

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

Fiscal Year Ended June 30, 2010

**Submitted by  
The Auditor  
State of Hawaii**



**N&K CPAs, Inc.**

ACCOUNTANTS|CONSULTANTS

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March 29, 2011

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

Dear Ms. Higa:

This is our report on the financial audit of the Department of Human Services of the State of Hawaii (DHS) as of and for the fiscal year ended June 30, 2010. Our audit was performed 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, 2010, 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, 2010, 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 performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the DHS for the fiscal year ended June 30, 2010.

## 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, 2010, 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 applicable to 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 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.

A handwritten signature in black ink, reading "Ron Shiigi". The signature is written in a cursive style with a large, stylized "R" and "S".

Ron Shiigi  
Principal

**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, 2010, which collectively comprise the DHS's basic financial statements as listed in the foregoing table of contents. These basic financial statements are the responsibility of the DHS's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note A, the financial statements of the DHS are intended to present the financial position and the changes in financial position, where applicable, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the DHS. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2010, 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, 2010, 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, 2011, 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.

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

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

*N&K CPAs, Inc.*

Honolulu, Hawaii  
March 18, 2011

**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Fiscal Year Ended June 30, 2010**

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, 2010. 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, 2010**

***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, 2010**

**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, 2010 and 2009.

**Condensed Statement of Net Assets**

	2010	2009
Current assets	\$ 261,064,784	\$ 227,567,322
Capital assets, net	<u>36,923,389</u>	<u>38,691,111</u>
Total assets	<u>\$ 297,988,173</u>	<u>\$ 266,258,433</u>
Current liabilities	\$ 334,504,001	\$ 285,887,788
Non-current liabilities	<u>9,476,174</u>	<u>10,638,729</u>
Total liabilities	<u>343,980,175</u>	<u>296,526,517</u>
Net assets		
Invested in capital assets	36,923,389	38,691,111
Restricted	1,687,062	2,100,110
Unrestricted deficit	<u>(84,602,453)</u>	<u>(71,059,305)</u>
Total net assets (deficit in)	<u>(45,992,002)</u>	<u>(30,268,084)</u>
Total liabilities and net assets	<u>\$ 297,988,173</u>	<u>\$ 266,258,433</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, 2010, the combined net assets of the DHS decreased by approximately \$15.7 million.

The deficit in unrestricted net assets of the DHS was approximately \$84.6 million as of June 30, 2010. This deficit in unrestricted net assets is principally the result of liabilities for program services that were incurred as of June 30, 2010, for which state allotments are not yet available. The largest liability as of June 30, 2010, is the estimated amount of medical assistance service provided as of June 30, 2010, for which the related claims and capitation fees will be processed and paid subsequently. Of the estimated \$254.2 million of medical assistance payable, the state share of these costs is approximately \$83.0 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 \$14.8 million as of June 30, 2010, 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, 2010.

**Department of Human Services  
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MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2010**

The DHS reported a total of approximately \$36.9 million in net assets invested in capital assets as of June 30, 2010. 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, 2010.

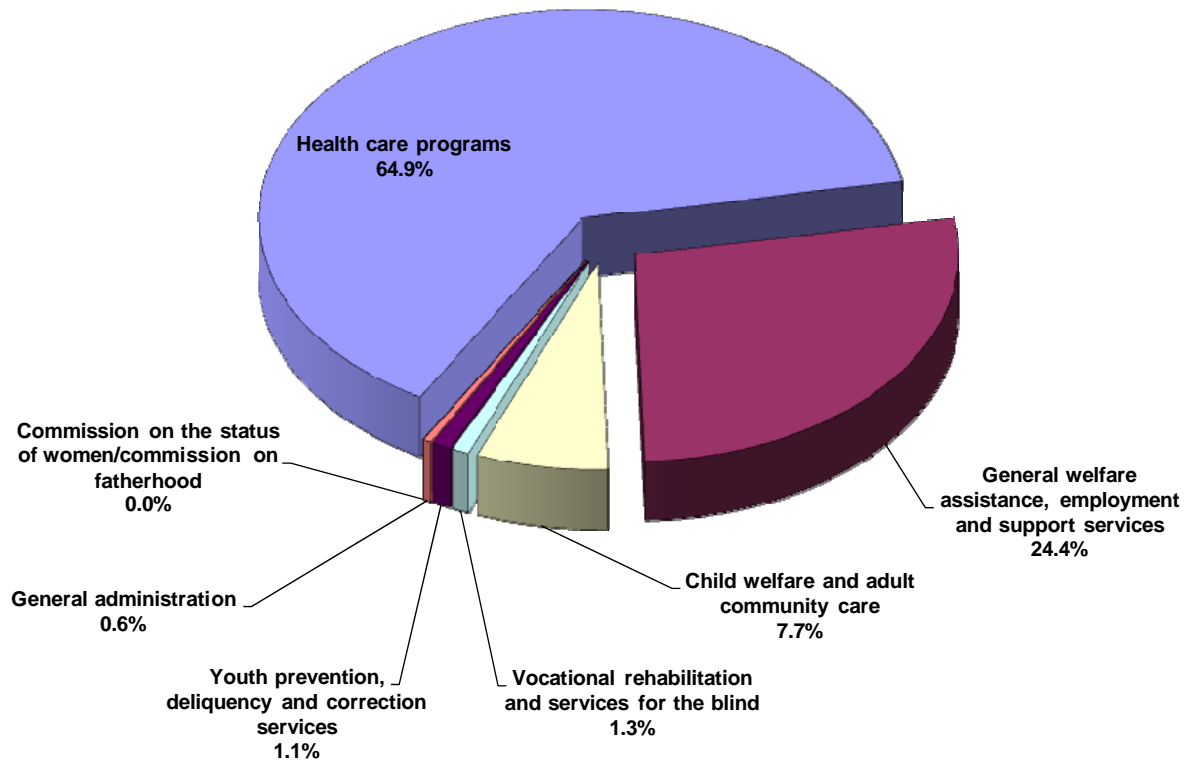
The changes in the net assets of the DHS from governmental activities are summarized below. The DHS directs its resources towards assisting people to meet their basic needs for food, shelter, medical care and other essentials for daily living. As such, the DHS does not conduct business-type activities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

	2010	2009	Percent Change
Revenues			
Program revenues	\$ 1,604,087,065	\$ 1,438,627,284	11.50 %
General revenues	<u>704,823,685</u>	<u>704,630,309</u>	0.03 %
Total revenues	<u>2,308,910,750</u>	<u>2,143,257,593</u>	7.73 %
Expenses			
Health care programs	1,486,074,562	1,416,740,049	4.89 %
General welfare assistance, employment and support services	633,215,414	532,569,746	18.90 %
Child welfare and adult community care services	152,454,381	167,333,630	(8.89) %
Youth prevention, delinquency and correction services	22,486,801	24,277,120	(7.37) %
Vocational rehabilitation and services for the blind	20,442,453	27,593,427	(25.92) %
General administration	9,723,431	12,362,674	(21.35) %
Commission on the status of women/ commission on fatherhood	<u>93,114</u>	<u>123,155</u>	(24.39) %
Total expenses	<u>2,324,490,156</u>	<u>2,180,999,801</u>	6.58 %
Change in net assets, before transfers	\$ <u>(15,579,406)</u>	\$ <u>(37,742,208)</u>	

