

**FINANCIAL AUDIT OF THE  
DEPARTMENT OF HUMAN SERVICES  
STATE OF HAWAII**

**Fiscal Year Ended June 30, 2003**



March 29, 2004

Ms. Lillian Koller  
Director  
Department of Human Services  
State of Hawaii

Dear Ms. Koller:

This is our report on the financial audit of the Department of Human Services of the State of Hawaii (DHS) as of and for the fiscal year ended June 30, 2003. Our audit was performed in accordance with the terms of our contract with the State of Hawaii and with the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

#### **OBJECTIVES OF THE AUDIT**

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the DHS's basic financial statements as of and for the fiscal year ended June 30, 2003, and to comply with the requirements of OMB Circular A-133. More specifically, the objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the presentation of the DHS's basic financial statements.
2. To determine whether expenditures and other disbursements have been made and all revenues and other receipts to which the DHS is entitled have been collected and accounted for in accordance with the laws, rules and regulations, and policies and procedures of the State of Hawaii and the federal government.
3. To determine whether the DHS has established sufficient internal controls to properly manage federal financial assistance programs and to comply with the applicable laws and regulations.
4. To determine whether the DHS has complied with the laws and regulations that may have a material effect on the basic financial statements and on its major federal financial assistance programs.

## SCOPE OF THE AUDIT

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the DHS for the fiscal year ended June 30, 2003.

## ORGANIZATION OF THE REPORT

This report is presented in six parts as follows:

- Part I - The basic financial statements and related notes of the DHS as of and for the fiscal year ended June 30, 2003, and our opinion on the basic financial statements.
- Part II - Our report on compliance and on internal control over financial reporting.
- Part III - Our report on compliance with requirements applicable to each major program and internal control over compliance.
- Part IV - The schedule of findings and questioned costs.
- Part V - The summary schedule of prior audit findings.
- Part VI - Response of the affected agency.

We wish to express our sincere appreciation for the excellent cooperation and assistance extended by the officers and staff of the DHS.

Sincerely,

  
Ron T. Shiigi  
Principal

**DEPARTMENT OF HUMAN SERVICES  
STATE OF HAWAII**

**TABLE OF CONTENTS**

	<u>Page</u>
<b>PART I      FINANCIAL SECTION</b>	
Independent Auditors' Report	7 - 8
Management's Discussion and Analysis	9 - 21
Basic Financial Statements	
Government-wide Financial Statements	
Statement of Net Assets	22
Statement of Activities	23
Fund Financial Statements	
Balance Sheet - Governmental Funds	24
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets	25
Statement of Revenues, Expenditures, and Changes in Fund Balances - Governmental Funds	26
Reconciliation of the Change in Fund Balances of Governmental Funds to the Statement of Activities	27
Statement of Revenues and Expenditures - Budget and Actual - General Fund	28
Statement of Revenues and Expenditures - Budget and Actual - Special Revenue Funds	29
Statement of Assets and Liabilities - Agency Funds	30
Notes to the Basic Financial Statements	31 - 42

**DEPARTMENT OF HUMAN SERVICES  
STATE OF HAWAII**

**TABLE OF CONTENTS**

	<u>Page</u>	
<b>PART I</b>	<b>FINANCIAL SECTION (Continued)</b>	
	Supplementary Information	
	Schedule of Expenditures of Federal Awards	44 - 46
<b>PART II</b>	<b>AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING</b>	
	Independent Auditors' Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of the Basic Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	48 - 49
<b>PART III</b>	<b>AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE</b>	
	Independent Auditors' Report on Compliance with Requirements Applicable to Each Major Program and Internal Control over Compliance in Accordance with OMB Circular A-133	51 - 53
<b>PART IV</b>	<b>SCHEDULE OF FINDINGS AND QUESTIONED COSTS</b>	55 - 65
<b>PART V</b>	<b>SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS</b>	
	Status Report	67 - 70
<b>PART VI</b>	<b>RESPONSE OF THE AFFECTED AGENCY</b>	
	Response of the Department of Human Services	72 - 82

**PART I**  
**FINANCIAL SECTION**



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## INDEPENDENT AUDITORS' REPORT

To the Director  
Department of Human Services  
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Human Services of the State of Hawaii (DHS), as of and for the fiscal year ended June 30, 2003, which collectively comprise the DHS's basic financial statements as listed in the foregoing table of contents. These basic financial statements are the responsibility of the DHS's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic 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.

As discussed in Note A, the financial statements of the DHS are intended to present the financial position and the changes in financial position, where applicable, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the DHS. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2003, and the changes in its financial position, where applicable, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information for the DHS, as of June 30, 2003, and the respective changes in financial position, where applicable, thereof and the respective budgetary comparison for the general and special revenue funds for the

fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note N, the DHS 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 financial statements.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 20, 2004, on our consideration of the DHS's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise the DHS's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

*Nishihama & Kishida, CPAs, Inc.*

Honolulu, Hawaii  
February 20, 2004



**Department of Human Services  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
(UNAUDITED)**

This discussion and analysis of the financial performance of the Department of Human Services (DHS) provides an overview of the financial activities of the DHS for the fiscal year ended June 30, 2003. The intent of this discussion is to allow management to provide an objective and easily readable analysis of the financial activities of the DHS based on currently known facts, decisions, or conditions. Readers are encouraged to consider the information presented here in conjunction with the basic financial statements and other supplementary information.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This MD&A serves as an introduction to the basic financial statements of the DHS. The basic financial statements are comprised of three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the basic financial statements.

***Government-wide Financial Statements***

The government-wide financial statements provide a broad overview of the finances of the DHS using the economic resources measurement focus and accrual basis of accounting, in a manner similar to private-sector businesses. It provides both long-term and short-term information about the overall financial status of the DHS.

The statement of net assets includes all of the assets and liabilities of the DHS, with the difference between the two reported as net assets. This statement is similar to that of the balance sheet of a private-sector business. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the DHS is improving or deteriorating. This statement also provides information on how services were financed in the short-term as well as what remains for future spending.

The statement of activities presents information showing how net assets changed during the fiscal year. All changes in net assets are reported using the accrual method of accounting, similar to the method used by most private-sector businesses. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are reported when the goods or services are received, regardless of the timing of the related cash flows. The activities of the DHS are principally supported by appropriations made available by the State Legislature and intergovernmental revenues from the federal government (governmental activities). The DHS does not recover any portion of its costs through user fees or charges for services (business-type activities).

**Department of Human Services  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

***Fund Financial Statements***

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objects. The DHS uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the DHS are divided between either governmental funds or fiduciary funds. Governmental funds are used to account for most, if not all, of a government entity's tax-supported activities. Fiduciary funds are used to account for resources that are held by a government entity as a trustee or agent for parties outside of the government entity. The resources of fiduciary funds cannot be used to support the government entity's own programs.

The fund financial statements of the DHS include the following types of funds:

**Governmental funds** - Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike government-wide financial statements, governmental fund financial statements focus on current sources and uses of spendable resources and balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government entity's near-term financing requirements. By comparing the governmental fund and government-wide financial statements, readers may better understand the long-term impact of the entity's near-term financing decisions. In order to facilitate a comparison between the governmental fund and government-wide financial statements, a reconciliation between the two is provided following each governmental fund financial statement.

**Fiduciary funds** - The fiduciary funds of the DHS consists of agency funds which are clearing accounts for assets held by the DHS in its role as custodian until the funds are allocated to the individuals, private organizations, or government agencies to which they belong. These activities are excluded from the government-wide financial statements of the DHS because the DHS cannot use these assets to finance its operations.

***Notes to the Basic Financial Statements***

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

**Department of Human Services  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

**FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The following table presents a condensed government-wide statement of net assets of the DHS as of June 30, 2003 and 2002.

**Condensed Statement of Net Assets**

	2003	2002
Current assets	\$ 106,803,875	\$ 95,623,381
Capital assets, net	<u>34,879,443</u>	<u>35,279,425</u>
Total assets	<u>\$ 141,683,318</u>	<u>\$ 130,902,806</u>
Current liabilities	\$ 151,342,478	\$ 126,982,743
Non-current liabilities	<u>10,518,424</u>	<u>8,187,537</u>
Total liabilities	<u>\$ 161,860,902</u>	<u>\$ 135,170,280</u>
Net assets		
Invested in capital assets	\$ 34,879,443	\$ 35,279,425
Unrestricted deficit	<u>(55,057,027)</u>	<u>(39,546,899)</u>
Total net assets	<u>\$ (20,177,584)</u>	<u>\$ (4,267,474)</u>

As noted earlier, an analysis of net assets over time may be a useful indicator of whether a government entity's financial condition is growing stronger or weakening. During the fiscal year ended June 30, 2003, the combined net assets of the DHS decreased by approximately \$15.9 million.

The deficit in unrestricted net assets of the DHS was approximately \$55.1 million as of June 30, 2003. This deficit in unrestricted net assets is principally the result of liabilities for program services that were incurred as of June 30, 2003, for which state allotments are not yet available. The largest liability as of June 30, 2003, is the estimated amount of medical assistance service provided as of June 30, 2003, for which the related claims will be processed and paid subsequently. Of the estimated \$133.6 million of medical assistance payable, the state share of these costs is approximately \$54.7 million. The estimated federal share of these claims to be paid in the future was recorded as intergovernmental revenues in the current fiscal year and is included in the balance due from other governments. In addition to the estimated medical assistance payable, the liability for compensated absences totaling \$15.8 million as of June 30, 2003, is not funded by state allotments until the employee uses the earned leave or is paid out upon termination. Therefore, there are no assets currently available to the DHS to pay for these liabilities as of June 30, 2003.

**Department of Human Services  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

The DHS reported a total of approximately \$34.9 million in net assets invested in capital assets as of June 30, 2003. Although the DHS is not the legal owner of the state buildings that are reported as part of its capital assets, the portion of the state facilities used by the DHS are required to be reported as part of its capital assets. The DHS uses these capital assets to provide services; consequently, these assets are not available for future spending and the related annual depreciation expense of the cost of these facilities is included in the statement of activities for the fiscal year ended June 30, 2003.

The changes in the net assets of the DHS from governmental activities are summarized below. The DHS directs its resources towards assisting people to meet their basic needs for food, shelter, medical care and other essentials for daily living. As such, the DHS does not conduct business-type activities and the accompanying analysis of the changes in net assets focuses on the cost of services and who provides the funds to pay for the costs.

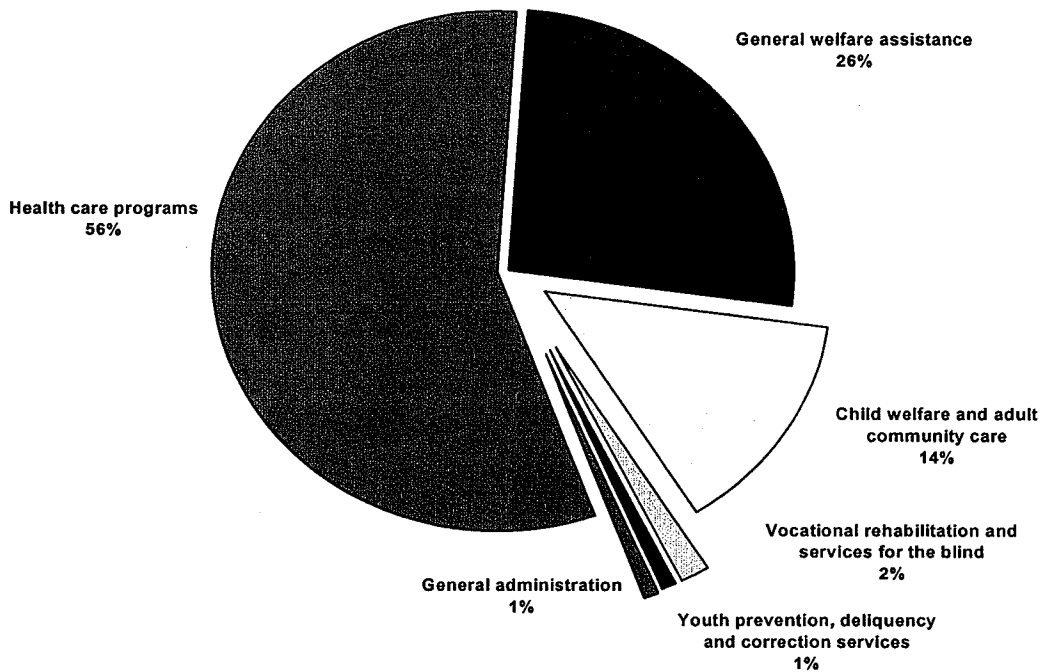
**Changes in Net Assets**

	<u>2003</u>	<u>2002</u>	<u>Percent Change</u>
<b>Revenues</b>			
Program revenues	\$ 852,668,727	\$ 758,255,106	12.45 %
General revenues	<u>587,788,962</u>	<u>562,342,949</u>	4.52 %
Total revenues	<u>1,440,457,689</u>	<u>1,320,598,055</u>	9.08 %
<b>Expenses</b>			
Health care programs	823,251,712	722,851,706	13.89 %
General welfare assistance, employment and support services	383,779,653	390,565,862	(1.74) %
Child welfare and adult community care services	201,368,793	170,868,464	17.85 %
Vocational rehabilitation and services for the blind	21,842,224	20,018,756	9.11 %
Youth prevention, delinquency and correction services	15,516,562	16,915,538	(8.27) %
General administration	<u>10,608,855</u>	<u>8,854,877</u>	19.81 %
Total expenses	<u>1,456,367,799</u>	<u>1,330,075,203</u>	9.50 %
Deficiency before transfers	(15,910,110)	(9,477,148)	67.88 %
Transfers	<u>--</u>	<u>(32,000)</u>	
Change in net assets	\$ <u>(15,910,110)</u>	\$ <u>(9,509,148)</u>	67.31 %

