to errors by the fiscal agent. The division conducted its own investigation of the overpayment and identified the problem in the area of "manually priced" type "112" claims for acute hospital payments. After analysis of claims payment history over a period of 34 months, it was determined that 25 of 1,071 claims were priced incorrectly.

The division held discussions with the fiscal agent and it was found that of the 25 claims identified as manually priced in error, all of the overpaid amounts were recovered within two weeks.

To resolve future occurrence of incorrect payments, which in large part was the result of manual claims processing, the fiscal agent will revise or expand their current claims auditing (internal claims auditing systems) activities to incorporate review of all "manually priced claims" to ensure the State of accurate processing and payment of Medicaid claims.

The division will incorporate in the next fiscal agent Request for Proposal (RFP), an annual claims review audit requirement by an independent auditing organization for future quality control measures for claims processing and payments.

FINDING #5: Contracts for current medicaid providers.

Response:

It is correct that the Med-QUEST Division has not executed contracts for 41 current Medicaid facility providers (hospitals and nursing homes). It is not correct, however, that the department and these providers do not have the protection of a contract. Like the Medicaid non-facility providers, these facility providers complete and sign a Medicaid provider application which specifies the provider responsibilities and agreements. These responsibilities are based on the Hawaii Administrative Rules (HAR). The HAR specifies the requirements for becoming a Medicaid provider, identifies the services which are reimbursable under the Medicaid program, and specifies the reimbursement methodology by provider type. The roles and responsibilities of the division, department and the Medicaid providers are clearly delineated in the HAR so there is no confusion or misunderstanding. All Medicaid providers are given Medicaid Provider Manuals which specify the claim processing requirements. As pointed out by the Auditor, payments to these providers have been made by the department's fiscal agent. The department is protected in that the fiscal agent pays the providers in accordance with the application/contract, HAR, Medicaid Provider Manual, and Medicaid policy.

The Med-QUEST Division is consulting with the Department of the Attorney General to determine whether the contracts for facilities may be replaced with the current application/contracting process for non-facility providers such as physicians, psychologists, optometrists, therapists, pharmacies, and laboratories. Like the facility providers, these non-facility providers complete an application to serve as a Medicaid provider, are governed by the appropriate sections of the Hawaii Administrative Rules and are paid by the fiscal agent. The application itself could be modified and additional annual procedures could be implemented to ensure compliance with the HAR requirements.

FINDING #6: HAWI System.

A. Year 2000.

Response:

In order to address the Year 2000 compliance issues, the Department of Human Services is in the process of obtaining the approvals necessary to have consultants assist state staff in upgrading our dedicated mainframe's operating systems software and application software. Currently the state's central computing center's schedule does not meet our department's timeframes and as such we are pursuing a separate upgrade schedule to become Year 2000 compliant on our dedicated mainframe which is located at the Information and

Communication Services Division (ICSD) of the Department of Accounting and General Services (DAGS).

We anticipate the first of the two contracts for this upgrade to be executed in the fourth quarter of fiscal year 1998. The necessary procurement, attorney general and governor approvals have been obtained and the contract with Software AG Americas (SAGA) has been signed. This contract will specifically address the upgrades necessary for all SAGA system software products, other Third Party vendor system software products on the mainframe and the re-programming needed of any application processes which are not Year 2000 compliant. This consultant contract will also provide the necessary documentation which include a Year 2000 project plan, impact analysis, scope of effort, staffing, estimated programming hours, utilization of automated tools, and identify any other Year 2000 compliance risks and considerations.

The second contract will address all IBM system software products on the HAWI System which are required to be upgraded for Year 2000 compliance within this mainframe complex. This contract is anticipated to be executed in the fourth quarter of fiscal year 1998.

The HAWI system's databases have contained the required century fields within its structure since 1986. The format is CCYYMMDD or CCYYMM and is considered Year 2000 compliant. It is the mainframe system software and application processes, online or batch, which require thorough analyses to determine scope and maintenance effort for the Year 2000 compliance issues. The Information Systems Office has conducted a preliminary review of the application modules which may require conversion or re-writes of programming code and have determined that this effort was not complex but voluminous. It is the department's intent to become Year 2000 compliant by the second quarter of fiscal year 1999 to avoid any future date processing problems associated with the Financial, Food Stamp, and Medicaid programs administered on our Federally certified Family Assistance Management Information System (FAMIS) system.

B. Data Back-up procedures and disaster recovery.

<u>Response</u>:

The HAWI system is one of the mainframes residing within the state's central computing center and relies on the general management and operations of the ICSD. The system backup and recovery process, though not tested on a regular schedule, has been performing successfully on several occasions to satisfy ongoing operational requirements. All HAWI system related backups such as the system software, application software, and production data are stored off-site at the Queen Liliuokalani Building away from the central computing center located at the Kalanimoku Building. This off-site storage process is cycled daily to ensure the most current version is stored in a secure place.

