

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

Fiscal Year Ended June 30, 2012

**Submitted by
The Auditor
State of Hawaii**



March 18, 2013

Ms. Jan Yamane, Acting State Auditor
Office of the Auditor
State of Hawaii

Dear Ms. Yamane:

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, 2012. Our audit was conducted in accordance with the terms of our contract with the Office of the Auditor, 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*, and the *Compliance Supplement for Single Audits of State and Local Governments*.

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, 2012, and to comply with the requirements of OMB Circular A-133, which establishes audit requirements for state and local governments that receive federal financial assistance. More specifically, the objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the DHS's basic financial statements and the schedule of expenditures of federal awards as of and for the fiscal year ended June 30, 2012, in accordance with accounting principles generally accepted in the United States of America.
2. To consider the DHS's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements.
3. To perform tests of the DHS's compliance with laws, regulations, contracts, and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D and 103F, Hawaii Revised Statutes), that could have a direct and material effect on the determination of financial statement amounts.
4. To consider the DHS's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance.

5. To provide an opinion on the DHS's compliance with applicable laws, regulations, contracts, and grants that could have a direct and material effect on each major program.

SCOPE OF THE AUDIT

Our audit was conducted 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, 2012.

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, 2012, and our opinion on the basic financial statements and supplementary information.
- Part II - Our report on internal control over financial reporting and on compliance and other matters.
- Part III - Our report on compliance with requirements that could have a direct and material effect on each major program and on 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 by 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,

N&K CPAs, Inc.



Brian Isobe
Principal

**DEPARTMENT OF HUMAN SERVICES
STATE OF HAWAII**

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**DEPARTMENT OF HUMAN SERVICES
STATE OF HAWAII**

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PART I
FINANCIAL SECTION

INDEPENDENT AUDITORS' REPORT

To 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, 2012, 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 opinions 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 opinions.

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, 2012, 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, 2012, 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 18, 2013, on our consideration of the DHS's internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who consider it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted principally of inquiries of management regarding the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the DHS's basic financial statements. The 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 financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

N&K CPAs, Inc.

Honolulu, Hawaii
March 18, 2013

**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal Year Ended June 30, 2012**

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, 2012. The intent of this discussion is to allow management to provide an objective and easily readable analysis of the financial activities of the DHS based on currently known facts, decisions, or conditions. Readers are encouraged to consider the information presented here in conjunction with the basic financial statements and other supplementary information.

OVERVIEW OF THE BASIC 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, 2012**

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 objectives. 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 statements.

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, 2012**

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, 2012 and 2011.

Condensed Statement of Net Assets

	<u>2012</u>	<u>2011</u>
Current assets	\$ 155,624,930	\$ 180,695,089
Capital assets, net	<u>27,761,439</u>	<u>27,230,404</u>
Total assets	\$ <u>183,386,369</u>	\$ <u>207,925,493</u>
Current liabilities	\$ 124,229,810	\$ 161,904,040
Non-current liabilities	<u>10,071,832</u>	<u>9,564,578</u>
Total liabilities	<u>134,301,642</u>	<u>171,468,618</u>
Net assets		
Invested in capital assets	27,761,439	27,230,404
Restricted	1,863,184	1,956,910
Unrestricted	<u>19,460,104</u>	<u>7,269,561</u>
Total net assets	<u>49,084,727</u>	<u>36,456,875</u>
Total liabilities and net assets	\$ <u>183,386,369</u>	\$ <u>207,925,493</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, 2012, the combined net assets of the DHS increased by approximately \$12.6 million.

The unrestricted net assets of the DHS was approximately \$19.5 million as of June 30, 2012. The largest liability as of June 30, 2012, is the estimated amount of medical assistance service provided as of June 30, 2012, for which the related claims and capitation fees will be processed and paid subsequently. Of the estimated \$51.6 million of medical assistance payable, the State's share of these costs is approximately \$24 million. The estimated federal share of these costs 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 approximately \$14.6 million as of June 30, 2012, 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, 2012.

**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012**

The DHS reported a total of approximately \$27.8 million in net assets invested in capital assets as of June 30, 2012. 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, 2012.

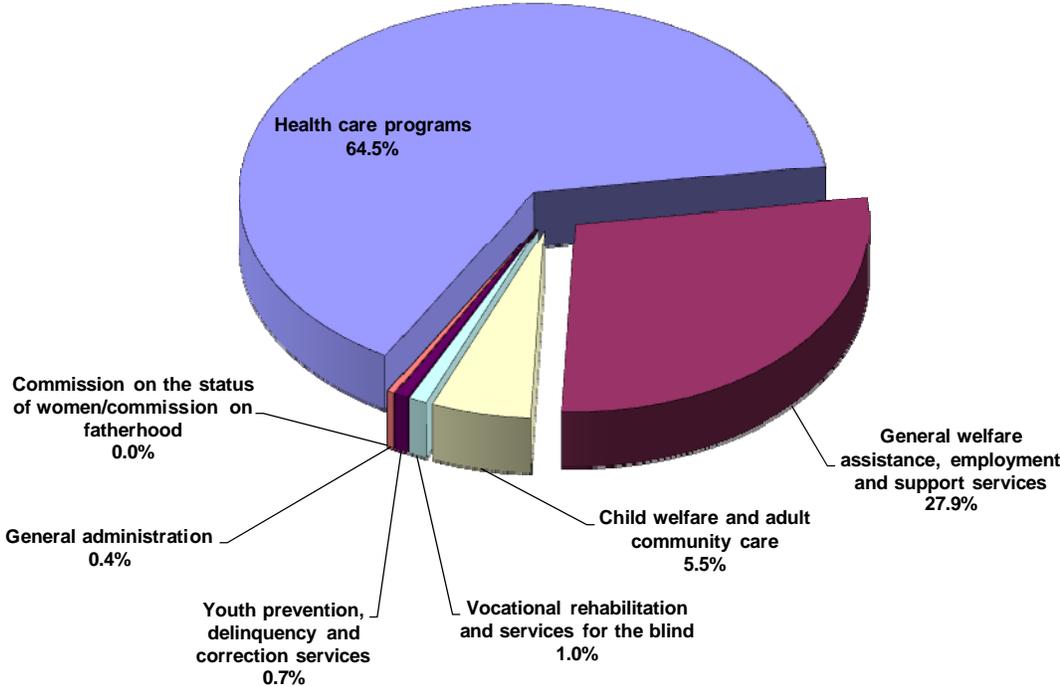
The changes in the net assets of the DHS from governmental activities are summarized below. The DHS directs its resources towards assisting people to meet their basic needs for food, shelter, medical care and other essentials for daily living. As such, the DHS does not conduct business-type activities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

Changes in Net Assets

	2012	2011	Percent Change
Revenues			
Program revenues	\$ 1,462,025,145	\$ 1,770,603,483	(17.43) %
General revenues	<u>1,069,699,460</u>	<u>859,083,682</u>	24.52 %
Total revenues	<u>2,531,724,605</u>	<u>2,629,687,165</u>	(3.73) %
Expenses			
Health care programs	1,614,963,450	1,663,787,860	(2.93) %
General welfare assistance, employment and support services	698,005,474	729,345,892	(4.30) %
Child welfare and adult community care services	137,768,737	147,853,916	(6.82) %
Vocational rehabilitation and services for the blind	25,207,510	21,478,800	17.36 %
Youth prevention, delinquency and correction services	18,135,099	20,157,892	(10.03) %
General administration	9,800,155	9,012,414	8.74 %
Commission on the status of women/ commission on fatherhood	<u>101,469</u>	<u>89,897</u>	12.87 %
Total expenses	<u>2,503,981,894</u>	<u>2,591,726,671</u>	(3.39) %
Change in net assets, before transfers	\$ <u>27,742,711</u>	\$ <u>37,960,494</u>	

**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012**

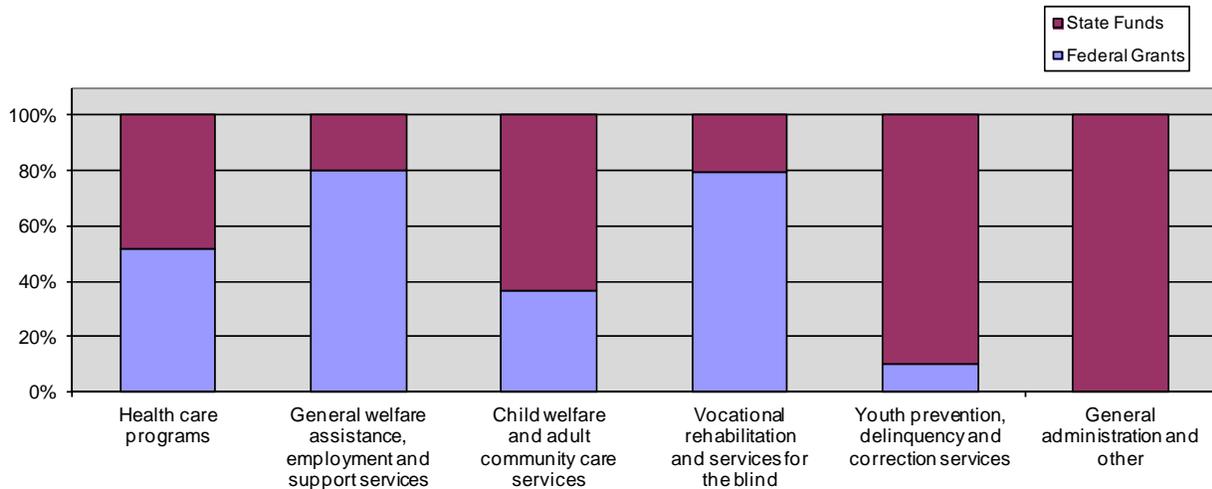
The total cost of all programs and services was approximately \$2.5 billion, a 3.4% decrease from the prior fiscal year. Health care and general welfare assistance programs comprised 64.5% and 27.9%, respectively, of the total costs. The following chart presents each major activity as a percent of the total cost of all DHS activities:



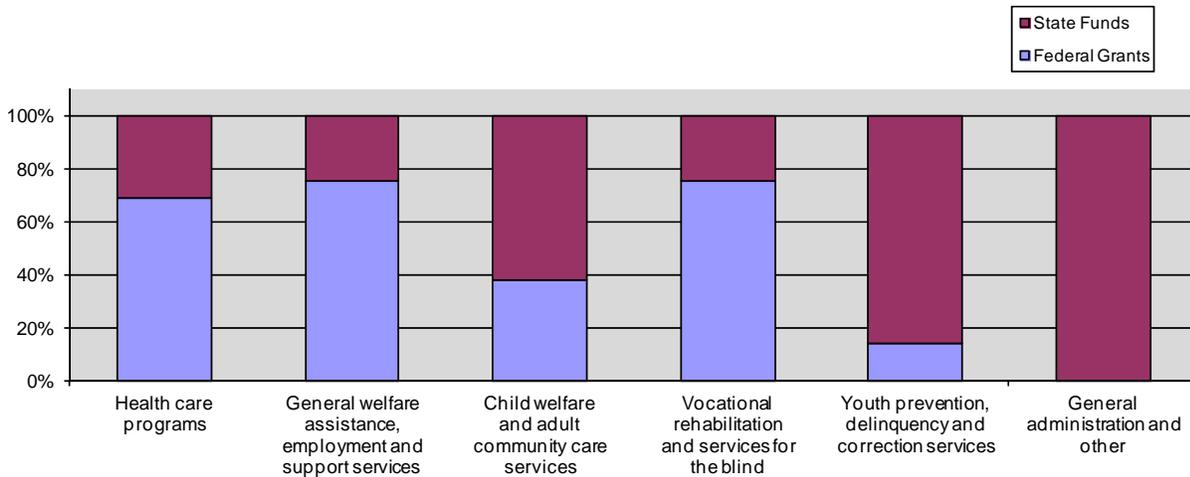
**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012**

Program revenues consist primarily of operating grants from the federal government. Revenues from these federal grants paid for 58.4% 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, 2012 and 2011:

Fiscal Year 2012



Fiscal Year 2011



**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012**

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 an accrual basis decreased by \$86 million over the prior fiscal year. This decrease is primarily related to health care program costs and general welfare assistance, employment and support services costs administered by the DHS which have decreased by approximately \$49 million or 2.95% and \$32 million or 4.33%, respectively. Insufficient funds in fiscal year 2010 caused three months of health care payments to be paid in fiscal year 2011. Payments have since been caught up by fiscal year 2012, resulting in a decrease in health care program costs for fiscal year 2012. The decrease in the costs for the general welfare assistance, employment and support service programs is due to the increase in contractual obligations in fiscal year 2011, which has been reduced in fiscal year 2012.

