

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

**Fiscal Year Ended June 30, 2007**

**Submitted by  
The Auditor  
State of Hawaii**



**NISHIHAMA & KISHIDA, CPAS, INC.**  
CERTIFIED PUBLIC ACCOUNTANTS

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March 28, 2008

Ms. Marion Higa, State Auditor  
Office of the Auditor  
State of Hawaii

Dear Ms. Higa:

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, 2007. 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, 2007, 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, 2007.

## 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, 2007, 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 - Corrective action plan as provided the Department of Human Services, State of Hawaii.

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

Sincerely,

Nishihama & Kishida CPAs, Inc.

  
Ron Shiigi  
Principal

**DEPARTMENT OF HUMAN SERVICES  
STATE OF HAWAII**

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**DEPARTMENT OF HUMAN SERVICES  
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**PART I**  
**FINANCIAL SECTION**



**NISHIHAMA & KISHIDA, CPAS, INC.**  
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## **INDEPENDENT AUDITORS' REPORT**

To the Auditor  
Office of the Auditor  
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, 2007, 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, 2007, 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, 2007, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 25, 2008, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* and important in assessing 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 an opinion 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  
March 25, 2008



**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Fiscal Year Ended June 30, 2007**

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, 2007. 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 BASIC THE FINANCIAL STATEMENTS**

The Management's Discussion and Analysis (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)  
Fiscal Year Ended June 30, 2007**

***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)  
Fiscal Year Ended June 30, 2007**

**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, 2007 and 2006.

**Condensed Statement of Deficit in Net Assets**

	<u>2007</u>	<u>2006</u>
Current assets	\$ 169,130,098	\$ 249,888,447
Capital assets, net	<u>40,754,826</u>	<u>42,325,781</u>
Total assets	\$ <u>209,884,924</u>	\$ <u>292,214,228</u>
Current liabilities	\$ 215,035,851	\$ 317,128,578
Non-current liabilities	<u>9,803,001</u>	<u>9,786,264</u>
Total liabilities	<u>224,838,852</u>	<u>326,914,842</u>
Deficit in net assets		
Invested in capital assets	40,754,826	42,325,781
Restricted	1,276,923	1,053,957
Unrestricted deficit	<u>(56,985,677)</u>	<u>(78,080,352)</u>
Total deficit in net assets	<u>(14,953,928)</u>	<u>(34,700,614)</u>
Total liabilities and deficit in net assets	\$ <u>209,884,924</u>	\$ <u>292,214,228</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, 2007, the combined net assets of the DHS increased by approximately \$19.7 million.

The deficit in unrestricted net assets of the DHS was approximately \$57.0 million as of June 30, 2007. This deficit in unrestricted net assets is principally the result of liabilities for program services that were incurred as of June 30, 2007, for which state allotments are not yet available. The largest liability as of June 30, 2007, is the estimated amount of medical assistance service provided as of June 30, 2007, for which the related claims will be processed and paid subsequently. Of the estimated \$131.9 million of medical assistance payable, the state share of these costs is approximately \$56.0 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 \$15.2 million as of June 30, 2007, 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, 2007.

**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2007**

The DHS reported a total of approximately \$40.8 million in net assets invested in capital assets as of June 30, 2007. 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, 2007.

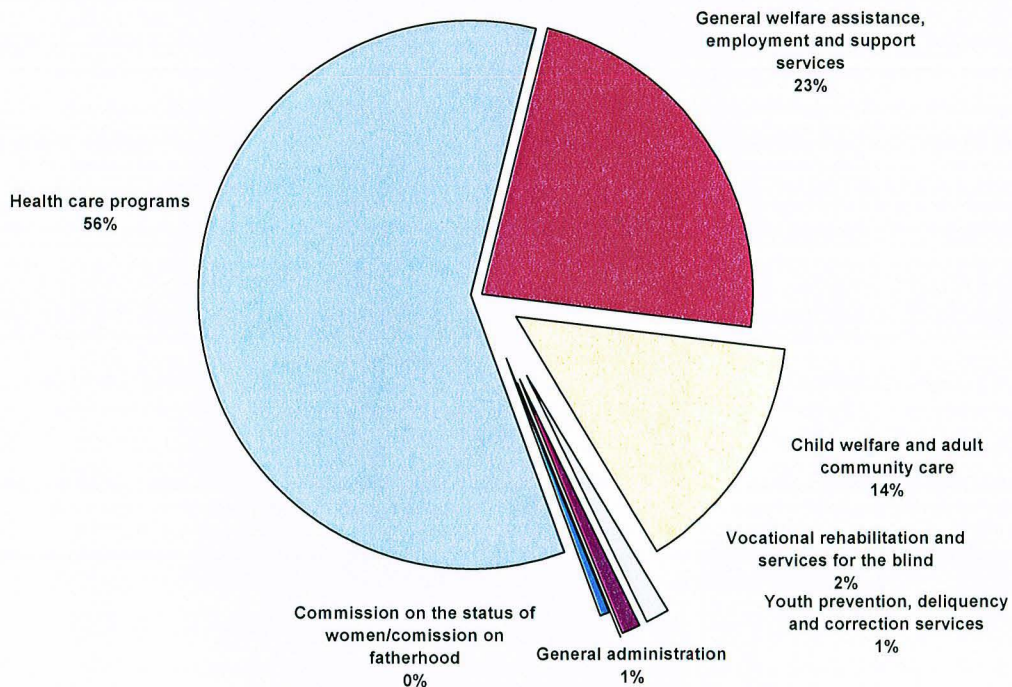
The changes in the net assets of the DHS from governmental activities are summarized below. The DHS directs its resources towards assisting people to meet their basic needs for food, shelter, medical care and other essentials for daily living. As such, the DHS does not conduct business-type activities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

**Change in Net Assets**

	<u>2007</u>	<u>2006</u>	Percent Change
Revenues			
Program revenues	\$ 1,022,304,629	\$ 1,101,767,450	(7.21) %
General revenues	<u>731,104,924</u>	<u>623,851,583</u>	17.19 %
Total revenues	<u>1,753,409,553</u>	<u>1,725,619,033</u>	1.61 %
Expenses			
Health care programs	1,042,628,055	1,062,635,792	(1.88) %
General welfare assistance, employment and support services	405,182,367	375,155,588	8.00 %
Child welfare and adult community care services	249,760,689	246,120,226	1.48 %
Vocational rehabilitation and services for the blind	24,420,402	22,812,703	7.05 %
Youth prevention, delinquency and correction services	19,830,959	18,855,910	5.17 %
General administration	10,985,970	11,073,922	(0.79) %
Commission on the status of women/ commission on fatherhood	<u>112,798</u>	<u>128,198</u>	(12.01) %
Total expenses	<u>1,752,921,240</u>	<u>1,736,782,339</u>	0.93 %
Change in net assets, before transfers in	\$ <u>488,313</u>	\$ <u>(11,163,306)</u>	(104.37) %

**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2007**

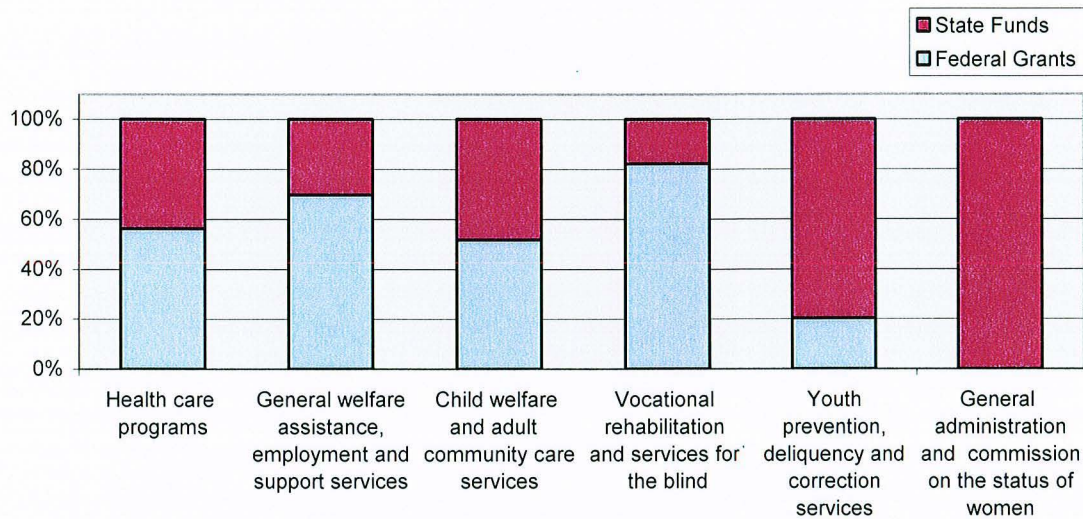
The total cost of all programs and services was approximately \$1.75 billion, a 0.9% increase from the prior fiscal year. Health care and general welfare assistance programs comprised 56% and 23%, respectively, of the total costs. The following chart presents each major activity as a percent of the total cost of all DHS activities:



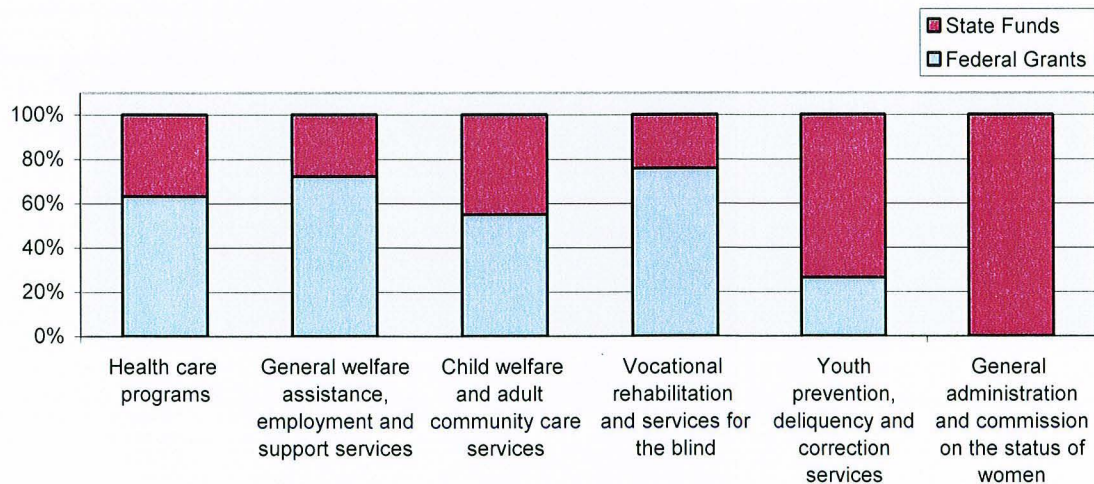
**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2007**

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 the fiscal years ended June 30, 2007 and 2006:

***Fiscal Year 2007***



***Fiscal Year 2006***





**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2007**

**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 \$15.7 million over the prior fiscal year. This increase is primarily related to general welfare assistance, employment and support services program costs administered by the DHS which have increased by approximately \$29.5 million or 7.88%. The increased expenditures in this program are principally due to increased legislative authority to expend.

At June 30, 2007, the total governmental fund balance of the DHS consisted of a deficit in unreserved fund balance of approximately \$110.8 million. The deficit in the unreserved fund balance of the general fund totaling \$51.2 million is principally comprised of liabilities for program services that were incurred as of June 30, 2007, for which state allotments were not yet available. The deficit in the unreserved fund balance of the special revenue fund totaling \$59.6 million is principally the result of encumbrances that were not liabilities as of June 30, 2007, and, therefore, the related intergovernmental revenues were not recorded.

Reservations of governmental fund balances for encumbrances totaled approximately \$70.3 million at June 30, 2007. 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.

The following table presents total revenues and expenditures of the governmental funds of the DHS for the fiscal years ended June 30, 2007 and 2006:

	<u>2007</u>	<u>2006</u>	<u>Percent Change</u>
<b>REVENUES</b>			
State allotted appropriations	\$ 710,334,497	\$ 602,803,032	17.84 %
Intergovernmental revenues	1,022,304,629	1,101,767,450	(7.21) %
Non-imposed employee fringe benefits	<u>20,770,427</u>	<u>21,048,551</u>	(1.32) %
Total	\$ <u>1,753,409,553</u>	\$ <u>1,725,619,033</u>	1.61 %

**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2007**

	<u>2007</u>	<u>2006</u>	<u>Percent Change</u>
<b>EXPENDITURES</b>			
Health care programs	\$ 1,042,507,676	\$ 1,062,023,906	(1.84) %
General welfare assistance, employment and support services	404,447,206	374,921,535	7.88 %
Child welfare and adult community care services	250,020,363	246,140,982	1.58 %
Vocational rehabilitation and services for the blind	24,440,086	22,842,489	6.99 %
Youth prevention, delinquency and correction services	19,047,785	18,704,262	1.84 %
General administration	11,002,800	11,108,200	(0.95) %
Commission on the status of women/ commission on fatherhood	<u>112,798</u>	<u>128,198</u>	(12.01) %
 Total	 \$ <u>1,751,578,714</u>	 \$ <u>1,735,869,572</u>	 0.90 %

**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	\$ 452,928,934	\$ 450,528,934	\$ 445,200,228	\$ 5,328,706
General welfare assistance, employment and support services	115,703,046	114,220,619	98,737,400	15,483,219
Child welfare and adult community care services	148,063,211	151,585,638	118,294,986	33,290,652
Vocational rehabilitation and services for the blind	3,973,693	3,973,693	3,973,086	607
Youth prevention, delinquency and correction services	17,722,432	17,722,432	15,871,585	1,850,847
General administration	8,635,437	8,985,437	8,985,260	177
Commission on the status of women / Commission on fatherhood	<u>103,788</u>	<u>113,788</u>	<u>103,634</u>	<u>10,154</u>
	 \$ <u>747,130,541</u>	 \$ <u>747,130,541</u>	 \$ <u>691,166,179</u>	 \$ <u>55,964,362</u>



**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2007**

The differences between the original and final budget for the individual programs were due to intrafund transfers.