**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2010**

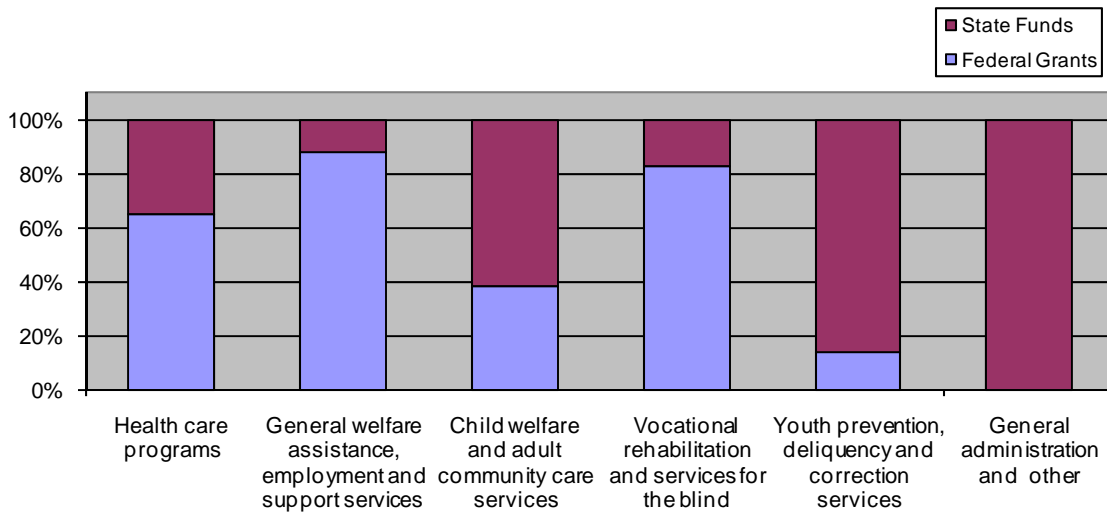
The total cost of all programs and services was approximately \$2.3 billion, a 6.42% increase from the prior fiscal year. Health care and general welfare assistance programs comprised 64.9% and 24.4%, respectively, of the total costs. The following chart presents each major activity as a percent of the total cost of all DHS activities:



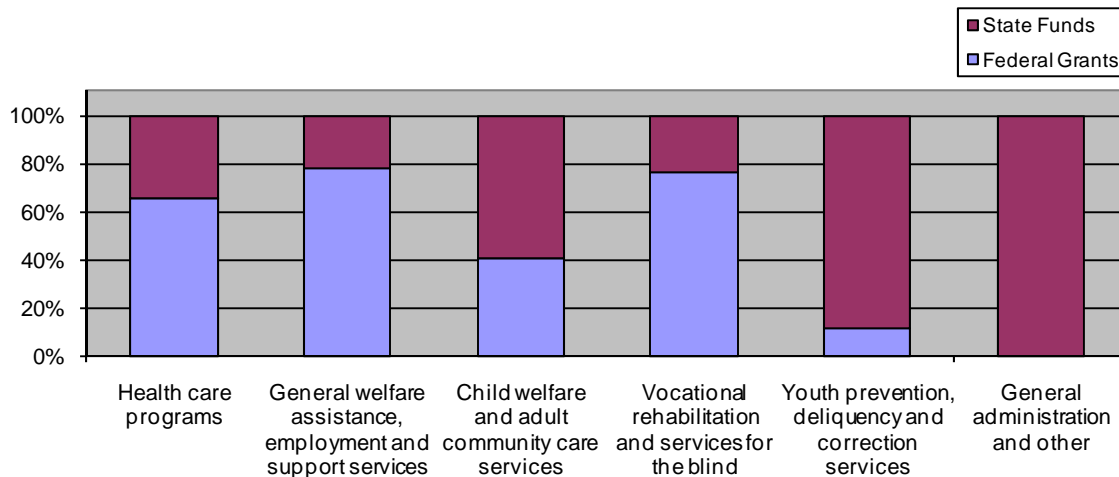
**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2010**

Program revenues consist primarily of operating grants from the federal government. Revenues from these federal grants paid for 69.0% 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, 2010 and 2009:

***Fiscal Year 2010***



***Fiscal Year 2009***



**Department of Human Services  
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MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2010**

**FINANCIAL ANALYSIS OF THE FUND FINANCIAL STATEMENTS**

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

Total expenditures reported on a modified accrual basis increased by \$143.5 million over the prior fiscal year. This increase is primarily related to health care program costs and general welfare assistance, employment and support services costs administered by the DHS which have increased by approximately \$70.2 million or 4.72% and \$100.6 million or 15.90%, respectively. The increase in the health care program costs are due to the increase in the QUEST enrollment, the rate increase for QExA and the completion of the fee for services payments from the previous fiscal year. The Supplemental Nutrition Assistance Program payments increased for the fiscal year 2010, accounting for the majority of the increase in the general welfare assistance, employment and support services costs.

At June 30, 2010, the total governmental fund balance of the DHS consisted of a deficit in unreserved fund balance of approximately \$215.4 million. The deficit in the unreserved fund balance of the general fund totaling \$83.8 million is principally comprised of liabilities for program services that were incurred as of June 30, 2010, for which state allotments were not yet available. The deficit in the unreserved fund balance of the special revenue funds totaling \$131.6 million is principally the result of encumbrances that were not liabilities as of June 30, 2010, and, therefore, the related intergovernmental revenues were not recorded.

Reservations of governmental fund balances for encumbrances totaled approximately \$147.3 million at June 30, 2010. Reservations of governmental fund balances indicate the amount of resources that are not available for new spending because it has been reserved to liquidate purchase and contractual commitments.

The following table presents total revenues and expenditures of the governmental funds of the DHS for the fiscal years ended June 30, 2010 and 2009:

	2010	2009	Percent Change
<b>REVENUES</b>			
State allotted appropriations	\$ 683,915,952	\$ 679,001,321	0.72 %
Intergovernmental revenues	1,604,087,065	1,438,627,284	11.50 %
Non-imposed employee fringe benefits	<u>20,907,733</u>	<u>25,628,988</u>	(18.42) %
Total	\$ <u>2,308,910,750</u>	\$ <u>2,143,257,593</u>	7.73 %



**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2010**

	2010	2009	Percent Change
<b>EXPENDITURES</b>			
Health care programs	\$ 1,485,999,324	\$ 1,416,591,781	4.90 %
General welfare assistance, employment and support services	633,139,685	531,588,459	19.10 %
Child welfare and adult community care services	153,031,687	166,620,741	(8.16) %
Youth prevention, delinquency and correction services	21,832,172	23,608,972	(7.53) %
Vocational rehabilitation and services for the blind	20,635,195	27,426,109	(24.76) %
General administration	9,653,812	12,365,069	(21.93) %
Commission on the status of women/ commission on fatherhood	<u>93,114</u>	<u>123,155</u>	(24.39) %
Total	\$ <u>2,324,384,989</u>	\$ <u>2,178,324,286</u>	6.71 %

**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:

	Original Budget	Final Budget	Actual on Budgetary Basis	Variance Favorable (Unfavorable)
Health care programs	\$ 565,261,257	\$ 564,406,547	\$ 517,486,296	\$ 46,920,251
General welfare assistance, employment and support services	101,790,755	104,301,319	103,590,628	710,691
Child welfare and adult community care services	93,934,894	86,792,042	86,060,339	731,703
Youth prevention, delinquency and correction services	18,466,685	17,199,950	15,912,086	1,287,864
General administration	8,096,944	7,581,021	7,580,773	248
Vocational rehabilitation and services for the blind	3,835,464	3,652,459	3,651,681	778
Commission on the status of women/ commission on fatherhood	<u>166,713</u>	<u>152,803</u>	<u>97,292</u>	<u>55,511</u>
	\$ <u>791,552,712</u>	\$ <u>784,086,141</u>	\$ <u>734,379,095</u>	\$ <u>49,707,046</u>

**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2010**

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

The change in the Health Care Program's process of reimbursement to the State Department of Health - Developmentally Disabled Division resulted in a lower utilization of the budgeted appropriation. While the lower Safehouse program costs accounted for the majority of the Youth Prevention, Delinquency and Correction Services' savings. Thus the amounts expended in comparison to the amount budgeted appears favorable.