**Department of Human Services  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

The total cost of all programs and services was approximately \$1.46 billion, a 9.5% increase from the prior fiscal year. Health care and general welfare assistance programs comprised 56% and 26%, respectively, of the total costs. The following chart presents each major activity as a percent of the total cost of all DHS activities:

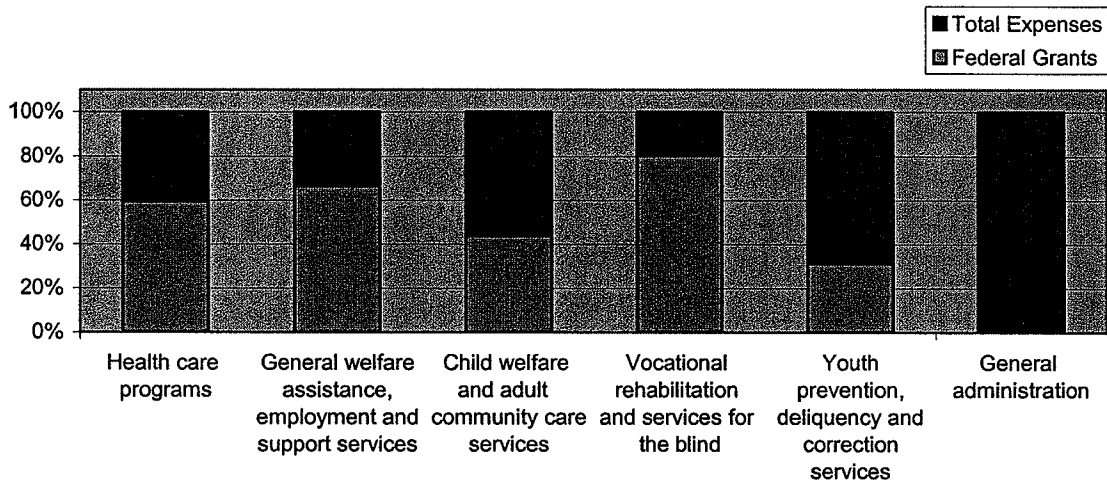


**Department of Human Services  
State of Hawaii**

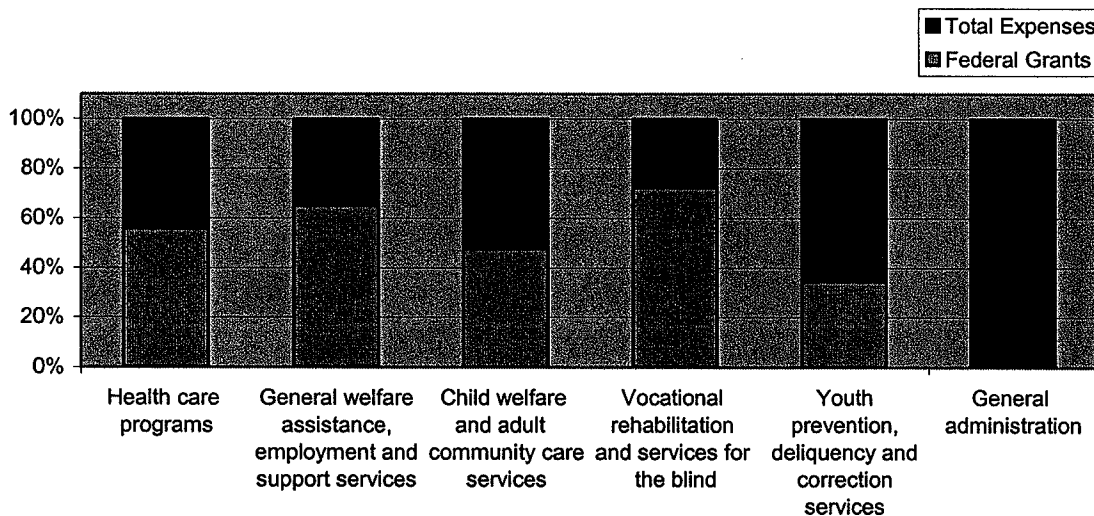
**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

Program revenues consist primarily of operating grants from the federal government. Revenues from these federal grants paid for 58.5% of the cost of all the DHS's activities. The following chart presents the percentage of costs funded by federal grants for each major activity of the DHS for fiscal years ending June 30, 2003 and 2002:

Fiscal Year 2003:



Fiscal Year 2002:



**Department of Human Services  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

**FINANCIAL ANALYSIS OF THE FUND FINANCIAL STATEMENTS**

As noted earlier, the DHS uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The DHS has two governmental fund types; the general fund and special revenue funds. The general fund is used to account for all financial resources except those required to be accounted for in another fund. The special revenue funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes. In general, operating grants the DHS receives from the federal government are accounted for in the special revenue funds and all allotments of state funds are accounted for in the general fund along with any other resources available to the DHS that are not accounted for in the special revenue funds.

Total expenditures reported on a modified accrual basis increased by \$124.5 million over the prior fiscal year. This increase is primarily related to health care program costs administered by the DHS which have increased by approximately \$100 million or 13.85%. In addition, child welfare and adult community care program costs increased by \$29.5 million or 17.32%. The increased expenditures in these programs are principally due to rising medical and administrative costs and not an increase in recipients.

At June 30, 2003, the total governmental fund balance of the DHS consisted of a deficit in unreserved fund balance of approximately \$85.1 million. The deficit in the unreserved fund balance of the general fund totaling \$54.2 million is principally comprised of liabilities for program services that were incurred as of June 30, 2003, for which state allotments were not yet available. The deficit in the unreserved fund balance of the special revenue fund totaling \$30.9 million is principally the result of federal funds held by DHS at June 30, 2003, that have been committed to liquidate purchase and contractual commitments that were not liabilities as of June 30, 2003, and, therefore, the related intergovernmental revenues were not recorded.

Reservations of governmental fund balances for encumbrances totaled approximately \$45.9 million at June 30, 2003. Reservations of governmental fund balances indicate the amount of resources that are not available for new spending because it has been reserved to liquidate purchase and contractual commitments.

**Department of Human Services  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

The following table presents total revenues and expenditures of the governmental funds of the DHS for the fiscal years ended June 30, 2003 and 2002:

	<u>2003</u>	<u>2002</u>	<u>Percent Change</u>
<b>REVENUES</b>			
State allotted appropriations	\$ 589,447,324	\$ 558,646,278	5.51 %
Intergovernmental revenues	852,668,727	758,255,106	12.45 %
Non-imposed employee fringe benefits	<u>14,959,179</u>	<u>9,605,913</u>	55.73 %
	<u>\$ 1,457,075,230</u>	<u>\$ 1,326,507,297</u>	9.84 %
<b>EXPENDITURES</b>			
Health care programs	822,243,397	722,208,139	13.85 %
General welfare assistance, employment and support services	382,570,031	390,137,437	(1.94) %
Child welfare and adult community care services	200,019,683	170,483,849	17.32 %
Vocational rehabilitation and services for the blind	21,462,592	19,904,391	7.83 %
Youth prevention, delinquency and correction services	15,955,720	16,306,711	(2.15) %
General administration	<u>10,035,507</u>	<u>8,717,731</u>	15.12 %
	<u>\$ 1,452,286,930</u>	<u>\$ 1,327,758,258</u>	9.38 %



**Department of Human Services  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

**BUDGETARY ANALYSIS**

As required by Section 37-68, Hawaii Revised Statutes, the DHS prepares a budget that becomes legally adopted when the State Legislature approves the executive budget with the enactment of an appropriations act. A comparison and analysis of the general fund is presented below as additional financial information:

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
Health care programs	\$ 325,290,675	\$ 344,491,548	\$ 329,977,473	\$ 14,514,075
General welfare assistance, employment and support services	128,443,339	126,220,543	123,018,112	3,202,431
Child welfare and adult community care services	105,160,725	104,014,224	95,264,494	8,749,730
Vocational rehabilitation and services for the blind	3,949,813	3,883,971	3,852,679	31,292
Youth prevention, delinquency and correction services	11,745,196	10,351,491	10,288,311	63,180
General administration	<u>8,306,100</u>	<u>8,250,354</u>	<u>7,860,463</u>	<u>389,891</u>
	<u>\$ 582,895,848</u>	<u>\$ 597,212,131</u>	<u>\$ 570,261,532</u>	<u>\$ 26,950,599</u>

The change from the original to the final budgeted allotments for health care programs was due to an emergency appropriation of \$22,726,806 for the Medicaid Program. Other differences between the original and final budget were due to intrafund transfers and restrictions on allotments communicated through executive memorandums.

Actual expenditures for the health care programs and adult community care services were approximately \$14.5 million and \$8.7 million, respectively, less than the additional amounts budgeted for the anticipated increase in health care costs. Also, expenditures on a budgetary basis do not include accrued claims expense for these health care programs that are outstanding at year end. Thus the amounts expended in comparison to the amounts budgeted appear favorable.

**Department of Human Services  
State of Hawaii**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)**

**CAPITAL ASSETS**

As of June 30, 2003 and 2002, the cost basis of capital assets, net of accumulated depreciation, used by the DHS are presented in the table below. Approximately, \$1.8 million of capital assets were added in the fiscal year ended June 30, 2003. Of this amount, \$1.2 million was related to the cost of renovating a building used by the Office of Youth Services. Annual depreciation totaling approximately \$2.2 million decreased the net cost basis during the fiscal year ended June 30, 2003.

**Capital Assets, Net of Depreciation**

	<u>2003</u>	<u>2002</u>
State office buildings and improvements	\$ 19,696,171	\$ 20,525,373
Buildings and improvements for the Office of Youth Services	<u>12,921,849</u>	<u>12,355,155</u>
Total buildings and improvements	32,618,020	32,880,528
Furniture, equipment and vehicles	2,261,417	2,398,891
Nondepreciable land	<u>6</u>	<u>6</u>
Total	\$ <u>34,879,443</u>	\$ <u>35,279,425</u>

In addition to the capital assets listed above, the DHS leases numerous office facilities from third-party lessors under operating lease arrangements. Those leases for additional space beyond the state facilities listed above as buildings and improvements are necessary to provide program services throughout the State.

**ECONOMIC FACTORS**

The DHS has three primary types of welfare assistance programs: (1) financial assistance in the form of cash benefits; (2) food stamp assistance that is also delivered in the form of cash benefits; and (3) medical assistance in the form of Medicaid fee-for-service coverage or managed care medical coverage under the Quest program. Individuals, couples and families may be eligible for one or all of these forms of assistance. However, eligibility for one program does not automatically make an individual/family eligible for other programs. The DHS tracks eligible individuals, couples or families as a single case (caseload).

Two years after the events of September 11, 2001, individuals receiving financial assistance in Hawaii continued to decline from 65,444 individuals in September 2001 to 45,908 individuals in September 2003 or a decrease of almost 30%. Much of this decline is due to the five-year limit on financial assistance benefits beginning in December 2001 as part of Hawaii's Welfare Reform Program (December 1996) but part of it can be attributed to the State's improving economic condition as evidenced by its declining unemployment rate. In September 2001, the

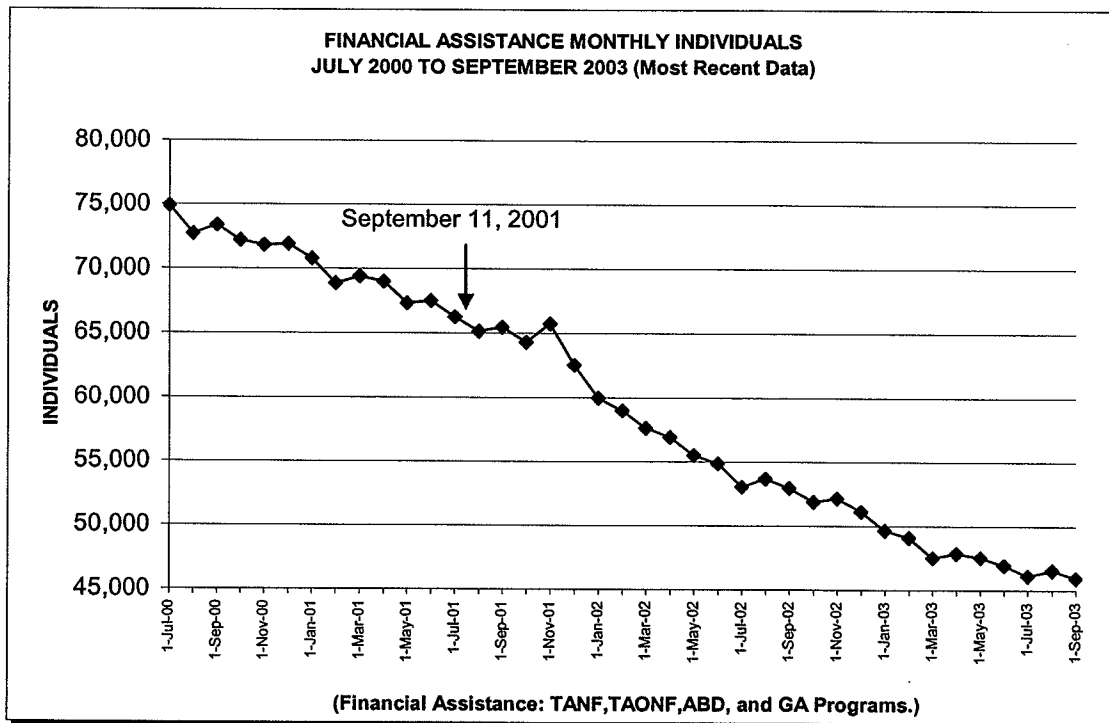
Department of Human Services  
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)

unemployment rate was 4.5% and it peaked at 5.5% two months later in November 2001. Since then the unemployment rate has steadily declined, reaching its lowest point in February 2003 at 3% before rising briefly to 4.4% in June 2003 and then declining again to 3.8% in December 2003. This is a normal seasonal pattern of change in stable times but the overall trend is downward in general from two years ago.