Actual expenditures for the general welfare assistance, employment and support services programs and child welfare and adult community care services programs were approximately \$15.5 million and \$33.3 million, respectively, less than the additional amounts budgeted due to increased third-party expenditures and a change in the processing of health care payments. 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.

**CAPITAL ASSETS**

As of June 30, 2007 and 2006, the cost basis of capital assets, net of accumulated depreciation, used by the DHS are presented in the table below. Approximately, \$2.9 million of capital assets were added in the fiscal year ended June 30, 2007. Annual depreciation totaling approximately \$4.8 million decreased the net cost basis during the fiscal year ended June 30, 2007.

**Capital Assets, Net of Depreciation**

	<u>2007</u>	<u>2006</u>
State office buildings and improvements	\$ 16,653,145	\$ 17,208,566
Buildings and improvements for the Office of Youth Services	<u>14,035,706</u>	<u>14,740,058</u>
Total buildings and improvements	30,688,851	31,948,624
Furniture, equipment and vehicles	10,065,969	10,377,151
Nondepreciable land	<u>6</u>	<u>6</u>
Total	\$ <u>40,754,826</u>	\$ <u>42,325,781</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

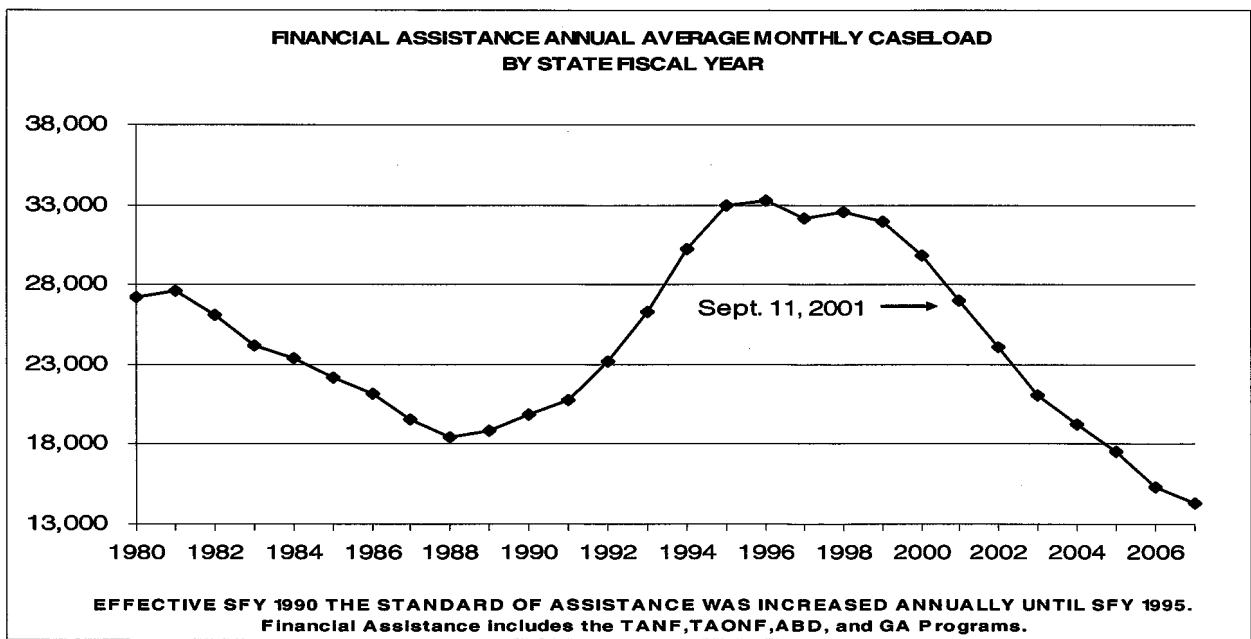
**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2007**

does not automatically make an individual/family eligible for other programs. The DHS tracks eligible individuals, couples or families as a single case (caseload).

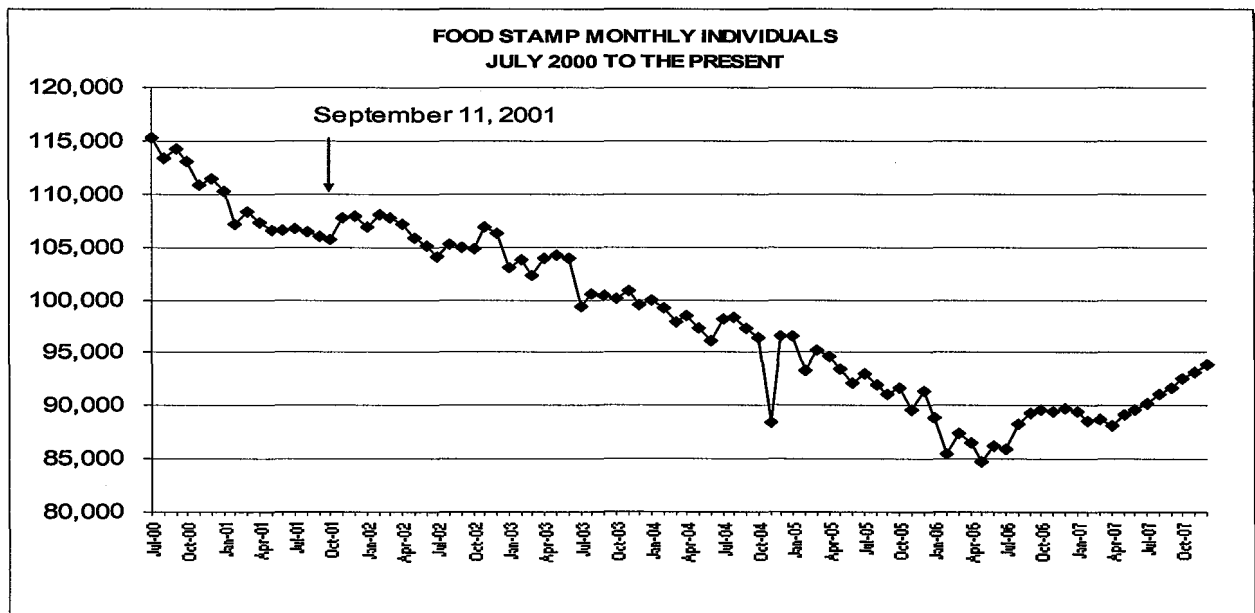
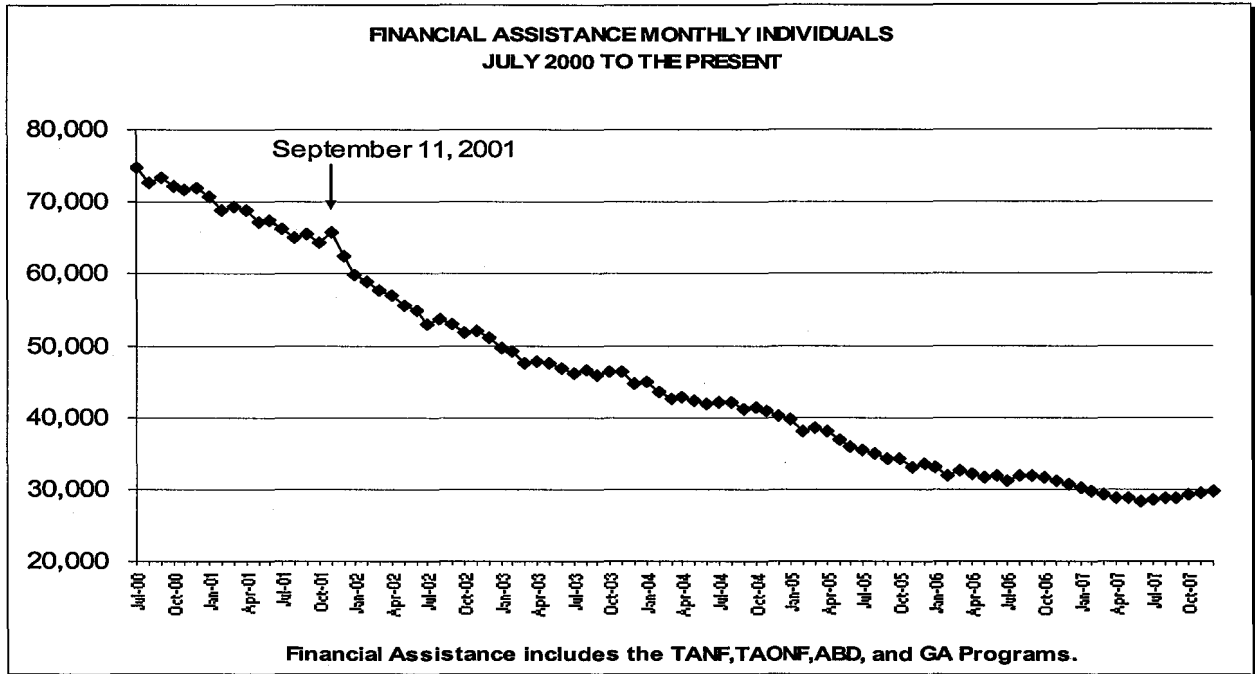
Six and one-half years after the events of September 11, 2001, individuals receiving financial assistance in Hawaii in family cases and in individual cases continued to decline from 65,444 individuals in September 2001 to 29,741 individuals in January 2008 or a decrease of 35,703 individuals or 55%. Much of this decline is due to the five-year limit on financial assistance benefits for family cases beginning in December 2001 as part of Hawaii's Welfare Reform Program (started in December 1996) but a large part of it can be attributed to the State's strong economy.

The number of individuals in Hawaii receiving Food Stamp benefits also declined since September 11, 2001 from 105,990 individuals in September 2001 to 94,338 individuals in January 2008. This is a decrease of 11,652 individuals or 11%. Recently, the number of Food Stamps clients has started to rise. This is in part due to a change in the periodic reporting requirements to continue participation in the Food Stamps Program.

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)  
Fiscal Year Ended June 30, 2007**



**Department of Human Services  
State of Hawaii  
STATEMENT OF DEFICIT IN NET ASSETS  
June 30, 2007**

	<u>Governmental Activities</u>
<b>ASSETS</b>	
Cash and cash equivalents	\$ 62,958,730
Receivables	3,426,511
Due from other governments	<u>102,744,857</u>
Total current assets	169,130,098
Capital assets, net of accumulated depreciation	<u>40,754,826</u>
Total assets	\$ <u>209,884,924</u>
<b>LIABILITIES</b>	
Vouchers payable	\$ 13,100,045
Accrued wages and employee benefits payable	7,289,309
Due to State of Hawaii	23,308,836
Due to other state agencies	34,017,661
Accrued medical assistance payable	131,920,000
Accrued compensated absences	<u>5,400,000</u>
Total current liabilities	215,035,851
Accrued compensated absences, less current portion	<u>9,803,001</u>
Total liabilities	<u>224,838,852</u>
<b>DEFICIT IN NET ASSETS</b>	
Invested in capital assets, net of related debt	40,754,826
Restricted	1,276,923
Unrestricted (deficit)	<u>(56,985,677)</u>
Total deficit in net assets	<u>(14,953,928)</u>
Total liabilities and deficit in net assets	\$ <u>209,884,924</u>

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
STATEMENT OF ACTIVITIES  
Fiscal Year Ended June 30, 2007**

Functions/Programs	Expenses	Program Revenues		Net (Expense)
		Charges for	Operating	Revenue and Changes
		Services	Grants and	in Net Assets
			Contributions	Governmental
				Activities
Governmental activities:				
Health care programs	\$ 1,042,628,055	\$ --	\$ 586,528,557	\$ (456,099,498)
General welfare assistance, employment and support services	405,182,367	--	281,932,564	(123,249,803)
Child welfare and adult community care services	249,760,689	--	129,767,548	(119,993,141)
Vocational rehabilitation and services for the blind	24,420,402	--	20,203,105	(4,217,297)
Youth prevention, delinquency and correction services	19,830,959	--	3,872,855	(15,958,104)
General administration	10,985,970	--	--	(10,985,970)
Commission on the status of women / Comission on fatherhood	112,798	--	--	(112,798)
Total	\$ 1,752,921,240	\$ --	\$ 1,022,304,629	\$ (730,616,611)
<b>General revenues:</b>				
				710,334,497
State allotments				20,770,427
Nonimposed employee fringe benefits				19,258,373
Transfers in				
Total general revenues				750,363,297
<b>Change in net assets</b>				19,746,686
<b>Deficit in net assets at July 1, 2006, as previously reported</b>				(43,385,863)
Prior period adjustment				8,685,249
<b>Deficit in net assets at July 1, 2006, as restated</b>				(34,700,614)
<b>Deficit in net assets at June 30, 2007</b>				\$ (14,953,928)

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
BALANCE SHEET  
GOVERNMENTAL FUNDS  
June 30, 2007**

	General	Special Revenue	Total
<b>ASSETS</b>			
Cash and cash equivalents	\$ 25,485,671	\$ 37,473,059	\$ 62,958,730
Receivables	2,163,974	1,262,537	3,426,511
Due from other funds	22,113,794	--	22,113,794
Due from other governments	<u>--</u>	<u>102,744,857</u>	<u>102,744,857</u>
Total assets	\$ <u>49,763,439</u>	\$ <u>141,480,453</u>	\$ <u>191,243,892</u>
<b>LIABILITIES AND FUND BALANCES</b>			
<b>LIABILITIES</b>			
Vouchers payable	\$ 8,381,065	\$ 4,718,980	\$ 13,100,045
Accrued wages and employee benefits payable	3,856,214	3,433,095	7,289,309
Due to other funds	--	22,113,794	22,113,794
Due to other state agencies	--	34,017,661	34,017,661
Due to State of Hawaii	23,308,836	--	23,308,836
Accrued medical assistance payable	<u>56,000,000</u>	<u>75,920,000</u>	<u>131,920,000</u>
Total liabilities	<u>91,546,115</u>	<u>140,203,530</u>	<u>231,749,645</u>
<b>FUND BALANCES</b>			
Reserved for encumbrances	9,456,499	60,819,207	70,275,706
Unreserved	<u>(51,239,175)</u>	<u>(59,542,284)</u>	<u>(110,781,459)</u>
Total fund balances (deficit)	<u>(41,782,676)</u>	<u>1,276,923</u>	<u>(40,505,753)</u>
Total liabilities and fund balances	\$ <u>49,763,439</u>	\$ <u>141,480,453</u>	\$ <u>191,243,892</u>

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 DEFICIT IN NET ASSETS  
June 30, 2007**

**Total deficit in fund balances - governmental funds** **\$ (40,505,753)**

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

Capital assets used in governmental activities are not  
financial resources and, therefore, are not reported  
in the governmental funds.