**CAPITAL ASSETS**

As of June 30, 2010 and 2009, the cost basis of capital assets, net of accumulated depreciation, used by the DHS are presented in the table below. Approximately \$136,726 of capital assets were added in the fiscal year ended June 30, 2010. Annual depreciation totaling approximately \$2.4 million decreased the net cost basis during the fiscal year ended June 30, 2010.

**Capital Assets, Net of Depreciation**

	<u>2010</u>	<u>2009</u>
State office buildings and improvements	\$ 15,466,248	\$ 15,844,457
Buildings and improvements for the Office of Youth Services	<u>11,101,272</u>	<u>11,805,623</u>
Total buildings and improvements	26,567,520	27,650,080
Furniture, equipment and vehicles	10,355,863	11,041,025
Nondepreciable land	<u>6</u>	<u>6</u>
Total	\$ <u>36,923,389</u>	\$ <u>38,691,111</u>

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

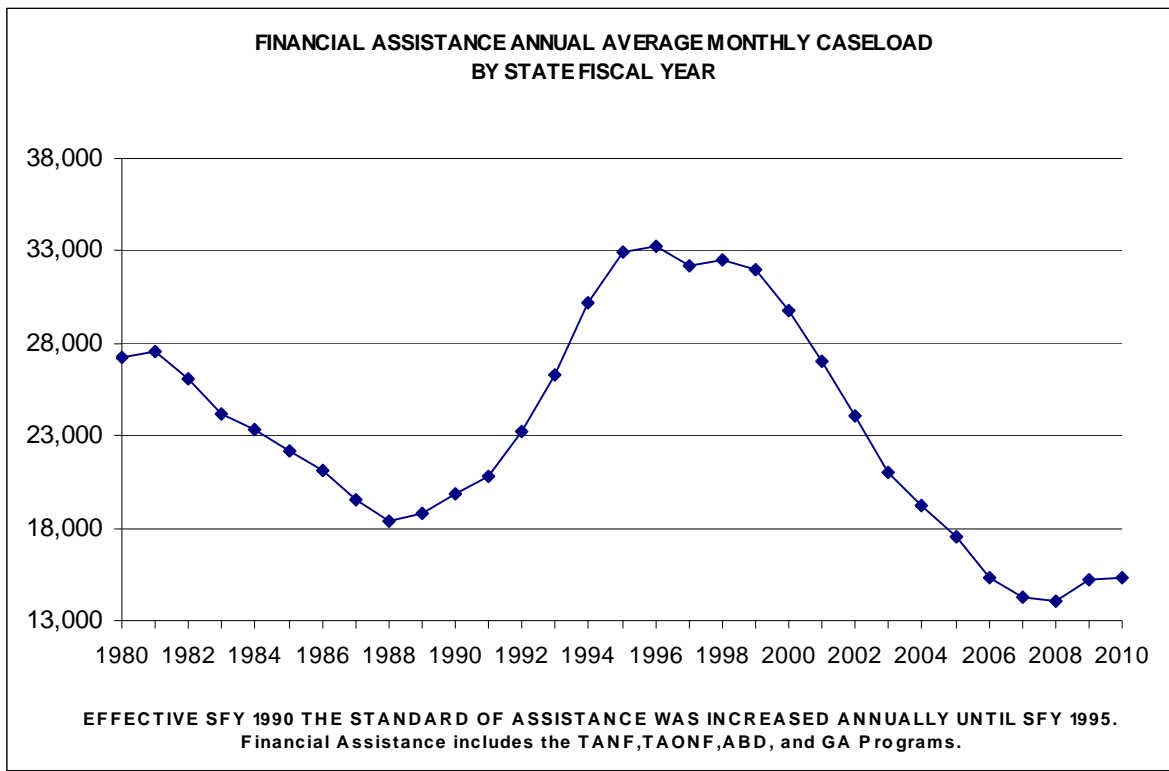
**ECONOMIC FACTORS**

The average monthly financial assistance caseload increased slightly from fiscal year 2009 to 2010, from 15,227 to 15,313 respectively, an increase of 86 cases for the period ending June 2010 (see figure 1). More recent data for the number of individuals receiving financial assistance shows an upward trend. In December 2009, a total of 31,978 individuals in Hawaii were receiving financial assistance as compared to 34,676 in December 2010, an increase of

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MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2010**

2,698 or 8.4% (see figure 2). However, the amount of federal and state monies available for financial assistance programs is decreasing. Federal funds targeted for state financial assistance programs are no longer available due to the expiration of federal stimulus programs. At the state-level, while Hawaii's economy has shown signs of stabilizing, the state continues to face severe budget shortfalls over the near term. Changes to program eligibility and benefit payment policies may be required which 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 156,355 in December 2010. During this period, SNAP participation increased by 68,184 or 77%. In the past twelve months from December 2009 to the same month in 2010, individuals receiving SNAP benefits have increased by 22,344 or 16.7%. The rise in SNAP participation can be attributed to challenging economic conditions in Hawaii and high unemployment rates. Additionally, the federal government provided additional funding for state SNAP programs in the American Recovery and Reinvestment Act of 2009 (ARRA). More recently, changes in SNAP eligibility requirements may result in more individuals qualifying for SNAP benefits.



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MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2010**

Figure 2.

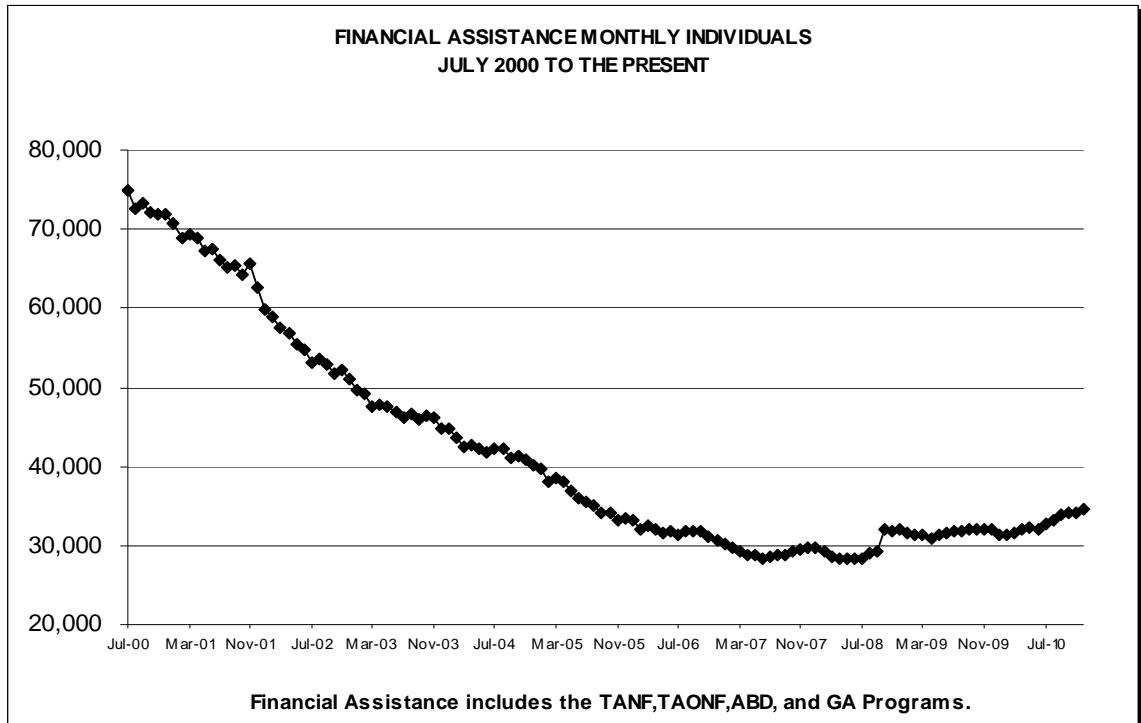
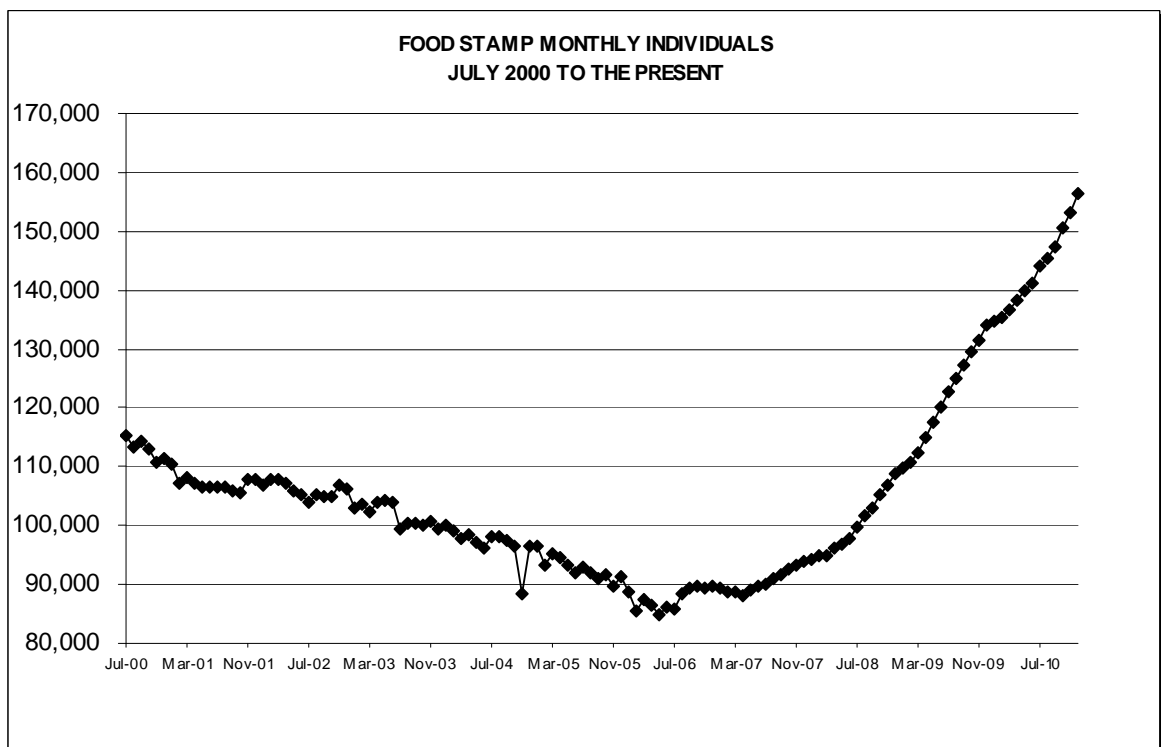