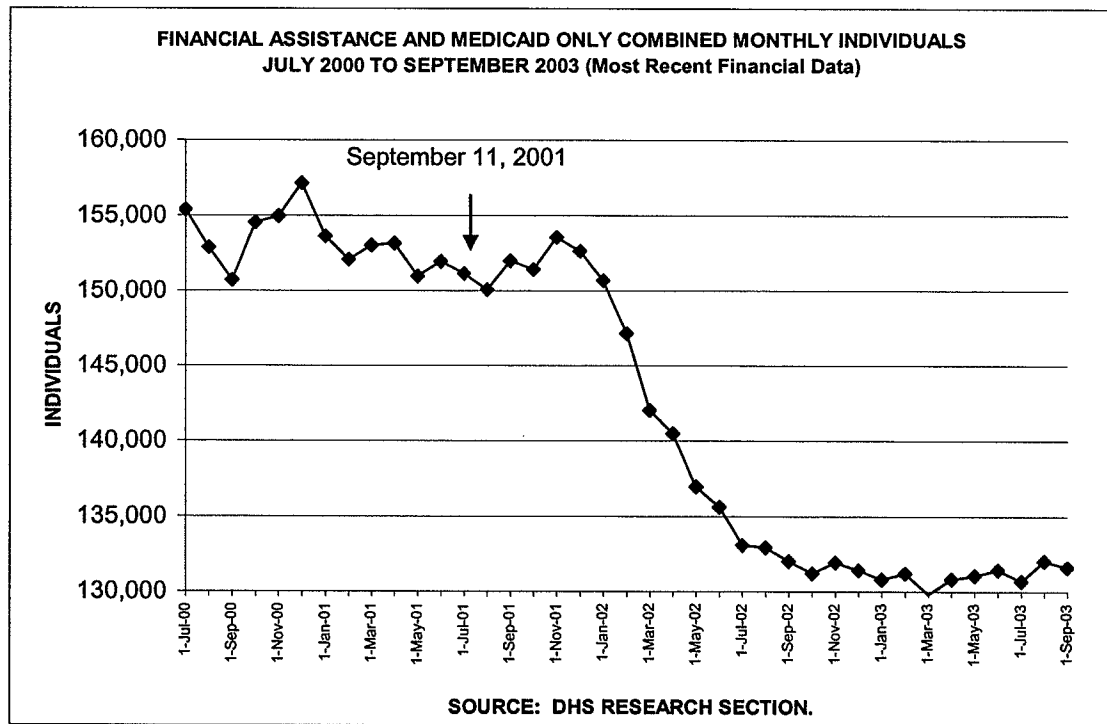
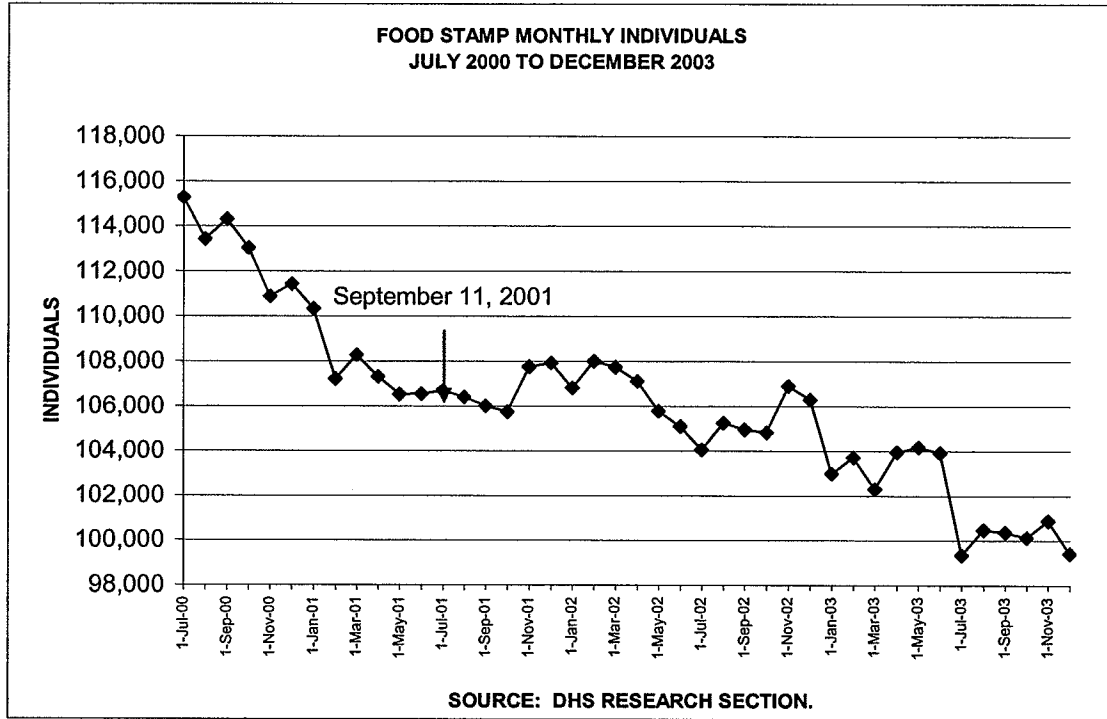
The number of individuals in Hawaii receiving Food Stamp benefits has also declined since September 11, 2001 from 105,990 in September 2001 to 99,413 in December 2003. This is an overall decrease of over 6,500 individuals or (6.2)%. Part of this decline is due to the decline in the number of individuals receiving financial assistance but part of it may also be due to the improving job market in Hawaii. Non-agricultural jobs in Hawaii have risen from 554,400 in September 2001 to 564,100 in September 2003 or an increase of almost 10,000 jobs. Federal, State, and local government jobs only increased by about 1,000 jobs over that period so the majority of the increase in jobs was due to private companies which is very encouraging to the State both now and for the future.

The following charts provide a trend analysis of currently known facts and conditions:



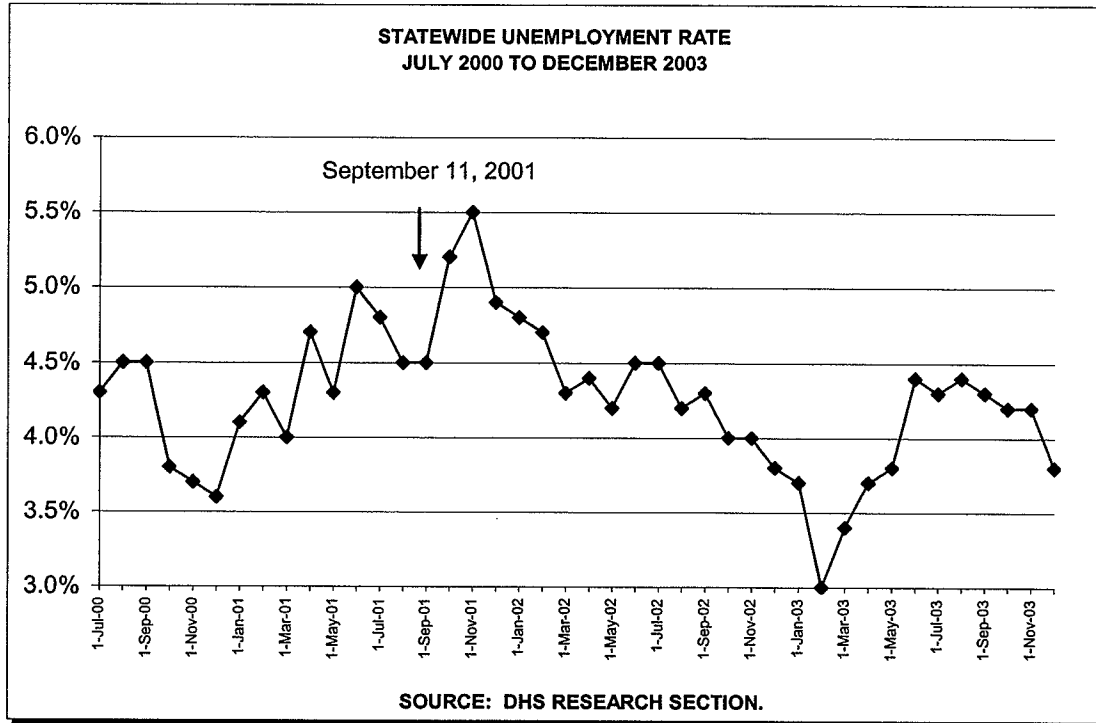
Department of Human Services  
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)



Department of Human Services  
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
(UNAUDITED)



**Department of Human Services  
State of Hawaii  
STATEMENT OF NET ASSETS  
June 30, 2003**

<b>ASSETS</b>	<u>Governmental Activities</u>
Cash and cash equivalents	\$ 42,042,382
Receivables	4,147,089
Due from other governments	<u>60,614,404</u>
Total current assets	106,803,875
Capital assets, net of accumulated depreciation	<u>34,879,443</u>
Total assets	\$ <u><u>141,683,318</u></u>
<b>LIABILITIES</b>	
Vouchers payable	\$ 4,652,363
Accrued wages and employee benefits payable	5,729,031
Due to State of Hawaii	2,061,084
Accrued medical assistance payable	133,600,000
Accrued compensated absences	<u>5,300,000</u>
Total current liabilities	151,342,478
Accrued compensated absences, less current portion	<u>10,518,424</u>
Total liabilities	<u>161,860,902</u>
<b>NET ASSETS</b>	
Invested in capital assets, net of related debt	34,879,443
Unrestricted (deficit)	<u>(55,057,027)</u>
Total net assets	\$ <u><u>(20,177,584)</u></u>

See accompanying notes to the basic financial statements.

Department of Human Services  
 State of Hawaii  
**STATEMENT OF ACTIVITIES**  
 Fiscal Year Ended June 30, 2003

Functions/Programs	Program Revenues			Net Expense and Changes in Net Assets
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
	\$	\$	\$	\$
Governmental activities:				
Health care programs	823,251,712	--	487,988,784	--
General welfare assistance, employment and support services	383,779,653	--	254,688,268	--
Child welfare and adult community care services	201,368,793	--	87,745,789	--
Vocational rehabilitation and services for the blind	21,842,224	--	17,250,635	--
Youth prevention, delinquency and correction services	15,516,562	--	4,995,251	--
General administration	<u>10,608,855</u>	--	--	--
<b>Total</b>	<b>\$ 1,456,367,799</b>	<b>\$ --</b>	<b>\$ 852,668,727</b>	<b>\$ (603,699,072)</b>
General revenues:				
State allotments				589,447,324
State-provided payroll fringe benefits				14,959,179
Lapsed appropriations				(16,617,541)
Transfers				<u>--</u>
Total general revenues and transfers				<u>587,788,962</u>
Change in net assets				(15,910,110)
Net assets at July 1, 2002				<u>(4,267,474)</u>
Net assets at June 30, 2003				<u>\$ (20,177,584)</u>

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
BALANCE SHEET  
GOVERNMENTAL FUNDS  
June 30, 2003**

	General	Special Revenue	Total
<b>ASSETS</b>			
Cash and cash equivalents	\$ 17,862,692	\$ 24,179,690	\$ 42,042,382
Receivables	2,432,889	1,714,200	4,147,089
Due from other funds	956,165	--	956,165
Due from other governments	--	60,614,404	60,614,404
 Total assets	 \$ 21,251,746	 \$ 86,508,294	 \$ 107,760,040
 <b>LIABILITIES AND FUND BALANCES</b>			
<b>LIABILITIES</b>			
Vouchers payable	\$ 1,829,911	\$ 2,822,452	\$ 4,652,363
Accrued wages and employee benefits payable	3,369,108	2,359,923	5,729,031
Due to other funds	--	956,165	956,165
Due to State of Hawaii	1,945,153	115,931	2,061,084
Accrued medical assistance payable	54,700,000	78,900,000	133,600,000
 Total liabilities	 61,844,172	 85,154,471	 146,998,643
 <b>FUND BALANCES</b>			
Reserved for encumbrances	13,617,189	32,280,116	45,897,305
Unreserved	(54,209,615)	(30,926,293)	(85,135,908)
 Total fund balances (deficit)	 (40,592,426)	 1,353,823	 (39,238,603)
 Total liabilities and fund balances	 \$ 21,251,746	 \$ 86,508,294	 \$ 107,760,040

See accompanying notes to the basic financial statements.