**Capital Assets**

Governmental capital assets	\$ 86,520,539	
Less accumulated depreciation	<u>(45,765,713)</u>	40,754,826

Accrued compensated absences liability is not  
due in the current period and therefore are not reported  
in the governmental funds.

(15,203,001)

**Deficit in net assets of governmental activities** **\$ (14,953,928)**

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, 2007**

	<u>General</u>	<u>Special Revenue</u>	<u>Total</u>
<b>REVENUES</b>			
State-allotted appropriations	\$ 710,334,497	\$ --	\$ 710,334,497
Intergovernmental	--	1,022,304,629	1,022,304,629
Nonimposed employee fringe benefits	<u>20,770,427</u>	<u>--</u>	<u>20,770,427</u>
	<u>731,104,924</u>	<u>1,022,304,629</u>	<u>1,753,409,553</u>
<b>EXPENDITURES</b>			
Health care programs	455,991,988	586,515,688	1,042,507,676
General welfare assistance, employment and support services	122,490,407	281,956,799	404,447,206
Child welfare and adult community care services	120,387,579	129,632,784	250,020,363
Vocational rehabilitation and services for the blind	4,337,222	20,102,864	24,440,086
Youth prevention, delinquency and correction services	15,174,930	3,872,855	19,047,785
General administration	11,002,800	--	11,002,800
Commission on the status of women/ Commission on fatherhood	<u>112,125</u>	<u>673</u>	<u>112,798</u>
	<u>729,497,051</u>	<u>1,022,081,663</u>	<u>1,751,578,714</u>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	1,607,873	222,966	1,830,839
<b>OTHER FINANCING SOURCES</b>			
Transfers in	<u>19,258,373</u>	<u>--</u>	<u>19,258,373</u>
<b>NET CHANGE IN FUND BALANCES</b>	20,866,246	222,966	21,089,212
<b>FUND BALANCES (DEFICIT) AT JULY 1, 2006</b>	<u>(62,648,922)</u>	<u>1,053,957</u>	<u>(61,594,965)</u>
<b>FUND BALANCES (DEFICIT) AT JUNE 30, 2007</b>	\$ <u>(41,782,676)</u>	\$ <u>1,276,923</u>	\$ <u>(40,505,753)</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, 2007**

**Net Change in fund balances - total governmental funds** **\$ 21,089,212**

**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 is depreciated over their estimated useful lives as  
depreciation expense.

Expenditures for capital assets	\$ 2,890,526	
Less current year depreciation and other changes	<u>(4,461,481)</u>	(1,570,955)

Change in workers' compensation liability 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	302,166
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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.	<u>(73,737)</u>
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**Change in net assets of governmental activities** **\$ 19,746,686**

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, 2007**

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
<b>REVENUES</b>				
State allotments	\$ <u>747,130,541</u>	\$ <u>747,130,541</u>	\$ <u>710,334,497</u>	\$ <u>(36,796,044)</u>
<b>EXPENDITURES</b>				
Health care programs	452,928,934	450,528,934	445,200,228	5,328,706
General welfare assistance, employment and support services	115,703,046	114,220,619	98,737,400	15,483,219
Child welfare and adult community care services	148,063,211	151,585,638	118,294,986	33,290,652
Vocational rehabilitation and services for the blind	3,973,693	3,973,693	3,973,086	607
Youth prevention, delinquency and correction services	17,722,432	17,722,432	15,871,585	1,850,847
General administration	8,635,437	8,985,437	8,985,260	177
Commission on the status of women / commission on fatherhood	<u>103,788</u>	<u>113,788</u>	<u>103,634</u>	<u>10,154</u>
	<u>747,130,541</u>	<u>747,130,541</u>	<u>691,166,179</u>	<u>55,964,362</u>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	\$ <u>--</u>	\$ <u>--</u>	\$ <u>19,168,318</u>	\$ <u>19,168,318</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, 2007**

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
<b>REVENUES</b>				
Intergovernmental revenues	\$ 971,861,989	\$ 971,861,989	\$ 943,251,046	\$ (28,610,943)
<b>EXPENDITURES</b>				
Health care programs	639,652,077	639,652,077	645,857,447	(6,205,370)
General welfare assistance, employment and support services	169,097,379	169,097,379	141,730,908	27,366,471
Child welfare and adult community care services	132,265,190	132,265,190	129,666,222	2,598,968
Vocational rehabilitation and services for the blind	21,353,966	21,353,966	18,370,529	2,983,437
Youth prevention, delinquency and correction services	7,416,193	7,416,193	4,592,417	2,823,776
General administration	2,077,184	2,077,184	1,883,844	193,340
Commission on the status of women / commission on fatherhood	--	--	673	(673)
	<u>971,861,989</u>	<u>971,861,989</u>	<u>942,102,040</u>	<u>29,759,949</u>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	\$ --	\$ --	\$ 1,149,006	\$ 1,149,006

See accompanying notes to the basic financial statements.

**Department of Human Services**  
**State of Hawaii**  
**STATEMENT OF FIDUCIARY NET ASSETS - FIDUCIARY FUNDS**  
**June 30, 2007**

	<u>Agency Funds</u>	<u>Private Purpose Trust Funds</u>
<b>ASSETS</b>		
Cash	\$ <u>1,044,067</u>	\$ <u>10,994</u>
Total assets	\$ <u>1,044,067</u>	\$ <u>10,994</u>
<b>LIABILITIES</b>		
Due to individuals	\$ 726,382	\$ --
Due to others	<u>317,685</u>	<u>--</u>
Total liabilities	\$ <u>1,044,067</u>	<u>--</u>
Net assets - held in trust		\$ <u>10,994</u>

See accompanying notes to the basic financial statements.

**Department of Human Services**  
**State of Hawaii**  
**STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS - FIDUCIARY FUNDS**  
**Fiscal Year Ended June 30, 2007**

	Private Purpose Trust Funds
<b>ADDITIONS</b>	
Donations	\$       --
Total additions	--
<b>DEDUCTIONS</b>	
Other	1,375
Total deductions	1,375
<b>CHANGE IN NET ASSETS</b>	(1,375)
Net assets at July 1, 2006	12,369
Net assets at June 30, 2007	\$       10,994

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2007**

**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's mission is to direct its resources toward protecting and helping those least able to care for themselves and to provide services designed toward achieving self sufficiency for clients as quickly as possible. The DHS is committed to maintaining a high level of quality, efficiency, and effectiveness in its services.

The DHS is part of the executive branch of the State of Hawaii (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 Med-QUEST Division administers the State's Medicaid program through which healthcare is provided to the low-income population. The Medicaid program is jointly financed by the State and the federal government. The Division develops and maintains working relationships with health plans, providers, federal and state authorities, community agencies, client advocacy groups, and others. Healthcare coverage is provided through either fee-for-service payments to healthcare providers or contracts with managed care health plans. The State's Children Health Insurance Program was established to expand health coverage to more children whose families may be working but do not earn enough to pay for health coverage for their children. The Division's operations are reported in the general, special revenue, and agency funds.

**General Welfare Assistance, Employment and Support Services:** The Benefit, Employment and Support Services Division provides monthly benefits to assist eligible clients with such essentials as food, clothing, shelter, emergency assistance, child care, and work support, as well as employment and training to help families attain self-sufficiency. Cash benefits are provided to individuals and families through the Temporary Assistance to Needy Families, Temporary Assistance to Other Needy Families, General Assistance, and Assistance to the Aged, Blind, and Disabled programs, as well as the Low Income Home Energy Program and Child Care Connection Hawaii. The Food Stamp program helps to ensure that no one goes hungry. The First-To-Work, Food Stamp Employment and Empowerment Hawaii Work programs provide job readiness, job development, job placement, case management, and other supportive services to ensure that families on public welfare are adequately prepared to end dependency, as well as providing a variety of at-risk youth and family strengthening programs to prevent family dependence. The Division's 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, 2007**

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

**Child Welfare and Adult Community Care Services:** The Social Services Division provides social services programs to ensure the health and safety of those least able to protect themselves from abuse and neglect. The Child Welfare Services (CWS) program provides services to ensure the safety and permanency of children in their own homes or, when necessary, in out-of-home placements. The program is community-based and neighbor-focused with many partnerships and collaborations with the private and public sectors. Services are focused on empowering families and building upon family strengths. When children cannot be safely returned to their family, the CWS program proceeds with permanent placement through adoption, legal guardianship, or other substitute long-term care, including independent living. The program also licenses foster families, boarding homes, group homes, and child placing-organizations. The Adult Protective Services program provides crisis intervention, including investigation and emergency services, to dependent adults who are reported to be abused, neglected, or financially exploited by others or seriously endangered due to self-neglect. The Home and Community-Based Services program provides comprehensive home and community-based services to disabled adults and children to enable them to live in their homes or in the community as long as possible to prevent premature institutionalization. The Division's operations are reported in the general, special revenue, and agency funds.

**Vocational Rehabilitation and Services for the Blind:** The Vocational Rehabilitation and Services for the Blind Division administers programs that provide rehabilitation services to assist eligible persons with disabilities to secure employment and to lead full and independent lives. The Vocational Rehabilitation (VR) program offers vocational evaluation, planning, counseling, treatment, training, job placement, and follow-up services to persons with physical or mental disabilities to enable them to become employed. The economic benefits of the VR program include increased earnings and purchasing power, increased tax revenues, and decreased dependency on public assistance. The Services to the Blind program, called Ho'opono, enables visually impaired adults to attain maximum vocational functional independence by providing varied services including vocational, counseling, assistive technology, and social and independent living skills training. Persons with visual impairment are also assisted in establishing and operating vending facilities. The Disability Determination program determines eligibility for Social Security Disability Insurance and Supplemental Security Income benefits under the federal Social Security Program. The Division's operations are reported in the general, special revenue, and agency funds.

**Youth Prevention, Delinquency and Correction Services:** The Office of Youth Services (OYS) develops and provides a continuum of services for youth at risk to prevent delinquency and to reduce recidivism through prevention, rehabilitation, and treatment services. Youth's needs, from prevention to incarceration to aftercare, are addressed through programs such as the Youth Services Centers, the Youth Gang Response System, and Ho'okala Adolescent Diversion as alternative to incarceration through immediate intervention services; non-residential and in-community aftercare services to prevent further incarceration; and community based residential services as an alternative to incarceration. OYS also manages and operates the Hawaii Youth Correctional Facility (HYCF) to provide safe and secure housing for the most violent and dangerous juvenile

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2007**

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

offenders. Although a core responsibility of OYS is to manage and operate HYCF, the agency places great emphasis on providing and supporting "front end" prevention, diversion, and intervention services. Incarcerated youth are provided counseling, treatment, and educational services for redirection and rehabilitation. The Division's operations are reported in the general, special revenue, and agency funds.

**General Administration:** General administration includes the five staff offices that support the DHS administration, operating divisions, and attached agencies. The Administrative Appeals Office (AAO) provides administrative due process hearings for three departmental divisions – Benefit Employment and Support Services, Med-QUEST, and Social Services. The AAO also serves as the rules coordinator for the DHS and reviews administrative proceedings for the adoption, modification, or repeal of departmental rules. AAO is also responsible for establishing a mediation process for the DHS. The Fiscal Management Office (FMO) provides staff assistance and advisory services for the administrative functions of fiscal management and housekeeping services. FMO formulates policies and procedures and administers the DHS's central accounting, funds management, client and vendor payment, employee payroll, inventory management, contracting, purchasing, records management, office space allocation, and central mail distribution function. The Management Services Office (MSO) provides research, budget, quality assurance, program and financial evaluation, and assessment capabilities to enable the DHS to oversee its programs and to make effective decisions concerning those programs. MSO conducts studies, analyses, evaluations, and reviews to ensure regulatory compliance, achievement of stated goals and objectives, and effective and efficient departmental programs and services and use of resources. The Office of Information Technology (OIT) is responsible for the overall administration, planning, direction, management, development, implementation, and maintenance of all information technology and information systems processing for the DHS statewide. The Personnel Office oversees the personnel programs of the DHS, including recruitment, examination, placement, position description, classification and pricing analysis, labor relations, civil rights, employee safety and relations, employee training and development, personnel transactions, and maintenance of personnel records. Those operations are reported in the general and special revenue funds.

**Commission on the Status of Women:** The Commission works for equality for women and girls in the State by acting as a catalyst for positive change through advocacy, education, collaboration, and program development. The Commission acts as a central clearinghouse and coordinating body for governmental and nongovernmental activities and information relating to the status of women and creates public awareness and understanding of the responsibilities, needs, potential, and contributions of women and their roles in a changing society. The Commission's operations are reported in the general and special revenue funds.



**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2007**

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

**Commission on Fatherhood:** The Commission promotes healthy relationships between parents and children and emphasizing the important role fathers play in the lives of their children. The Commission promotes, fosters, encourages, and financially supports programs designed to educate and train men who are both current and future fathers in effective parenting skills, behaviors, and attitudes, strategies for overcoming personal challenges, and opportunities to be productive responsible contributors to their family. The Commission's operations are reported in the special revenue fund.

The DHS has considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the DHS are such that exclusion would cause the DHS's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board (GASB) has set forth criteria to be considered in determining financial accountability.