At June 30, 2012, the total governmental fund balance of the DHS consisted of assigned, committed, and restricted fund balance of approximately \$34.0 million, \$1.4 million, and \$0.5 million, respectively. The assigned fund balance of the general fund totaling \$34.0 million is principally comprised of encumbrances for program services that were incurred as of June 30, 2012. The committed fund balance of the special revenue funds totaling \$1.4 million is principally the result of amounts that are limited by the state law for specific use.

The following table presents total revenues and expenditures of the governmental funds of the DHS for the fiscal years ended June 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>	Percent Change
REVENUES			
State allotted appropriations	\$ 1,050,382,743	\$ 840,138,066	25.03 %
Intergovernmental revenues	1,462,025,145	1,770,603,483	(17.43) %
Non-imposed employee fringe benefits	<u>19,316,717</u>	<u>18,945,616</u>	1.96 %
Total	\$ <u>2,531,724,605</u>	\$ <u>2,629,687,165</u>	(3.73) %

**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012**

	<u>2012</u>	<u>2011</u>	<u>Percent Change</u>
EXPENDITURES			
Health care programs	\$ 1,614,636,214	\$ 1,663,664,384	(2.95) %
General welfare assistance, employment and support services	697,250,642	728,822,404	(4.33) %
Child welfare and adult community care services	137,749,494	148,014,650	(6.94) %
Vocational rehabilitation and services for the blind	25,116,525	21,470,208	16.98 %
Youth prevention, delinquency and correction services	19,632,547	19,279,544	1.83 %
General administration	9,618,784	9,102,924	5.67 %
Commission on the status of women/ commission on fatherhood	<u>101,469</u>	<u>89,897</u>	12.87 %
Total	\$ <u>2,504,105,675</u>	\$ <u>2,590,444,011</u>	(3.33) %

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	\$ 806,921,341	\$ 809,475,124	\$ 802,643,184	\$ 6,831,940
General welfare assistance, employment and support services	146,174,134	141,777,490	135,762,448	6,015,042
Child welfare and adult community care services	87,703,589	89,635,654	86,182,012	3,453,642
Youth prevention, delinquency and correction services	17,322,724	17,097,542	16,782,842	314,700
General administration	7,102,509	7,945,467	7,915,574	29,893
Vocational rehabilitation and services for the blind	3,516,863	3,476,929	3,476,781	148
Commission on the status of women/ commission on fatherhood	<u>161,915</u>	<u>158,526</u>	<u>101,367</u>	<u>57,159</u>
	\$ <u>1,068,903,075</u>	\$ <u>1,069,566,732</u>	\$ <u>1,052,864,208</u>	\$ <u>16,702,524</u>

**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012**

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

For the Health Care programs, funds were appropriated to develop a new eligibility system to replace the HAWI Eligibility System. But due to delays in the procurement process, the award was not completed until FY2013. The legislature approved the budget message that lapsed the funds in FY2012 and was re-appropriated in FY2013. Also, the utilization of the budget appropriation for reimbursements from Department of Health for Medicaid services was lower than anticipated. The majority of the savings for the General Welfare Assistance, Employment and Support Services programs were due to vacancy savings, contractual balances not earned by the contractor, and delays in the eligibility determination for the Aged, Blind and Disabled program. This the amounts expended in comparison to the amount budgeted appears favorable.

CAPITAL ASSETS

As of June 30, 2012 and 2011, the cost basis of capital assets, net of accumulated depreciation, used by the DHS are presented in the table below. Approximately \$144,000 of capital assets were added in the fiscal year ended June 30, 2012. Annual depreciation totaling approximately \$2.2 million decreased the net cost basis during the fiscal year ended June 30, 2012.

Capital Assets, Net of Depreciation

	2012	2011
State office buildings and improvements	\$ 13,870,379	\$ 14,664,725
Buildings and improvements for the Office of Youth Services	12,937,757	11,218,300
Total buildings and improvements	26,808,136	25,883,025
Furniture, equipment and vehicles	953,297	1,347,373
Nondepreciable land	6	6
Total	\$ 27,761,439	\$ 27,230,404

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.

**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012**

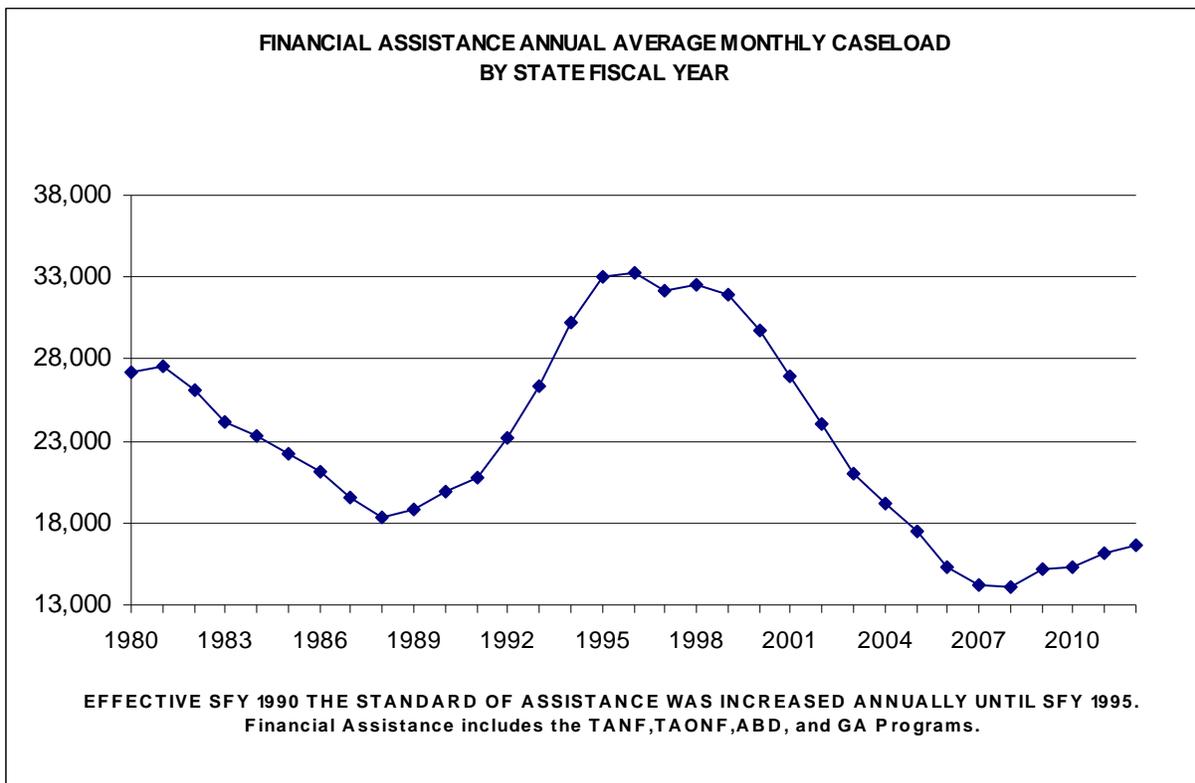
ECONOMIC FACTORS

The average monthly financial assistance caseload increased from state fiscal year 2011 to 2012, from 16,211 to 16,697 respectively, an increase of 486 cases for the period ending June 2012 (see figure 1). The number of individuals receiving financial assistance shows an upward trend. In June 2011, a total of 33,623 individuals in Hawaii were receiving financial assistance as compared to 35,265 in June 2012, an increase of 1,642 or 4.9% (see figure 2).

As in prior years, there is uncertainty regarding the amount of federal and state monies available for financial assistance programs. Additionally, changes to eligibility and benefit payment policies will have a direct impact on the number of individuals that can receive financial assistance in the future.

The number of individuals in Hawaii receiving Supplemental Nutrition Assistance Program (SNAP), formerly known as Food Stamp Program, benefits continued on a steep upward trend from 88,171 in April 2007, to 179,700 in September 2011. During this period, SNAP participation more than doubled and increased by 91,529. Over the past fiscal year, the number of individuals receiving SNAP benefits increased by 17,274 or 10.6%. The rise in SNAP participation can be attributed to recent economic conditions in Hawaii; changes in SNAP eligibility requirements have also contributed to more individuals qualifying for SNAP benefits.

Figure 1.



Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2012

Figure 2.