**Department of Human Services**  
**State of Hawaii**  
**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET**  
**TO THE STATEMENT OF NET ASSETS**  
**June 30, 2003**

<b>Total deficit in fund balances - governmental funds</b>		<b>\$ (39,238,603)</b>
 <b>Amounts reported for governmental activities in the statement of net assets are different because:</b>		
 Capital assets used in governmental activities are not financial resources and therefore are not reported in the governmental funds.		
Governmental capital assets	\$ 50,840,889	
Less accumulated depreciation	<u>(15,961,446)</u>	34,879,443
 Accrued compensated absences liability is not due in the current period and therefore is not reported in the governmental funds.		
		<u>(15,818,424)</u>
 <b>Net assets of governmental activities</b>		 <b>\$ <u>(20,177,584)</u></b>

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES  
GOVERNMENTAL FUNDS  
Fiscal Year Ended June 30, 2003**

	General	Special Revenue	Total
<b>REVENUES</b>			
State allotted appropriations	\$ 589,447,324	\$ --	\$ 589,447,324
Intergovernmental revenues	--	852,668,727	852,668,727
Non-imposed employee fringe benefits	<u>14,959,179</u>	--	<u>14,959,179</u>
	<u>604,406,503</u>	<u>852,668,727</u>	<u>1,457,075,230</u>
 <b>EXPENDITURES</b>			
Health care programs	334,254,613	487,988,784	822,243,397
General welfare assistance, employment and support services	127,881,763	254,688,268	382,570,031
Child welfare and adult community care services	112,451,866	87,567,817	200,019,683
Vocational rehabilitation and services for the blind	4,266,924	17,195,668	21,462,592
Youth prevention, delinquency and correction services	10,960,469	4,995,251	15,955,720
General administration	<u>10,035,507</u>	--	<u>10,035,507</u>
	<u>599,851,142</u>	<u>852,435,788</u>	<u>1,452,286,930</u>
 <b>EXCESS OF REVENUES OVER EXPENDITURES</b>	 4,555,361	 232,939	 4,788,300
 <b>OTHER CHANGES IN FUND BALANCES</b>			
Lapsed appropriations	<u>(16,617,541)</u>	--	<u>(16,617,541)</u>
 <b>NET CHANGE IN FUND BALANCES</b>	 (12,062,180)	 232,939	 (11,829,241)
 <b>FUND BALANCES (DEFICIT) AT JULY 1, 2002</b>	 <u>(28,530,246)</u>	 <u>1,120,884</u>	 <u>(27,409,362)</u>
 <b>FUND BALANCES (DEFICIT) AT JUNE 30, 2003</b>	 \$ <u>(40,592,426)</u>	 \$ <u>1,353,823</u>	 \$ <u>(39,238,603)</u>

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
RECONCILIATION OF THE CHANGE IN FUND BALANCES OF  
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES  
Fiscal Year Ended June 30, 2003**

**Net change in fund balances - total governmental funds** **\$ (11,829,241)**

**Amounts reported for governmental activities in the statement of activities are different because:**

Governmental funds report capital outlays as expenditures.  
However, in the statement of activities the cost of those assets are depreciated over their estimated useful lives.

Expenditures for capital assets	\$ 1,838,877	
Less: current fiscal year depreciation	<u>(2,238,859)</u>	(399,982)

Change in long-term compensated absences reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds. (3,680,887)

**Change in net assets of governmental activities** **\$ (15,910,110)**

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
STATEMENT OF REVENUES AND EXPENDITURES -  
BUDGET AND ACTUAL - GENERAL FUND  
Fiscal Year Ended June 30, 2003**

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
<b>Revenues</b>				
State allotments	\$ 582,895,848	\$ 597,212,131	\$ 589,447,324	\$ (7,764,807)
<b>Expenditures</b>				
Health care programs	325,290,675	344,491,548	329,977,473	14,514,075
General welfare assistance, employment and support services	128,443,339	126,220,543	123,018,112	3,202,431
Child welfare and adult community care services	105,160,725	104,014,224	95,264,494	8,749,730
Vocational rehabilitation and services for the blind	3,949,813	3,883,971	3,852,679	31,292
Youth prevention, delinquency and correction services	11,745,196	10,351,491	10,288,311	63,180
General administration	8,306,100	8,250,354	7,860,463	389,891
	<u>582,895,848</u>	<u>597,212,131</u>	<u>570,261,532</u>	<u>26,950,599</u>
 <b>Excess of revenues over expenditures</b>	 \$ <u>          --</u>	 \$ <u>          --</u>	 \$ <u>19,185,792</u>	 \$ <u>19,185,792</u>

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
STATEMENT OF REVENUES AND EXPENDITURES -  
BUDGET AND ACTUAL - SPECIAL REVENUE FUNDS  
Fiscal Year Ended June 30, 2003**

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
<b>Revenues</b>				
Intergovernmental revenues	\$ <u>745,921,893</u>	\$ <u>745,921,893</u>	\$ <u>680,367,601</u>	\$ <u>(65,554,292)</u>
<b>Expenditures</b>				
Health care programs	488,604,865	488,604,865	469,551,491	19,053,374
General welfare assistance, employment and support services	129,292,750	129,292,750	100,393,621	28,899,129
Child welfare and adult community care services	101,724,509	101,724,509	88,080,432	13,644,077
Vocational rehabilitation and services for the blind	17,662,444	17,662,444	15,395,433	2,267,011
Youth prevention, delinquency and correction services	7,248,986	7,248,986	5,326,418	1,922,568
General administration	<u>1,388,339</u>	<u>1,388,339</u>	<u>1,388,339</u>	<u>--</u>
	<u>745,921,893</u>	<u>745,921,893</u>	<u>680,135,734</u>	<u>65,786,159</u>
 <b>Excess of revenues over expenditures</b>	 \$ <u>          --</u>	 \$ <u>          --</u>	 \$ <u>      231,867</u>	 \$ <u>      231,867</u>

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
STATEMENT OF ASSETS AND LIABILITES - AGENCY FUNDS  
June 30, 2003**

**ASSETS**

Cash	\$ <u>1,339,972</u>
Total assets	\$ <u>1,339,972</u>

**LIABILITIES**

Due to individuals	\$ 897,851
Due to others	<u>442,121</u>
Total liabilities	\$ <u>1,339,972</u>

See accompanying notes to the basic financial statements.

**Department of Human Services**  
**State of Hawaii**  
**NOTES TO THE BASIC FINANCIAL STATEMENTS**  
**June 30, 2003**

**NOTE A - FINANCIAL REPORTING ENTITY**

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). The DHS administers programs that are designed to improve the social well-being and productivity of the people of the State of Hawaii (State).

The DHS is part of the executive branch of the State. The DHS's basic 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.

The accompanying basic financial statements reflect the financial position and results of operations of the following activities of the DHS:

**Health Care Programs:** The activities of the Med-Quest division of the DHS include the Medical Assistance Program, which is designed to provide payments for medical services to eligible individuals and families. Services are provided through the Fee-For-Service Medicaid Program or through the managed care QUEST Program. Its operations are reported in the general, special revenue, and agency funds.

**General Welfare Assistance, Employment and Support Services:** The activities of the Benefit, Employment and Support Services division of the DHS provide economic support, employment, training, and educational services to welfare recipients; and child care services and opportunities for early childhood education to preserve and strengthen eligible families and to enable them to achieve personal and economic self-sufficiency. Its operations are reported in the general, special revenue, and agency funds.

**Child Welfare and Adult Community Care Services:** The activities of the Social Services division of the DHS include child welfare services and adult care services under the Social Security Act. In addition, the activities related to the medical waivers programs are included in this functional activity. Its operations are reported in the general and special revenue funds.

**Vocational Rehabilitation and Services for the Blind:** The activities of the Vocational Rehabilitation and Services for the Blind division of the DHS provide 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. Its operations are reported in the general, special revenue, and agency funds.

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE A - FINANCIAL REPORTING ENTITY (Continued)**

**Youth Prevention, Delinquency and Correction Services:** The activities of the Office of Youth Services of the DHS include 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.

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

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES**

- (1) **Basis of Presentation** - The government-wide financial statements report all assets, liabilities, and activities of the DHS as a whole. The fiduciary funds are excluded from the government-wide financial statements because the DHS cannot use those assets to finance its operations.

The financial transactions of the DHS are recorded in individual funds that are reported in the fund financial statements and are described in the following sections. Each fund is considered a separate accounting entity. The operations of each are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues, and expenditures.

The fund financial statements focus on major funds rather than reporting funds by type. Each major fund is reported in separate columns and non-major funds are combined in one column. Major funds are funds which have total assets, liabilities, revenues or expenditures of the fund that are at least ten percent of the same element for all funds of its fund type or at least five percent of the same element for all governmental funds combined.

**Governmental Fund Types**

**General Fund** - The general fund is the general operating fund of the DHS. It is used to account for all financial activities 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** - Special revenue funds are used to account for the proceeds of specific revenue sources (other than expendable trusts) that are legally restricted to expenditures for specified purposes.



**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Fiduciary Fund Type**

Agency Funds - Agency funds are used to account for assets held by the DHS on behalf of outside parties, including other governments, or on behalf of individuals.

(2) ***Measurement Focus and Basis of Accounting***

**Government-wide Financial Statements** - The economic resources measurement focus and accrual basis of accounting is used for reporting the government-wide financial statements. With this measurement focus, all assets and liabilities associated with the operations of the DHS are included on the statement of net assets. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses are recorded at the time liabilities are incurred. Revenue from grants is recognized when all eligibility requirements have been satisfied.

**Governmental Funds** - All governmental funds are accounted for using a current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the accounting period when they become both measurable and available. 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 fiscal 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.

**Agency Funds** - Agency funds are used to account for resources held by the DHS as an agent for individual private organizations or government agencies. Agency funds are custodial in nature (i.e., assets equal liabilities) and do not involve measurement of results of operations.

(3) ***Use of Estimates*** - The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

(4) ***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 were established based on management's estimate of amounts collectible.

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

- (5) **Capital Assets** - Capital assets include land, improvements to land, buildings, building improvements, vehicles, machinery, equipment, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.

When capital assets are purchased, they are capitalized and depreciated in the government-wide financial statements. Capital assets are recorded as expenditures of the current period in the governmental fund financial statements.

Capital assets are valued at cost where historical records are available and at estimated historical cost where no records exist. Donated capital assets are valued at their estimated fair value on the date received.

Improvements to capital assets that materially add to the value or extend the life of the assets are capitalized. Other repairs and normal maintenance are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

The State has adopted the following capitalization policy:

Asset Type	Minimum Capitalization Amount	Estimated Useful Life
Land	All	Not applicable
Land improvements	\$ 100,000	15 years
Buildings and improvements	\$ 100,000	30 years
Furniture and equipment	\$ 5,000	7 years
Motor vehicles	\$ 5,000	5 years

- (6) **Accumulated Vacation** - Employees are credited with vacation at the rate of 96 to 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 accrued and reflected in the statement of net assets.
- (7) **Due to Individuals** - Due to individuals represents assets held by the DHS primarily in a agent capacity and is available to individuals receiving benefits under various programs primarily through the Electronic Benefits Transfer System.
- (8) **Appropriations** - Appropriations represent the authorizations granted by the State Legislature that permit 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.

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)**

- (9) ***Operating Grants and Contributions*** - Federal grants and assistance awards are recorded as intergovernmental receivables and revenues when all eligibility requirements have been satisfied.
- (10) ***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 basic financial statements.
- (11) ***Risk Management*** - The DHS is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.

**NOTE C - BUDGETING AND BUDGETARY CONTROL**

Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues and budgeted expenditures in the budgetary comparison schedules of the general and special revenue funds are derived primarily from acts of the State Legislature and from other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii.

To the extent not expended or encumbered, general fund appropriations generally lapse at the end of the fiscal year for which the appropriations were made. The State Legislature specifies the lapse date and any other particular conditions relating to terminating the authorization for other appropriations such as those related to the special revenue funds.

For purposes of budgeting, the DHS's budgetary fund structure and accounting principles differ from those utilized to present the fund financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP). The DHS's annual budget is prepared on the modified accrual basis of accounting with several differences, principally related to (1) the encumbrance of purchase orders and contract obligations, (2) the recognition of certain receivables, and (3) special revenue funds operating grant accruals and deferrals. These differences represent a departure from GAAP.

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE C - BUDGETING AND BUDGETARY CONTROL (Continued)**

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the fiscal year ended June 30, 2003.

	<u>General</u>	<u>Special Revenue</u>
Excess of revenues over expenditures and other uses - actual on a budgetary basis	\$ 19,185,792	\$ 231,867
Reserved for encumbrances at fiscal year-end	13,617,189	32,280,116
Expenditures for liquidation of prior fiscal year encumbrances	(10,577,639)	(16,272,314)
Net change in unreserved liabilities	2,792,520	(10,160,541)
Net change in accrued medical assistance payable	(15,100,000)	(27,600,000)
Accruals related to federal reimbursements for program expenditures	(5,319,828)	4,556,092
Net change in other receivables	(42,673)	111,800
Difference for revenues recognized for GAAP purposes	<u>          --</u>	<u>17,085,919</u>
Excess of revenues over expenditures and other uses - GAAP basis	\$ <u>4,555,361</u>	\$ <u>232,939</u>

**NOTE D - CASH AND CASH EQUIVALENTS**

The State Director of Finance is responsible for safekeeping of all monies paid into the State Treasury (cash pool). The Hawaii Revised Statutes authorize the State Director of Finance to invest in obligations of, or guaranteed by, the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions. Cash and deposits with financial institutions are collateralized in accordance with state statutes. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE D - CASH AND CASH EQUIVALENTS (Continued)**

The DHS also maintains cash in banks which are held separately from cash in the State Treasury. As of June 30, 2003, the carrying amount of total bank deposits was approximately \$181,000 and the corresponding bank balances which are represented were approximately \$624,000.