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES**

The basic financial statements of the DHS have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), as applicable to governmental units. The GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

- (1) ***Basis of Presentation*** - The government-wide financial statements (the statement of net assets and the statement of activities) report information of all of the non-fiduciary activities of the DHS. The effect of interfund activity has been removed from these government-wide financial statements.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. Program revenues include charges to customers who purchase, use, or directly benefit from goods or services provided by a given function. Program revenues also include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. State allotments and other items not properly included among program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

Net assets are restricted when constraints placed on them are either externally imposed or imposed by constitutional provisions or enabling legislation. Internally imposed designations of resources are not presented as restricted net assets. When both restricted and unrestricted resources are available for use, it is generally the DHS's policy to use restricted resources first, then unrestricted resources as they are needed.

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2007**

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

The financial activities are recorded in individual funds, each of which is deemed to be a separate accounting entity. The DHS uses fund accounting to report on its financial position and results of operations. Fund accounting is designed to demonstrate the legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts.

Separate financial statements are provided for governmental funds and fiduciary funds. However, the fiduciary funds are not included in the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

The financial activities of the DHS that are reported in the accompanying fund financial statements have been classified into the following major governmental funds. In addition, a description of the DHS' fiduciary fund is as follows.

**Governmental Fund Types**

The DHS reports the following major governmental funds:

***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 Fund***

This special revenue fund is used to account for the proceeds of specific revenue resources and used for restricted purposes.

**Fiduciary Fund Type**

***Agency Funds***

Agency funds account for various assets held by the DHS pending distribution to other governments and individuals.

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

**Government-wide Financial Statements** - The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2007**

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

**Governmental Funds Financial Statements** - The governmental funds financial statements are reported using the current financial resources management focus and the modified-accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the DHS considers revenues other than federal grants and assistance awards to be available if they are collected within 60 days of the end of the current 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.

Federal grants and assistance awards made on the basis of entitlement periods are recorded as revenue when available and entitlement occurs which is generally within 12 months of the end of the current fiscal year. All other federal reimbursement-type grants are recorded as intergovernmental receivables and revenues when the related expenditures or expenses are incurred as of fiscal year-end and funds are available.

Expenditures are generally recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

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

**Fiduciary Funds** - Fiduciary funds are used to account for resources held by the DHS as an agent for individuals, private organizations, other governmental agencies, and/or other funds. Fiduciary funds are custodial in nature (i.e., assets equal liabilities) and do not involve measurement of results of operations. The private purpose trust fund is used to account for donations received by the DHS which are used to benefit clients of the Ho'opono, Services for the Blind Program under the Vocational Rehabilitation and Services for the Blind division.

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2007**

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

- (3) **Use of Estimates** - The preparation of the 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.
- (5) **Capital Assets** - Capital assets include land and land improvements, infrastructure assets, buildings and improvements, equipment, and all other tangible and intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at their estimated fair market value at the date of donation.

Maintenance and repairs are charged to operations when incurred. Betterments and major improvements which significantly increase values, change capacities, or extend useful lives are capitalized. Upon sale or retirement of capital assets, the cost and the related accumulated depreciation, as applicable, are removed from the respective accounts, and any resulting gain or loss is recognized in the statement of activities.

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) **Compensated Absences** - The DHS permits employees to accumulate earned but unused vacation and sick leave benefits. There is no liability for unpaid accumulated sick leave since sick leave is not convertible to pay upon termination of employment. All vacation pay is accrued when incurred. Employees are credited with vacation at the rate of 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year-end and is convertible to pay upon termination of employment. Such accumulated vacation has been accrued and reflected in the statement of net assets.

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

- (7) ***Due to Individuals*** - Due to individuals represents assets held by the DHS primarily in an 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.
- (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.
- (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 in the statement of revenues and expenditures - budget and actual (budgetary basis) - are those estimates as compiled and reviewed by the DHS.

Budgeted expenditures are derived primarily from the General Appropriations Act of 2005 (Act 178, Session Laws of Hawaii (SLH) 2005), and from other authorizations contained in the State Constitution, HRS, and other specific appropriation acts in various SLH.

All expenditures of these appropriated funds are made pursuant to the appropriations in the fiscal 2005 - 2007 biennial budget. The general and special revenue funds have legally appropriated annual budgets.

The final legally adopted budget in the accompanying statement of revenues and expenditures - budget and actual (budgetary basis) - general and special revenue funds represents the original appropriations, transfers, and other legally authorized legislative and executive changes.

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

The legal level of budgetary control is maintained at the appropriation line item level by department, program, and source of funds as established in the appropriations act. The Governor is authorized to transfer appropriations between programs within the same department and source of funds; however, transfers of appropriations between departments generally require legislative authorization. Records and reports reflecting the detail level of control are maintained by and are available at the DHS. During the fiscal year ended June 30, 2007, there were no expenditures in excess of appropriations at the legal level of budgetary control.

To the extent not expended or encumbered, general and special revenue fund appropriations generally lapse at the end of the fiscal year for which the appropriations are made. The State Legislature specifies the lapse dates and any other contingencies which may terminate the authorizations for other appropriations.

Budgets adopted by the State Legislature for the general and special revenue funds are presented in the accompanying statement of revenues and expenditures - budget and actual (budgetary basis). The DHS's annual budget is prepared on the modified accrual basis of accounting with several differences from the preparation of the statement of revenues, expenditures, and changes in fund balances, principally related to (1) encumbrance of purchase orders and contract obligations, (2) accrued revenues and expenditures, and (3) unbudgeted programs (federal award programs). The first two differences represent departures from GAAP.

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the fiscal year ended June 30, 2007.

	<u>General</u>	<u>Special Revenue</u>
Excess of revenues over expenditures and other uses - actual on a budgetary basis	\$ 19,168,318	\$ 1,149,006
Reserved for encumbrances at fiscal year-end	9,456,499	60,819,207
Expenditures for liquidation of prior fiscal year encumbrances	(5,920,824)	(66,783,764)
Net changes in unreserved liabilities	(330,683)	(10,536,828)
Net change in accrued medical assistance payable	19,717,539	51,192,779
Accruals related to federal reimbursements for program expenditures	(42,164,192)	40,083,482
Net change in other receivables	1,681,216	(18,809)
Difference for revenues recognized for GAAP purposes	<u>--</u>	<u>(75,682,107)</u>
Excess of revenues and other financing sources over expenditures and other financing uses - GAAP basis	\$ <u>1,607,873</u>	\$ <u>222,966</u>

**Department of Human Services  
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**NOTE D - CASH AND CASH EQUIVALENTS**

The State Director of Finance is responsible for the safekeeping of all monies paid into the State Treasury. The State Director of Finance pools and invests any monies of the State, which in the Director's judgment, are in excess of amounts necessary for meeting the immediate requirements of the State. Legally authorized investments include 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.

Information relating to the bank balance, insurance, and collateral of cash deposits is determined on a statewide basis and not for individual departments or divisions.

**Interest Rate Risk**

As a means of limiting its exposure to fair value losses arising from rising interest rates, the State's investment policy generally limits maturities on investments to not more than five years from the date of investment.

**Credit Risk**

The State's investment policy limits investments in state and U.S. Treasury securities, time certificates of deposit, U.S. government or agency obligations, repurchase agreements, commercial paper, bankers' acceptances, and money market funds and student loan resource securities maintaining a Triple-A rating.

**Custodial Credit Risk**

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the State will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The State's investments are held at broker/dealer firms which are protected by the Securities Investor Protection Corporation (SIPC) up to a maximum amount. In addition, excess-SIPC coverage is provided by the firms' insurance policies. In addition, the State requires the institutions to set aside in safekeeping, certain types of securities to collateralize repurchase agreements. The State monitors the market value of these securities and obtains additional collateral when appropriate.

**Concentration of Credit Risk**

The State's policy provides guidelines for portfolio diversification by placing limits on the amount the State may invest in any one issuer, types of investment instruments, and position limits per issue of an investment instrument.

**Cash in Bank**

The DHS maintains cash in banks which are held separately from cash in the State Treasury. As of June 30, 2007, the carrying amount of total bank deposits was approximately \$392,000 and the corresponding bank balances which are represented were approximately \$373,000.

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**NOTE E - RECEIVABLES**

Receivables of the DHS, net of an allowance for doubtful accounts, consisted of the following at June 30, 2007:

	<u>General</u>	<u>Special Revenue</u>
Welfare benefit overpayments	\$ 23,676,557	\$ 25,460,443
QUEST premiums receivable	1,655,550	2,244,450
Social Security interim assistance loans	942,000	--
CSEA receivable	61,510	--
	<u>26,335,617</u>	<u>27,704,893</u>
Less allowance for doubtful accounts:		
Welfare benefit overpayments	22,568,307	24,268,693
QUEST premiums receivable	<u>1,603,336</u>	<u>2,173,663</u>
	<u>24,171,643</u>	<u>26,442,356</u>
Receivables, net	\$ <u>2,163,974</u>	\$ <u>1,262,537</u>

**NOTE F - CAPITAL ASSETS**

For the fiscal year ended June 30, 2007, capital assets activity for the DHS was as follows:

<u>Governmental Activities</u>								
	<u>Balance</u>	<u>Prior</u>	<u>Balance</u>			<u>Net</u>		<u>Balance</u>
	<u>July 1, 2006</u>	<u>Period</u>	<u>July 1, 2006</u>	<u>Additions</u>	<u>Disposals</u>	<u>Transfers</u>	<u>Other</u>	<u>June 30, 2007</u>
		<u>Adjustment</u>	<u>Restated</u>					
<b>Depreciable Assets</b>								
Building and improvements	\$ 46,185,353	\$ --	\$ 46,185,353	\$ --	\$ --	\$ 252,722	\$ --	\$ 46,438,075
Furniture and equipment	6,207,746	29,251,121	35,458,867	2,878,526	113,441	17,209	46,873	38,288,034
Motor vehicles	1,898,392	--	1,898,392	12,000	44,809	(71,159)	--	1,794,424
<b>Non-Depreciable Assets</b>								
Land	6	--	6	--	--	--	--	6
<b>Total at historical cost</b>	<u>54,291,497</u>	<u>29,251,121</u>	<u>83,542,618</u>	<u>2,890,526</u>	<u>158,250</u>	<u>198,772</u>	<u>46,873</u>	<u>86,520,539</u>
<b>Less Accumulated Depreciation:</b>								
Building and Improvements	14,236,729	--	14,236,729	1,540,850	--	(28,355)	--	15,749,224
Furniture and Equipment	4,662,108	20,565,872	25,227,980	3,205,665	98,450	13,326	(14,298)	28,334,223
Motor Vehicles	1,752,128	--	1,752,128	51,189	44,809	(55,992)	(20,250)	1,682,266
<b>Total accumulated depreciation</b>	<u>20,650,965</u>	<u>20,565,872</u>	<u>41,216,837</u>	<u>4,797,704</u>	<u>143,259</u>	<u>(71,021)</u>	<u>(34,548)</u>	<u>45,765,713</u>
<b>Capital Assets, Net</b>	<u>\$ 33,640,532</u>	<u>\$ 8,685,249</u>	<u>\$ 42,325,781</u>	<u>\$ (1,907,178)</u>	<u>\$ 14,991</u>	<u>\$ 269,793</u>	<u>\$ 81,421</u>	<u>\$ 40,754,826</u>



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

Depreciation expense for the fiscal year ended June 30, 2007 was charged to functions/programs of the DHS as follows:

	<u>Governmental Activities</u>
Health care programs	\$ 243,972
General welfare assistance, employment and support services	3,400,381
Child welfare and adult community care services	240,782
Vocational rehabilitation and services for the blind	88,234
Youth prevention, delinquency and correction services	756,708
General administration	<u>67,627</u>
	<b>\$ <u>4,797,704</u></b>

**NOTE G - ACCRUED COMPENSATED ABSENCES**

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, 2007, was as follows:

	<u>Amount</u>
Balance at July 1, 2006	\$ 15,129,264
Additions	7,523,874
Reductions	<u>(7,450,137)</u>
Balance at June 30, 2007	15,203,001
Less current portion	<u>(5,400,000)</u>
	<b>\$ <u>9,803,001</u></b>

**NOTE H - 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, 2007, were as follows:

	<u>Balance July 1, 2006</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2007</u>
<b>ASSETS</b>				
Cash and other assets held in trust	\$ <u>1,033,093</u>	\$ <u>128,258,245</u>	\$ <u>128,247,271</u>	\$ <u>1,044,067</u>
<b>LIABILITIES</b>				
Due to individuals and others	\$ <u>1,033,093</u>	\$ <u>128,258,245</u>	\$ <u>128,247,271</u>	\$ <u>1,044,067</u>

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**NOTE I - NONIMPOSED 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 \$20,770,000 for the fiscal year ended June 30, 2007, 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.

**NOTE J - FUND BALANCE DEFICITS**

The general and special revenue funds of the DHS have deficits in the unreserved fund balances at June 30, 2007, aggregating to \$51,239,175 and \$59,542,284, 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 K - INTERFUND RECEIVABLE AND PAYABLE**

The general fund had a receivable due from the special revenue fund totaling \$22,113,794 as of June 30, 2007, for federal reimbursements of program expenditures.

**NOTE L - LEASES**

The DHS leases office facilities and equipment under various operating leases expiring through 2023. Certain leases include renewal and escalation clauses. The DHS's general fund share of lease costs is paid from the State General Fund. The federal share of these lease costs allocable to programs is reported in the special revenue fund of the DHS. The following is a schedule of the federal share of minimum future lease commitments for noncancelable operating leases as of June 30, 2007:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2008	\$ 1,252,000
2009	1,180,000
2010	982,000
2011	835,000
2012	687,000
2013 - 2017	3,053,000
2018 - 2022	2,199,000
2023	<u>73,000</u>
	<u>\$ 10,261,000</u>

The DHS's federal share of rent expenditures for operating leases for the fiscal year ended June 30, 2007, amounted to approximately \$1,204,000, and is included in the accompanying financial statements.

**Department of Human Services  
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**NOTE M - RETIREMENT BENEFITS**

**Employees' Retirement System**

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.