Figure 3.



**Department of Human Services  
State of Hawaii  
STATEMENT OF NET ASSETS  
June 30, 2010**

**ASSETS**

Cash and cash equivalents	\$ 70,764,929
Receivables	6,201,352
Due from other governments	<u>184,098,503</u>
 Total current assets	 261,064,784
 Capital assets, net of accumulated depreciation	 <u>36,923,389</u>
 Total assets	 \$ <u><u>297,988,173</u></u>

**LIABILITIES**

Vouchers payable	\$ 14,896,522
Accrued wages and employee benefits payable	8,593,940
Due to State general fund	47,129,952
Due to other state agencies	4,323,587
Accrued medical assistance payable	254,160,000
Accrued compensated absences	<u>5,400,000</u>
Total current liabilities	334,504,001
 Accrued compensated absences, less current portion	 <u>9,476,174</u>
 Total liabilities	 <u><u>343,980,175</u></u>

**NET ASSETS**

Invested in capital assets, net of related debt	36,923,389
Restricted	1,687,062
Unrestricted (deficit)	<u>(84,602,453)</u>
Total net assets	<u>(45,992,002)</u>
 Total liabilities and net assets	 \$ <u><u>297,988,173</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, 2010**

Functions/Programs	Expenses	Program Revenues		Net (Expenses) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	
Governmental activities:				
Health care programs	\$ 1,486,074,562	\$ --	\$ 966,117,341	\$ (519,957,221)
General welfare assistance, employment and support services	633,215,414	--	559,308,597	(73,906,817)
Child welfare and adult community care services	152,454,381	--	58,480,210	(93,974,171)
Vocational rehabilitation and services for the blind	20,442,453	--	16,983,906	(3,458,547)
Youth prevention, delinquency and correction services	22,486,801	--	3,197,011	(19,289,790)
General administration	9,723,431	--	--	(9,723,431)
Commission on the status of women / commission on fatherhood	93,114	--	--	(93,114)
Total governmental activities	\$ <u>2,324,490,156</u>	\$ <u>--</u>	\$ <u>1,604,087,065</u>	\$ <u>(720,403,091)</u>
<b>General revenues:</b>				
State allotments, net of lapsed appropriations				683,915,952
Nonimposed employee fringe benefits				<u>20,907,733</u>
Total general revenues				<u>704,823,685</u>
Transfers				<u>(144,512)</u>
Change in net assets				(15,723,918)
Deficit in net assets at June 30, 2009				<u>(30,268,084)</u>
Deficit in net assets at June 30, 2010				\$ <u>(45,992,002)</u>

See accompanying notes to the basic financial statements.

**Department of Human Services**  
**State of Hawaii**  
**BALANCE SHEET**  
**GOVERNMENTAL FUNDS**  
**June 30, 2010**

	General	Med-Quest Special Revenue Fund	Human Services Special Revenue Fund	Total
<b>ASSETS</b>				
Cash and cash equivalents	\$ 21,044,611	\$ 22,024,109	\$ 27,696,209	\$ 70,764,929
Receivables	5,022,096	108,756	1,070,500	6,201,352
Due from other funds	45,356,822	12,640,376	--	57,997,198
Due from other governments	<u>--</u>	<u>142,231,462</u>	<u>41,867,041</u>	<u>184,098,503</u>
 Total assets	 \$ <u>71,423,529</u>	 \$ <u>177,004,703</u>	 \$ <u>70,633,750</u>	 \$ <u>319,061,982</u>
<b>LIABILITIES AND FUND BALANCES</b>				
<b>LIABILITIES</b>				
Vouchers payable	\$ 6,991,241	\$ 945,733	\$ 6,959,548	\$ 14,896,522
Accrued wages and employee benefits payable	3,988,615	615,383	3,989,942	8,593,940
Due to other funds	--	--	57,997,198	57,997,198
Due to other state agencies	--	4,323,587	--	4,323,587
Due to State general fund	47,129,952	--	--	47,129,952
Accrued medical assistance payable	<u>83,040,000</u>	<u>171,120,000</u>	<u>--</u>	<u>254,160,000</u>
 Total liabilities	 <u>141,149,808</u>	 <u>177,004,703</u>	 <u>68,946,688</u>	 <u>387,101,199</u>
<b>FUND BALANCES</b>				
Reserved for encumbrances	14,082,603	79,052,398	54,216,164	147,351,165
Unreserved	<u>(83,808,882)</u>	<u>(79,052,398)</u>	<u>(52,529,102)</u>	<u>(215,390,382)</u>
 Total fund balances (deficit)	 <u>(69,726,279)</u>	 <u>--</u>	 <u>1,687,062</u>	 <u>(68,039,217)</u>
 Total liabilities and fund balances	 \$ <u>71,423,529</u>	 \$ <u>177,004,703</u>	 \$ <u>70,633,750</u>	 \$ <u>319,061,982</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, 2010**

**Total deficit in fund balances - governmental funds** \$ (68,039,217)

**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	\$ 89,405,395	
Less accumulated depreciation	<u>(52,482,006)</u>	36,923,389

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

(14,876,174)