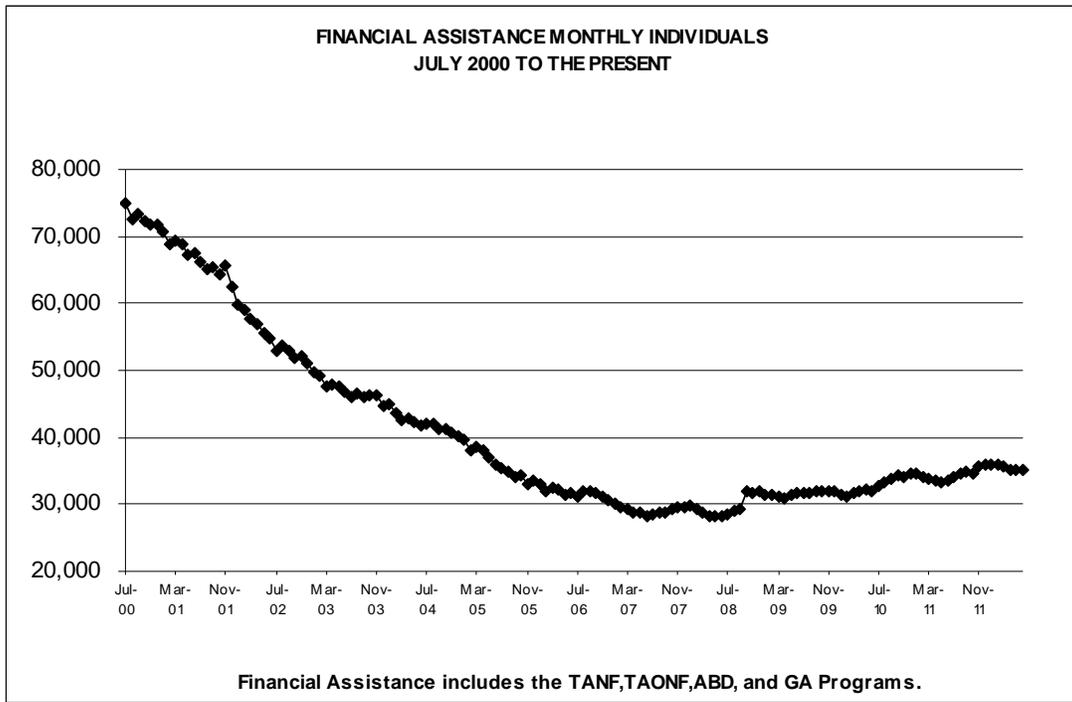
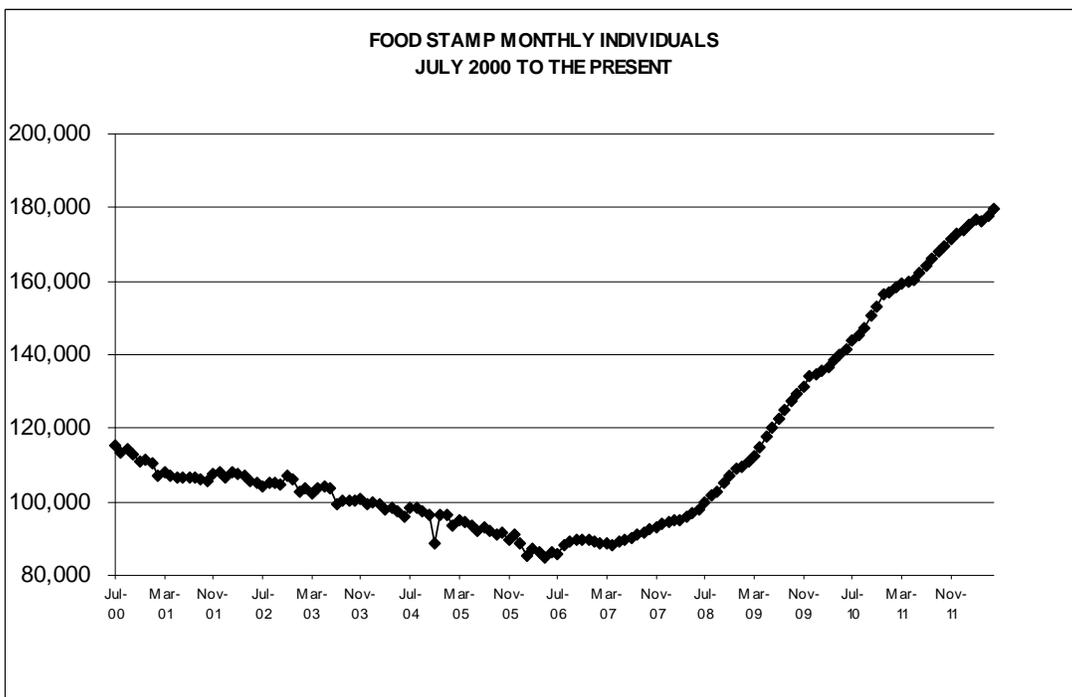


Figure 3.



**Department of Human Services
State of Hawaii
STATEMENT OF NET ASSETS
June 30, 2012**

	<u>Governmental Activities</u>
ASSETS	
Cash and cash equivalents	\$ 111,067,292
Receivables	11,445,507
Due from other governments	<u>33,112,131</u>
Total current assets	155,624,930
Capital assets, net of accumulated depreciation	<u>27,761,439</u>
Total assets	\$ <u><u>183,386,369</u></u>
LIABILITIES	
Vouchers payable	\$ 9,621,162
Accrued wages and employee benefits payable	6,824,217
Due to State general fund	51,677,431
Accrued medical assistance payable	51,607,000
Accrued compensated absences	<u>4,500,000</u>
Total current liabilities	124,229,810
Accrued compensated absences, less current portion	<u>10,071,832</u>
Total liabilities	<u><u>134,301,642</u></u>
NET ASSETS	
Invested in capital assets, net of related debt	27,761,439
Restricted	1,863,184
Unrestricted	<u>19,460,104</u>
Total net assets	<u><u>49,084,727</u></u>
Total liabilities and net assets	\$ <u><u>183,386,369</u></u>

See accompanying notes to the basic financial statements.

**Department of Human Services
State of Hawaii
STATEMENT OF ACTIVITIES
Fiscal Year Ended June 30, 2012**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>		<u>Net (Expenses) Revenue and Changes in Net Assets</u>
		<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	
Governmental activities:				
Health care programs	\$ 1,614,963,450	\$ --	\$ 830,681,882	\$ (784,281,568)
General welfare assistance, employment and support services	698,005,474	--	558,969,664	(139,035,810)
Child welfare and adult community care services	137,768,737	--	50,359,646	(87,409,091)
Vocational rehabilitation and services for the blind	25,207,510	--	20,009,512	(5,197,998)
Youth prevention, delinquency and correction services	18,135,099	--	2,004,441	(16,130,658)
General administration	9,800,155	--	--	(9,800,155)
Commission on the status of women / commission on fatherhood	<u>101,469</u>	<u>--</u>	<u>--</u>	<u>(101,469)</u>
Total governmental activities	<u>\$ 2,503,981,894</u>	<u>\$ --</u>	<u>\$ 1,462,025,145</u>	<u>(1,041,956,749)</u>
General revenues:				
				1,050,382,743
				<u>19,316,717</u>
				<u>1,069,699,460</u>
				<u>(15,114,859)</u>
				12,627,852
				<u>36,456,875</u>
				<u>\$ 49,084,727</u>

See accompanying notes to the basic financial statements.

**Department of Human Services
State of Hawaii
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2012**

	<u>General</u>	<u>Med-QUEST Special Revenue Fund</u>	<u>Human Services Special Revenue Fund</u>	<u>Total</u>
ASSETS				
Cash and cash equivalents	\$ 58,674,508	\$ 11,895,242	\$ 40,497,542	\$ 111,067,292
Receivables	10,475,964	90,043	879,500	11,445,507
Due from other funds	49,950,159	--	--	49,950,159
Due from other governments	<u>--</u>	<u>54,520,414</u>	<u>--</u>	<u>54,520,414</u>
 Total assets	 <u>\$ 119,100,631</u>	 <u>\$ 66,505,699</u>	 <u>\$ 41,377,042</u>	 <u>\$ 226,983,372</u>
LIABILITIES AND FUND BALANCES				
LIABILITIES				
Vouchers payable	\$ 5,037,192	\$ 997,665	\$ 3,586,305	\$ 9,621,162
Accrued wages and employee benefits payable	4,399,072	657,274	1,767,871	6,824,217
Due to other funds	--	37,198,760	12,751,399	49,950,159
Due to other governments	--	--	21,408,283	21,408,283
Due to State general fund	51,677,431	--	--	51,677,431
Accrued medical assistance payable	<u>23,955,000</u>	<u>27,652,000</u>	<u>--</u>	<u>51,607,000</u>
 Total liabilities	 <u>85,068,695</u>	 <u>66,505,699</u>	 <u>39,513,858</u>	 <u>191,088,252</u>
FUND BALANCES				
Restricted	--	--	491,856	491,856
Committed	--	--	1,371,328	1,371,328
Assigned	<u>34,031,936</u>	<u>--</u>	<u>--</u>	<u>34,031,936</u>
 Total fund balances	 <u>34,031,936</u>	 <u>--</u>	 <u>1,863,184</u>	 <u>35,895,120</u>
 Total liabilities and fund balances	 <u>\$ 119,100,631</u>	 <u>\$ 66,505,699</u>	 <u>\$ 41,377,042</u>	 <u>\$ 226,983,372</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 NET ASSETS
June 30, 2012**

Total fund balances - governmental funds		\$ 35,895,120
 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	\$ 87,230,060	
Less accumulated depreciation	<u>(59,468,621)</u>	27,761,439
 Accrued compensated absences are not due in the current period and therefore are not reported in the governmental funds.		
		<u>(14,571,832)</u>
 Net assets of governmental activities		 \$ <u>49,084,727</u>

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, 2012**

	General	Med-QUEST Special Revenue Fund	Human Services Special Revenue Fund	Total
REVENUES				
State-allotted appropriations	\$ 1,050,382,743	\$ --	\$ --	\$ 1,050,382,743
Intergovernmental	--	830,681,882	631,343,263	1,462,025,145
Nonimposed employee fringe benefits	<u>19,316,717</u>	<u>--</u>	<u>--</u>	<u>19,316,717</u>
	<u>1,069,699,460</u>	<u>830,681,882</u>	<u>631,343,263</u>	<u>2,531,724,605</u>
EXPENDITURES				
Health care programs	783,954,332	830,681,882	--	1,614,636,214
General welfare assistance, employment and support services	138,245,190	--	559,005,452	697,250,642
Child welfare and adult community care services	87,133,194	--	50,616,300	137,749,494
Vocational rehabilitation and services for the blind	5,189,229	--	19,927,296	25,116,525
Youth prevention, delinquency and correction services	17,628,105	--	2,004,442	19,632,547
General administration	9,618,784	--	--	9,618,784
Commission on the status of women/ commission on fatherhood	<u>101,469</u>	<u>--</u>	<u>--</u>	<u>101,469</u>
	<u>1,041,870,303</u>	<u>830,681,882</u>	<u>631,553,490</u>	<u>2,504,105,675</u>
EXCESS OF REVENUES OVER (UNDER)				
EXPENDITURES	27,829,157	--	(210,227)	27,618,930
OTHER FINANCING SOURCES				
Transfers in (out)	<u>(15,231,359)</u>	<u>--</u>	<u>116,500</u>	<u>(15,114,859)</u>
NET CHANGE IN FUND BALANCES	12,597,798	--	(93,727)	12,504,071
FUND BALANCES AT JULY 1, 2011	<u>21,434,138</u>	<u>--</u>	<u>1,956,911</u>	<u>23,391,049</u>
FUND BALANCES AT JUNE 30, 2012	<u>\$ 34,031,936</u>	<u>\$ --</u>	<u>\$ 1,863,184</u>	<u>\$ 35,895,120</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, 2012**

Net change in fund balances - total governmental funds		\$	12,504,071
 Amounts reported for governmental activities in the statement of activities are different because:			
 Governmental funds report capital outlays as expenditures, however, in the statement of activities the cost of those assets are depreciated over their estimated useful lives as depreciation expense.			
Expenditures for capital assets		\$ 143,909	
Add current year depreciation and other changes		<u>387,126</u>	531,035
 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>(407,254)</u>
 Change in net assets of governmental activities		 \$	 <u>12,627,852</u>

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, 2012**

	Original	Final	Actual on Budgetary Basis	Variance Favorable (Unfavorable)
REVENUES				
State allotments	\$ <u>1,068,903,075</u>	\$ <u>1,069,566,732</u>	\$ <u>1,050,382,743</u>	\$ <u>(19,183,989)</u>
EXPENDITURES				
Health care programs	806,921,341	809,475,124	802,643,184	6,831,940
General welfare assistance, employment and support services	146,174,134	141,777,490	135,762,448	6,015,042
Child welfare and adult community care services	87,703,589	89,635,654	86,182,012	3,453,642
Youth prevention, delinquency and correction services	17,322,724	17,097,542	16,782,842	314,700
General administration	7,102,509	7,945,467	7,915,574	29,893
Vocational rehabilitation and services for the blind	3,516,863	3,476,929	3,476,781	148
Commission on the status of women / commission on fatherhood	<u>161,915</u>	<u>158,526</u>	<u>101,367</u>	<u>57,159</u>
	<u>1,068,903,075</u>	<u>1,069,566,732</u>	<u>1,052,864,208</u>	<u>16,702,524</u>
Excess of revenues over (under) expenditures	<u>--</u>	<u>--</u>	<u>(2,481,465)</u>	<u>(2,481,465)</u>
OTHER FINANCING SOURCES				
Transfers out	<u>--</u>	<u>--</u>	<u>(15,231,359)</u>	<u>(15,231,359)</u>
	<u>--</u>	<u>--</u>	<u>(15,231,359)</u>	<u>(15,231,359)</u>
EXCESS OF REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES				
	\$ <u>--</u>	\$ <u>--</u>	\$ <u>(17,712,824)</u>	\$ <u>(17,712,824)</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, 2012**