**NOTE E - RECEIVABLES**

Receivables of the DHS, net of an allowance for doubtful accounts, consisted of the following at June 30, 2003:

	<u>General</u>	<u>Special Revenue</u>
Welfare benefit overpayments	\$ 16,341,620	\$ 21,787,380
QUEST premiums receivable	2,700,000	--
Social Security interim assistance loans	850,000	--
CSEA receivable	182,089	--
	<u>20,073,709</u>	<u>21,787,380</u>
Less allowance for doubtful accounts:		
Welfare benefit overpayments	15,055,820	20,073,180
QUEST premiums receivable	2,585,000	--
	<u>17,640,820</u>	<u>20,073,180</u>
Receivables, net	\$ <u>2,432,889</u>	\$ <u>1,714,200</u>

**NOTE F - CAPITAL ASSETS**

The changes in capital assets were as follows:

	Governmental Activities					Balance June 30, 2003
	Balance July 1, 2002	Additions	Disposals	Net Transfers	Other	
Depreciable assets						
Buildings and improvements	\$ 42,163,734	\$ 1,212,650	\$ --	\$ --	\$ --	\$ 43,376,384
Furniture and equipment	4,857,619	533,928	172,374	(14,507)	216,225	5,420,891
Vehicles	1,983,082	92,299	22,489	--	(9,284)	2,043,608
Nondepreciable assets						
Land	6	--	--	--	--	6
Total at historical cost	<u>49,004,441</u>	<u>1,838,877</u>	<u>194,863</u>	<u>(14,507)</u>	<u>206,941</u>	<u>50,840,889</u>
Less accumulated depreciation for:						
Buildings and improvements	9,283,206	1,454,946	--	--	20,212	10,758,364
Furniture and equipment	2,827,088	544,318	160,873	9,262	260,435	3,480,230
Vehicles	1,614,722	215,285	22,488	--	(84,667)	1,722,852
Total accumulated depreciation	<u>13,725,016</u>	<u>2,214,549</u>	<u>183,361</u>	<u>9,262</u>	<u>195,980</u>	<u>15,961,446</u>
Total capital assets, net	\$ <u>35,279,425</u>	\$ <u>(375,672)</u>	\$ <u>11,502</u>	\$ <u>(23,769)</u>	\$ <u>10,961</u>	\$ <u>34,879,443</u>

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE F - CAPITAL ASSETS (Continued)**

Depreciation expense was charged to functions as follows:

	<u>Governmental Activities</u>
Health care programs	\$ 656,528
General welfare assistance, employment and support services	500,254
Child welfare and adult community care services	232,420
Vocational rehabilitation and services for the blind	93,406
Youth prevention, delinquency and correction services	677,149
General administration	<u>54,792</u>
	<u>\$ 2,214,549</u>

**NOTE G - LONG-TERM LIABILITY**

The only long-term liability of the DHS for governmental activities is for accrued compensated absences. The change in the long-term liability during the fiscal year ended June 30, 2003, was as follows:

	<u>Amount</u>
Balance at July 1, 2002	\$ 12,137,537
Additions	8,735,279
Reductions	<u>(5,054,392)</u>
Balance at June 30, 2003	<u>\$ 15,818,424</u>

The portion of the accrued compensated absences liability due within one year is estimated at \$5,300,000. The compensated absences liability has been paid primarily by the general fund in the past.

**NOTE H - NON-IMPOSED EMPLOYEE FRINGE BENEFITS**

Payroll fringe benefit costs of the DHS's employees that are funded by state appropriations (general fund) are assumed by the State and are not charged to the DHS's operating funds. These costs, totaling approximately \$14,959,000 for the fiscal year ended June 30, 2003, have been reported as revenues and expenditures in the general fund of the DHS.

Payroll fringe benefit costs related to federally-funded salaries are not assumed by the State and are recorded as expenditures in the special revenue funds of the DHS.

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE I - FUND BALANCE DEFICITS**

The general and special revenue funds of the DHS have deficits in the unreserved fund balances at June 30, 2003 aggregating to \$54,209,615 and \$30,926,293, respectively. Those deficits resulted primarily from expenditures being recorded on the accrual basis when incurred, and revenues being recognized only when corresponding funds are measurable and available.

**NOTE J - CHANGES IN ASSETS AND LIABILITIES OF THE AGENCY FUNDS**

The agency funds are purely custodial (assets equal liabilities) and thus do not involve the measurement of results of operations. The changes in assets and liabilities of the agency funds for the fiscal year ended June 30, 2003, were as follows:

	Balance July 1, 2002	Additions	Deductions	Balance June 30, 2003
<b>ASSETS</b>				
Cash - special and temporary deposits	\$ <u>1,511,883</u>	\$ <u>1,661,549</u>	\$ <u>1,833,460</u>	\$ <u>1,339,972</u>
<b>LIABILITIES</b>				
Due to individuals and others	\$ <u>1,511,883</u>	\$ <u>1,661,549</u>	\$ <u>1,833,460</u>	\$ <u>1,339,972</u>

**NOTE K - LEASE COMMITMENTS**

The DHS leases office facilities from third party lessors under various operating leases expiring through 2008. Certain leases include renewal and escalation clauses. Future minimum lease rentals under non-cancelable operating leases with terms of one year or more at June 30, 2003, are as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2004	\$ 1,697,000
2005	803,000
2006	385,000
2007	117,000
2008	<u>23,000</u>
	<b>\$ <u>3,025,000</u></b>

Total rent expense related to the above leases for the fiscal year ended June 30, 2003, amounted to approximately \$2,027,000.

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE K - LEASE COMMITMENTS (Continued)**

In addition, the DHS uses state-owned facilities that are reported as capital assets in the government-wide financial statements. The State's share of lease costs for those facilities was not reported in the general fund of the DHS since the allotted appropriations of the DHS were reduced by that amount. The federal share of these lease costs allocable to programs was reported in the special revenue funds of the DHS.

**NOTE L - RETIREMENT BENEFITS**

**Employees' Retirement System**

Substantially all eligible employees of the DHS are required by Chapter 88, Hawaii Revised Statutes (HRS), to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the ERS at City Financial Tower, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

Members of the ERS belong to either a contributory or noncontributory option. Only employees of the DHS hired on or before June 30, 1984 are eligible to participate in the contributory option. Members are required by state statute to contribute 7.8% of their salary to the contributory option and the DHS is required to contribute to both options at an actuarially determined rate. No contributions were required or made by the DHS for the fiscal years ended June 30, 2002 and 2001. Contributions by the DHS for the fiscal year ended June 30, 2003, were approximately \$6,171,900. The contribution rate for the fiscal year ended June 30, 2003, was 8.87%.

**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 retired state employees. Contributions are financed on a pay-as-you-go basis. The DHS's share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 2003, was approximately \$5,354,000.

**Deferred Compensation Plan**

The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All plan assets are held in a trust fund to protect them from claims of general creditors. The State has no responsibility for loss due to the investment or failure of investment of funds and assets in the plan, but does have the duty of due care that would be required of an ordinary prudent investor. Accordingly, the assets and liabilities of the State's deferred compensation plan are not reported in the State's or DHS's basic financial statements.



**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE M - RISK MANAGEMENT**

The DHS is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. The State generally is at risk for the first \$250,000 per occurrence of property losses and the first \$3 million with respect to general liability claims. Losses in excess of those retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is \$25 million (\$10 million for earthquake, named hurricane and flood) and the annual aggregate for general liability losses per occurrence is \$7 million. The State also has an insurance policy to cover medical malpractice risk in the amount of \$30 million per occurrence with no annual aggregate limit.

The State is generally self-insured for workers' compensation and automobile claims. The State's estimated reserve for losses and loss adjustment costs include the accumulation of estimates for losses and claims reported prior to fiscal year-end, estimates (based on projections of historical developments) of claims incurred but not reported, and estimates of costs for investigating and adjusting all incurred and unadjusted claims. Amounts reported are subject to the impact of future changes in economic and social conditions. The State believes that, given the inherent variability in any such estimates, the reserves are within a reasonable and acceptable range of adequacy. Reserves are continually monitored and reviewed, and as settlements are made and reserves adjusted, the differences are reported in current operations. A liability for a claim is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.

**NOTE N - COMMITMENTS AND CONTINGENCIES**

**Accumulated Sick Leave**

Employees earn sick leave credits at the rate of one and three-quarters working days for each month of service without limit, but can be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a public employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the ERS. Accumulated sick leave as of June 30, 2003, amounted to approximately \$51,106,000.

**Medicaid Program**

In June 2000, the U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services (CMS), informed the DHS of its preliminary conclusion that the State's nursing facility tax program resulted in a disallowance of approximately \$18 million of federal financial participation in the Medical Assistance Program for the period July 1, 1993 through June 30, 1997. The CMS concluded that state income tax credits made available to private pay patients were associated with nursing facility taxes assessed and collected by the State and violated Section 1903(w)(4)(A) of the Social Security Act and 42 CFR Part 433.68(f), which specifies that a hold harmless provision exists when a 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.

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2003**

**NOTE N - COMMITMENTS AND CONTINGENCIES (Continued)**

In January 2001, the CMS reached a final decision and issued a notice of disallowance in the amount of \$17,750,950. The CMS instructed the DHS to reduce future federal financial participation awards by the amount of disallowance. The DHS appealed the final decision of the Regional Administrator with the Department Appeals Board under 45 CFR Part 16. If the final administrative decision upholds the disallowance, the amount of the disallowance plus interest will be offset against a subsequent grant award since the DHS elected to retain the disputed funds during the appeals process. As of February 20, 2004, the contingency remains pending and the final outcome cannot be determined at this time.

In the normal course of operating the Medical Assistance Program, the DHS reimburses providers of medical services to Medicaid recipients under a Prospective Payment System (PPS). Under PPS, standard costs and rates are negotiated between the 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, 2003, cannot be determined at this time. Any adjustments would be funded from future appropriations.

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

**SUPPLEMENTARY INFORMATION**

**Department of Human Services  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
Fiscal Year Ended June 30, 2003**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures <sup>1</sup>
<b>U.S. Department of Health and Human Services</b>			
Promoting Safe and Stable Families	93.556		\$ 1,767,091
Temporary Assistance for Needy Families (TANF) <sup>2</sup>	93.558		58,227,652
Low-Income Home Energy Assistance	93.568		1,797,491
Child Care and Development Block Grant <sup>2</sup>	93.575		17,670,643
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		11,274,863
Head Start	93.600		114,983
Child Welfare Services - State Grants	93.645		1,260,572
Foster Care - Title IV-E	93.658		17,818,265
Adoption Assistance	93.659		6,987,995
Social Services Block Grant <sup>2</sup>	93.667		11,086,110
Child Abuse and Neglect State Grants	93.669		158,692
Family Violence Prevention and Services/Grants for Battered Women's Shelters - Grants to States and Indian Tribes	93.671		819,560
Chafee Foster Care Independent Living	93.674		646,689
State Children's Health Insurance Program	93.767		6,963,875
State Survey and Certification of Health Care Providers and Suppliers	93.777		338,894
Medical Assistance Program (Medicaid; Title XIX)	93.778		494,564,413
Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	93.779		455,483
<b>Pass-through Judiciary</b>			
State Court Improvement Program	93.586	G9801HISCIP	17,786
<b>Pass-through State Department of Labor and Industrial Relations</b>			
Refugee and Entrant Assistance - State Administered Programs	93.566		<u>8,111</u>
<b>Total U.S. Department of Health and Human Services</b>			<b>\$ <u>631,979,168</u></b>

**Department of Human Services  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
Fiscal Year Ended June 30, 2003**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures <sup>1</sup>
<b>U.S. Department of Agriculture</b>			
Food Stamps <sup>3</sup>	10.551		\$ 155,215,207
State Administrative Matching Grants for Food Stamp Program	10.561		<u>10,434,255</u>
<b>Total U.S. Department of Agriculture</b>			<u>165,649,462</u>
<b>U.S. Department of Justice</b>			
Juvenile Accountability Incentive Block Grants (JAIBG)	16.523		1,206,001
Juvenile Justice and Delinquency Prevention - Allocation to States (State Formula Grants)	16.540		634,100
Title V - Delinquency Prevention Program	16.548		136,454
Part E - State Challenge Activities (Challenge Grants)	16.549		62,984
Edward Byrne Formula Grant Program	16.579		125,839
Enforcing Underage Drinking Laws Program	16.727		<u>300,472</u>
<b>Total U.S. Department of Justice</b>			<u>2,465,850</u>
<b>U.S. Department of Labor</b>			
Employment Programs for People with Disabilities	17.720		224,711
Pass-through State Department of Labor and Industrial Relations Senior Community Service Employment Program	17.235	PY02-SCSEP-CC-DHS	<u>275,657</u>
<b>Total U.S. Department of Labor</b>			<u>500,368</u>
<b>U.S. Department of Education</b>			
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126		9,246,026
Rehabilitation Services - Service Projects	84.128		124,855
Rehabilitation Long-Term Training	84.129		112,305
Independent Living - State Grants	84.169		355,857
Rehabilitation Services - Independent Living Services for Older Individuals Who are Blind	84.177		300,966
Supported Employment Services for Individuals with Severe Disabilities	84.187		205,455

**Department of Human Services  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2003**

<u>Federal Grantor/Pass-through Grantor and Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Federal Expenditures<sup>1</sup></u>
Assistive Technology	84.224		\$ 437,347
Projects with Industry (PWI)	84.234		147,037
Rehabilitation Training - State Vocational Rehabilitation Unit In-Service Training	84.265		14,223
Capacity Building For Traditionally Underserved Populations (Capacity Building)	84.315		36,811
Pass-through State Office of Children and Youth			
Safe and Drug-Free Schools and Communities - State Grants	84.186	S186B000012	69,352
		S186B010012	<u>323,190</u>
<b>Total U.S. Department of Education</b>			<u>11,373,424</u>
<b>Corporation for National and Community Service</b>			
Foster Grandparent Program	94.011		465,452
Senior Companion Program	94.016		<u>396,232</u>
<b>Total Corporation for National and Community Service</b>			<u>861,684</u>
<b>Social Security Administration</b>			
Social Security - Disability Insurance	96.001		<u>4,854,316</u>
<b>Total Social Security Administration</b>			<u>4,854,316</u>
<b>TOTAL FEDERAL EXPENDITURES</b>			<u>\$ 817,684,272</u>

<sup>1</sup> The accompanying schedule of expenditures of federal awards is prepared on the cash basis of accounting.