**Deficit in net assets of governmental activities** \$ (45,992,002)

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, 2010**

	General	Med-Quest Special Revenue Fund	Human Services Special Revenue Fund	Total
<b>REVENUES</b>				
State-allotted appropriations	\$ 683,915,952	\$ --	\$ --	\$ 683,915,952
Intergovernmental	--	966,117,341	637,969,724	1,604,087,065
Nonimposed employee fringe benefits	<u>20,907,733</u>	--	--	<u>20,907,733</u>
	<u>704,823,685</u>	<u>966,117,341</u>	<u>637,969,724</u>	<u>2,308,910,750</u>
<b>EXPENDITURES</b>				
Health care programs	519,881,983	966,117,341	--	1,485,999,324
General welfare assistance, employment and support services	73,827,660	--	559,312,025	633,139,685
Child welfare and adult community care services	94,073,287	--	58,958,400	153,031,687
Vocational rehabilitation and services for the blind	3,749,371	--	16,885,824	20,635,195
Youth prevention, delinquency and correction services	18,635,161	--	3,197,011	21,832,172
General administration	9,653,812	--	--	9,653,812
Commission on the status of women/ commission on fatherhood	<u>93,114</u>	--	--	<u>93,114</u>
	<u>719,914,388</u>	<u>966,117,341</u>	<u>638,353,260</u>	<u>2,324,384,989</u>
<b>EXCESS OF REVENUES OVER (UNDER) EXPENDITURES</b>	(15,090,703)	--	(383,536)	(15,474,239)
<b>OTHER FINANCING SOURCES</b>				
Transfers out	<u>(115,000)</u>	--	<u>(29,512)</u>	<u>(144,512)</u>
<b>NET CHANGE IN FUND BALANCES</b>	(15,205,703)	--	(413,048)	(15,618,751)
<b>FUND BALANCES (DEFICIT) AT JULY 1, 2009</b>	<u>(54,520,576)</u>	--	<u>2,100,110</u>	<u>(52,420,466)</u>
<b>FUND BALANCES (DEFICIT) AT JUNE 30, 2010</b>	\$ <u><u>(69,726,279)</u></u>	\$ --	\$ <u><u>1,687,062</u></u>	\$ <u><u>(68,039,217)</u></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, 2010**

**Net change in fund balances - total governmental funds** \$ (15,618,751)

**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	\$	136,726	
Less current year depreciation and other changes		<u>(1,904,448)</u>	(1,767,722)

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.

1,662,555

**Change in net assets of governmental activities** \$ (15,723,918)

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, 2010**

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
<b>REVENUES</b>				
State allotments	\$ <u>791,522,712</u>	\$ <u>784,086,141</u>	\$ <u>683,915,952</u>	\$ <u>(100,170,189)</u>
<b>EXPENDITURES</b>				
Health care programs	565,261,257	564,406,547	517,486,296	46,920,251
General welfare assistance, employment and support services	101,790,755	104,301,319	103,590,628	710,691
Child welfare and adult community care services	93,934,894	86,792,042	86,060,339	731,703
Youth prevention, delinquency and correction services	18,466,685	17,199,950	15,912,086	1,287,864
General administration	8,096,944	7,581,021	7,580,773	248
Vocational rehabilitation and services for the blind	3,835,464	3,652,459	3,651,681	778
Commission on the status of women / commission on fatherhood	<u>166,713</u>	<u>152,803</u>	<u>97,292</u>	<u>55,511</u>
	<u>791,552,712</u>	<u>784,086,141</u>	<u>734,379,095</u>	<u>49,707,046</u>
<b>EXCESS OF REVENUES OVER (UNDER) EXPENDITURES</b>				
	\$ <u>          --</u>	\$ <u>          --</u>	\$ <u>(50,463,143)</u>	\$ <u>(50,463,143)</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, 2010**

			Actual on Budgetary Basis		
			Med-Quest	Human Services	Variance
			Special Revenue	Special Revenue	Favorable
	Original	Final	Fund	Fund	(Unfavorable)
REVENUES					
Intergovernmental revenues					
Med-Quest	\$ 983,391,621	\$ 983,391,621	\$ 985,719,535	\$ --	\$ 2,327,914
Human services	368,879,326	368,879,326	--	255,158,337	(113,720,989)
	<u>1,352,270,947</u>	<u>1,352,270,947</u>	<u>985,719,535</u>	<u>255,158,337</u>	<u>(111,393,075)</u>
EXPENDITURES					
Health care programs	983,391,621	983,391,621	977,638,672	--	5,752,949
General welfare assistance, employment and support services	268,075,951	268,075,951	--	207,479,588	60,596,363
Child welfare and adult community care services	66,955,540	66,955,540	--	54,871,799	12,083,741
Vocational rehabilitation and services for the blind	26,562,485	26,562,485	--	15,312,187	11,250,298
Youth prevention, delinquency and correction services	5,173,910	5,173,910	--	3,344,109	1,829,801
General administration	<u>2,111,440</u>	<u>2,111,440</u>	<u>--</u>	<u>2,058,824</u>	<u>52,616</u>
	<u>1,352,270,947</u>	<u>1,352,270,947</u>	<u>977,638,672</u>	<u>283,066,507</u>	<u>91,565,768</u>
Excess of revenues over (under) expenditures	<u>--</u>	<u>--</u>	<u>8,080,863</u>	<u>(27,908,170)</u>	<u>(19,827,307)</u>
OTHER FINANCING SOURCES (USES)					
Transfers in	--	--	--	5,051,367	5,051,367
Transfers out	<u>--</u>	<u>--</u>	<u>(5,051,367)</u>	<u>--</u>	<u>(5,051,367)</u>
	<u>--</u>	<u>--</u>	<u>(5,051,367)</u>	<u>5,051,367</u>	<u>--</u>
EXCESS OF REVENUES AND OTHER SOURCES OVER (UNDER)					
EXPENDITURES AND OTHER USES	\$ --	\$ --	\$ 3,029,496	\$ (22,856,803)	\$ (19,827,307)

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
STATEMENT OF FIDUCIARY NET ASSETS - FIDUCIARY FUNDS  
June 30, 2010**

	<u>Agency Funds</u>	<u>Private Purpose Trust Funds</u>
<b>ASSETS</b>		
Cash	\$ <u>1,548,764</u>	\$ <u>45,405</u>
Total assets	\$ <u><u>1,548,764</u></u>	\$ <u><u>45,405</u></u>
<b>LIABILITIES</b>		
Due to individuals	\$ 1,015,014	\$ --
Due to others	<u>533,750</u>	<u>--</u>
Total liabilities	\$ <u><u>1,548,764</u></u>	<u>--</u>
Net assets - held in trust		\$ <u><u>45,405</u></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, 2010**

	<u>Private Purpose Trust Funds</u>
<b>ADDITIONS</b>	
Donations	\$ <u>40,300</u>
Total additions	<u>40,300</u>
<b>DEDUCTIONS</b>	
Other	<u>5,984</u>
Total deductions	<u>5,984</u>
<b>CHANGE IN NET ASSETS</b>	34,316
Net assets at July 1, 2009	<u>11,089</u>
Net assets at June 30, 2010	\$ <u><u>45,405</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, 2010**

**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. 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, 2010**

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

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

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

**Youth Prevention, Delinquency and Correction Services:** The Office of Youth Services (OYS) develops and provides a continuum of services for youth at risk to prevent delinquency and to reduce recidivism through prevention, rehabilitation, and treatment services. Youth's needs, from prevention to incarceration to aftercare, are addressed through programs such as the Youth Services Centers, the Youth Gang Response System, and Ho'okala Adolescent Diversion as alternative to incarceration through



**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2010**

**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, 2010**

**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 GASB 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.

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

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2010**

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

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

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

The financial activities of the DHS that are reported in the accompanying fund financial statements have been classified into the following major governmental funds. In addition, a description of the DHS'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 for the proceeds of specific revenue sources that are legally restricted for specific purposes. 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, 2010**

**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 are reported as reservations of fund balances since they do not constitute expenditures or liabilities.