	Original	Final	Actual on Budgetary Basis		Variance Favorable (Unfavorable)
			Med-QUEST Special Revenue Fund	Human Services Special Revenue Fund	
REVENUES					
Intergovernmental revenues					
Med-QUEST	\$ 891,041,451	\$ 891,041,451	\$ 859,978,074	\$ --	\$ (31,063,377)
Human services	<u>293,696,652</u>	<u>293,696,652</u>	<u>--</u>	<u>180,435,849</u>	<u>(113,260,803)</u>
	<u>1,184,738,103</u>	<u>1,184,738,103</u>	<u>859,978,074</u>	<u>180,435,849</u>	<u>(144,324,180)</u>
EXPENDITURES					
Health care programs	891,041,451	891,041,451	822,189,716	--	68,851,735
General welfare assistance, employment and support services	187,936,970	187,936,970	--	116,852,630	71,084,340
Child welfare and adult community care services	62,122,626	62,122,626	--	48,416,430	13,706,196
Vocational rehabilitation and services for the blind	36,503,100	36,503,100	--	20,623,827	15,879,273
Youth prevention, delinquency and correction services	5,782,653	5,782,653	--	2,699,494	3,083,159
General administration	<u>1,351,303</u>	<u>1,351,303</u>	<u>--</u>	<u>1,278,911</u>	<u>72,392</u>
	<u>1,184,738,103</u>	<u>1,184,738,103</u>	<u>822,189,716</u>	<u>189,871,292</u>	<u>172,677,095</u>
Excess of revenues over (under) expenditures	<u>--</u>	<u>--</u>	<u>37,788,358</u>	<u>(9,435,443)</u>	<u>28,352,915</u>
OTHER FINANCING SOURCES (USES)					
Transfers in	--	--	--	3,505,647	3,505,647
Transfers out	<u>--</u>	<u>--</u>	<u>(3,505,647)</u>	<u>--</u>	<u>(3,505,647)</u>
	<u>--</u>	<u>--</u>	<u>(3,505,647)</u>	<u>3,505,647</u>	<u>--</u>
EXCESS OF REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES					
	\$ <u>--</u>	\$ <u>--</u>	\$ <u>34,282,711</u>	\$ <u>(5,929,796)</u>	\$ <u>28,352,915</u>

See accompanying notes to the basic financial statements.

**Department of Human Services
State of Hawaii
STATEMENT OF FIDUCIARY NET ASSETS - FIDUCIARY FUNDS
June 30, 2012**

	Agency Funds	Private Purpose Trust Funds
ASSETS		
Cash	\$ <u>1,468,383</u>	\$ <u>71,855</u>
Total assets	\$ <u>1,468,383</u>	\$ <u>71,855</u>
LIABILITIES		
Due to individuals	\$ 929,658	\$ --
Due to others	<u>538,725</u>	<u>--</u>
Total liabilities	\$ <u>1,468,383</u>	<u>--</u>
NET ASSETS - HELD IN TRUST		\$ <u>71,855</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, 2012

	<u>Private Purpose Trust Funds</u>
ADDITIONS	
Donations	\$ <u>11,500</u>
Total additions	<u>11,500</u>
 DEDUCTIONS	
Other	<u>7,559</u>
Total deductions	<u>7,559</u>
CHANGE IN NET ASSETS	3,941
 NET ASSETS AT JULY 1, 2011	 <u>67,914</u>
 NET ASSETS AT JUNE 30, 2012	 \$ <u><u>71,855</u></u>

See accompanying notes to the basic financial statements.

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2012**

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 Supplemental Nutrition Assistance Program (SNAP) - formerly known as the Food Stamp Program, helps to ensure that no one goes hungry. The First-To-Work, 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. In 2011, the state homeless programs previously administered by the Hawaii Public Housing Authority, was transferred to the Division. 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, 2012**

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. Youths' 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

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2012**

NOTE A - FINANCIAL REPORTING ENTITY (Continued)

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 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, 2012**

NOTE A - FINANCIAL REPORTING ENTITY (Continued)

Commission on Fatherhood: The Commission promotes healthy relationships between parents and children, 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 Governmental Accounting Standards Board is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

- (1) ***Basis of Presentation*** - The government-wide financial statements, which are 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 properly excluded from program revenues are reported instead as general revenues. Resources that are dedicated internally are reported as general revenues rather than program revenues.

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.

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2012**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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's 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 Funds

The Special Revenue Funds are used to account and report the proceeds of specific revenue sources that are legally restricted or committed to expenditure for specific purposes other than debt service or capital projects. The Special Revenue Funds are as follows:

Med-QUEST - accounts for the programs related to the health care programs of the State.

Human Services - accounts for social services programs, which include public welfare and eligibility and disability determination.

Fiduciary Fund Type

Trust and Agency Funds

Trust and agency funds account for various assets held by the DHS in a trustee capacity or as an agent for individuals, private organizations, other governmental agencies or other funds.

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2012**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

(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.

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 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, 2012**

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 Medicaid providers for a retroactive adjustment to previously made payments and 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. Capital assets are depreciated using the straight-line method over the useful lives below.

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.

**Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
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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) ***Fund Balance*** - In the governmental fund financial statements, fund balances are classified using a hierarchy based on the extent to which the DHS is bound to follow constraints on the specific purposes for which amounts in the funds may be spent.

The DHS reports the following classifications:

Restricted Fund Balance - Restricted fund balances are restricted to specific purposes which are usually imposed by external parties such as grantors, contributors, or laws or regulations of other governments.

Committed Fund Balance - Committed fund balances are amounts that can only be used for specific purposes pursuant to formal action of the State Legislature.

Assigned Fund Balance - Assigned fund balances are amounts that are constrained by the State's intent to be used for specific purposes, but are neither restricted or committed. The State Legislature authorizes the amounts to specific purposes through the budgetary process. Assigned amounts within general fund include non-liquidated encumbrances at year end that are carried forward to the next fiscal year.

Unassigned Fund Balance - Unassigned fund balance is the residual classification for the General Fund. This classification represents General Fund balance that has not been assigned to other funds, and that has not been restricted or assigned to specific purposes within the General Fund.

When both restricted and unrestricted funds are available for use, it is DHS's policy to use restricted fund balance first, then unrestricted fund balance. Furthermore, fund balances are reduced in the following order when expenditures are incurred for purposes for which amounts in any of these unrestricted classifications can be used: committed, assigned then unassigned.

**Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2012**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

- (12) **Net Assets** - 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.
- (13) **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.
- (14) **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.

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 by the Council on Revenues and the Director of Finance. Budgeted expenditures are derived primarily from the Appropriations Act of 2011 (Act 164, SLH 2011), and from other authorizations contained in the State Constitution, Hawaii Revised Statutes, and other specific appropriation acts in various Session Laws of Hawaii (SLH).

All expenditures of these appropriated funds are made pursuant to the appropriations in the fiscal 2011 - 2013 biennial budget. The general and special revenue funds have legally appropriated annual budgets.

**Department of Human Services
State of Hawaii
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June 30, 2012**

NOTE C - BUDGETING AND BUDGETARY CONTROL (Continued)

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.

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 State Department of Accounting and General Services. During the fiscal year ended June 30, 2012, there were no expenditures in excess of appropriations in the individual funds.

To the extent not expended or encumbered, general 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 cash basis of accounting except for the encumbrance of purchase orders and contract obligations (basis difference), which is a departure from GAAP.

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the fiscal year ended June 30, 2012.

	<u>General</u>	<u>Med-QUEST</u>	<u>Human Services</u>
Excess of revenues over (under) expenditures and other sources (uses) - actual on a budgetary basis	\$ (17,712,824)	\$ 34,282,711	\$ (5,929,796)
Reserved for encumbrances at fiscal year-end	47,815,510	29,057,683	23,293,128
Expenditures for liquidation of prior fiscal year encumbrances	(20,805,073)	(60,312,119)	(19,775,322)
Net changes in unreserved liabilities	(3,676,357)	(12,643)	(1,784,039)
Net change in accrued medical assistance payable	(1,461,000)	27,921,000	--
Accruals related to federal reimbursements for program expenditures	2,151,057	(1,625,733)	(525,324)
Net change in other receivables	6,286,485	(14,707)	(144,500)
Difference for revenues recognized for GAAP purposes	<u>--</u>	<u>(29,296,192)</u>	<u>4,772,126</u>
Net change in fund balances - GAAP basis	\$ <u>12,597,798</u>	\$ <u>--</u>	\$ <u>(93,727)</u>

**Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2012**

NOTE D - CASH AND CASH EQUIVALENTS

The State's Director of Finance is responsible for the safekeeping of all monies paid into the State Treasury. The 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 specific requirements of the State. Investment earnings are allocated to the Primary government based on its equity interest in the pooled monies. 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, auction rate securities 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, 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. The State also 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.

**Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2012**

NOTE D - CASH AND CASH EQUIVALENTS (Continued)

Cash in Bank

The DHS maintains cash in banks which are held separately from cash in the State Treasury. As of June 30, 2012, the carrying amount of total bank deposits was approximately \$542,000 and the corresponding bank balances which are represented were approximately \$620,000.

NOTE E - RECEIVABLES

Receivables of the DHS, net of an allowance for doubtful accounts, consisted of the following at June 30, 2012:

	<u>General</u>	<u>Med-QUEST</u>	<u>Human Services</u>
Welfare benefit overpayments	\$ 23,980,290	\$ 2,191,000	\$ 22,524,116
Medicaid providers receivable	8,981,100	--	--
QUEST premiums receivable	50,510	51,490	--
Social Security interim assistance loans	464,000	--	--
CSEA receivable	<u>91,407</u>	<u>--</u>	<u>--</u>
	<u>33,567,307</u>	<u>2,242,490</u>	<u>22,524,116</u>
Less allowance for doubtful accounts:			
Welfare benefit overpayments	23,045,289	2,105,500	21,644,616
QUEST premiums receivable	<u>46,054</u>	<u>46,947</u>	<u>--</u>
	<u>23,091,343</u>	<u>2,152,447</u>	<u>21,644,616</u>
Receivables, net	\$ <u>10,475,964</u>	\$ <u>90,043</u>	\$ <u>879,500</u>

NOTE F - INTERFUND RECEIVABLE AND PAYABLE

The general fund had a net receivable due from the special revenue funds totaling \$49,950,159 as of June 30, 2012, for federal reimbursements of program expenditures. The Med-QUEST and Human Services special revenue funds had a payable to the general fund totaling \$37,987,760 and \$12,751,399, respectively, as of June 30, 2012, for federal reimbursements of program expenditures.

**Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2012**

NOTE G - CAPITAL ASSETS

For the fiscal year ended June 30, 2012, capital assets activity for the DHS was as follows:

	Balance		Net			Balance
	July 1, 2011	Additions	Disposals	Transfers	Other	June 30, 2012
Depreciable Assets						
Building and improvements	\$ 47,968,324	\$ --	\$ --	\$ 2,552,202	\$ 68,890	\$ 50,589,416
Furniture and equipment	35,714,992	136,209	(968,306)	(16,455)	116,602	34,983,042
Motor vehicles	1,702,129	7,700	(52,233)	--	--	1,657,596
Non-Depreciable Assets						
Land	<u>6</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>6</u>
Total at historical cost	<u>85,385,451</u>	<u>143,909</u>	<u>(1,020,539)</u>	<u>2,535,747</u>	<u>185,492</u>	<u>87,230,060</u>
Less Accumulated Depreciation:						
Building and improvements	22,085,298	1,653,445	--	42,537	--	23,781,280
Furniture and equipment	34,462,058	457,139	(949,892)	(15,280)	118,360	34,072,385
Motor vehicles	<u>1,607,691</u>	<u>65,298</u>	<u>(52,233)</u>	<u>(5,800)</u>	<u>--</u>	<u>1,614,956</u>
Total accumulated depreciation	<u>58,155,047</u>	<u>2,175,882</u>	<u>(1,002,125)</u>	<u>21,457</u>	<u>118,360</u>	<u>59,468,621</u>
Capital Assets, Net	\$ <u>27,230,404</u>	\$ <u>(2,031,973)</u>	\$ <u>(18,414)</u>	\$ <u>2,514,290</u>	\$ <u>67,132</u>	\$ <u>27,761,439</u>

Depreciation expense for the fiscal year ended June 30, 2012 was charged to functions/programs of the DHS as follows:

	<u>Governmental Activities</u>
Health care programs	\$ 207,556
General welfare assistance, employment and support services	651,610
Child welfare and adult community care services	296,405
Vocational rehabilitation and services for the blind	53,908
Youth prevention, delinquency and correction services	842,892
General administration	<u>123,511</u>
	<u>\$ 2,175,882</u>

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2012**

NOTE H - 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, 2012, was as follows:

	<u>Amount</u>
Balance at July 1, 2011	\$ 14,164,578
Additions	6,513,826
Reductions	<u>(6,106,572)</u>
Balance at June 30, 2012	14,571,832
Less current portion	<u>(4,500,000)</u>
	\$ <u>10,071,832</u>

NOTE I - FUND BALANCE

Fund balance constraints by purpose as of June 30, 2012 were as follows:

	<u>General</u>	<u>Med-QUEST Special Revenue Fund</u>	<u>Human Services Special Revenue Fund</u>	<u>Total</u>
RESTRICTED:				
Child Welfare and Adult Community Care	\$ --	\$ --	\$ 411,145	\$ 411,145
General Welfare Assistance, Employment and Support Services	<u>--</u>	<u>--</u>	<u>80,711</u>	<u>80,711</u>
Total - Restricted	<u>--</u>	<u>--</u>	<u>491,856</u>	<u>491,856</u>
COMMITTED:				
Commission on the Status of Women / Commission on Fatherhood	--	--	5,494	5,494
Child Welfare and Adult Community Care	--	--	526,879	526,879
Vocational Rehabilitation	<u>--</u>	<u>--</u>	<u>838,955</u>	<u>838,955</u>
Total - Committed	<u>--</u>	<u>--</u>	<u>1,371,328</u>	<u>1,371,328</u>
ASSIGNED:				
Human Services	<u>34,031,936</u>	<u>--</u>	<u>--</u>	<u>34,031,936</u>
Total - Assigned	<u>34,031,936</u>	<u>--</u>	<u>--</u>	<u>34,031,936</u>
Total Fund Balances	\$ <u>34,031,936</u>	\$ <u>--</u>	\$ <u>1,863,184</u>	\$ <u>35,895,120</u>

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2012**

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

The agency funds are purely custodial (assets equal liabilities) and thus do not involve the measurement of results of operations. The changes in assets and liabilities of the agency funds for the fiscal year ended June 30, 2012, were as follows:

	<u>Balance</u> <u>July 1, 2011</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 2012</u>
ASSETS				
Cash	\$ <u>1,578,814</u>	\$ <u>132,194,254</u>	\$ <u>132,304,685</u>	\$ <u>1,468,383</u>
LIABILITIES				
Due to individuals and others	\$ <u>1,578,814</u>	\$ <u>132,194,254</u>	\$ <u>132,304,685</u>	\$ <u>1,468,383</u>

NOTE K - 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 \$19,317,000 for the fiscal year ended June 30, 2012, 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 L - LEASES

The DHS leases office facilities 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, 2012:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2013	\$ 1,913,000
2014	1,770,000
2015	1,513,000
2016	1,026,000
2017	545,000
2018 - 2022	2,223,000
2023	<u>73,000</u>
	\$ <u>9,063,000</u>

**Department of Human Services
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NOTE L - LEASES (Continued)

The DHS's federal share of rent expenditures for operating leases for the fiscal year ended June 30, 2012, amounted to approximately \$2,040,000, and is included in the accompanying financial statements.

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. All contributions, benefits, and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. The ERS issues an annual comprehensive financial report that is available to the public. 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 noncontributory 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. The benefit plan options are similar to the current contributory plan. Almost 58,000 current members, all members of the noncontributory plan and certain members of the contributory plan, were eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006, were required to join the hybrid plan.

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

**Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
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NOTE M - RETIREMENT BENEFITS (Continued)

investigators are required to contribute 12.2% of their salary. The funding method used to calculate the total employer contribution requirement is the Entry Age 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.

The DHS's general fund share of the expense for pension benefits for the fiscal years ended June 30, 2012, 2011, and 2010 was paid from the State General Fund and totaled approximately \$7,075,000, \$7,220,000, and \$8,570,000, respectively. The DHS's federal share of pension benefits expense for the fiscal years ended June 30, 2012, 2011, and 2010 was approximately \$2,703,000, \$2,563,000, and \$3,303,000, respectively. The employer contribution rate for the fiscal years ended June 30, 2012, 2011, and 2010 was 14.70%, 14.69%, and 14.58%, respectively.

Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State of Hawaii Employer-Union Health Benefits Trust Fund (EUTF), an agent multiple-employer plan provides certain health care (medical, prescription, vision and dental) and life insurance benefits for retired State employees. Act 88 established the EUTF during the 2001 legislative session and is codified in HRS 87A. Contributions are based on negotiated collective bargaining agreements and are limited by State statute to the actual cost of benefit coverage. The DHS's share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 2012, was approximately \$5,192,000.

For employees hired before July 1, 1996, the State pays the entire monthly contribution for employees retiring with 10 or more years of credited service, and 50% of the monthly contribution for employees retiring with fewer than 10 years of credited service. A retiree can elect family plan to cover dependents.

For employees hired after June 30, 1996 but before July 1, 2001, 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 base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Retirees in this category can elect a family plan to cover dependents.

For employees hired on or after July 1, 2001, 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 base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage but must pay the difference.

**Department of Human Services
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NOTE M - RETIREMENT BENEFITS (Continued)

The State is required to contribute the annual required contribution (ARC) of the employer, an amount that is actuarially determined. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

Measurement of the actuarial valuation and the ARC are made for the State as a whole and are not separately computed for the individual state departments and agencies such as the DHS. The State has only computed the allocation of the other postemployment benefit (OPEB) costs to component units and proprietary funds that are reported separately in the State's Comprehensive Annual Financial Report (CAFR). Therefore, the OPEB costs for the DHS was not available and are not included in the financial statements. The State's CAFR includes the note disclosures and required supplementary information on the State's OPEB plans.

The EUTF issues an annual financial report that is available to the public. That report may be obtained by writing to the State of Hawaii Employer-Union Health Benefits Trust Fund at 201 Merchant Street, Suite 1520, Honolulu, Hawaii 96813.

NOTE N - RISK MANAGEMENT

The DHS is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; and workers' compensation. The State records 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 \$1 million per occurrence minimum. This policy includes windstorm, earthquake, flood damage, tsunami, and volcanic action coverage. The limit of loss per occurrence is \$225 million, except for terrorism which is \$50 million per occurrence.

The State also has a crime insurance policy for various types of coverages with a limit of loss of \$10 million per occurrence with a \$500,000 deductible per occurrence, except for claims expense coverage which has a \$100,000 per occurrence and a \$1,000 deductible. Losses not covered by insurance are paid from legislative appropriations of the State's General Fund.

**Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2012**

NOTE M - RISK MANAGEMENT (Continued)

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 million self-insured retention per occurrence. The annual aggregate per occurrence is \$15 million.

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, 2012, 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 DHS's portion of the State's workers' compensation expense for the fiscal year ended June 30, 2012, was approximately \$401,000.

NOTE N - COMMITMENTS AND CONTINGENCIES

Encumbrances

Encumbrances as of June 30, 2012 were as follows:

<u>Fund</u>	<u>Amount</u>
General	\$ 47,815,510
Med-QUEST	29,057,683
Human Services	<u>23,293,128</u>
Total	\$ <u>100,166,321</u>

**Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2012**

NOTE N - COMMITMENTS AND CONTINGENCIES (Continued)

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, 2012, accumulated sick leave was approximately \$41 million.

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 has been the State's historical practice that certain types of judgments and settlements against an agency of the State are paid from the State General Fund through an appropriation bill which is submitted annually by the Department of the Attorney General to the State Legislature.

NOTE O - RELATED PARTY TRANSACTIONS

The DHS had various amounts due to the State totaling \$51,677,431 as of June 30, 2012, which included federal reimbursements for program expenditures totaling \$49,950,159, receivables totaling \$1,399,000, and cash held outside of the State Treasury totaling \$328,272.

SUPPLEMENTARY INFORMATION

**Department of Human Services
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2012**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures ¹	Amount Provided to Subrecipient
U.S. Department of Health and Human Services				
Promoting Safe and Stable Families	93.556		\$ 920,110	\$ 631,920
Temporary Assistance for Needy Families ²	93.558		65,106,232	7,311,539
Low-Income Home Energy Assistance	93.568		5,886,827	161,013
Child Care and Development Block Grant ²	93.575		15,768,890	4,633,729
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		9,173,194	--
Chaffee Education and Training Vouchers Program (ETV)	93.599		222,183	--
Head Start	93.600		117,705	--
Family Connections Grant	93.605		377,596	--
Children's Justice Grants to States	93.643		117,127	--
Stephanie Tubbs Jones Child Welfare Services Program	93.645		361,495	--
Foster Care - Title IV-E	93.658		19,137,783	--
ARRA - Foster Care - Title IV-E	93.658		29,428	--
Adoption Assistance	93.659		13,348,354	--
ARRA - Adoption Assistance	93.659		3,891	--
Guardianship Assistance	93.090		482,766	--
Social Services Block Grant ²	93.667		14,434,320	7,489,028
Child Abuse and Neglect State Grants	93.669		151,199	102,500
Family Violence Prevention and Services/Grants for Battered Women's Shelters - Grants to States and Indian Tribes	93.671		854,154	561,971
Chafee Foster Care Independence Program	93.674		332,256	247,682
State Survey and Certification of Health Care Providers	93.777		398,666	--
Medical Assistance Program	93.778		778,978,198	--
ARRA - Medical Assistance Program	93.778		33,699,822	--
Children's Health Insurance Program	93.767		29,364,318	--
Demonstration to Maintain Independence and Employment	93.769		5,107	--
Medicaid Transformation Grants	93.793		240,254	--
Total U.S. Department of Health and Human Services			\$ 989,511,875	\$ 21,139,382