<sup>2</sup> Grant awards totaling \$13,650,000 were transferred from CFDA 93.558 Temporary Assistance for Needy Families to CFDA 93.667 Social Services Block Grant (\$4,200,000) and to CFDA 93.575 Child Care and Development Block Grant (\$9,450,000).

<sup>3</sup> Expenditures represent assistance utilized through the Electronic Benefits Transfer System.

**PART II**

**AUDITORS' REPORT ON COMPLIANCE AND ON  
INTERNAL CONTROL OVER FINANCIAL REPORTING**



NISHIHAMA & KISHIDA, CPA'S, INC.  
CERTIFIED PUBLIC ACCOUNTANTS

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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN  
AUDIT OF THE BASIC FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

To the Director  
Department of Human Services  
State of Hawaii

We have audited the basic financial statements of the Department of Human Services of the State of Hawaii (DHS), as of and for the fiscal year ended June 30, 2003, and have issued our report thereon dated February 20, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Compliance**

As part of obtaining reasonable assurance about whether the DHS's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives and circulars, 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*.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the DHS's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on 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 DHS's ability to record, process, summarize and report financial data consistent with the assertions of management in the basic financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 03-1 through 03-2.

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 basic 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, we believe that none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and use of management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Nishihama & Kishida, CPAs, Inc.*

Honolulu, Hawaii  
February 20, 2004

**PART III**

**AUDITORS' REPORT ON COMPLIANCE  
WITH REQUIREMENTS APPLICABLE TO EACH MAJOR  
PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE**



NISHIHAMA & KISHIDA, CPA'S, INC.  
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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS  
APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER  
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

To the Director  
Department of Human Services  
State of Hawaii

**Compliance**

We have audited the compliance of the Department of Human Services of the State of Hawaii (DHS) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2003. The DHS's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the DHS's management. Our responsibility is to express an opinion on the DHS's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the DHS's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the DHS's compliance with those requirements.

As described in items 03-3 to 03-8 in the accompanying schedule of findings and questioned costs, the DHS did not comply with the following requirements:

CFDA Number	Name of Federal Program	Type of Compliance Requirement	Ref. No.
93.778	Medical Assistance Program	Eligibility, Special Tests and Provisions, Reporting	03-3, 03-4, 03-5, 03-6
93.575 and 93.596	Child Care Cluster	Allowability, Eligibility	03-7, 03-8

Compliance with those requirements is necessary, in our opinion, for the DHS to comply with the requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the DHS complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2003.

### Internal Control Over Compliance

The management of the DHS is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the DHS's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance 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 compliance that, in our judgment, could adversely affect the DHS's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 03-3 to 03-8.

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 noncompliance with the applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program 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 compliance 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 items 03-3 and 03-4 to be material weaknesses. We also noted other matters involving the internal control over compliance that we have reported to the management of the DHS in a separate letter dated February 20, 2004.

This report is intended solely for the information and use of management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

*Nishihama & Kishida, CPAs, Inc.*

Honolulu, Hawaii  
February 20, 2004

**PART IV**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**Department of Human Services  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Fiscal Year Ended June 30, 2003**

**SECTION I - SUMMARY OF AUDITORS' RESULTS**

**Financial Statements**

Type of auditors' report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness(es) identified?	<input type="checkbox"/> yes	<input checked="" type="checkbox"/> no
Reportable condition(s) identified not considered to be material weaknesses?	<input checked="" type="checkbox"/> yes	<input type="checkbox"/> none reported
Noncompliance material to the financial statements noted?	<input type="checkbox"/> yes	<input checked="" type="checkbox"/> no

**Federal Awards**

Internal control over major program:		
Material weakness(es) identified?	<input checked="" type="checkbox"/> yes	<input type="checkbox"/> no
Reportable condition(s) identified not considered to be material weaknesses?	<input checked="" type="checkbox"/> yes	<input type="checkbox"/> none reported

Type of auditors' report issued on compliance for major programs:	Qualified
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Any audit findings disclosed that are required to be reported in accordance with OMB Circular A-133, Section .510(a)?	<input checked="" type="checkbox"/> yes	<input type="checkbox"/> no
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Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
10.551	Food Stamps
10.561	State Administrative Matching Grants for Food Stamp Program
93.558	Temporary Assistance for Needy Families
93.575	Child Care and Development Block Grant
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund
93.667	Social Services Block Grant (Title XX)
93.767	State Children's Insurance Program
93.777	State Survey and Certification of Health Care Providers and Suppliers
93.778	Medical Assistance Program

Dollar threshold used to distinguish between Type A and Type B programs:	\$3,000,000
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Auditee qualified as a low-risk auditee?	<input type="checkbox"/> yes	<input checked="" type="checkbox"/> no
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**Department of Human Services**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2003**

**SECTION II - FINANCIAL STATEMENT FINDINGS**

**Ref.**

**No. Internal Control Findings**

**03-1 Properly Record All Fixed Assets in the State Property Inventory Records**

Divisions within the DHS are responsible for reporting the acquisition and disposal of fixed assets to the State Procurement Office on a quarterly basis to update the state property inventory records. In the prior fiscal year, we informed the DHS that a building used by the Office of Youth Services with a cost of \$2,153,500 was not included on the state property records.

Section 103D-106 of the Hawaii Revised Statutes states in part, "...the administrative heads of the executive departments, and all other persons, offices, and boards of a public character... shall prepare and file with the administrator of the state procurement office an annual inventory return of state property in the possession, custody, control, or use of the officer making the return, or of the department or office of the government over which the officer presides...."

Although the DHS has issued reminders to all division offices to properly report fixed asset purchases to the State Procurement Office, personnel did not always adhere to the established procedures.

The Department of Accounting and General Services (DAGS) uses the information from the state property inventory records to assist the DHS in compiling the department's fixed assets and depreciation information for the fiscal year. We noted that during the current fiscal year, the DHS changed the carrying value of items that were acquired in previous fiscal years to correctly state the cost of the assets. We noted three instances where the items' carrying value was corrected with a net change to the fixed asset listing of approximately \$79,000.

**Recommendation**

To ensure that the state property inventory records are complete and accurate, the DHS should implement monitoring procedures to ensure that all appropriate personnel properly and accurately report all fixed asset acquisitions and dispositions to the State Procurement Office on a quarterly basis. The DHS should also implement a process to review, in a timely manner, the transactions that are posted to the department property inventory records to ensure that the transactions were properly posted to the state property inventory records.



**Department of Human Services**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2003**

**Ref.**  
**No.**

**Internal Control Findings (Continued)**

**03-2 Maintain Vacation and Sick Leave Records Properly**

The DHS prepared a summary leave schedule to determine the amount of its accrued compensated absence liability and reported the liability to the State Comptroller. The liability was based on the balance of earned hours per individual leave records (Form DPS-7) multiplied by each employee's hourly salary rate. We noted the following conditions:

- There were numerous instances where the Form G-1, *Application for Leave of Absence*, was authorized after the employee took vacation.
- There were numerous instances where the accrued vacation and sick leave hours on the summary leave schedule did not agree to the individual Form DPS-7. In one instance, this resulted in an overstatement of accrued vacation and sick leave totaling 190 hours or \$6,684.

Although the DHS established procedures to conduct random quality control reviews of leave records, it appears that the leave records were not always updated accurately on a timely basis.

**Recommendation**

The DHS should increase the number of random quality control reviews of leave records to ensure that vacation and sick leave records are accurately maintained on a timely basis. In addition, the summary leave schedule should be reviewed before reporting the balances to the State Comptroller.

**Department of Human Services  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2003**

**SECTION III - FEDERAL AWARD FINDINGS**

<b>Ref.</b>		<b>Questioned</b>
<b><u>No.</u></b>	<b>Compliance and Internal Control Findings</b>	<b><u>Costs</u></b>

**03-3 Improve Utilization Controls over Medicaid Claims**

The development and administration of the state's Medicaid Assistance Program (MAP) is the responsibility of the Med-QUEST Division (MQD). There have been significant changes that have impacted the operations of MAP. On August 1, 2001, the management and processing of DHS's pharmacy benefits was contracted to Affiliated Computer Services (ACS), and effective July 1, 2002, ACS became the MQD's new fiscal agent. In addition, on November 1, 2002, the Hawaii Prepaid Medical Management Information System (HPMMIS), DHS's new non-drug claims processing system, became operational. The HPMMIS is operated and maintained by the Arizona Health Care Cost Containment System (AHCCCS). Substantial time and effort was needed in order to complete the transition to a new fiscal agent, migrate to the new claims processing system, and ensure compliance with the Health Insurance Portability and Accountability Act (HIPAA).

Although the pre-payment edit functions contained in the HPMMIS, the Peer Review Organization (PRO) contract, and the DHS's extensive list of medical services and procedures which require prior authorization remain the primary controls used to prevent unnecessary utilization of care and services and to ensure proper and accurate payment of Medicaid claims, we did note that several controls and procedures previously in place were no longer present.

Title 42 CFR Part 456 Subpart A requires a statewide program of control of the utilization of all Medicaid (CFDA 93.778) Services. During our review of the internal controls, we noted the following conditions:

- The review of Surveillance and Utilization Review Subsystem (SURS) reports and Explanation of Medical Benefit (EOMB) responses is no longer being performed. The HPMMIS has not been able to produce these reports and the DHS is currently working with AHCCCS to develop these reports. Without these reports, the DHS is severely limited in its ability to analyze recipient and provider utilization data which could uncover potentially fraudulent or abusive behavior.
- The post payment review of a sample of electronic media claims (EMC) is no longer being performed. Well over 50% of all Medicaid claims are received electronically. This function was previously performed by HMSA, the former DHS fiscal agent.

**Department of Human Services  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2003**

<u>Ref. No.</u>	<b>Compliance and Internal Control Findings (Continued)</b>	<u>Questioned Costs</u>
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- Title 42 CFR Part 455.12 requires the DHS to have methods for identification, investigation, and referral of fraudulent activity. The Medicaid Investigations Unit (MIU) is an important component of this process. The MIU continues to receive referrals of potential fraud from the DHS staff nurses as part of their prior authorization duties. However, the number of referrals of potential fraud to the MIU has decreased significantly in large part because utilization control activities such as the review of SURS reports, the review of EOMB responses, and the audit of EMC claims are no longer being performed.
- In addition, the MIU does not maintain adequate records documenting the number of complaints received, the work performed, the disposition of the cases, and follow-up activities. The documentation of the details and results of full investigations performed was adequate; however, without more comprehensive documentation of the activities of the MIU it is difficult to evaluate the effectiveness of the unit and whether appropriate action is being taken on all complaints.

A lack of staffing and the inability of the HPMMIS to generate the necessary data and reports have contributed to the conditions described above.

In a report dated September 4, 2003, Heritage Information Systems, Inc. (Heritage), a healthcare auditing and consulting company, reported similar findings and recommendations stemming from an audit of ACS activities as the DHS's current pharmacy benefit manager (PBM). For example, Heritage noted the need to explore edits, analysis, and reporting which could aid in anti-fraud efforts.

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**Recommendation**

To ensure compliance with federal regulations, we recommend the DHS perform the following:

- Obtain the necessary HPMMIS and ACS PBM management reports to allow a post-payment review of recipient utilization and provider service profiles and exception criteria based on parameters set by the MQD. The analysis of these reports should help identify exceptions or abnormal patterns of treatment or service and allow for the correction of misutilization practices of recipients and providers. It also serves as an important tool to identify and investigate potential fraudulent behavior.

**Department of Human Services  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2003**

<u>Ref. No.</u>	<b>Compliance and Internal Control Findings (Continued)</b>	<u>Questioned Costs</u>
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- Given the high percentage of claims submitted via electronic media, the DHS should consider preparing a request for proposal to continue the EMC audits. This could be an opportunity to provide additional provider education as well as a valuable referral source of potential fraud to the MIU.
  