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

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**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

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

- (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.
  
- (7) ***Due to Individuals*** - Due to individuals represents assets held by the DHS primarily in an agent capacity and is available to individuals receiving benefits under various programs primarily through the Electronic Benefits Transfer System.
  
- (8) ***Appropriations*** - Appropriations represent the authorizations granted by the State Legislature that permit a state agency, within established fiscal and budgetary controls, to incur obligations and to make expenditures. Appropriations are allotted quarterly. The allotted appropriations lapse if not expended by or encumbered at the end of the fiscal year.
  
- (9) ***Operating Grants and Contributions*** - Federal grants and assistance awards are recorded as intergovernmental receivables and revenues when all eligibility requirements have been satisfied.
  
- (10) ***Intrafund and Interfund Transactions*** - Significant transfers of financial resources between activities included within the same fund are offset within that fund.
  
- (11) ***Risk Management*** - The DHS is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.
  
- (12) ***Deferred Compensation Plan*** - The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

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

**Department of Human Services  
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**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 2009 (Act 162, SLH 2009), and from other authorizations contained in the State Constitution, HRS, and other specific appropriation acts in various SLH.

All expenditures of these appropriated funds are made pursuant to the appropriations in the fiscal 2009 - 2011 biennial budget. The general and special revenue funds have legally appropriated annual budgets.

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

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, 2010, 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, 2010.

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

	<u>General</u>	<u>Med-Quest</u>	<u>Human Services</u>
Excess of revenues over (under) expenditures and other uses - actual on a budgetary basis	\$ (50,463,143)	\$ 3,029,496	\$ (22,856,803)
Reserved for encumbrances at fiscal year-end	14,082,603	79,052,398	54,216,164
Expenditures for liquidation of prior fiscal year encumbrances	(7,036,459)	(58,973,053)	(27,751,134)
Net changes in unreserved liabilities	1,181,540	4,948,150	(5,778,420)
Net change in accrued medical assistance payable	(19,740,000)	(40,420,000)	--
Accruals related to federal reimbursements for program expenditures	45,092,907	35,469,902	(36,022,211)
Net change in other receivables	1,791,849	(3,504,699)	(13,750)
Difference for revenues recognized for GAAP purposes	<u>--</u>	<u>(19,602,194)</u>	<u>37,793,106</u>
Net change in fund balances - GAAP basis	\$ <u>(15,090,703)</u>	\$ <u>--</u>	\$ <u>(413,048)</u>

**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, and money market funds and student loan resource securities maintaining a Triple-A rating.



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

**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.

**Cash in Bank**

The DHS maintains cash in banks which are held separately from cash in the State Treasury. As of June 30, 2010, the carrying amount of total bank deposits was approximately \$470,000 and the corresponding bank balances which are represented were approximately \$625,000.

**NOTE E - RECEIVABLES**

Receivables of the DHS, net of an allowance for doubtful accounts, consisted of the following at June 30, 2010:

	<u>General</u>	<u>Med-Quest</u>	<u>Human Services</u>
Welfare benefit overpayments	\$ 24,240,052	\$ 2,145,500	\$ 22,936,202
Medicaid providers receivable	3,381,152	--	--
QUEST premiums receivable	179,902	371,099	--
Social Security interim assistance loans	352,000	--	--
CSEA receivable	155,199	--	--
	<u>28,308,305</u>	<u>2,516,599</u>	<u>22,936,202</u>
Less allowance for doubtful accounts:			
Welfare benefit overpayments	23,110,552	2,045,500	21,865,702
QUEST premiums receivable	175,657	362,343	--
	<u>23,286,209</u>	<u>2,407,843</u>	<u>21,865,702</u>
Receivables, net	\$ <u>5,022,096</u>	\$ <u>108,756</u>	\$ <u>1,070,500</u>

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**NOTE F - CAPITAL ASSETS**

For the fiscal year ended June 30, 2010, capital assets activity for the DHS was as follows:

	Balance July 1, 2009	Additions	Disposals	Net Transfers	Other	Balance June 30, 2010
Depreciable Assets						
Building and improvements	\$ 46,630,992	\$ --	\$ --	\$ --	\$ 494,119	\$ 47,125,111
Furniture and equipment	40,455,609	96,492	--	--	24,000	40,576,101
Motor vehicles	1,788,391	40,234	102,724	(21,724)	--	1,704,177
Non-Depreciable Assets						
Land	<u>6</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>6</u>
Total at historical cost	<u>88,874,998</u>	<u>136,726</u>	<u>102,724</u>	<u>(21,724)</u>	<u>518,119</u>	<u>89,405,395</u>
Less Accumulated Depreciation:						
Building and improvements	18,980,912	1,576,679	--	--	--	20,557,591
Furniture and equipment	29,685,936	718,265	--	--	24,002	30,428,203
Motor vehicles	<u>1,517,039</u>	<u>95,225</u>	<u>102,724</u>	<u>(13,328)</u>	<u>--</u>	<u>1,496,212</u>
Total accumulated depreciation	<u>50,183,887</u>	<u>2,390,169</u>	<u>102,724</u>	<u>(13,328)</u>	<u>24,002</u>	<u>52,482,006</u>
Capital Assets, Net	\$ <u>38,691,111</u>	\$ <u>(2,253,443)</u>	\$ <u>--</u>	\$ <u>(8,396)</u>	\$ <u>494,117</u>	\$ <u>36,923,389</u>

Depreciation expense for the fiscal year ended June 30, 2010 was charged to functions/programs of the DHS as follows:

	Governmental Activities
Health care programs	\$ 221,425
General welfare assistance, employment and support services	838,208
Child welfare and adult community care services	320,714
Vocational rehabilitation and services for the blind	65,779
Youth prevention, delinquency and correction services	806,223
General administration	<u>137,820</u>
	\$ <u>2,390,169</u>

**NOTE G - ACCRUED COMPENSATED ABSENCES**

The only long-term liability of the DHS for governmental activities is for accrued compensated absences. The change in the long-term liability during the fiscal year ended June 30, 2010, was as follows:

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**NOTE G - ACCRUED COMPENSATED ABSENCES (Continued)**

	<u>Amount</u>
Balance at July 1, 2009	\$ 16,538,729
Additions	7,062,430
Reductions	<u>(8,724,985)</u>
Balance at June 30, 2010	14,876,174
Less current portion	<u>(5,400,000)</u>
	\$ <u>9,476,174</u>

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

The agency funds are purely custodial (assets equal liabilities) and thus do not involve the measurement of results of operations. The changes in assets and liabilities of the agency funds for the fiscal year ended June 30, 2010, were as follows:

	<u>Balance July 1, 2009</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2010</u>
<b>ASSETS</b>				
Cash	\$ <u>1,263,272</u>	\$ <u>152,277,282</u>	\$ <u>151,991,790</u>	\$ <u>1,548,764</u>
<b>LIABILITIES</b>				
Due to individuals and others	\$ <u>1,263,272</u>	\$ <u>152,277,282</u>	\$ <u>151,991,790</u>	\$ <u>1,548,764</u>

**NOTE I - NONIMPOSED EMPLOYEE FRINGE BENEFITS**

Payroll fringe benefit costs of the DHS's employees that are funded by state appropriations (general fund) are assumed by the State and are not charged to the DHS's operating funds. These costs, totaling approximately \$20,908,000 for the fiscal year ended June 30, 2010, have been reported as revenues and expenditures in the general fund of the DHS.

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

**NOTE J - FUND BALANCE DEFICITS**

The general, Med-Quest and Human Services special revenue funds of the DHS have deficits in the unreserved fund balances at June 30, 2010, aggregating to \$83,808,882, \$79,052,398 and \$52,529,102, respectively. Those deficits resulted primarily from expenditures being recorded on the accrual basis when incurred, and revenues being recognized only when corresponding funds are measurable and available.