**Department of Human Services
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2012**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures ¹	Amount Provided to Subrecipient
U.S. Department of Agriculture				
Supplemental Nutrition Assistance Program ³	10.551		\$ 446,137,742	\$ --
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	10.561		14,372,973	1,242,144
National School Lunch Program	10.555		62,021	--
School Breakfast Program	10.553		43,717	--
Total U.S. Department of Agriculture			<u>460,616,453</u>	<u>1,242,144</u>
U.S. Department of Justice				
Juvenile Justice and Delinquency Prevention - Allocation to States	16.540		372,909	328,623
Title V - Delinquency Prevention Program	16.548		178	--
Juvenile Accountability Block Grant	16.523		25,655	24,426
Crime Victim Assistance	16.575		172,635	--
Total U.S. Department of Justice			<u>571,377</u>	<u>353,049</u>
U.S. Department of Labor				
Pass-through State Department of Labor and Industrial Relations Senior Community Service Employment Program	17.235		292,614	--
Total U.S. Department of Labor			<u>292,614</u>	<u>--</u>
U.S. Department of Education				
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126		9,606,057	443,416
Independent Living - State Grants	84.169		431,891	155,369
Rehabilitation Services - Independent Living Services for Older Individuals Who are Blind	84.177		87,633	--
Supported Employment Services for Individuals with the most Significant Disabilities	84.187		228,151	158,800
Assistive Technology	84.224		322,584	--
Rehabilitation Training - State Vocational Rehabilitation Unit In-Service Training	84.265		19,570	--
Rehabilitation Long-Term Training	84.129		7,272	--
ARRA - Rehabilitation Services - Vocational Rehabilitation Grants to States, Recovery Act	84.390		1,189,402	--
Safe and Drug-Free Schools and Communities - State Grants	84.186		92,499	92,499
Total U.S. Department of Education			<u>11,985,059</u>	<u>850,084</u>

**Department of Human Services
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2012**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures ¹	Amount Provided to Subrecipient
Corporation for National and Community Service				
Foster Grandparent Program	94.011		\$ 475,814	\$ --
Senior Companion Program	94.016		<u>416,759</u>	<u>--</u>
Total Corporation for National and Community Service			<u>892,573</u>	<u>--</u>
Social Security Administration				
Social Security - Disability Insurance	96.001		<u>7,025,459</u>	<u>--</u>
Total Social Security Administration			<u>7,025,459</u>	<u>--</u>
U.S. Department of the Interior				
Pass-through the State Governor's Office				
Economic, Social, Political Developments of the Territories	15.875	Hawaii-CI-2011-1	<u>5,614,371</u>	<u>--</u>
Total U.S. Department of the Interior			<u>5,614,371</u>	<u>--</u>
U.S. Department of Housing and Urban Development				
Emergency Solutions Grants Program	14.231		298,708	227,647
Housing Opportunities for Persons with AIDS	14.241		180,315	--
Homeless Prevention and Rapid Re-Housing Program Technical Assistance	14.262		461,302	--
Shelter Plus Care	14.238		1,643,208	1,643,208
Supportive Housing Program	14.235		<u>173,985</u>	<u>173,985</u>
Total U.S. Department of Housing and Urban Development			<u>2,757,518</u>	<u>2,044,840</u>
TOTAL FEDERAL EXPENDITURES			<u>\$ 1,479,267,299</u>	<u>\$ 25,629,499</u>

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

² Grant awards totaling \$24,890,000 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 Care Development Block Grant (\$15,000,000).

³ 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**

**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, 2012, which collectively comprise the DHS's basic financial statements and have issued our report thereon dated March 18, 2013. 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

Management of the DHS is responsible for establishing and maintaining effective 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 opinions 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.

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the DHS's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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*.

We noted certain matters that we reported to management of the DHS, in a separate letter dated March 18, 2013.

This report is intended solely for the information and use of the Office of the Auditor, 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.

N&K CPAs, Inc.

Honolulu, Hawaii
March 18, 2013

PART III

**AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR
PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE**

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH
REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON
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 Department of Human Services of the State of Hawaii (DHS) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the DHS's major federal programs for the fiscal year ended June 30, 2012. 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 2012-01 to 2012-09 in the accompanying schedule of findings and questioned costs, the DHS did not comply with the following requirements:

CFDA Number	Name of Federal Program	Type of Compliance Requirement	Ref. No.
93.575 and 93.596	Child Care Cluster	Activities Allowed, Allowable Costs and Reporting	2012-01, 2012-07
93.778	Medical Assistance Program	Activities Allowed, Allowable Costs, Eligibility and Special Tests and Provisions	2012-02 - 2012-05
14.238	Shelter Care Plus	Reporting and Subrecipient Monitoring	2012-07 - 2012-09

Compliance with such 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 compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the fiscal year ended June 30, 2012. The results of our auditing procedures also disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item 2012-06.

Internal Control Over Compliance

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 to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses in internal control over compliance and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2012-01 to 2012-05 to be material weaknesses.

A significant deficiency in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2012-06 to 2012-09 to be significant deficiencies.

The DHS's response to the findings identified in our audit are 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.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

N&K CPAs, Inc.

Honolulu, Hawaii
March 18, 2013

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, 2012**

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

Material weakness(es) identified? yes no

Significant deficiency(ies) identified? yes none reported

Noncompliance material to the financial statements noted? yes no

Federal Awards

Internal control over major program:

Material weakness(es) identified? yes no

Significant deficiency(ies) identified? yes 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? yes no

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
10.551	Supplemental Nutrition Assistance Program (SNAP)
10.561	State Administrative Matching Grants for the Supplemental Nutrition Assistance Program
14.238	Shelter Plus Care
15.875	Economic, Social, and Political Development of the Territories
93.575	Child Care and Development Block Grant
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund
93.767	Children's Health Insurance Program
93.777	State Survey and Certification of Health Care Providers and Suppliers
93.778	Medical Assistance Program
96.001	Social Security - Disability Insurance (DI)

Dollar threshold used to distinguish between Type A and Type B programs: \$4,437,800

Auditee qualified as a low-risk auditee? yes no

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2012**

SECTION II - FINANCIAL STATEMENT FINDINGS

None

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2012**

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Ref. <u>No.</u>	Compliance and Internal Control Findings	<u>Questioned Costs</u>
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2012-01 Improve the Accuracy of Child Care Reimbursements

Federal agency: U.S. Department of Health and Human Services
CFDA No.: 93.575 and 93.596
Program: Child Care and Development Block Grant;
 Child Care Mandatory and Matching Funds of
 the Child Care and Development Fund

Criteria: Title 45 CFR Part 98.67 requires that the DHS shall expend and account for Child Care and Development funds in accordance with their own laws and procedures for expending and accounting for their own funds. According to the Amendment to Chapter 17-798.2 Hawaii Administrative Rules, child care payments shall include the monthly cost of child care per child, which shall be made in accordance with the established fee scale and rate table as stipulated in the amendment.

Condition: We noted six (6) instances in which benefit payments totaling \$1,318 were overpaid to participants and four (4) instances in which benefit payments totaling \$2,827 were underpaid to participants.

Cause: Program workers' clerical error or oversight which resulted in incorrect co-pay percentage being applied or incorrect reimbursement calculation based on the level of child care need.

Effect: Benefit payments were incorrectly calculated resulting in over and under payments.

\$ 1,318

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, 2012**

<u>Ref. No.</u>	Compliance and Internal Control Findings (Continued)	<u>Questioned Costs</u>
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2012-02 Complete Eligibility Applications and Annual Eligibility Re-Verifications in a Timely Manner

Federal agency: U.S. Department of Health and Human Services
CFDA No.: 93.778
Program: Medical Assistance Program

Criteria: Title 42 CFR Part 435.911 requires the determination of eligibility of individuals who apply for Medicaid benefits within 45 days from the date of application. In addition, Title 42 CFR Part 435.916 requires annual re-verifications of participant eligibility.

Condition: Although the DHS is still behind in its processing of Medicaid applications and annual eligibility re-verifications, the number of applications outstanding greater than 45 days as of the end of the fiscal year decreased significantly from the prior year by 88%. As of June 30, 2012, the number of applications outstanding greater than 45 days was 549 compared to 4,475 applications as of June 30, 2011. This is a reduction in backlog of about 14 days to 2 days.

The number of overdue annual re-verifications also decreased from 6,308 as of June 30, 2011, to 2,304 as of June 30, 2012 which is a decrease of 62% from the prior fiscal year ending balance. The backlog is approximately 7 days.

While authorized overtime was a means to reduce the overdue applications and re-verifications, it was not sufficient to bring application and re-verification processing current.

Cause: The DHS continues to experience challenges in processing eligibility applications and annual re-verifications on a timely basis due to staffing requirements.

Effect: The backlog of applications pending eligibility determinations and overdue annual re-verifications may result in the risk that ineligible recipients may be receiving Medicaid benefits.

\$ --

Recommendation

The DHS should assess the staffing requirements at the MQD Eligibility Branch and make every effort to eliminate the backlog of applications pending eligibility determinations and perform timely annual re-verifications.

Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2012

<u>Ref. No.</u>	<u>Compliance and Internal Control Findings (Continued)</u>	<u>Questioned Costs</u>
2012-03	Perform ADP System Risk Analysis and System Security Review	
	<p>Federal agency: U.S. Department of Health and Human Services</p> <p>CFDA No.: 93.778</p> <p>Program: Medical Assistance Program</p> <p>Criteria: Title 45 CFR Part 95.621 requires the conducting of a review of the Automatic Data Processing (ADP) system on a biennial basis. At a minimum, the review shall include an evaluation of physical and data security operating procedures and personnel practices.</p> <p>Condition: We noted that the last ADP system risk analysis and system security review was conducted in April 2008.</p> <p>Cause: The DHS does not have the necessary resources to perform risk analysis and system reviews on a biennial basis.</p> <p>Effect: The system serves as a critical control over participant eligibility and the processing of payments. Therefore, the lack of biennial system reviews increases the risk that non-compliance with regard to utilization, fraud and accuracy of claims could go undetected.</p>	<p>\$ <u> --</u></p>
	<p>Recommendation</p> <p>The DHS should allocate the necessary resources needed to perform the ADP risk analysis and system security review on a biennial basis.</p>	

Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2012

<u>Ref. No.</u>	Compliance and Internal Control Findings (Continued)	<u>Questioned Costs</u>
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2012-04 Monitor the Medicaid Drug Rebate Program

Federal agency: U.S. Department of Health and Human Services
CFDA No.: 93.778
Program: Medical Assistance Program

Criteria: The Medicaid Drug Rebate Program, as set forth in Section 1927 of the Social Security Act requires the DHS to maintain drug utilization data that identifies the number of units of each covered outpatient drug for which the DHS reimbursed providers. The number of units is applied to the unit rebate amount to determine the actual rebate amount due from each manufacturer.

Condition: The DHS contracts Affiliated Computer Services, Inc. (ACS) to perform the daily operations of the drug rebate program including billing, collection, accounting and dispute resolution. While the day-to-day operations of the drug rebate program have been subcontracted to ACS, DHS is still ultimately accountable for the drug rebate program. We noted that much reliance is placed on ACS to operate the drug rebate program, as there is no monitoring of subcontractor activities.

Cause: Due to the complexity involved in the drug rebate calculations, the DHS does not have the necessary resources and staffing requirements to perform monitoring procedures of subcontractor activities.

Effect: The lack of sub-monitoring activities may result in the risk that the drug rebates are not being calculated correctly and accurately reported.

\$ --

Recommendation

The DHS should establish formal procedures to monitor its subcontractor activities of the drug rebate program.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2012**

<u>Ref. No.</u>	Compliance and Internal Control Findings (Continued)	<u>Questioned Costs</u>
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2012-05	Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims	
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Federal agency: U.S. Department of Health and Human Services
CFDA No.: 93.778
Program: Medical Assistance Program

Criteria: Title 42 CFR Part 456 Subpart A requires a statewide program of control of the utilization of all Medicaid services. In addition, Title 42 CFR Part 456.23 requires a post payment review process that allows State personnel to review recipient utilization and provider service profiles and exception criteria to identify and correct misutilization practices of recipients and providers. Lastly, Title 42 CFR Part 455.13 requires the Medicaid agency to have methods for identification, investigation, and referral of fraudulent activity.

Condition: 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.