Prior to June 30, 1984, the plan consisted of only a contributory plan. In 1984, legislation was enacted to add a new contributory plan for members of the ERS who are also covered under Social Security. Police officers, firefighters, judges, elected officials, and persons employed in positions not covered by Social Security are precluded from the noncontributory plan. The noncontributory plan provides for reduced benefits and covers most eligible employees hired after June 30, 1984. Employees hired before that date were allowed to continue under the contributory plan or to elect the new noncontributory plan and receive a refund of employee contributions. All benefits vest after five and ten years of credited service under the contributory and noncontributory plans, respectively.

Both plans provide a monthly retirement allowance based on the employee's age, years of credited service, and average final compensation (AFC). The AFC is the average salary earned during the five highest paid years of service, including the vacation payment, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after that date is based on the three highest paid years of service excluding the vacation payment.

On July 1, 2006, a new hybrid contributory plan became effective pursuant to Act 179, SLH of 2004. Members in the hybrid plan are eligible for retirement at age 62 with 5 years of credited service or age 55 and 30 years of credited service. Members receive a benefit multiplier of 2% for each year of credited service in the hybrid plan. All members of the noncontributory plan and certain members of the contributory plan, are eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006, are required to join the hybrid plan.

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.

**Funding Policy**

Most covered employees of the contributory option are required to contribute 7.8% of their salary. Police officers, firefighters, investigators of the departments of the County Prosecuting Attorney and the Attorney General, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Normal Actuarial Cost Method. Effective July 1, 2005, employer contribution rates are a fixed percentage of compensation, including the normal cost plus amounts required to pay for the unfunded actuarial accrued liability.

**Department of Human Services  
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June 30, 2007**

**NOTE M - RETIREMENT BENEFITS (Continued)**

**Post-Retirement Health Care and Life Insurance Benefits**

In addition to providing pension benefits, the State, pursuant to HRS Chapter 87, provides certain health care and life insurance benefits to all qualified employees. The DHS's share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 2007, was approximately \$5,835,000.

For employees hired before July 1, 1996, the State pays the entire monthly health care premium for employees retiring with ten or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than ten years of credited service.

For employees hired after June 30, 1996, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium. For employees hired after June 30, 1996, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium; for those retiring with over 25 years of service, the State pays the entire health care premium.

Effective July 1, 2003, the Hawaii Employer-Union Health Benefits Trust Fund (EUTF) replaced the Hawaii Public Employees Health Fund under Act 88, SLH of 2001. The EUTF was established to provide a single delivery system of health benefits for state and county employees, retirees, and their dependents.

**Cost of Retirement Benefits**

The DHS's general fund share of the expense for pension benefits for the fiscal year ended June 30, 2007, was paid from the State General Fund and totaled approximately \$6,698,000. The DHS's federal share of pension benefits expense for the fiscal year ended June 30, 2007, was approximately \$4,657,000. The employer contribution rate for the fiscal year ended June 30, 2007, was 13.39%.

The DHS's general and federal share of pension and post-retirement benefit expenses are included in the accompanying financial statements.

**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 the DHS's basic financial statements.

**Department of Human Services  
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NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2007**

**NOTE N - RISK MANAGEMENT**

GASB Statement No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues, establishes accounting and financial reporting standards for risk financing and insurance-related activities of state governmental entities and requires the recordation of a liability for risk financing and insurance-related losses if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. The excess layers insured with commercial insurance companies are consistent with the prior fiscal year. Settled claims have not exceeded the coverage provided by commercial insurance companies in any of the past three fiscal years. A summary of the State's underwriting risks is as follows:

**Property Insurance**

The State has an insurance policy with a variety of insurers in a variety of layers for property coverage. The deductible for coverage is 3% of loss subject to a \$250,000 per occurrence minimum. This policy includes windstorm, earthquake, flood damage, tsunami, and volcanic action coverage. The limit of loss per occurrence is \$100,000,000, except for flood and earthquake which individually is a \$50,000,000 aggregate loss, and terrorism which is \$50,000,000 per occurrence.

The State also has a crime insurance policy for various types of coverages with a limit of loss of \$10,000,000 per occurrence with a \$500,000 deductible per occurrence. Losses not covered by insurance are paid from legislative appropriations of the State's General Fund.

**General Liability (including torts)**

Claims under \$10,000 are handled by the risk management office of the Department of Accounting and General Services. All other claims are handled by the Department of the Attorney General. The State has personal injury and property damage liability, including automobile and public errors and omissions, insurance policy in force with a \$4,000,000 deductible per occurrence. The annual aggregate per occurrence is \$10,000,000.

Losses under the deductible amount or over the aggregate limit are paid from legislative appropriations of the State's General Fund.

**Self-Insured Risks**

The State generally self-insures its automobile no-fault and workers' compensation losses. Automobile losses are administered by third-party administrators. The State administers its workers' compensation losses. The State records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. At June 30, 2007, the State recorded an estimated loss for workers' compensation, automobile and general liability claims as long-term debt as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's General Fund. The Department's portion of the State's workers' compensation expense for the fiscal year ended June 30, 2007, was approximately \$228,000.

**Department of Human Services  
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NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2007**

**NOTE O - COMMITMENTS AND CONTINGENCIES**

**Accumulated Sick Leave**

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a DHS employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the ERS. At June 30, 2007, accumulated sick leave was approximately \$48,190,000.

**Litigation**

From time to time, the DHS is named as a defendant in various legal proceedings. Although the DHS and its counsel are unable to express opinions as to the outcome of the litigation, it is their opinion that any potential liability arising therefrom will not have a material adverse effect on the financial position of the DHS because judgments, if any, against the DHS are judgments against the State and would be paid by legislative appropriations of the State General Fund and not by the DHS.

**NOTE P - RELATED PARTY TRANSACTIONS**

The DHS had various amounts due to the State totaling \$23,308,836 as of June 30, 2007, which included federal reimbursements for program expenditures totaling \$22,113,794, receivables totaling \$942,000, and cash held outside of the State Treasury totaling \$253,042.

The State Department of Health (DOH) administers Medicaid Waiver programs that qualify for federal reimbursement under the Medical Assistance Program. Effective July 1, 2005, the DOH is responsible for paying providers for these claims and the DHS is responsible for transferring funds to the DOH for the federal share of these claims. At June 30, 2007 the estimated amount due to DOH for claims qualifying for federal reimbursement (including an estimated amount of claims incurred but not reported) totaled \$34,017,661.

**NOTE Q - PRIOR PERIOD ADJUSTMENT**

The governmental funds financial statements of the DHS as of June 30, 2006, did not report capital assets placed in service prior to June 30, 2006. The net effect of the addition of the capital assets, net of accumulated depreciation, to the net assets invested in capital assets of the DHS at June 30, 2006, is an increase of \$8,685,249.

## **SUPPLEMENTARY INFORMATION**

**Department of Human Services  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
Fiscal Year Ended June 30, 2007**

<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>
<b>U.S. Department of Health and Human Services</b>			
Promoting Safe and Stable Families	93.556		\$ 1,704,851
Temporary Assistance for Needy Families <sup>2</sup>	93.558		84,815,605
Low-income Home Energy Assistance	93.568		2,411,757
Child Care and Development Block Grant <sup>2</sup>	93.575		16,630,566
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		11,199,493
Chafee Education and Training Vouchers Program (ETV)	93.599		263,765
Head Start	93.600		125,560
Children's Justice Grants to States	93.643		106,502
Child Welfare Services - State Grants	93.645		955,578
Foster Care - Title IV-E	93.658		23,442,461
Adoption Assistance	93.659		11,559,654
Adoption Incentive Payments	93.603		124,675
Social Services Block Grant <sup>2</sup>	93.667		20,590,562
Child Abuse and Neglect State Grants	93.669		129,699
Family Violence Prevention and Services/Grants for Battered Women's Shelters - Grants to States and Indian Tribes	93.671		840,842
Chafee Foster Care Independence Program	93.674		634,582
State Children's Insurance Program	93.767		18,883,769
State Survey and Certification of Health Care Providers and Suppliers	93.777		455,213
Medical Assistance Program	93.778		691,925,255
Pass-through State Department of Labor and Industrial Relations			
Refugee and Entrant Assistance - State Administered Programs	93.566		16,822
Pass-through Partners in Development			
Native American Programs	93.612	90NA7748/01	<u>12,331</u>
<b>Total U.S. Department of Health and Human Services</b>			<b>\$ <u>886,829,542</u></b>



**Department of Human Services  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2007**

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		\$ 154,735,692
State Administrative Matching Grants for Food Stamp Program	10.561		<u>11,492,999</u>
<b>Total U.S. Department of Agriculture</b>			<u>166,228,691</u>
<b>U.S. Department of Justice</b>			
Juvenile Justice and Delinquency Prevention - Allocation to States	16.540		873,335
Title V - Delinquency Prevention Program	16.548		22,980
Part E - State Challenge Activities	16.549		13,212
Juvenile Accountability Block Grant	16.523		667,526
Edward Byrne Memorial Formula Grant Program	16.579		96,126
Crime Victim Assistance	16.575		<u>172,751</u>
<b>Total U.S. Department of Justice</b>			<u>1,845,930</u>
<b>U.S. Department of Labor</b>			
Pass-through State Department of Labor and Industrial Relations			
Senior Community Service Employment Program	17.235	PY06-SCSEP-CC-DHS	<u>221,253</u>
<b>Total U.S. Department of Labor</b>			<u>221,253</u>
<b>U.S. Department of Education</b>			
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126		12,825,524
Rehabilitation Services Demonstration and Training Programs	84.235		253,640
Rehabilitation Long-Term Training	84.129		75,066
Independent Living - State Grants	84.169		477,836
Rehabilitation Services - Independent Living Services for Older Individuals Who are Blind	84.177		314,443
Supported Employment Services for Individuals with Severe Disabilities	84.187		197,900
Assistive Technology	84.224		378,454
Rehabilitation Training - State Vocational Rehabilitation Unit In-Service Training	84.265		8,838
Safe and Drug-free Schools and Communities - State Grants	84.186		<u>582,953</u>
<b>Total U.S. Department of Education</b>			<u>\$ 15,114,654</u>

**Department of Human Services  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2007**

<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>
<b>Corporation for National and Community Service</b>			
Foster Grandparent Program	94.011		\$ 477,494
Senior Companion Program	94.016		399,265
Retired and Senior Volunteer Program	94.002		<u>24,077</u>
<b>Total Corporation for National and Community Service</b>			<u>900,836</u>
<b>Social Security Administration</b>			
Social Security - Disability Insurance	96.001		<u>5,649,337</u>
<b>Total Social Security Administration</b>			<u>5,649,337</u>
<b>U.S. Department of the Interior</b>			
Pass-through the State Governor's Office			
Economic, Social, Political Developments of the Territories	15.875	Hawaii-COFA-2006-1	2,642,819
		Hawaii-COFA-2007-1	<u>10,571,277</u>
<b>Total U.S. Department of the Interior</b>			<u>13,214,096</u>
<b>TOTAL FEDERAL EXPENDITURES</b>			<b>\$ <u>1,090,004,339</u></b>

<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 \$17,290,000 were transferred from CFDA 93.558 Temporary Assistance for Needy Families to CFDA 93.667 Social Services Block Grant (\$9,890,000) and to CFDA 93.575 Child Card Development Block Grant (\$7,400,000).

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

## **PART II**

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



NISHIHAMA & KISHIDA, CPAs, INC.  
CERTIFIED PUBLIC ACCOUNTANTS

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

To the Auditor  
Office of the Auditor  
State of Hawaii

We have audited the financial statements of the governmental activities and each major fund of the Department of Human Services of the State of Hawaii (DHS), as of and for the fiscal year ended June 30, 2007, which collectively comprise the DHS's basic financial statements and have issued our report thereon dated March 25, 2008. 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.

**Internal Control Over Financial Reporting**

In planning and performing our audit, we considered the DHS's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the DHS's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the DHS's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the DHS's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the DHS's financial statements that is more than inconsequential will not be prevented or detected by the DHS's internal control. We consider the deficiencies described in items 2007-01 to 2007-04 in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the DHS's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the DHS's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

The DHS's response to the findings identified in our audit is described in Part VI, Corrective Action Plan of this report. We did not audit the DHS's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Office of the Auditor, management of the DHS, and 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  
March 25, 2008

**PART III**

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



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

To the Auditor  
Office of the Auditor  
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, 2007. 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 2007-01, and 2007-05 to 2007-14 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.
15.875	Economic, Social, Political Developments of the Territories	Reporting	2007-01
93.778	Medical Assistance Program	Activities Allowed, Allowable Costs, Eligibility, and Special Tests and Provisions	2007-05, 2007-06, 2007-08, 2007-09, 2007-10, 2007-11
93.575 and 93.596	Child Care Cluster	Activities Allowed and Eligibility	2007-07, 2007-13
93.558	Temporary Assistance for Needy Families	Eligibility	2007-12
93.659	Adoption Assistance	Eligibility	2007-14

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, 2007.

### 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 the 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, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the DHS's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the entity's internal control that might be significant deficiencies or material weaknesses as described below. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be significant deficiencies and others that we consider to be material weaknesses.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is



a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2007-05 to 2007-14 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we consider items 2007-05 to 2007-07 to be material weaknesses.

The DHS's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the DHS's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Office of the Auditor, the management of the DHS, 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  
March 25, 2008

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

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Fiscal Year Ended June 30, 2007**

**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
Significant deficiencies identified that are 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
Significant deficiencies identified that are 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
Any audit findings disclosed that are required to be reported in accordance with section .510(a) of OMB Circular A-133?	<input checked="" type="checkbox"/> yes <input type="checkbox"/> no

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
15.875	Economic, Social, and Political Development of the Territories
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
93.658	Foster Care Title IV-E
93.659	Adoption Assistance
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:	\$    3,270,013
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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  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

**SECTION II - FINANCIAL STATEMENT FINDINGS**

**Ref.**

**No.**

**Internal Control Findings**

**2007-01 Improve Reconciliation Process of Federal Funds Received**

During our audit, we noted that the Med-QUEST Division did not always reconcile federal expenditures recorded in its accounting records to the federal financial reports. As a result, federal expenditures totaling \$10,571,277 were not properly recorded in the DHS's accounting records. Since fiscal year 2004, the DHS has been receiving federal funds under the Compact Impact assistance grant (CFDA 15.875). However, prior to fiscal year 2007, the DHS has not included the grant in its Schedule of Expenditure of Federal Awards as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*.