- Document preliminary investigations of complaints of Medicaid fraud, abuse or any questionable practices, to determine whether there is sufficient basis to warrant a full investigation as required by Title 42 CFR Part 455.14. The method of documentation should be more standardized to provide better information on complaints received, referrals of suspected claims, preliminary investigations performed, and dispositions of all complaints and referrals. Records should indicate the activity of the MIU and demonstrate the procedures for investigation, cooperation with legal authorities, referral of cases and follow-up activities. This will provide the DHS with the information necessary to assess the effectiveness of the MIU's ability to evaluate all complaints and reports regarding fraud or abuse and to conduct investigations of alleged fraud.

**Department of Human Services**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2003**

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned Costs</b>
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**03-4 Obtain the Necessary Reports From the HPMMIS**

As part of our review of the Medicaid Program (CFDA 93.778), we noted several instances in which the DHS was unable to comply with federal requirements because necessary reports from the HPMMIS were unavailable. In addition to being unable to perform a review of SURS reports and other valuable utilization control functions, the DHS did not report approximately \$6.3 million of medical waiver expenditures. These medical waiver expenditures are administered by the Social Services Division (SSD), and reported on the Medicaid federal financial report (CMS-64) prepared by MQD.

In the past, the SSD would code each invoice received for payment to the proper waiver program and payments were processed by way of the State's disbursement system using purchase orders and invoices. Beginning November 2002, medical waiver claims were now processed as medical claims through HPMMIS. However, the HPMMIS was unable to generate reports summarizing medical waiver expenditures by each waiver program, which is required on the CMS-64. Therefore, the DHS has not reported approximately \$6.3 million in medical waiver expenditures.

Based upon discussions with the DHS personnel and review of AHCCCS request logs, there is a large backlog of pending reports and other HPMMIS projects not yet accomplished.

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**Recommendation**

The DHS should continue work with AHCCCS on developing the necessary HPMMIS reports and completing pending projects as soon as possible to ensure compliance with federal reporting requirements and provisions for utilization controls.

**Department of Human Services**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2003**

<u>Ref. No.</u>	<b>Compliance and Internal Control Findings (Continued)</b>	<u>Questioned Costs</u>
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**03-5 Improve Accuracy of Medicaid Claims Processing**

As part of our review of internal controls, detailed tests of Medicaid (CFDA 93.778) claims were performed. Non-drug claims were processed using the state-owned system, Medicaid Management Information System (MMIS) through October 2002. In November 2002, the DHS changed its claims processing system from the MMIS, operated and maintained by HMSA, to the Hawaii Prepaid Medical Management Information System (HPMMIS) operated and maintained by the State of Arizona. All drug claims were processed by ACS, MQD's pharmacy benefit manager (PBM) for the fiscal year ended June 30, 2003.

During our tests of non-drug claims, we noted several errors caused by either provider billing errors or system errors. The errors resulted in a minimal net underpayment.

We also reviewed the results of the ACS PBM audit performed by Heritage Information Systems, Inc. (Heritage), a healthcare auditing and consulting company. The report noted potential overpayments of approximately \$462,000. The potential overpayments were caused by improper reimbursement formulas being applied, inappropriate quantities or package sizes being paid for, and claims that should have been denied because they were covered under the managed care program.

\$ 462,000

**Recommendation**

Due to the complexity of the Medicaid claims processing function, there is a high inherent risk that claims processing errors may occur. In connection with its utilization controls over Medicaid claims, the DHS should perform post payment claim reviews. Post payment Medicaid claims testing performed in the past has effectively brought to light areas for improvement in claims processing and has resulted in system changes. The transition to a new claims processing system accentuates the value of this function. The DHS should perform regular post payment reviews on a sample of claims to detect processing errors and identify ways to improve the new claims processing system and procedures.

**Department of Human Services  
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
 Fiscal Year Ended June 30, 2003**

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned Costs</b>
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<b>03-6</b>	<b>Complete Eligibility Applications and Annual Eligibility Re- verifications in a Timely Manner</b>	
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Title 42 CFR Part 435.911 requires the DHS to determine the eligibility of individuals who apply for Medicaid (CFDA 93.778) benefits within 45 days from the date of application. Applications that are not reviewed within 45 days are presumed to be eligible, resulting in the risk that ineligible recipients may be receiving Medicaid benefits. Hawaii administrative rules also require annual re-verifications of participant eligibility.

Since September 11, 2001, the DHS has fallen behind in its processing of Medicaid applications and annual eligibility re-verifications. As of June 30, 2003, the number of applications outstanding greater than 45 days was reduced to 260; however, the number of overdue applications was as high as 1,000 as of January 2003. In addition, the number of overdue annual re-verifications remained relatively high at 1,600 as of June 30, 2003.

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**Recommendation**

The DHS should make every effort to eliminate the backlog of applications pending eligibility determinations and the overdue annual re-verifications to reduce the risk that ineligible recipients are receiving Medicaid benefits.

**Department of Human Services  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2003**

<u>Ref. No.</u>	<b>Compliance and Internal Control Findings (Continued)</b>	<u>Questioned Costs</u>
03-7	<b>Ensure Proper Eligibility Determination and Maintain all Required Documentation in Child Care Case Files</b>	
	During our tests of allowability and eligibility for the Child Care Cluster (CFDA 93.575 and 93.596), we noted the following errors:	
	<ul style="list-style-type: none"> <li>• One instance in which an improper eligibility determination resulted in an overpayment of \$250.</li> </ul>	\$ 250
	<ul style="list-style-type: none"> <li>• Six instances in which required documentation was not maintained in the participant case file. Title 45 CFR Part 98.65 (e) requires that appropriate documentation be maintained to allow the verification that funds are expended in accordance with statutory and regulatory requirements of the program. As such, child care benefit payments, totaling \$6,685 should not have been made.</li> </ul>	<u>6,685</u>
		\$ <u>6,935</u>

**Recommendation**

The DHS should ensure that proper eligibility determinations are made and that all required documents are maintained in each case file to support the allowability and eligibility of the child care payments being claimed for federal reimbursement. The DHS should continue to perform case file reviews in order to assess case manager performance. During fiscal year 2003, the DHS performed a review of case files at units managed by third party contractors and similar errors were noted. Follow-up reviews should be performed until the error rate has decreased at all units.



**Department of Human Services**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2003**

<u>Ref. No.</u>	<b>Compliance and Internal Control Findings (Continued)</b>	<u>Questioned Costs</u>
<b>03-8</b>	<b>Improve the Accuracy of Child Care Reimbursements</b>	
	During our tests of allowability and eligibility for the Child Care Cluster (CFDA 93.575 and 93.596), we noted several benefit payment errors. The errors noted were as follows:	
	<ul style="list-style-type: none"> <li>• Two instances in which the case manager applied improper child care rates. The errors resulted in a total underpayment of \$179.</li> </ul>	\$ (179)
	<ul style="list-style-type: none"> <li>• One instance in which an income calculation error by the case manager resulted in an improper application of the co-payment percentage. The error resulted in an underpayment of \$25.</li> </ul>	____(25)
		\$ <u>(204)</u>

**Recommendation**

The DHS should ensure that reimbursements to child care program participants are calculated properly. The DHS should continue to perform case file reviews in order to assess contractor performance. During fiscal year 2003, the DHS performed a review of case files at units managed by third party contractors and similar errors were noted. Follow-up reviews should be performed until the error rate has decreased at all units.

**PART V**  
**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**

## STATUS REPORT

This section contains the current status of our prior audit recommendations. The recommendations are referenced to the pages of the previous audit report for the fiscal year ended June 30, 2002, dated March 3, 2003.

Recommendations	Status
<b>SECTION II - FINANCIAL STATEMENT FINDINGS</b>	
<b>02-1 Replace the Existing Automated Recovery System (ARS) (page 56-57)</b>	
<p>The DHS should implement the HARI System as soon as possible. To increase operational efficiencies, the HARI System should be integrated with the HAWI System. The HARI System should also be interfaced with the lockbox collection system, which will allow the DHS to maintain current levels of accounting controls and operational efficiencies.</p> <p>In addition, the DHS should continue with its plans to identify long outstanding receivable balances and submit those accounts for approval for write-off by the State Department of the Attorney General. By transferring these uncollectible receivable balances to a separate database, the DHS will be working with only recent data when data from the ARS is exported to the HARI System. This should allow the DHS to monitor receivable balances more closely through a better analysis of the aging and collection history of a smaller population of accounts.</p>	Accomplished.
<b>02-2 Maintain Vacation and Sick Leave Records Properly (page 58)</b>	
<p>The DHS should increase the number of random quality control reviews of leave records to ensure that vacation and sick leave records are accurately maintained on a timely basis. In addition, the summary leave schedule should be reviewed before reporting the balances to the State Comptroller.</p>	Not accomplished. See Reference No. 03-2.

Recommendations	Federal CFDA Number	Status
<b>SECTION III - FEDERAL AWARD FINDINGS</b>		
<b>02-3 Improve Utilization Controls over Medicaid Claims (page 59-60)</b>		
<p>Although the transition to a new claims system and a new fiscal agent requires a substantial amount of resources, the DHS must comply with federal regulations regarding utilization controls over Medicaid services by performing the following:</p> <ul style="list-style-type: none"> <li>• Conduct preliminary investigations of complaints of Medicaid fraud, abuse or any questionable practices, to determine whether there is sufficient basis to warrant a full investigation as required by Title 45 CFR Part 455.14. The method of documentation should be more standardized to provide better information on complaints received, referrals of suspect claims, preliminary investigations performed, and dispositions of all complaints and referrals. Records should indicate the activity of the MIU and demonstrate the procedures for investigation, cooperation with legal authorities, referral of cases and follow-up activities. This will provide the DHS with the information necessary to assess the effectiveness of the MIU's ability to evaluate all complaints and reports regarding fraud or abuse and to conduct investigations of alleged fraud.</li> </ul> <p>Given the reports of widespread Medicaid fraud occurring at the local and national level, the DHS should consider committing additional resources to the MIU, which is presently staffed by one person.</p> <ul style="list-style-type: none"> <li>• The new utilization review subsystem of the HPMMIS was available in November 2002. Therefore, the DHS should finalize parameters and procedures necessary to put into operation the HPMMIS utilization post-payment review subsystem as soon as possible.</li> </ul> <p>The DHS should consider selecting its sample claims for review by the EQRO/PRO on a quarterly basis based on claims paid. Selecting claims paid for post-payment review by the</p>	93.778	Not accomplished. See Reference No. 03-3.

Recommendations	Federal CFDA Number	Status
<p>EQRO/PRO on a quarterly basis would allow the DHS to identify problematic areas, and if necessary, to recoup funds in a more timely manner.</p>		
<p><b>02-4 Improve Accuracy of Medicaid Claims Processing (page 61)</b></p>		
<p>Due to the complexity of the Medicaid claims processing function, there is a high inherent risk that claims processing errors may occur. In connection with its utilization controls over Medicaid claims, the DHS should perform post-payment claim reviews. Post-payment Medicaid claims testing performed in the past has effectively brought to light areas for improvement in claims processing and has resulted in system changes. The results of our tests in the current fiscal year reinforce our recommendation that the DHS should perform regular post-payment reviews on a sample of claims to detect processing errors and identify ways to improve the claims processing system and procedures.</p>	93.778	Not accomplished. See Reference No. 03-4.
<p><b>02-5 Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner (page 62)</b></p>		
<p>The DHS should make every effort to eliminate the backlog of applications pending eligibility determinations and the over due annual re-verifications to reduce the risk that ineligible recipients are receiving Medicaid benefits.</p>	93.778	Not accomplished. See Reference No. 03-6.
<p><b>02-6 Maintain all Required Documentation in Child Care Case Files (page 63)</b></p>		
<p>The DHS should ensure that proper eligibility determinations are made and that all required documents are received timely and are properly maintained in each case file to support the allowability and eligibility of the child care payments being claimed for federal reimbursement. The DHS should implement formal procedures to monitor the agency contracted to perform monthly child care payment services in order to assess contractor performance. During fiscal year 2002, the DHS did perform a review of case files at a single unit and similar errors were noted. Follow-up reviews should be performed until the error rate has decreased at all units.</p>	93.575 93.596	Not accomplished. See Reference No. 03-7.

Recommendations	Federal CFDA Number	Status
<b>02-7 Improve the Accuracy of Child Care Reimbursements (page 64)</b>	93.575 93.596	Partially accomplished. The DHS has improved the accuracy of HANA. However, we still noted instances of improper payment amounts due to case manager errors. See Reference No. 03-8.
<p>In June 2002, the DHS implemented a new payment system, Hawaii Automated Network for Assistance (HANA), which automatically calculates child care reimbursements. Upon implementation, the DHS noted errors in payment calculation and corrective action was taken to improve the accuracy of reimbursement calculations performed by HANA. The DHS should continue to monitor and assess system performance to ensure that reimbursements to child care program participants are calculated properly.</p>		

**PART VI**  
**RESPONSE OF THE AFFECTED AGENCY**

LINDA LINGLE  
GOVERNOR



LILLIAN B. KOLLER, ESQ.  
DIRECTOR

HENRY OLIVA  
DEPUTY DIRECTOR

STATE OF HAWAII  
DEPARTMENT OF HUMAN SERVICES  
P. O. Box 339  
Honolulu, Hawaii 96809

March 19, 2004

Mr. Ronald T. Shiigi  
Nishihama & Kishida, CPA's, Inc.  
American Savings Bank Tower  
1001 Bishop Street, Suite 1700  
Honolulu, Hawaii 96813-3696

Dear Mr. Shiigi:

We have reviewed your report *Financial Audit of the Department of Human Services, State of Hawaii, Fiscal Year Ended June 30, 2003*. Generally, we concur with your findings and recommendations.