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**NOTE K - INTERFUND RECEIVABLE AND PAYABLE**

The general fund had a net receivable due from the special revenue funds totaling \$45,356,822 as of June 30, 2010, for federal reimbursements of program expenditures. The Med-Quest special revenue fund had a receivable from the general fund totaling \$12,640,376 as of June 30, 2010, for overdrawn federal funds used to reimburse the State's share of program expenditures.

**NOTE L - LEASES**

The DHS leases office facilities and equipment under various operating leases expiring through 2023. Certain leases include renewal and escalation clauses. The DHS's general fund share of lease costs is paid from the State General Fund. The federal share of these lease costs allocable to programs is reported in the special revenue fund of the DHS. The following is a schedule of the federal share of minimum future lease commitments for noncancelable operating leases as of June 30, 2010:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2011	\$ 1,684,000
2012	1,175,000
2013	968,000
2014	825,000
2015	619,000
2016 - 2020	2,443,000
2021 - 2023	<u>953,000</u>
	<u>\$ 8,667,000</u>

The DHS's federal share of rent expenditures for operating leases for the fiscal year ended June 30, 2010, amounted to approximately \$1,916,000, 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.

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

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 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, 2010, 2009, and 2008 was paid from the State General Fund and totaled approximately \$8,570,000, \$10,110,000, and \$6,855,000, respectively. The DHS's federal share of pension benefits expense for the fiscal years ended June 30, 2010, 2009, and 2008 was approximately \$3,303,000, \$3,957,000, and \$5,083,000, respectively. The employer contribution rate for the fiscal years ended June 30, 2010, 2009, and 2008 was 14.58%, 14.80%, and 13.42%, respectively.

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

**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, 2010, was approximately \$5,352,000.

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 dependants.

For employees hired after June 30, 1996 but before July 1, 2001, and who retire with at less 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 at less 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.

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.

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

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 \$100 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.

**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 \$10 million.

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

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**NOTE N - RISK MANAGEMENT (Continued)**

**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, 2010, 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, 2010, was approximately \$315,000.

**NOTE O - COMMITMENTS AND CONTINGENCIES**

**Accumulated Sick Leave**

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a DHS employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the ERS. At June 30, 2010, accumulated sick leave was approximately \$43 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 P - RELATED PARTY TRANSACTIONS**

The DHS had various amounts due to the State totaling \$47,129,952 as of June 30, 2010, which included federal reimbursements for program expenditures totaling \$45,356,822, receivables totaling \$1,481,500, and cash held outside of the State Treasury totaling \$291,630.



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June 30, 2010**

**NOTE P - RELATED PARTY TRANSACTIONS (Continued)**

The State Department of Health, Adult Mental Health Division and the Child and Adolescent Mental Health Division (DOH) administers programs that qualify for federal reimbursement under the Medical Assistance Program. The DOH is responsible for paying providers for these claims and the DHS is responsible for transferring funds to the DOH for the federal share of these claims. At June 30, 2010, the estimated amount due to DOH for claims qualifying for federal reimbursement (including an estimated amount of claims incurred but not reported) totaled \$4,323,587.

## **SUPPLEMENTARY INFORMATION**

**Department of Human Services**  
**State of Hawaii**  
**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)**  
**Fiscal Year Ended June 30, 2010**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures <sup>1</sup>	Amount Provided to Subrecipient
<b>U.S. Department of Health and Human Services</b>				
Promoting Safe and Stable Families	93.556		\$ 964,901	\$ --
Temporary Assistance for Needy Families <sup>2</sup>	93.558		141,059,829	21,115,320
ARRA - Emergency Contingency Fund For Temporary Assistance For Needy Families (TANF) State Program	93.714		7,681,353	--
Low-Income Home Energy Assistance	93.568		4,986,935	217,659
Child Care and Development Block Grant <sup>2</sup>	93.575		27,606,405	6,101,014
ARRA - Child Care and Development Block Grant	93.713		3,777,803	--
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		12,509,253	--
Chaffee Education and Training Vouchers Program (ETV)	93.599		165,589	--
Head Start	93.600		89,506	--
Family Connections Grant	93.605		333,000	--
Children's Justice Grants to States	93.643		89,382	--
Child Welfare Services - State Grants	93.645		728,223	--
Foster Care - Title IV-E	93.658		18,270,832	--
ARRA - Foster Care - Title IV-E	93.658		432,519	--
Adoption Assistance	93.659		14,342,971	--
ARRA - Adoption Assistance	93.659		2,080,469	--
Social Services Block Grant <sup>2</sup>	93.667		18,117,571	2,113,818
Child Abuse and Neglect State Grants	93.669		81,850	--
Family Violence Prevention and Services/Grants for Battered Women's Shelters - Grants to States and Indian Tribes	93.671		557,907	--
Chafee Foster Care Independence Program	93.674		750,106	--
State Survey and Certification of Health Care Providers and Suppliers (Title XVIII) Medicare	93.777		499,499	--
Medical Assistance Program	93.778		727,399,745	--
ARRA - Medical Assistance Program	93.778		173,115,434	--
Children's Health Insurance Program	93.767		28,679,781	--
Medicaid Transformation Grants	93.793		2,845,128	--
Demonstration to Maintain Independence and Employment	93.769		1,961,152	--
<b>Pass-through State Department of Labor and Industrial Relations</b>				
Refugee and Entrant Assistance - State Administered Programs	93.566		44,498	--
<b>Total U.S. Department of Health and Human Services</b>			<b>\$ 1,189,171,641</b>	<b>\$ 29,547,811</b>

**Department of Human Services  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2010**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures <sup>1</sup>	Amount Provided to Subrecipient
<b>U.S. Department of Agriculture</b>				
Supplemental Nutrition Assistance Program <sup>3</sup>	10.551		\$ 345,020,704	\$ --
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	10.561		14,363,610	1,387,506
National School Lunch Program	10.555		70,725	--
School Breakfast Program	10.553		45,498	--
<b>Total U.S. Department of Agriculture</b>			<u>359,500,537</u>	<u>1,387,506</u>
<b>U.S. Department of Justice</b>				
Juvenile Justice and Delinquency Prevention - Allocation to States	16.540		297,791	252,201
Title V - Delinquency Prevention Program	16.548		76,179	76,251
Juvenile Accountability Block Grant	16.523		252,633	237,215
Crime Victim Assistance	16.575		153,403	--
<b>Total U.S. Department of Justice</b>			<u>780,006</u>	<u>565,667</u>
<b>U.S. Department of Labor</b>				
Pass-through State Department of Labor and Industrial Relations Senior Community Service Employment Program	17.235	PY08-SCSEP-CC-DHS	319,341	--
<b>Total U.S. Department of Labor</b>			<u>319,341</u>	<u>--</u>
<b>U.S. Department of Education</b>				
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126		8,262,478	486,930
Independent Living - State Grants	84.169		388,417	242,843
Rehabilitation Services - Independent Living Services for Older Individuals Who are Blind	84.177		229,251	--
Supported Employment Services for Individuals with Significant Disabilities	84.187		192,021	99,700
Assistive Technology	84.224		467,852	296,359
Rehabilitation Training - State Vocational Rehabilitation Unit In-Service Training	84.265		21,199	--
Rehabilitation Long-Term Training	84.129		121,789	--
ARRA - Rehabilitation Services - Vocational Rehabilitation Grants to States, Recovery Act	84.390		572,732	--
ARRA - Independent Living Services for Older Individuals Who are Blind, Recovery Act	84.399		\$ 19,795	\$ --

**Department of Human Services  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2010**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures <sup>1</sup>	Amount Provided to Subrecipient
ARRA - Independent Living State Grants, Recovery Act	84.398		\$ 55,281	\$ --
Safe and Drug-Free Schools and Communities - State Grants	84.186		<u>287,936</u>	<u>277,879</u>
<b>Total U.S. Department of Education</b>			<u>10,618,751</u>	<u>1,403,711</u>
<b>Corporation for National and Community Service</b>				
Foster Grandparent Program	94.011		446,259	--
Senior Companion Program	94.016		398,750	--
Retired and Senior Volunteer Program	94.002		<u>52,661</u>	<u>--</u>
<b>Total Corporation for National and Community Service</b>			<u>897,670</u>	<u>--</u>
<b>Social Security Administration</b>				
Social Security - Disability Insurance	96.001		<u>6,469,869</u>	<u>--</u>
<b>Total Social Security Administration</b>			<u>6,469,869</u>	<u>--</u>
<b>U.S. Department of the Interior</b>				
Pass-through the State Governor's office				
Economic, Social, Political Developments of the Territories	15.875		<u>21,800,019</u>	<u>--</u>
<b>Total U.S. Department of the Interior</b>			<u>21,800,019</u>	<u>--</u>
<b>TOTAL FEDERAL EXPENDITURES</b>			<u>\$ 1,589,557,834</u>	<u>\$ 32,904,695</u>

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

<sup>2</sup> Grant awards totaling \$24,740,000 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 (\$14,850,000).