The issues concerning emergency power during a short or prolonged outage have yet to be addressed. The lack of funding for this major capital improvement project has precluded the state's central computing center from implementing such disaster recovery contingencies. Several proposals for disaster recovery procedures, including a second computing site for the state, have been submitted by the ICSD but have yet to be realized. At this point, the department's HAWI system does not have an uninterrupted power supply (UPS) system to temporarily sustain the system's resources during a power failure and does not have a generator, fuel tank, and water tanks for adequate air conditioning to sustain the environment in which the computer equipment reside during a prolonged power outage. Without the necessary funding for the disaster recovery plan as requested by DAGS, the department's ability to provide benefits to its clients through HAWI in the event of a power service disruption could be seriously impacted.

FINDING #7: Other internal control areas.

A. Budgeting practices.

Response:

The Med-QUEST Division (MQD) agrees that there was inadequate documentation of data and assumptions used for the health care program forecast for FY 97. For the current biennium period the MQD has developed models for the Medicaid Fee for Service and Hawaii QUEST programs. These models have been submitted to the legislative auditor in response to the Legislative Auditor's December, 1997 Management Audit.

The department does include caseload information as part of its projection method for foster board payments. The caseload information includes client and cost data by type of service provided. The department will continue analyzing caseload data and expenditures as it seeks to improve the projection method.

B. Records maintained by the Medicaid Investigation Unit.

Response:

Surveillance and utilization system reports (SURS) are generated quarterly by the State's fiscal agent. These reports are reviewed by the Medical Standards Branch (MSB) staff. Generally, one of the three (3) quality assurance registered nurses in the MSB reviews the reports in consultation with a medical/dental/psychiatric consultant. If further investigation is needed the Medicaid Investigator is consulted.

Although it is true that the Medicaid Investigation Unit has only one investigator, SURS is a responsibility of the MSB and involves reviews by health care professionals as well as the Medicaid Investigator. The Legislative Auditor did not review the files of completed SURS cases. These reports are comprehensive and well documented and kept by the registered nurse assigned to the case.

The Medicaid Investigator functions as an integral member of the MSB and is responsible for prioritizing investigations of cases of potential fraud and abuse and for receiving and investigating complaints from all sources. Generally, complaints and cases which are potentially the most costly to the program and the State are handled first. Very few complaints and cases are not reviewed. The MQD's one investigator was responsible for the recovery of $1,560,000 in overpayments and referrals to the State Attorney General's office in fiscal year 1996.

As recommended by the Legislative Auditor during discussions with the MQD, beginning in January 1998, the Medicaid Investigator began to keep detailed records on all complaints received, including actions taken and final case dispositions.

C. Deposits of the Med-QUEST Division cash receipts.

Response:

The Med-QUEST Division (MQD) would like to note that there was only one instance where deposits were delayed due to misrouting of the checks. This involved third party liability (TPL) receipts which are initially processed through the department's Fiscal Management Office, which maintains the TPL case files and pursues TPL recoveries. In February 1998, the department implemented procedures that would ensure the proper and timely routing of checks to the MQD for depositing. These procedures include a follow-up process for routing delays. It should be noted that the MQD is functionally responsible for and does perform the activities for receiving and depositing all Med-QUEST program receipts, with TPL checks as the only exception.

D. Evaluation Office.

Response:

We responded earlier to the auditor's finding that the department has reduced its quality assurance reviews with clarification that the department stopped AFDC/TANF program reviews during the months October 1996 to June 1997, and resumed such reviews effective July 1997. Currently, the quality control staff continues to sample and review client case files for the TANF, Food Stamp, and Medicaid programs.

The program and management evaluation staff (PME) of the Evaluation Office (currently the Management Services Office) has been performing various program evaluation activities including the development of evaluation instruments and mechanisms. The PME staff is currently participating in an evaluation of the PONO program, which began in December 1996. This evaluation tracks cohorts (random samples of recipients) as they enter the TANF system and progress through the five-year eligibility. Outcomes being measured include: income, earnings, work participation, hours worked, case closings, and recidivism.

The Management Services Office, in consultation with the Director, is assessing and prioritizing program evaluation needs and activities.

Corrective actions related to previous program evaluations and internal control reviews are being implemented. The Financial Management Office will be issuing policies and procedures and is currently providing staff training for petty cash and imprest funds. The Management Services Office will resume reviews of these financial transactions and internal controls in the next fiscal year after completion of the training program.

E. Federally required contract performance reviews.

<u>Response</u>:

The department has completed the financial reviews of its subrecipients for the fiscal year ended June 30, 1996. A site review of the financial records of the for-profit organization was recently conducted.

F. Federal reporting deadlines.

<u>Response</u>:

The federal regulations for the single audit of the department allow thirteen months for the submittal of the 1995 and 1996 audit reports. We agree that the department did submit the reports after the July 30th deadline. The 1995 audit report due July 30, 1996 was submitted August 13, 1996. The 1996 audit report due July 30, 1997 was submitted July 31, 1997. In both instances, more time was needed to develop responses and corrective action plans for the audit findings and recommendations. In the future, the department will strive to meet these deadlines or request extensions from the federal government if it is anticipated that the audit report may be submitted after the deadline.