Attached are our responses and corrective action plans related to your audit findings and recommendations. We wish to thank you for this opportunity to respond.

Sincerely,

Lillian B. Koller, Esq.  
Director

Attachment



Date Prepared: March 2004

**Audit Finding: 03-1 Properly Record All Fixed Assets in the State Property Inventory Records**

**Auditor's Recommendation:** To ensure that the state property inventory records are complete and accurate, the DHS should implement monitoring procedures to ensure that all appropriate personnel properly and accurately report all fixed asset acquisitions and dispositions to the State Procurement Office on a quarterly basis. The DHS should also implement a process to review, in a timely manner, the transactions that are posted to the department property inventory records to ensure that the transactions were properly posted to the state property inventory records.

**Corrective Action Taken or Planned:** In verifying this particular finding, the Office of Youth Services (OYS) discovered that the building was in fact entered into the inventory with an erroneous item class code. This error will be corrected with the next inventory update. The OYS will also reexamine the departmental procedures to review and monitor major fixed asset acquisitions and ensure that these procedures are in place at the Hawaii Youth Correctional Facility (HYCF).

Departmental personnel are reminded to properly record fixed asset acquisitions and disposals on a timely basis. The State Procurement Office, Inventory Management Branch (SPO-IMB) has statewide procedures in place to track unrecorded equipment acquisitions. In addition, the Department of Accounting and General Services (DAGS), Public Works Division distributes, on a monthly basis, an MCD Report 300 – Total Expenditures for DAGS Projects, for fixed asset and inventory system reporting purposes. Due to the new financial reporting requirements and standards established by GASB Statement No. 34, the SPO-IMB and DAGS has implemented statewide procedures to insure that state agencies report all fixed asset and capital improvement acquisitions in a timely manner. Information is extracted from the state's Financial and Accounting Management Information System (FAMIS) and a report is generated on all acquisitions that may not have been recorded in the State's inventory system. The reports must be verified by the State agencies and appropriate action taken to record the acquisitions. Error reports are issued until the equipment transactions are correctly recorded. In addition, quarterly and annual reminders are issued for inventory purposes. Inventory procedures refresher training is also conducted as needed and an overview of the laws and penalties is presented in the yearly departmental Administrative Procedures for Clericals and Administrative Procedures for

Supervisors training sessions.

In March 2003, stricter departmental inventory procedures were issued establishing each employee as being responsible and accountable for maintaining and safeguarding inventory assigned to the individual. Furthermore, it requires that a property custodian be assigned for each office/unit, holding the property custodian responsible and accountable for all fixed assets under their management.

Processes are in place to review and monitor major fixed asset acquisitions. The DHS will continue to strive to report them on a more timely and accurate basis.

Start Date: March 2000

End Date: Ongoing

Responding Person: Winifred Doi, Administrative & Technical Officer; Office of Youth Services  
Susy Kawamoto, Property & Procurement Staff; Fiscal Management Office (FMO)

Date Prepared: March 2004

**Audit Finding: 03-2 Maintain Vacation and Sick Leave Records Properly**

**Auditor's Recommendation:** The DHS should increase the number of random quality control reviews of leave records to ensure that vacation and sick leave records are accurately maintained on a timely basis. In addition, the summary leave schedule should be reviewed before reporting the balances to the State Comptroller.

**Corrective Action Taken or Planned:** Actions taken:

Quality control reviews of leave records were conducted affecting 31 employees in 2002 and 36 employees in 2003.

Training in the area of leave records was provided to appropriate staff in 2003. Ninety-six (96) employees attended the neighbor island training sessions and 120 employees attended sessions on Oahu.

Actions planned:

The department's Personnel Office (PERS) will increase the review of leave records and continue to provide training to the appropriate staff responsible for maintaining accurate leave records.

It is recognized that the existing leave record system is decentralized, manual and prone to errors. To improve the accuracy of the summary leave schedule, the Fiscal Management Office's Pre-Audit Staff will review a sample selection of the approximately 2,300 individual employee leave balances included in the schedule.

**Start Date:** August 1997

**End Date:** Ongoing

**Responding Person:** Edwin Nose, Personnel Officer; PERS  
Edwin Igarashi, Fiscal Management Officer; FMO

Date Prepared: March 2004

**Audit Finding:** 03-3 Improve Utilization Controls Over Medicaid Claims

**Auditor's Recommendation:** To ensure compliance with federal regulations, we recommend the DHS perform the following:

- Obtain the necessary HPMMIS and ACS PBM management reports to allow a post-payment review of recipient utilization and provider service profiles and exception criteria based on parameters set by the MQD. The analysis of these reports should help identify exceptions or abnormal patterns of treatment or service and allow for the correction of misutilization practices of recipients and providers. It also serves as an important tool to identify and investigate potential fraudulent behavior.
- Given the high percentage of claims submitted via electronic media, the DHS should consider preparing a request for proposal to continue the EMC audits. This could be an opportunity to provide additional provider education as well as a valuable referral source of potential fraud to the MIU.
- Document preliminary investigations of complaints of Medicaid fraud, abuse or any questionable practices, to determine whether there is sufficient basis to warrant a full investigation as required by Title 42 CFR Part 455.14. The method of documentation should be more standardized to provide better information on complaints received, referrals of suspected claims, preliminary investigations performed, and dispositions of all complaints and referrals. Records should indicate the activity of the MIU and demonstrate the procedures for investigation, cooperation with legal authorities, referral of cases and follow-up activities. This will provide the DHS with the information necessary to assess the effectiveness of the MIU's ability to evaluate all complaints and reports regarding fraud or abuse and to conduct investigations of alleged fraud.

**Corrective Action Taken or Planned:** The department agrees that these reports are very important to identify and to correct inappropriate utilization of services, including fraud and abuse by providers. It is also agreed that recipient and provider utilization need to be reviewed. Thus, while waiting for these reports, the Med-QUEST Division (MQD) has identified aberrant utilization claims for review and prior authorization. The MQD has instituted measures to correct some utilization problems and referred cases of possible provider fraud and abuse for further investigation.

The department agrees that EMC audits are valuable in identifying errors in claim submittals that can be addressed through provider education and in discovering cases of possible provider fraud and abuse. The recommendation will be taken into consideration.

A spreadsheet has been developed for use by the MIU. All complaints and referrals will be recorded. This spreadsheet will also record the status of complaints and referrals.

**Start Date:** July 1999

**End Date:** Ongoing

**Responding Person:** Dr. Lynette Honbo, Medical Standards Branch Administrator;  
MQD

Date Prepared: February 2004

**Audit Finding: 03-4 Obtain the Necessary Reports From the HPMMIS**

Auditor's Recommendation: The DHS should continue work with AHCCCS on developing the necessary HPMMIS reports and completing pending projects as soon as possible to ensure compliance with federal reporting requirements and provisions for utilization controls.

Corrective Action Taken or Planned: The DHS continues to work with AHCCCS to develop the necessary HPMMIS reports and complete pending projects, i.e., open system tickets and system services requests. Report requests, tickets and system service requests are received and submitted to AHCCCS daily. Bi-weekly, these new requests are prioritized with existing requests by the MQD Data Standards Committee, composed of HPMMIS stakeholders. AHCCCS completes work off this priority list. This is an on-going, operational process that addresses both existing and new report and system requests.

Start Date: November 2002

End Date: Ongoing

Responding Person: Randy Chau, Systems Officer; MQD

Date Prepared: March 2004

**Audit Finding: 03-5 Improve Accuracy of Medicaid Claims Processing**

**Auditor's Recommendation:** Due to the complexity of the Medicaid claims processing function, there is a high inherent risk that claims processing errors may occur. In connection with its utilization controls over Medicaid claims, the DHS should perform post payment claim reviews. Post payment Medicaid claims testing performed in the past has effectively brought to light areas for improvement in claims processing and has resulted in system changes. The transition to a new claims processing system accentuates the value of this function. The DHS should perform regular post payment reviews on a sample of claims to detect processing errors and identify ways to improve the new claims processing system and procedures.

**Corrective Action Taken or Planned:** The new claims processing system has been in place since November 2002. Since implementation, the MQD has continued to review claims payments on an ad hoc basis when the state staff, provider and/or ACS staff identify payment issues. The MQD enlisted the assistance of the Quality Control Staff of the Management Services Office to conduct some post-payment reviews of anesthesia claims. The scope of work will be expanded once the QC staff is able to assume additional duties. The department's fiscal agent, ACS, also has its own quality review staff that review claim payments for accuracy. Any errors detected are corrected and reported to the MQD on the monthly report card.

The Heritage audit results will be used to correct and collect any overpayments made by the ACS PBM. The MQD will work with ACS to identify system changes to increase or change the edits and generate utilization reports to identify potential payment problems.

Start Date: November 2002

End Date: Ongoing

Responding Person: Aileen Hiramatsu, Med-QUEST Division Administrator

Date Prepared: March 2004

**Audit Finding: 03-6 Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner**

**Auditor's Recommendation:** The DHS should make every effort to eliminate the backlog of applications pending eligibility determinations and the overdue annual re-verifications to reduce the risk that ineligible recipients are receiving Medicaid benefits.

**Corrective Action Taken or Planned:** Backlogged Applications:

The department's Eligibility Branch has been able to timely process applications when it is fully staffed with trained personnel. However, staff turnover and increased numbers of applications have caused a backlog of applications. The Eligibility Branch has resorted to special projects to correct the backlog problem.

An option being considered is a possible movement of two positions from the ongoing cases unit(s) to the applications unit. This cannot occur, however, until planned changes are instituted in the eligibility review process for families with children (see below).

Annual Eligibility Reviews:

Although all of the annual re-verifications have not been done, the number of over dues is not as high as in the past. The situation should improve when the branch introduces passive renewals for families with children in June 2004.

Start Date: Ongoing

End Date: Ongoing

Responding Person: Ann G. Tam Sing, Eligibility Branch Administrator; MQD



Date Prepared: March 2004

Audit Finding: **03-7 Ensure Proper Eligibility Determination and Maintain All Required Documentation in Child Care Case Files**

Auditor's Recommendation: The DHS should ensure that proper eligibility determinations are made and that all required documents are maintained in each case file to support the allowability and eligibility of the child care payments being claimed for federal reimbursement. The DHS should continue to perform case file reviews in order to assess case manager performance. During fiscal year 2003, the DHS performed a review of case files at units managed by third party contractors and similar errors were noted. Follow-up reviews should be performed until the error rate has decreased at all units.

Corrective Action Taken or Planned: The DHS has decided to terminate the child care payment services contracts on Oahu and neighbor islands and, instead, issue payment through the DHS direct services staff on a statewide basis. The Employment and Child Care Program Office (ECCPO), in conjunction with the branch offices, expects to begin the transition of child care payment cases from the contractor on April 1, 2004 and continue until June 06, 2004. The transition plan, including the training of the DHS staff, is currently being drafted.

The ECCPO and branches conducted a cost analysis and determined that the departmental staff can provide services of equivalent or better quality at a lower cost. The department will then be able to exercise better supervisory and jurisdictional controls.

Additionally, the department, through training, routine monitoring and audits will ensure that the eligibility is determined properly and all case records pertaining to the child care subsidy program are maintained in accordance with the policies and procedures.

Start Date: July 2002

End Date: Ongoing

Responding Person: Pankaj Bhanot, Employment & Child Care Program Administrator;  
Benefit, Employment & Support Services Division (BESSD)

Date Prepared: March 2004

**Audit Finding: 03-8 Improve the Accuracy of Child Care Reimbursements**

**Auditor's Recommendation:** The DHS should ensure that reimbursements to child care program participants are calculated properly. The DHS should continue to perform case file reviews in order to assess contractor performance. During fiscal year 2003, the DHS performed a review of case files at units managed by third party contractors and similar errors were noted. Follow-up reviews should be performed until the error rate has decreased at all units.

**Corrective Action Taken or Planned:** The DHS has decided to terminate the child care payment services contracts on Oahu and neighbor islands and, instead, will issue payments through the DHS direct services staff on a statewide basis. The Employment and Child Care Program Office (ECCPO) in conjunction with the branch offices is expecting to begin the transition of child care payment cases from the contractor on April 1, 2004 and continue until June 06, 2004. The transition plan, including the training of the DHS staff, is currently being drafted.

The ECCPO and branches conducted a cost analysis and determined that the departmental staff can provide services of equivalent or better quality at a lower cost. The department will then be able to exercise better supervisory and jurisdictional controls. It will also ensure uniform application of departmental rules, policies and procedures pertaining to the child care subsidy program.

Additionally, the department, through training, routine monitoring and audits will ensure that child care payments are issued properly and accurately. In the event that a staff shortage occurs, the department will be able to mobilize additional staff to insure the payments are issued timely.

Start Date: July 2002

End Date: Ongoing

Responding Person: Pankaj Bhanot, Employment & Child Care Program Administrator; BESSD