**Recommendation**

In order to ensure all federal expenditures are recorded properly and included in the Schedule of Expenditure of Federal Awards, the DHS should consistently perform reconciliations between federal expenditures recorded on the DHS's accounting records and the financial reports filed with each respective federal agency.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

**Ref.**

**No.**

**Internal Control Findings (Continued)**

**2007-02 Reconcile Accounts to Supporting Documentation**

The DHS contracts with JP Morgan Chase Treasury Services (JP Morgan) to provide the Electronic Benefits Transfer (EBT) processing required to deliver cash assistance and food stamp benefits under the different assistance programs administered by the DHS. The DHS is responsible for determining the eligibility and the amount of benefits to be provided to all participants and transmits this data to JP Morgan. JP Morgan provides EBT debit cards to the DHS and makes the assistance available on the participants' EBT cards. The DHS deposits the amounts made available to the participants into a bank account where they are held until withdrawn by JP Morgan when the benefits are used by the participant.

We noted that the DHS reconciles the book balance of the amounts posted to the financial records of the DHS for the EBT account and the bank balance. However, the DHS does not perform a reconciliation between JP Morgan's records of the benefits made less amounts used by participants and the amount remaining in the bank account. Upon preliminary investigation, the majority of the difference is the timing between the date the participants' account is adjusted for withdrawals and the date JP Morgan withdraws the cash from the bank.

**Recommendation**

JP Morgan reports the amounts made available to the participants, less the benefits used. The cash at the bank represents the amounts deposited, based on the amount that have been, or will be made available to the participants, less withdrawals made by JP Morgan for the benefits used. The JP Morgan report of benefits available and the cash at bank are closely related and should be reconciled.

The DHS should perform an additional reconciliation between the JP Morgan report and the bank account. The monthly reconciliation will ensure that all cash transactions have been properly recorded and that no errors have occurred.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

**Ref.**  
**No.**      **Internal Control Findings (Continued)**

**2007-03 Properly Record All Capital Assets in the State Property Inventory Records**

Divisions within the DHS are responsible for reporting the acquisition and disposal of capital assets to the State Procurement Office on a quarterly basis to update the state property inventory records.

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 capital assets and depreciation information for the fiscal year. We noted that during the current fiscal year, the DHS added \$29,251,121 in capital asset additions (\$8,685,249, net of accumulated depreciation) that were purchased in prior fiscal years. We also noted one instance where a current fiscal year acquisition of a capital asset, with a cost of \$2,694,283 was not properly added to the capital asset listing.

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 capital asset purchases to the State Procurement Office, the DHS's personnel did not always adhere to the established procedures.

**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 acquisitions and dispositions were properly posted to the state property inventory records.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

**Ref.  
No.**

**Internal Control Findings (Continued)**

**2007-04 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 twelve instances where the "Application for Leave of Absence" (Form G-1) was authorized after the employee took vacation.
- There were three instances where the vacation or sick leave hours per the employee's Form DPS-7 did not agree to the "Vacation and Sick leave Accrual Listing" as of June 30, 2007. This resulted in an understatement of accrued vacation and sick leave totaling 6.75 hours or \$139.
- There was one instance where the vacation and sick hours per the employee's Form DPS-7 did not agree to the "Application of Leave of Absence" (Form G-1) filed for the period tested. The employee had multiple Form G-1s filed and in total the hours posted to the DPS-7 was correct, resulting in no overstatement or understatement in the accrued vacation and sick leave balances.

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 and tested before reporting the balances to the State Comptroller.

We recognize that the approval of vacation could occur after the fact, such as in emergencies, or when an employee must care for a dependent who becomes ill. In those instances, the DHS should notate on the employee's record that telephonic approval was given.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

**SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS**

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings</b>	<b>Questioned Costs</b>
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**2007-05 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). The DHS information retrieval and non-drug claims processing system is the Hawaii Prepaid Medical Management Information System (HPMMIS). The HPMMIS is operated and maintained by the Arizona Health Care Cost Containment System (AHCCCS). In addition, the management and processing of the DHS's pharmacy benefits is contracted to Affiliated Computer Services, Inc. (ACS).

Due to the complexity of the Medicaid program operations and the large volume of transactions, much reliance is placed on HPMMIS and its system of internal controls to accurately maintain enrollment and participant data and to ensure Medicaid costs are allowable, properly coded and accurately paid. 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 internal controls, we noted that the primary controls used to prevent unnecessary utilization of care and services and to ensure proper and accurate payment of Medicaid claims were front-end controls such as pre-payment edit functions contained in HPMMIS and an extensive list of medical services and procedures which require prior authorization. However, we noted a lack of back-end control activities such as a post payment review of a sample of Medicaid claims or a review of utilization data for potentially fraudulent or abusive activity. Furthermore, for certain back-end control activities performed by the quality review organization (QIO formerly known as peer review organization), we noted a lack of follow-up by the DHS on findings and recommendations reported.

More specifically, we noted the following conditions:

- The review of Surveillance and Utilization Review Subsystem (SURS) reports is not being performed. Although a limited number of HPMMIS SURS reports are available, the development of more useful and meaningful reports has been slow due to a lack of personnel. Currently, MQD staff resources focus on the front-end control of prior authorization of fee-for-service services. However, without effective SURS activities, the DHS is severely limited in its ability to analyze recipient and provider utilization data which could uncover potentially fraudulent or abusive behavior.



**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

<b><u>Ref. No.</u></b>	<b><u>Compliance and Internal Control Findings (Continued)</u></b>	<b><u>Questioned Costs</u></b>
	<ul style="list-style-type: none"> <li>• A post payment review of a sample of electronic media claims (EMC) is no longer performed. Well over 50% of all Medicaid claims are received electronically. Another function no longer performed is the review of Explanation of Medical Benefits (EOMB) sent to a sample of participants which was used to detect provider fraud and abuse.</li> <li>• There is no formal ongoing post payment review of a sample of claims. It has been over four years since the last third party review was performed, which focused on pharmacy claims and the monitoring of ACS, its pharmacy benefits manager (PBM). This report issued by an independent healthcare auditing and consulting company reported potential overpayments of approximately \$462,000 and recommended the need to explore additional edits, analysis, and reporting in order to expand anti-fraud efforts. As part of our review of internal controls, we performed a test of drug and non-drug claims which did reveal some nominal claims processing errors.</li> <li>• The DHS has contracted a third party organization to perform certain utilization control activities such as acute hospital reviews, pre-admission screening and resident reviews (PASRR) for nursing facilities, and long-term care level of care determinations. However, due to a lack of staffing, follow-up activities such as ensuring recovery of overpayments is not being done timely.</li> <li>• Title 42 CFR Part 455.13 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. Currently, the DHS has very little or no formal activities to identify suspected fraud. 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. Referrals are now limited to complaints received via the MQD phone line. During the fiscal year 2007, the MIU referred one case to the Medicaid Fraud and Abuse Unit (MFCU) which operates under the State Attorney General's office.</li> </ul> <p>In 2007, total federal expenditures for this program were approximately \$692,000,000. Medicaid is the largest dollar federal grant program in the United States and is considered a program of higher risk. Therefore, the DHS's inability to effectively implement and operate a system over utilization control and program integrity results in noncompliance with federal guidelines and an increase in risk that fraudulent activity will go undetected and that unallowable costs will be charged to the federal grant.</p>	\$ <u>          </u> --

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
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**Recommendation**

To ensure compliance with federal regulations, the DHS should increase its back-end control activities over the Medicaid program. The DHS should consider the following:

- Complete the development of meaningful SURS reports and regularly analyze the reports as required by Title 42 CFR Part 456.23. 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.
- Prepare a request for proposal to continue the EMC audits, given the high percentage of claims submitted via electronic media. This could be an opportunity to provide additional provider education as well as a valuable referral source of potential fraud to the MIU.
- Perform regular post payment reviews on a sample of drug and non-drug claims to detect processing errors and identify ways to improve the claims processing system and procedures.
- Implement proper corrective action on problems or noncompliance identified by its QIO such as recovery of overpayments and implementation of recommendations issued.
- Allocate the necessary resources needed to actively identify and investigate suspected fraud as required by Title 42 CFR Part 455.13.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
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**2007-06 Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner**

The DHS has fallen behind in its processing of Medicaid applications and annual eligibility re-verifications. As of June 30, 2007, the number of applications outstanding greater than 45 days was 2,565. This is almost eight times more than the overdue balance at the beginning of the fiscal year. In addition, the number of overdue annual re-verifications was 12,857 as of June 30, 2007, which is almost four and a half times more than the prior fiscal year ending balance.

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. Furthermore, Title 42 CFR Part 435.916 also requires annual re-verifications of participant eligibility.

\$           --

**Recommendation**

The DHS should assess the staffing needs at the MQD Eligibility Branch and make every effort to eliminate the backlog of applications pending eligibility determinations and perform annual re-verifications timely as required by federal regulations and to reduce the risk that ineligible recipients are receiving Medicaid benefits.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
<b>2007-07</b>	<b>Maintain All Required Documentation in Child Care Case Files</b>	
	<p>For the fiscal year 2007, total federal expenditures for the Child Care Cluster (CFDA 93.575 and 93.596) were approximately \$27,800,000. Failure to maintain supporting documentation to support eligibility determinations resulted in noncompliance with federal grant guidelines. During our testing of eligibility, we noted the following errors:</p> <ul style="list-style-type: none"><li>• Five instances in which the required documentation was not maintained in the participant case file. Missing documentation included child care provider receipts and verification of income resulting in overpayments totaling \$1,563.</li><li>• One instance in which the "Simplified Report Form" (SRF), annual re-determination form, was not completed. As a result five months of child care payments totaling \$1,373 were deemed questionable.</li><li>• One instance in which the DHS was unable to locate a case file resulting in overpayments totaling \$5,280.</li></ul> <p>Title 45 CFR Part 98.65(e) requires that appropriate documentation be maintained to allow the verification that child care federal funds are expended in accordance with the statutory and regulatory requirements.</p>	
	<b>Recommendation</b>	
	<p>The DHS should ensure that required documents are maintained in each case file to support the allowability and eligibility of the child care payments claimed for federal reimbursement. The DHS should perform secondary reviews on a sample basis to ensure that all required documents are properly completed and maintained in the case files.</p>	
		<b>\$ <u>8,216</u></b>

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned Costs</b>
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**2007-08 Monitor the Medicaid Drug Rebate Program**

On November 5, 1990, Congress enacted the Omnibus Budget Reconciliation Act of 1990 legislation, which among other provisions established the Medicaid drug rebate program. The Center for Medicare and Medicaid Services (CMS) have issued release memorandums to state agencies and manufacturers, throughout the history of the program, to give guidance on numerous issues related to the drug rebate program.

The MQD contracts ACS to perform the daily operations of the drug rebate program including billing, collection, accounting and dispute resolution. On a quarterly basis, the MQD reports the drug rebates invoiced and collected, including any interest received on the Form CMS 64.9R. This amount is used to reduce the amount to be reimbursed by the federal agency for Medicaid expenditures, thereby, returning the federal share of the drug rebate received and any interest.

While the day-to-day operations of the drug rebate program have been subcontracted to ACS, the DHS is still ultimately accountable for the drug rebate program. Much reliance is placed on ACS to operate the drug rebate program, however, there is little monitoring of subcontractor activities. This lack of DHS oversight of ACS could result in future noncompliance with CMS guidelines such as issues which occurred under the previous fiscal agent that the DHS is still trying to resolve. The DHS continues to try and collect outstanding drug rebates and related interest originating under the previous fiscal agent. Some of these outstanding balances date as far back as 1991.

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**Recommendation**

The DHS should establish formal procedures to monitor its subcontractor to ensure the drug rebate program operates in compliance with CMS guidelines and help identify issues timely and prevent difficult time consuming problems such as collecting old outstanding balances.

Department of Human Services  
State of Hawaii  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
Fiscal Year Ended June 30, 2007

<u>Ref.</u> <u>No.</u>	Compliance and Internal Control Findings (Continued)	<u>Questioned</u> <u>Costs</u>
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**2007-09 Maintain All Required Documentation in Medicaid Files**

During our tests of allowability and eligibility for the Medicaid (CFDA 93.778) program, we noted four case files in which application, renewal or eligibility determination forms were missing, resulting in noncompliance with federal guidelines governing proper maintenance of records.

Title 42 CFR Section 431.17 requires the DHS to maintain individual records on each applicant and recipient that contain information on the date of application, date and basis of disposition, facts essential to determine initial and continuing eligibility, provision of medical assistance, basis for discontinuing assistance, and disposition of income and eligibility information.

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**Recommendation**

The DHS should ensure that all required documents are maintained in each case file to support the allowability and eligibility of the Medicaid assistance payments being claimed for federal reimbursement. The DHS should perform case file reviews in order to assess case manager performance.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
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**2007-10 Maintain All Required Medicaid Provider Documentation**

In order to receive Medicaid payments, providers are required to be licensed in accordance with federal, state, and local laws and regulations to participate in the Medicaid program. A completed and signed Provider Information Form (Form 1139) constitutes the full written agreement. The prior year audit revealed numerous instances in which the provider agreement or other required documents were not present in the provider case files as required.

In 2006, the MQD conducted a mass mailing to all providers for the purpose of updating provider files with the current uniform documentation requirements. As a result of the mass mailing, the MQD received new provider agreements from approximately 70% of all Medicaid providers. According to MQD administration, the task of updating provider agreements is an ongoing project which will not be completed until additional staffing is available. The MQD cannot ensure that proper documentation is maintained for all Medicaid providers. As a result, payments may have been made to ineligible providers.