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 that back-end control activities can be improved.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2012**

<u>Ref. No.</u>	<u>Compliance and Internal Control Findings (Continued)</u>	<u>Questioned Costs</u>
2012-05	<p>Improve Controls over Utilization, Fraud, and Accuracy of Medicaid Claims (Continued)</p> <p>More specifically, we noted the following conditions:</p> <ul style="list-style-type: none"> • The DHS has contracted a Peer Review Organization (PRO) to perform certain utilization control activities such as acute hospital reviews, pre-admission screening and resident reviews (PASRR) for nursing facilities and long-term level of care determinations. In order for the PRO to perform such reviews, claims samples must meet specific claims sampling criteria which are determined by the MQD through the use of the Data Warehouse (DW) and additional information obtained from providers and health plans. The MQD is backlogged in generating samples for managed care claims. The latest sample generated for managed care claims during the fiscal year ended June 30, 2012 was for calendar year 2010. • The Surveillance and Utilization Review Subsystem (SURS) functions include the generation of utilization reports by MQD using DW. 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. SURS personnel were generating reports using DW without formal training. It was in October 2012 when MQD improved the process of generating both standardized and customized reports through the use of EDIWatch. • There is still no formal ongoing post payment review of a sample of claims. It has been over eight years since the last review and the monitoring of ACS, its pharmacy benefits manager (PBM). That report issued by an independent healthcare auditing and consulting company recommended the need to explore additional edits, analysis, and reporting in order to expand anti-fraud efforts. • The Medicaid Investigations Unit (MIU) is an important component of identifying and investigating fraudulent activity. In the past, this unit was comprised of one individual and in June 2008, this individual retired from the DHS. The position was later filled by other individuals during the months of January to June 2011 and March to December 2012. To date, the position remains vacant. However, the DHS is currently in the process of looking to fill the position. 	

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2012**

<u>Ref. No.</u>	<u>Compliance and Internal Control Findings (Continued)</u>	<u>Questioned Costs</u>
2012-05	<p>Improve Controls over Utilization, Fraud, and Accuracy of Medicaid Claims (Continued)</p> <p>Cause: The DHS continues to experience challenges to improve back-end control activities due to limitations in resources and staffing.</p> <p>Effect: Weaknesss in back-end control activities may result in the risk of failure to identify and correct misutilization practices and potential fraud. More specifically, we noted the following effects:</p> <ul style="list-style-type: none"> • The backlog in generating managed care claims samples according to specific sampling criteria has delayed the process of reviewing managed care claims for PRO functions. • Due to the lack of a staff investigator there has been no follow-up on any fraud referrals which may result in ongoing fraud and abuse activity. In addition, any referrals from SURS is now being communicated directly from SURS personnel to the Medicaid Fraud Control Unit. 	\$ <u><u> --</u></u>

Recommendation

To ensure compliance with federal regulations, the DHS should improve controls over utilization, fraud, and accuracy of Medicaid claims by increasing back-end control activities. Control activities designed to maintain program integrity need to be made a higher priority. The DHS should also consider the following:

- Continue to work with EDIWatch to improve and assess the effectiveness of SURS reports. In addition, continue to improve content and functionality of DW.
- 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. The Payment Error Rate Measurement conducted by Centers for Medicare and Medicaid Services is an example of a post payment review.
- Continue the effort to permanently hire an investigator to identify and investigate suspected fraud.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2012**

<u>Ref. No.</u>	<u>Compliance and Internal Control Findings (Continued)</u>	<u>Questioned Costs</u>
2012-06	Prepare Time Reports Accurately	
	<p>Federal agency: U.S. Social Security Administration CFDA No.: 96.001 Program: Social Security - Disability Insurance (DI)</p> <p>Criteria: The Social Security Administration's (SSA) Program Operations Manual System policy instructions, DI 39506.231, require that the hours worked by staffing category and employment status, such as full-time, part-time, or temporary employees, be accurately reported on the Time Reports of Personnel Service for Disability Determination Services (Form SSA-4514).</p> <p>Condition: Total on-duty, holiday and leave, and overtime hours reported on the Form SSA-4514 was not arithmetically correct.</p> <p>Cause: The DHS improved its report template by replacing manual inputs with formulas for amounts that are totals. However, replacement for one category was overlooked and the manual input total from a previous report period remained for all report periods during the fiscal year. In addition, the supporting worksheet did not have control totals to which the Form SSA-4514 could have been reconciled to improve report accuracy.</p> <p>Effect: Hours worked by staffing category and employment status were not accurately reported on the quarterly Form SSA-4514 for December 31, 2011, March 31, 2012 and June 30, 2012.</p>	<p>\$ <u> --</u></p>
	Recommendation	
	<p>The DHS should improve its review process to ensure the accurate preparation of the Form SSA-4514 prior to submission to the SSA. The review process should include reconciliations between the Form SSA-4514 and supporting documents that have control totals.</p>	

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2012**

<u>Ref. No.</u>	Compliance and Internal Control Findings (Continued)	<u>Questioned Costs</u>
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2012-07	Federal Funding Accountability and Transparency Act (FFATA) Reporting	
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Federal agency:	U.S. Department of Housing and Urban Development U.S. Department of Health and Human Services
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CFDA No.:	14.238 93.575
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Program:	Shelter Plus Care Child Care and Development Block Grant
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Criteria: In accordance with 2 CFR Part 170, the DHS is required to report executive compensation and first-tier subcontract awards on contracts and orders expected to be \$25,000 or more made with a new Federal Assistance Identification Number effective October 1, 2010 through the Federal Funding Accountability and Transparency Subaward Reporting System. Reporting must be accomplished by the end of the month following the month in which the subaward is obligated.

Condition: During our testing of the reporting compliance requirement, we noted that the DHS did not adhere to the Federal Funding Accountability and Transparency Act (FFATA) reporting requirements for its first-tier subcontract awards. While we noted that a certain program had reported subaward data accurately with supporting documentation available, the reporting was not done by the end of the month following the month in which the subaward was obligated. We also noted a program which has yet to report subaward data.

Cause: Notice of the FFATA reporting requirement was not given to programs and departments in a timely manner. There are also no formal policies and procedures in place to compile and report data to address the FFATA reporting requirements.

Effect: The DHS did not adhere to the FFATA reporting requirements.	\$ <u> --</u>
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Recommendation

The DHS should implement formal policies and procedures to comply with federal regulations and submit the required FFATA reports in a timely manner.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2012**

<u>Ref. No.</u>	Compliance and Internal Control Findings (Continued)	<u>Questioned Costs</u>
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2012-08 Improve Subrecipient Monitoring Procedures

Federal agency: U.S. Department of Housing and Urban Development
CFDA No.: 14.238
Program: Shelter Plus Care

Criteria: In accordance with OMB Circular A-133, Part 3 of the Compliance Supplement, the DHS is required to monitor the subrecipient's use of Federal awards through reporting, site visits, regular contact, or other means to provide reasonable assurance that the subrecipient administers Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements and those performance goals are achieved.

Condition: Although tenant listings and timesheets are reviewed before payment is made, no site visits were performed for any of its six (6) subrecipients since January 2011. Audit reports submitted by subrecipients tested did not have any findings reported.

Cause: We were informed by management that site visits were not performed due to a drastic reduction in workforce and turnover in key positions.

Effect: The DHS's ability to monitor compliance with participant eligibility, matching requirements and other requirements of the program is limited. Therefore, there is an increased risk of non compliance by the subrecipient.

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Recommendation

The DHS should improve its subrecipient monitoring procedures by performing site visits on a more frequent basis, especially for those subrecipients who have a history of non-compliance, have new personnel, or have new or substantially changed systems. As an alternative, the DHS should ensure that subrecipients perform adequate monitoring and building site visits.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2012**

<u>Ref. No.</u>	Compliance and Internal Control Findings (Continued)	<u>Questioned Costs</u>
2012-09	<p>Improve Monitoring of Subrecipient's Compliance with Matching Requirement</p> <p>Federal agency: U.S. Department of Housing and Urban Development (HUD) CFDA No.: 14.238 Program: Shelter Plus Care</p> <p>Criteria: OMB A-133 Compliance Supplement requires the grantee to provide or ensure the provision of supportive housing services that are at least equal in value to the aggregate amount of rental assistance funded by HUD. The manner in which the value of supportive services is calculated is contained in 24 CFR Section 582.110(c).</p> <p>Condition: To ensure subrecipient's compliance with the matching requirements of the program, financial data that is summarized on an annual performance report is used by the DHS to monitor compliance with the supportive services match. However, the financial data reported is not supported by underlying documentation.</p> <p>Cause: The DHS does not require the subrecipient to submit underlying documentation to support the financial data reported.</p> <p>Effect: The lack of supporting documentation and other procedures to substantiate the financial data amounts reported could be inaccurate with the result being non-compliance with the matching requirement.</p> <p>Recommendation</p> <p>The DHS should require subrecipients to submit documentation which supports the financial data reported on the annual performance reports.</p>	<p>\$ <u> --</u></p>

PART V
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

**Department of Human Services
State of Hawaii
STATUS REPORT
Fiscal Year Ended June 30, 2012**

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, 2011, dated March 5, 2012.

SECTION II - FINANCIAL STATEMENT FINDINGS

<u>Recommendations</u>	<u>Status</u>
<p>2011-01 Submit Accurate Financial Status Reports (page 63)</p> <p>The DHS should ensure that a thorough review of financial data compilations and computations are performed in the preparation of the financial statements. All adjustments to reported expenditures should be properly identified and adjusted for.</p>	<p>Accomplished.</p>

**Department of Human Services
State of Hawaii
STATUS REPORT (Continued)
Fiscal Year Ended June 30, 2012**

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

<u>Recommendations</u>	<u>CFDA Number</u>	<u>Status</u>
<p>2011-02 Maintain All Required Documentation in Child Care Case Files (page 64)</p> <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 in order to assess case manager performance.</p>	<p>93.575 and 93.596</p>	<p>Accomplished.</p>
<p>2011-03 Improve the Accuracy of Child Care Reimbursements (page 65)</p> <p>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 asses case worker performance.</p>	<p>93.575 and 93.596</p>	<p>Not accomplished. See Reference No. 2012-01.</p>
<p>2011-04 Complete Eligibility Applications and Annual Eligibility Re-Verifications in a Timely Manner (page 66)</p> <p>The DHS should assess the staffing requirements at the MQD Eligibility Branch and make every effort to eliminate the backlog of applications pending eligibility determinations and perform timely annual re-verifications. In addition, the DHS should maintain documentation to support participation eligibility and implement a corrective action plan to properly resolve the errors caused by the passive renewal process.</p>	<p>93.778</p>	<p>Partially accomplished. See Reference No. 2012-02.</p>
<p>2011-05 Perform ADP System Risk Analysis and System Security Review (page 68)</p> <p>The DHS should allocate the necessary resources needed to perform the ADP risk analysis and system security review on a biennial basis.</p>	<p>93.778</p>	<p>Not accomplished. See Reference No. 2012-03.</p>

**Department of Human Services
State of Hawaii
STATUS REPORT (Continued)
Fiscal Year Ended June 30, 2012**

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (Continued)

<u>Recommendations</u>	<u>CFDA Number</u>	<u>Status</u>
<p>2011-06 Monitor the Medicaid Drug Rebate Program (page 69)</p> <p>The DHS should establish formal procedures to monitor its subcontractor activities of the drug rebate program. In addition, the DHS should resolve outstanding issues on a timely basis.</p>	93.778	Not accomplished. See Reference No. 2012-04.
<p>2011-07 Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims (pages 70-73)</p> <p>To ensure compliance with federal regulations, the DHS should improve controls over utilization, fraud and accuracy of Medicaid claims by increasing back-end control activities. Control activities designed to maintain program integrity needs to be made a higher priority. The DHS should consider the following:</p> <ul style="list-style-type: none"> • Verify that the data in the DSW is accurate and complete and that proper reviews and reconciliations are performed to ensure consistency with the data in the HPMMIS. • Allocate the necessary resources to assist in the generation of useful and meaningful data and reports for PRO and SURS functions. • 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. • Allocate the necessary resources to permanently hire an investigator to identify and investigate suspected fraud. 	93.778	Partially accomplished. See Reference No. 2012-05.

**Department of Human Services
State of Hawaii
STATUS REPORT (Continued)
Fiscal Year Ended June 30, 2012**

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS (Continued)

<u>Recommendations</u>	<u>CFDA Number</u>	<u>Status</u>
2011-08 Prepare Time Reports Accurately (page 74) The DHS should establish a review and approval process to ensure the accurate preparation of the Form SSA-4514 prior to submission to the SSA.	96.001	Not accomplished. See Reference No. 2012-06.

PART VI
CORRECTIVE ACTION PLAN

NEIL ABERCROMBIE
GOVERNOR



PATRICIA McMANAMAN
DIRECTOR

BARBARA A. YAMASHITA
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES
P. O. Box 339
Honolulu, Hawaii 96809-0339

March 18, 2013

Brian Isobe
N&K CPAs, Inc.
American Savings Bank Tower
1001 Bishop Street, Suite 1700
Honolulu, Hawaii 96813-3696

Dear Mr. Isobe:

Attached are the Department of Human Services' responses and corrective action plans related to your fiscal year 2012 audit report findings and recommendations. We appreciate the opportunity to comment on the audit report.

Sincerely,


pm Patricia McManaman
Director

Attachment

Ref. No. 2012-01 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: In response to SFY 2011 audit findings, the Department modified the child care subsidy electronic system to automatically calculate income eligibility, co-payment rates, activity hour, and provider rates. Also, the Child Care Program Office (CCPO) continues to work with the training office and subsidy contractor to emphasize the need for correct payment issuances and continues to review cases with the contractor to ensure accuracy of payments issued.

CCPO will continue to maintain the corrective action steps taken in response to the FY 2011 audit. In addition, the Management Services Office/Quality Control Staff began in March 2013 to conduct secondary sample case reviews of the contractor's cases to assist in identifying areas in which additional training or policy clarification may be needed for the contract staff.

End Date: Ongoing

Responding Person: Dana Balansag, Benefit, Employment & Support Services Division (BESSD) Child Care Program Office Administrator
Phone: (808) 586-7187

Ref. No. 2012-02 Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner

Auditor's Recommendation: The DHS should assess the staffing requirements at the MQD Eligibility Branch and make every effort to eliminate the backlog of applications pending eligibility determinations and perform timely annual re-verifications.

Corrective Actions Taken or Planned: We appreciate the auditor's recognition of our substantial improvement despite the more than 40% increase in enrollment. It should be noted that the auditor did not exclude from its testing applicants who have 90 days rather than 45 days in accordance with federal regulations and Hawaii Administrative Rules to receive eligibility determinations.

The MQD is working with existing staff to address the backlogs of work at each unit with special projects and with approved overtime. MQD is also actively recruiting to fill all vacant positions statewide. Filling vacant eligibility positions has become top priority ever since MQD was able to resume hiring following the prolonged hiring freeze. In addition, MQD is utilizing temporary 89-day appointments to temporarily fill vacant positions until they are permanently filled.

A new eligibility system (KOLEA) is being developed to be operational no later than January 1, 2014 to be in compliance under the Affordable Care Act. This new system will expedite the processing of applications and eligibility reviews through verification and determination of non-aged, blind, and disabled individuals.

End Date: Ongoing

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

Ref. No. 2012-03 Perform ADP System Risk Analysis and System Security Review

Auditor's Recommendation: The DHS should allocate the necessary resources needed to perform the ADP risk analysis and system security review on a biennial basis.

Corrective Action Taken or Planned: The MQD has initiated a system security assessment of its network, which will include network vulnerability scanning, external penetration testing and configuration reviews. This assessment is expected to be completed by the end of the current fiscal year.

MQD continues to request that funding to complete security assessments and make security improvements be restored to our base budget.

End Date: June 30, 2013

Responding Person: Randall Chau, MQD Systems Office Administrator
Phone: (808) 692-7951

Ref. No. 2012-04 Monitor the Medicaid Drug Rebate Program

Auditor's Recommendation: The DHS should establish formal procedures to monitor its subcontractor activities of the drug rebate program.

Corrective Action Taken or Planned: As noted in the auditor's findings, the drug rebate program is complex as it requires knowledge of pharmaceutical products. MQD had a full-time pharmacist that was subject to reduction in force by the previous administration. We have requested during this legislative session a part-time pharmacist that will be able to assist in the development of procedures and monitoring of the contractor for drug rebates. We also will be reorganizing our Program Integrity Section within the Finance Office to assist in monitoring different health care activities, including pharmacy drugs and rebates claimed via the contracted QUEST and QExA health plans.

End Date: Ongoing

Responding Person: Brian Pang, MQD Finance Officer
Phone: (808) 692-7956

Ref. No. 2012-05 Improve Controls over Utilization, Fraud, and Accuracy of Medicaid Claims

Auditor's Recommendation: To ensure compliance with federal regulations, the DHS should improve controls over utilization, fraud, and accuracy of Medicaid claims by increasing back-end control activities. Control activities designed to maintain program integrity need to be made a higher priority. The DHS should also consider the following:

- Continue to work with EDIWatch to improve and assess the effectiveness of SURS reports. In addition, continue to improve content and functionality of DW.
- 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. The Payment Error Rate Measurement conducted by Centers for Medicare and Medicaid Services is an example of a post payment review.
- Continue the effort to permanently hire an investigator to identify and investigate suspected fraud.

Corrective Actions Taken or Planned: The Surveillance and Utilization Review Subsystem (SURS) has been procured and the MQD Financial Integrity Staff (FIS) began formal training with EDI Watch in October 2012. The training with EDI Watch will assist in generating standardized and customized reports for the FIS staff for post-payment reviews in a more meaningful manner.

Following the reduction in force under the previous administration, MQD has only three positions dedicated to program integrity. The single Medicaid Investigator position has been vacant as of January 2013, and MQD is currently recruiting to fill this position. MQD has requested five additional dedicated program integrity positions, including an auditor, a second investigator, a third nurse, and two analysts. In the absence of these new positions, MQD will need to pursue the lengthy process of taking positions needed for other operational purposes, redescribe them, and complete a reorganization.

End Date: Ongoing

Responding Person: Gary Ojiri, MQD Third Party Liability Specialist
Phone: (808) 692-7977

Ref. No. 2012-06 Prepare Time Reports Accurately

Auditor's Recommendation: The DHS should improve its review process to ensure the accurate preparation of the Form SSA-4514 prior to submission to the SSA. The review process should include reconciliations between the Form SSA-4514 and supporting documents that have control totals.

Corrective Action Taken or Planned: The Disability Determination Branch (DDB) will take action to address the finding and auditor's recommendation.

The DDB Administrator will revise the Excel worksheets that will be used to compile the data needed to prepare Form SSA-4514.

The DDB Secretary will obtain control totals for the supporting documents. The Secretary will then reconcile the control totals to the actual input totals on the Excel worksheets.

Prior to submission to the SSA, the DDB Administrator will review Form SSA-4514 for accuracy and ensure that the supporting documents reconcile to the form.

End Date: March 31, 2013

Responding Person: Vikki Nakamura, Division of Vocational Rehabilitation (DVR) Disability Determination Branch Administrator
Phone: (808) 979-7013

Ref. No. 2012-07 Federal Funding Accountability and Transparency Act (FFATA) Reporting

Auditor's Recommendation: The DHS should implement formal policies and procedures to comply with federal regulations and submit the required FFATA reports in a timely manner.

Corrective Action Taken or Planned: Pursuant to a joint memorandum issued by the State Director of Finance, the State Comptroller, and the Director of the Hawaii Fair Share Initiative of the Lt. Governor's Office, dated May 25, 2012, the Department of Human Services (DHS) undertook a "good faith" effort to comply with the FFATA reporting requirements. The processes to access and use the FFATA Sub-Award Reporting System (FSRS), obtain and enter the required information (e.g. subcontractor DUNS number) proved to be quite time consuming. This significantly contributed to the reporting delay. The effort is continuing and DHS will issue specific procedures to ensure timely reporting.

End Date: June 30, 2013

Responding Person: Edwin Igarashi, Fiscal Management Office (FMO) Fiscal Management Officer
Phone: (808) 586-4856

Ref. No. 2012-08

Improve Subrecipient Monitoring Procedures

Auditor's
Recommendation:

The DHS should improve its subrecipient monitoring procedures by performing site visits on a more frequent basis, especially for those subrecipients who have a history of non-compliance, have new personnel, or have new or substantially changed systems. As an alternative, the DHS should ensure that subrecipients perform adequate monitoring and building site visits.

Corrective Action
Taken or Planned:

DHS has monitored the Shelter Plus Care (S+C) program via desk monitoring for several years due to drastic staff reductions (which began in 2009) and due to the fact that HUD does not allow any administrative fees for this program. DHS receives S+C funding on behalf of the neighbor islands (Maui, Kauai and Hawaii Island). HUD's funding does not allow the State to use any S+C grant funds for the purposes of monitoring subrecipients. Inasmuch as the subrecipients are all located on the neighbor islands, increased site monitoring would come with added expenses to the State for which the State would not be reimbursed by HUD.

The DHS staff will make every effort to increase site monitoring of the S+C grantees. While these providers are limited in number (5 grantees on three islands), they are all located on the Neighbor Islands. Because the costs of site monitoring are not covered by HUD and the costs of Neighbor Island travel are high, the DHS will combine site monitoring of the S+C programs with monitoring visits for other programs and services.

In July, 2012, HUD staff audited DHS's administration of the Homelessness Prevention and Rapid Rehousing Program (HPRP). Based on the recommendations made by HUD, DHS implemented a risk matrix to evaluate sub-grantees' risk for non-compliance. Factors such as staffing, prior experience, and program design were used to create the matrix. That risk matrix has since been implemented and is being used to evaluate risk of non-compliance of subgrantees for S+C and other federal (and State) programs.

Subrecipients of the S+C program are contractually required to conduct unit inspections prior to the client assuming tenancy in a unit. The apartments/units must meet HUD habitability standards and fall within acceptable (Fair market rent) limits as well. These factors are documented by the subrecipients and are routinely monitored by DHS when payment requests are submitted by the agencies.

End Date:

Ongoing

Responding Person:

Lori Tshako, Benefit, Employment & Support Services Division (BESSD) Homeless Program Administrator
Phone: (808) 586-7072

Ref. No. 2012-09 Improve Monitoring of Subrecipient’s Compliance with Matching Requirement

Auditor’s Recommendation: The DHS should require subrecipients to submit documentation which supports the financial data reported on the annual performance reports.

Corrective Action Taken or Planned: Currently, Shelter Plus Care (S+C) subrecipients are required to provide a service “match” for funds they receive from HUD for rental subsidies. These matching funds usually come in the form of the provision of mental health, substance abuse, or case management services for this population of homeless individuals who have certified disabilities. The service match is documented through compilation on a HUD-based data collection system called E-SNAPS. The subrecipients currently input data which is vetted by the DHS staff and then forwarded to HUD.

The Auditor’s recommendation is a welcomed one. DHS will implement the requirement that documentation to verify the matching services be submitted to the Department.

End Date: April 30, 2013

Responding Person: Lori Tsuhako, BESSD Homeless Program Administrator
Phone: (808) 586-7072