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**Recommendation**

The DHS should ensure all provider agreements are properly completed and maintained.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
<b>2007-11</b>	<b>Improve Controls over Voiding of Outstanding Checks</b>	
	<p>MQD contracts with Affiliated Computer Services, Inc. (ACS) to serve as the fiscal agent. During fiscal year 2006, controls to void checks and the associated claims were implemented by ACS. However, during our review of the outstanding checklist as of June 30, 2007, we noted 44 checks that were outstanding beyond 180 days of issuance totaling \$25,420. Of this amount, MQD claimed and received FFP for \$14,693 as of June 30, 2007.</p> <p>Title 42 CFR Section 433.40(c) requires the State to credit the Medicaid program (CFDA 93.778) for checks that are outstanding beyond 180 days of issuance. If the State has claimed and received Federal Financial Participation (FFP) for the amount of the outstanding check, it must refund the amount of the FFP received by adjusting the Quarterly Statement of Expenditures for that quarter.</p>	\$ <u>          --          </u>
	<b>Recommendation</b>	
	<p>The DHS should ensure that outstanding checks beyond 180 days of issuance are voided and credited to the Medicaid program properly. The DHS implement controls to monitor ACS's monthly bank reconciliations to ensure that checks outstanding beyond 180 days of issuance are properly credited to the Medicaid program.</p>	



**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
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<b>2007-12</b>	<b>Maintain All Required Documentation in Temporary Assistance for Needy Families (TANF) Files</b>	
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During our tests of eligibility for the TANF (CFDA 93.558) program, we noted two case files in which the Verification Record (DHS 1241) was not completed.

Title 45 CFR Section 205 requires the DHS to maintain individual records on each applicant and recipient that contain information on the date of application, date and basis of disposition, facts essential to determine initial and continuing eligibility, basis for discontinuing assistance, and disposition of income and eligibility information.

\$ 2,724

**Recommendation**

The DHS should ensure that all required documents are maintained in each case file to support the allowability and eligibility of the TANF payments being claimed for federal reimbursement. A secondary review would help ensure that all required documents are properly completed.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings</b>	<b><u>Questioned Costs</u></b>
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**2007-13 Improve the Accuracy of Child Care Reimbursements**

For the fiscal year 2007, total federal expenditures for the Child Care Cluster (CFDA 93.575 and 93.596) program were approximately \$27,800,000. During our testing of allowability and eligibility for the Child Care payments, we noted six benefit payment errors. The errors were a result of case worker error or oversight such as improper reimbursement rate being applied, incorrect calculation of activity hours and employment or provider changes not being updated timely. The errors noted resulted in a net overpayment.

\$ 739

**Recommendation**

The DHS should ensure that reimbursements to child care program participants are calculated properly. The DHS should perform post payment reviews of a sample of child care payments to ensure accuracy and assess case worker performance.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2007**

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

**2007-14 Maintain All Required Documentation in Adoption Assistance Files**

During our tests of Adoption Assistance (CFDA 93.659) program case files, the DHS was unable to locate a case file.

The DHS is required to maintain individual records on each recipient that contain information on the date of application, facts essential to determine eligibility and support allowability of the claim for reimbursement.

\$ 13,188

**Recommendation**

The DHS should ensure that all required documents are maintained in each case file to support the allowability and eligibility of the Adoption Assistance payments being claimed for federal reimbursement.

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

**Department of Human Services  
State of Hawaii  
STATUS REPORT  
Fiscal Year Ended June 30, 2007**

This section contains the current status of the prior auditors' recommendations. The recommendations are referenced to the pages of the previous audit report for the fiscal year ended June 30, 2006, dated August 10, 2007.

Recommendations	Status
<b>SECTION II - FINANCIAL STATEMENT FINDINGS</b>	
<p><b>06-1 Properly Record All Fixed Assets in the State Property Inventory Records (pages 58 - 59)</b></p> <p>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 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. The DHS's Property and Procurement Office issued an internal communication memorandum in November 2005 stating the purchasing unit of fixed asset items should be responsible for performing inventory procedures unless otherwise agreed upon.</p>	<p>Not accomplished. See Reference No. 2007-03.</p>
<p><b>06-2 Maintain Vacation and Sick Leave Records Properly (pages 59 - 60)</b></p> <p>Approvals of vacation could occur after the fact, such as when an employee must care for a dependent who becomes ill the night before. In those instances, DHS should ensure that the employee's record be annotated to reflect that telephonic approval was given. The DHS should increase the number of quality control reviews of leave records and perform them periodically throughout the year to ensure that vacation and sick leave and compensatory time records are accurately maintained and reviewed on a timely basis. The reviews should include ensuring that there is a secondary review performed on the leave records by the supervisor of the employee responsible for maintaining the records. In addition, a secondary review of the information used to prepare the summary leave schedule should be performed before compiling the schedule, including ensuring that the beginning balances are correct. These reviews should be documented with the initials of the employee responsible for performing the review.</p>	<p>Not accomplished. See Reference No. 2007-04.</p>

**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2007**

<u>Recommendations</u>		<u>Federal CFDA Number</u>	<u>Status</u>
<b>SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS</b>			
<b>06-3</b>	<b>Allocate Costs Properly (pages 61 - 62)</b>  To ensure that the costs contained in the DHS's departmental cost allocation are allocated properly, the DHS should ensure that a secondary review is performed on all supporting cost allocation documents by the supervisor of the employee responsible for preparing the documents. This review should be documented with the initials of the employee responsible for performing the review.	<b>93.558 93.778 10.551</b>	Accomplished.
<b>06-4</b>	<b>Improve Accuracy of TANF Benefit Payments (page 62)</b>  Program staff should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the benefit payments being claimed for federal reimbursements. A secondary review would help to ensure that all required documents are properly completed and benefit payments are the correct amount.	<b>93.558</b>	Accomplished.
<b>06-5</b>	<b>Maintain All Required Documentation in TANF Case Files (page 63)</b>  Program staff should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the benefit payments being claimed for federal reimbursements. A secondary review would help to ensure that all required documents are properly completed.	<b>93.558</b>	Not accomplished. See Reference No. 2007-12.
<b>06-6</b>	<b>Improve Utilization Controls Over Medicaid Claims (pages 64 - 65)</b>  DHS should obtain the necessary HPMMIS management reports to allow post payment review of recipient utilization and provider service profiles and exception criteria based on parameters set by the MQD.	<b>93.777 93.778</b>	Not accomplished. See Reference No. 2007-05.

**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2007**

	<u>Recommendations</u>	<u>Federal CFDA Number</u>	<u>Status</u>
06-7	<b>Improve Accuracy of Medicaid Claims Processing (pages 65 - 66)</b>  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.	93.777	Not accomplished. See Reference No. 2007-05.
06-8	<b>Improve Controls Over the Medicaid Drug Rebate Program (pages 66 - 67)</b>  DHS should establish procedures to monitor their subcontractor to ensure rebate interest payments are collected and not disregarded as part of the dispute resolution process by either the manufacturer or the DHS.	93.777 93.778	Not accomplished. See Reference No. 2007-08.
06-9	<b>Maintain All Required Documentation in Medicaid Case Files (pages 67 - 68)</b>  DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the medical assistance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.	93.777 93.778	Not accomplished. See Reference No. 2007-09.
06-10	<b>Complete Medicaid Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner (pages 68 - 69)</b>  DHS should assess the staffing needs at the Eligibility Branch and make every effort to ensure each unit is fully staffed with trained personnel in order to timely process applications and perform annual re-verifications. Adequate staffing would likely reduce the backlog of applications, pending eligibility determinations, and overdue annual re-verifications and also minimize the risk that ineligible recipients are receiving Medicaid benefits.	93.777 93.778	Not accomplished. See Reference No. 2007-06.
06-11	<b>Maintain All Required Medicaid Provider Documentation (page 70)</b>  DHS should ensure all provider agreements are properly completed and maintained.	93.777 93.778	Not accomplished. See Reference No. 2007-10.

**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2007**

<u>Recommendations</u>		<u>Federal CFDA Number</u>	<u>Status</u>
<b>06-12</b>	<b>Implement Controls to Ensure the Medicaid Program is Credited Timely for Outstanding or Uncashed Checks (page 71)</b>	<b>93.777 93.778</b>	
	DHS should implement controls to adequately monitor ACS's monthly bank reconciliations to properly credit the Medicaid program for checks that are outstanding or uncashed beyond 180 days of issuance.		Not accomplished. See Reference No. 2007-11.
<b>06-13</b>	<b>Improve the Accuracy of Medicaid Reports (pages 72 - 73)</b>	<b>93.777 93.778</b>	
	DHS should ensure that complete and accurate information is submitted on the Medicaid Drug Rebate Schedule Form CMS 64.9R.		Accomplished.
<b>06-14</b>	<b>Maintain All Required Documentation in Adoption Assistance Case (page 73)</b>	<b>93.659</b>	
	DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the adoption assistance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.		Not accomplished. See Reference No. 2007-14.
<b>06-15</b>	<b>Maintain All Required Documentation in Child Care Case Files (page 74)</b>	<b>93.575 93.596</b>	
	DHS should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the child care payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.		Not accomplished. See Reference No. 2007-07.
<b>06-16</b>	<b>Identify Federal Award Information and Applicable Compliance Requirements to Child Care Subrecipients (page 75)</b>	<b>93.575 93.596</b>	
	DHS should include the federal award information (e.g., CFDA title and number, award name, name of federal agency and amount of federal funds) and applicable compliance requirements in the subrecipient contracts to ensure Federal award information and applicable compliance requirements are identified to subrecipients at the time of the award.		Partially accomplished. DHS is in the process of executing supplemental agreements for on-going contracts to ensure federal award information and applicable compliance requirements are identified to subrecipients.



**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2007**

	<u>Recommendations</u>	<u>Federal CFDA Number</u>	<u>Status</u>
<b>06-17</b>	<b>Improve Accuracy of Foster Care Maintenance Payments (page 76)</b>  Program staff should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the foster care maintenance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed and foster care maintenance payments are the correct amount.	<b>93.658</b>	Accomplished.
<b>06-18</b>	<b>Maintain All Required Documentation in Foster Care Files (page 77)</b>  Program staff should ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the foster care maintenance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.	<b>93.658</b>	Accomplished.
<b>06-19</b>	<b>Improve Controls Over Foster Care Disbursements (page 78)</b>  Program staff should reevaluate existing policies and procedures to ensure that program expenditures are allowed and charged to the proper program.	<b>93.658</b>	Accomplished.
<b>06-20</b>	<b>Monitor Social Services Block Grant Earmarking Requirements (page 79)</b>  The program should evaluate and modify these agreements to include a requirement to provide programs or services to children or families that meet federal poverty guidelines in order to comply with earmarking requirements. In addition, DHS should ensure that the program implement monitoring procedures and reporting requirements to ensure each contractor is in compliance with earmarking requirements.	<b>93.667</b>	Accomplished.

**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2007**

	<u>Recommendations</u>	<u>Federal CFDA Number</u>	<u>Status</u>
<b>06-21</b>	<b>Maintain All Required Documentation in SCHIP Case Files (page 80)</b>	<b>93.767</b>	
	Program staff should ensure that all required documents are properly completed and maintained in each case file to support the eligibility of individuals who receive child health assistance. A secondary review would help to ensure all required documents are properly completed.		Accomplished.
<b>06-22</b>	<b>Identify Federal Award Information and Applicable Compliance Requirements to Food Stamp Subrecipients (page 81)</b>	<b>10.551 10.561</b>	
	DHS should include the federal award information (e.g., CFDA title and number, award name, name of federal agency and amount of federal funds) and applicable compliance requirements in the subrecipient contracts to ensure Federal award information and applicable compliance requirements are identified to subrecipients at the time of the award.		Accomplished.
<b>06-23</b>	<b>Maintain Adequate Security over EBT Cards (page 82)</b>	<b>10.551 10.561</b>	
	DHS should adhere the program to the policies and procedures for maintaining adequate security over EBT cards to prevent loss or theft.		Accomplished

**PART VI**  
**CORRECTIVE ACTION PLAN**



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

March 27, 2008

Mr. Ronald T. Shiigi  
N&K CPAs, Inc.  
American Savings Bank Tower  
1001 Bishop Street, Suite 1700  
Honolulu, Hawaii 96813-3696

Dear Mr. Shiigi:

Attached are the Department of Human Services' responses and corrective action plans related to your fiscal year 2007 audit report findings and recommendations. We appreciate the opportunity to comment on the audit report.

Sincerely,

  
Lillian B. Koller  
Director

Attachment

**Ref. no. 2007-01****Improve Reconciliation Process of Federal Funds Received****Auditor's  
Recommendation:**

In order to ensure all federal expenditures are recorded properly and included in the Schedule of Expenditure of Federal Awards, the DHS should consistently perform reconciliations between federal expenditures recorded on the DHS's accounting records and the financial reports filed with each respective federal agency.

**Corrective Action  
Taken or Planned:**

The DHS will consistently perform reconciliations between the federal expenditures recorded on the state's general ledger and the financial reports filed with all federal agencies.

**Start Date:**

Ongoing

**End Date:**

Ongoing

**Responding  
Person:**

Ann H. Kinningham, Med-QUEST Division (MQD) Finance Officer  
Phone: (808) 692-7956

**Ref. no. 2007-02****Reconcile Accounts to Supporting Documentation****Auditor's  
Recommendation:**

JP Morgan reports the amounts made available to the participants, less the benefits used. The cash at the bank represents the amounts deposited, based on the amount that have been, or will be made available to the participants, less withdrawals made by JP Morgan for the benefits used. The JP Morgan report of benefits available and the cash at bank are closely related and should be reconciled.

The DHS should perform an additional reconciliation between the JP Morgan report and the bank account. The monthly reconciliation will ensure that all cash transactions have been properly recorded and that no errors have occurred.

**Corrective Action  
Taken or Planned:**

The Accounting Staff performs the additional reconciliation between the JP Morgan report and the EBT bank account on a monthly basis, to ensure that all cash transactions have been properly recorded and no errors have occurred.

**Start Date:**

January 2008

**End Date:**

Ongoing

Responding  
Person:

Cynthia Gomez, Program Accounting Section I Supervisor  
Phone: (808) 586-5647

**Ref. no. 2007-03**

**Properly Record All Capital 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 acquisitions and dispositions were properly posted to the state property inventory records.

Corrective Action  
Taken or Planned:

In March 2003, stricter departmental inventory procedures were issued establishing each employee as being responsible and accountable for maintaining and safeguarding property inventory assigned to the individual. In addition, property custodians are assigned to each office/unit and are responsible for fixed assets under their management. The statewide inventory system, centrally managed by the State Department of Accounting and General Services-Inventory Management Branch (DAGS-IMB), reports and distributes information for all transactions that have not been recorded properly in the state inventory. These transaction registers are distributed regularly after each inventory period (i.e. quarterly) for review by the affected DHS offices. The transactions must be corrected and submitted to ensure that the transactions are properly posted.

The DHS offices are also required to reconcile on a quarterly basis, a DAGS-IMB report called the Reconciliation of FAMIS Expenditures for State Property. This report is used to verify that the department's equipment and fixed asset expenditure transactions recorded in the FAMIS accounting system are also accurately posted in the Fixed Asset Inventory System (FAIS). This statewide monitoring and reconciliation process was implemented to maintain the financial reporting integrity of the FAIS.

In November 2005, a DHS memorandum, Fiscal

Management Office (FMO) Circular 05-05, was issued to specify the responsibility of inventory reporting, due to uncertainty on which office was responsible for recording fixed asset purchases in the FAIS in instances where two or more offices were involved. This has helped to ensure the timely posting of such transactions.

DHS uses the detailed procedures outlined in the DAGS Inventory System Manual and the Hawaii Administrative Rules (HAR) to provide instructions and guidelines for all DHS offices. In addition, the department issues internal circulars and memorandums that serve to update and revise inventory procedures, as changes are enacted on a statewide level and in the HAR, and to provide clarification and information such as historical examples. The Inventory System Manual, the HAR, the FMO circulars and memorandums all serve to provide guidelines and procedures for inventory reporting and management. All departmental personnel with inventory responsibilities are provided these resources and trained on inventory policies and procedures.

The department provides inventory training in partnership with DAGS Inventory Management Branch and conducts refresher training sessions. The IMB plans to conduct a series of inventory training sessions for the 2008 and 2009 calendar years. Department offices are also encouraged to consult with the DHS Property and Procurement Staff (PPS) as necessary, whenever questions arise, thus providing "on-the-job" training. For example, PPS has directly worked with certain DHS offices on the process to properly record software acquisition and development costs as capital assets.

Start Date: Ongoing

End Date: Ongoing

Responding Person: Susy Kawamoto, Property and Procurement Staff Supervisor  
Phone: (808) 586-4864

**Ref. no. 2007-04      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 and tested before reporting the balances to the

State Comptroller.

We recognize that the approval of vacation could occur after the fact, such as in emergencies, or when an employee must care for a dependent who becomes ill. In those instances, the DHS should notate on the employee's record that telephonic approval was given.

**Corrective Action  
Taken or Planned:**

The DHS will continue to insure departmental procedures regarding the approval process of leave requests are in compliance with appropriate collective bargaining unit agreements and policies and procedures. The DHS will also continue random audits of leave records, training of staff personnel assigned the duties of maintaining the leave records, and training of supervisory personnel of leave records.

To improve the accuracy of the summary leave schedule, the Fiscal Management Office – Pre-Audit Staff (PAS) conducts a sample review of approximately 10% of all of the leave summary totals for over 2,000 employees. In addition, the department's procedures require that the employee responsible for maintaining the leave records at each office compile and check the information submitted in the summary schedules. The appropriate supervisor is then required to review the schedules and confirm the accuracy by signing the schedules.

**Start Date:** Ongoing

**End Date:** Ongoing

**Responding  
Person(s):** Edwin Nose, Personnel Officer  
Phone: (808) 586-4951  
Eloise Uehara, Pre-Audit Staff Supervisor  
Phone: (808) 586-5020

**Ref. no. 2007-05      Improve Utilization Controls over Medicaid Claims**

**Auditor's  
Recommendation:**

To ensure compliance with federal regulations, the DHS should increase its back-end control activities over the Medicaid program. The DHS should consider the following:

- Complete the development of meaningful SURS reports and regularly analyze the reports as required by Title 42 CFR Part 456.23. 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.

- Prepare a request for proposal to continue the EMC audits, given the high percentage of claims submitted via electronic media. This could be an opportunity to provide additional provider education as well as a valuable referral source of potential fraud to the MIU.
- Perform regular post payment reviews on a sample of drug and non-drug claims to detect processing errors and identify ways to improve the claims processing system and procedures.
- Implement proper corrective action on problems or noncompliance identified by its QIO such as recovery of overpayments and implementation of recommendations issued.
- Allocate the necessary resources needed to actively identify and investigate suspected fraud as required by Title 42 CFR Part 455.13.

Corrective Action  
Taken or Planned:

HPMMIS management reports have been produced for review and use by MQD staff. Two Medical Standards Branch nurse positions have been assigned to regularly analyze the SURS reports to identify exceptions, abnormal patterns and to identify mistakes for corrective actions. Modifications to the SURS reports are being made as needed with dialogue ongoing between the Medical Standards Branch and Systems Office.

The DHS will consider the continued use of EMC audits to enhance provider education opportunities as well as provide a referral source of potential fraud to the MIU.

The DHS will review its capacity to perform regular post payment reviews on samplings of drug and non-drug claims to detect processing errors and identify ways for claims processing system and procedural improvements.

The DHS will take proper correction actions on problems or noncompliance identified by its QIO.

The DHS will seek the necessary resources needed to actively identify and investigate suspected fraud as required by federal regulations and is working closely with the Attorney General's Medicaid Fraud Control Unit on all complaints.

Start Date:

Ongoing

End Date: Ongoing

Responding Person: Lois Lee, Acting Med-Quest Administrator (A-MQDA)  
Phone: (808) 692-8050

**Ref. no. 2007-06      Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner**

Auditor's Recommendation: The DHS should assess the staffing needs at the MQD Eligibility Branch and make every effort to eliminate the backlog of applications pending eligibility determinations and perform annual re-verifications timely as required by federal regulations and to reduce the risk that ineligible recipients are receiving Medicaid benefits.

Corrective Action Taken or Planned: The DHS is working with existing staff to address the backlogs of work at each unit with approved overtime for pay or compensatory time off. Efforts continue to fill all vacant positions as quickly as possible. Also, emergency hire (for 89 day periods) appointments are used to provide the needed resources during prolonged recruitment periods. Two new EB Worker positions appropriated in Act 236, SLH 2007 will be established and filled as soon as the funds are released.

Start Date: Ongoing

End Date: Ongoing

Responding Person: Alan Takahashi, Eligibility Branch Administrator  
Phone: (808) 587-7291

**Ref. no. 2007-07      Maintain All Required Documentation in Child Care Case Files**

Auditor's Recommendation: The DHS should ensure that required documents are maintained in each case file to support the allowability and eligibility of the child care payments claimed for federal reimbursement. The DHS should perform secondary reviews on a sample basis to ensure that all required documents are properly completed and maintained in the case files.

Corrective Action Taken or Planned: The Administration for Children and Families (ACF) enacted a supplement to 45 CFR 98 entitled, "Child Care Development Fund Error Rate Reporting." Under this policy, which had been in effect on October 1, 2007, States are required to report error rates in the expenditure of CCDF grant funds. This would involve a 2-step process of review. The first step would be case review of case

sampling done by the State agency who administers the fund; the second step would be a review conducted by another party for the purposes of documenting errors in the calculation, determination, and issuance of the CCDF funds. The ACF had divided up the States into 3 groups to stagger the implementation of this error rate reporting. Each group would begin upon the start of the preceding federal fiscal year, beginning with group 1 on October 1, 2007. Hawaii is part of group 2 which will be subject to this error rate reporting on October 1, 2008.

In order for Hawaii to be in compliance with this requirement, case reviews as recommended will need to be implemented. Hawaii is proposing to utilize staff from its DHS/BESSD/Employment, Child Care Program Office (ECCPO) to conduct the initial case reviews which would involve review of documents and calculations that validate the issuance of the child care payment, as well as the accuracy in the amount that is issued. Through this action, we believe this would address this audit finding and recommended action.

Start Date: April 2008  
End Date: Ongoing  
Responding Person: Scott Nakasone, Acting ECCP Administrator  
Phone: (808) 586-7062

**Ref. no. 2007-08      Monitor the Medicaid Drug Rebate Program**

Auditor's Recommendation: The DHS should establish formal procedures to monitor its subcontractor to ensure the drug rebate program operates in compliance with CMS guidelines and help identify issues timely and prevent difficult time consuming problems such as collecting old outstanding balances.

Corrective Action Taken or Planned: The DHS has written procedures for late interest payments and for monitoring the current subcontractor. The DHS will continue to establish written drug rebate program procedures to address the collection of old outstanding balances.

Start Date: Ongoing  
End Date: Ongoing  
Responding Person: Ann H. Kinningham, MQD Finance Officer  
Phone: (808) 692-7956

**Ref. no. 2007-09**

**Auditor's  
Recommendation:**

**Corrective Action  
Taken or Planned:**

The continuing staffing vacancies in our Eligibility Branch challenged by the continued expansion of the Medical Assistance Program contributes to the ongoing deficiencies in case record documentation and maintenance.

Efforts continue to fill all vacant positions as quickly as possible. Also, emergency hire (for 89 day periods) appointments are used to provide the needed resources during recruitment periods.

Corrective action has been taken for one of the cases cited. The unit involved was informed that the form DHS 1100 is needed for a food stamp medical case.

For another case cited, the DHS determined that there was no error because the case did not have a medical program involvement for April 2007. The medically needy status was closed in February 1989 and an application for medical only was not submitted until June 25, 2007.

**Start Date:**

End Date:

**Responding  
Persons:**

**Ref. no. 2007-10**

**Auditor's  
Recommendation:**

### Corrective Action

Taken or Planned: agreements are properly completed and maintained. The Health Coverage Management Branch periodically requests reports from the Systems Office to monitor and update the records of all providers.

Start Date: Ongoing

End Date: Ongoing

Responding Person: Lois Lee, A-MQDA  
Phone: (808) 692-8050

**Ref. no. 2007-11      Improve Controls over Voiding of Outstanding Checks**

Auditor's Recommendation: The DHS should ensure that outstanding checks beyond 180 days of issuance are voided and credited to the Medicaid program properly. The DHS implement controls to monitor ACS's monthly bank reconciliations to ensure that checks outstanding beyond 180 days of issuance are properly credited to the Medicaid program.

Corrective Action Taken or Planned: Work was done in June 2007 to address this finding, with the MQD understanding that this control would be effective in FY 2008. However, program testing and monitoring was not fully implemented until August 2007 thus outstanding checks were found in July 2007. The DHS currently monitors the monthly bank reconciliations to ensure that checks outstanding beyond 180 days of issuance are voided and properly credited back to the Medicaid program.

Start Date: Ongoing

End Date: Ongoing

Responding Person: Ann H. Kinningham, MQD Finance Officer  
Phone: (808) 692-7956

**Ref. no. 2007-12      Maintain All Required Documentation in Temporary Assistance for Needy Families (TANF) Files**

Auditor's Recommendation: The DHS should ensure that all required documents are maintained in each case file to support the allowability and eligibility of the TANF payments being claimed for federal reimbursement. A secondary review would help ensure that all required documents are properly completed.

Corrective Action Staff will be reminded in writing of the need to maintain all

Taken or Planned: required documents in the case records.

Start Date: Ongoing

End Date: Ongoing

Responding Person: Sandy Morishige, Program Specialist, BESSD  
Phone: (808) 586-5713

**Ref. no. 2007-13      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 perform post payment reviews of a sample of child care payments to ensure accuracy and assess case worker performance.

Corrective Action Taken or Planned: The Administration for Children and Families (ACF) enacted a supplement to 45 CFR 98 entitled, "Child Care Development Fund Error Rate Reporting." Under this policy, which had been in effect on October 1, 2007, States are required to report error rates in the expenditure of CCDF grant funds. This would involve a 2-step process of review. The first step would be case review of case sampling done by the State agency who administers the fund; the second step would be a review conducted by another party for the purposes of documenting errors in the calculation, determination, and issuance of the CCDF funds. The ACF had divided up the States into 3 groups to stagger the implementation of this error rate reporting. Each group would begin upon the start of the preceding federal fiscal year, beginning with group 1 on October 1, 2007. Hawaii is part of group 2 which will be subject to this error rate reporting on October 1, 2008.

In order for Hawaii to be in compliance with this requirement, case reviews as recommended will need to be implemented. Hawaii is proposing to utilize staff from its DHS/BESSD/ECCPO to conduct the initial case reviews which would involve review of documents and calculations that validate the issuance of the child care payment, as well as the accuracy in the amount that is issued. Through this action, we believe this would address this audit finding and recommended action.

Start Date: April 2008

End Date: Ongoing

Responding Person: Scott Nakasone, Acting ECCP Administrator  
Phone: (808) 586-7062

**Ref. no. 2007-14      Maintain All Required Documentation in Adoption Assistance Files**

Auditor's Recommendation: The DHS should ensure that all required documents are maintained in each case file to support the allowability and eligibility of the Adoption Assistance payments being claimed for federal reimbursement.

Corrective Action Taken or Planned: In March 2008, feedback regarding the missing documentation was given to the Section Administrator and the supervisor of the cited unit. They will continue efforts to locate the missing file and they agreed to monitor compliance with Child Welfare Services (CWS) policies and procedures to ensure all case documents are maintained in the proper case records.

The final results of the Title IV-E Adoption Assistance audit and recommendations made will also be disseminated statewide to all section administrators with a reminder to all staff to maintain compliance with CWS policies and procedures and file documents in the appropriate CWS case records. Supervisors will be advised to conduct periodic Quality Assurance reviews of adoption cases to ensure that required documentation are on file and completed properly.

Start Date: March 2008

End Date: Ongoing

Responding Person: John Walters, CWS – Program Development Administrator,  
Social Services Division  
Phone: (808) 586-5675