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

## **PART II**

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

**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, 2010, which collectively comprise the DHS's basic financial statements and have issued our report thereon dated March 18, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

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

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. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying schedule of findings and questioned costs, that we consider to be significant deficiencies in internal control over financial reporting. We consider the deficiency described in the accompanying schedule of findings and questioned costs as item 2010-01 to be a significant deficiency.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the DHS's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

This report is intended solely for the information and use of the Office of the Auditor, management of the DHS, 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, 2011



### **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, 2010. 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 2010-02 to 2010-06 in the accompanying schedule of findings and questioned costs, the DHS did not comply with the following requirements:

<b>CFDA Number</b>	<b>Name of Federal Program</b>	<b>Type of Compliance Requirement</b>	<b>Ref. No.</b>
93.778	Medical Assistance Program	Activities Allowed, Allowable Costs, Eligibility, and Special Tests and Provisions	2010-02 - 2010-06
93.575, 93.713 and 93.596	Child Care Cluster	Activities Allowed and Eligibility	2010-07, 2010-08

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, 2010. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 2010-09.

### **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 2010-02 to 2010-08 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 2010-09 to be a significant deficiency.

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.

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

*N&K CPAs, Inc.*

Honolulu, Hawaii  
March 18, 2011

**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, 2010**

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

**Financial Statements**

Type of auditors' report issued:	Unqualified	
Internal control over financial reporting:		
Material weakness(es) identified?	<input type="checkbox"/> yes	<input checked="" type="checkbox"/> no
Significant deficiency(ies) identified?	<input checked="" type="checkbox"/> yes	<input type="checkbox"/> none reported
Noncompliance material to the financial statements noted?	<input type="checkbox"/> yes	<input checked="" type="checkbox"/> no

**Federal Awards**

Internal control over major program:		
Material weakness(es) identified?	<input checked="" type="checkbox"/> yes	<input type="checkbox"/> no
Significant deficiency(ies) identified	<input checked="" type="checkbox"/> yes	<input type="checkbox"/> none reported
Type of auditors' report issued on compliance for major programs:	Qualified	
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of OMB Circular A-133?	<input checked="" type="checkbox"/> yes	<input type="checkbox"/> no

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
10.551	Supplemental Nutrition Assistance Program
10.561	State Administrative Matching Grants for the Supplemental Nutrition Assistance Program
15.875	Economic, Social, Political Developments of the Territories
84.126	Rehabilitation Services - Vocational Rehabilitation Grants to States
84.390	Rehabilitation Services - Vocational Rehabilitation Grants to States - ARRA
93.558	Temporary Assistance for Needy Families
93.568	Low Income Housing Energy Assistance
93.575	Child Care and Development Block Grant
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund
93.658	Foster Care - Title IV-E
93.659	Adoption Assistance
93.667	Social Services Block Grant
93.713	Child Care and Development Block Grant - ARRA
93.714	Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program
93.767	Children's Health Insurance Program
93.777	State Survey and Certification of Health Care Providers and Suppliers
93.778	Medical Assistance Program

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

**SECTION I - SUMMARY OF AUDITORS' RESULTS (Continued)**

Dollar threshold used to distinguish between Type A and Type B programs:	\$4,768,696	
Auditee qualified as a low-risk auditee?	<input type="checkbox"/> yes	<input checked="" type="checkbox"/> no

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

**SECTION II - FINANCIAL STATEMENT FINDINGS**

**Ref.**

**No.**

**Internal Control Findings**

**2010-01 Properly Record All Capital Assets in the State Property Inventory Records**

All divisions of the DHS are responsible for reporting the acquisition and disposal of capital assets to the State Procurement Office on a quarterly basis to update the state property inventory records. The Department of Accounting and General Services (DAGS) uses the information from the state property inventory records to assist the DHS in compiling the department's capital assets and depreciation information for the fiscal year. We noted that during the fiscal year ended June 30, 2010, the DHS reported \$89,793 in capital asset additions (\$47,473, net of accumulated depreciation) that were purchased in prior fiscal years.

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

We noted that the DHS is properly adding the capital assets to the state property inventory control records, however, the information from the state property inventory control records were now always included in the capital asset listing in the proper period.

**Recommendation**

To ensure that the state property inventory records are complete and accurate, the DHS should implement a process to review, in a timely manner, the transactions that are posted to the department property inventory records to ensure that acquisitions and dispositions were properly posted to the state property inventory records and included in the capital asset listings used for financial reporting.



**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

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

<b>Ref. <u>No.</u></b>	<b>Compliance and Internal Control Findings</b>	<b><u>Questioned Costs</u></b>
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**2010-02 Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.778  
Medical Assistance Program

The development and administration of the State's Medicaid Assistance Program (MAP) is the responsibility of the Med-QUEST Division (MQD). The DHS information retrieval and non-drug claims processing system is the Hawaii Prepaid Medical Management Information System (HPMMIS). The HPMMIS is operated and maintained by the Arizona Health Care Cost Containment System (AHCCCS). In addition, the management and processing of the DHS's pharmacy benefits is contracted to Affiliated Computer Services, Inc. (ACS).

Due to the complexity of the Medicaid program operations and the large volume of transactions, much reliance is placed on HPMMIS and its system of internal controls to accurately maintain enrollment and participant data and to ensure Medicaid costs are allowable, properly coded and accurately paid. Title 42 CFR Part 456 Subpart A requires a statewide program of control of the utilization of all Medicaid services.

During our review of internal controls, we noted that the primary controls used to prevent unnecessary utilization of care and services and to ensure proper and accurate payment of Medicaid claims were front-end controls such as pre-payment edit functions contained in HPMMIS and an extensive list of medical services and procedures which require prior authorization. However, we noted a lack of back-end control activities such as a post payment review of a sample of Medicaid claims or a review of utilization data for potentially fraudulent or abusive activity. Furthermore, for certain back-end control activities performed by the quality improvement organization (QIO) formerly known as peer review organization, we noted a lack of follow-up by the DHS on findings and recommendations reported.

More specifically, we noted the following conditions:

- The Surveillance and Utilization Review Subsystem (SURS) reports are still not being used to effectively identify potential fraud or abuse. Due to a lack of meaningful, user friendly SURS reports needed to identify potential fraud and abuse cases, minimal resources were dedicated to SURS review.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

<b><u>Ref. No.</u></b>	<b><u>Compliance and Internal Control Findings (Continued)</u></b>	<b><u>Questioned Costs</u></b>
<b>2010-02</b>	<p><b>Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims (Continued)</b></p> <p>Instead, SURS personnel were assigned to rate setting functions, follow-up of Payment Error Rate Measurement (PERM) audits and follow-up of other open recovery efforts. As a result, there were no cases referred to the Medicaid Fraud Control Unit (MFCU) which operates under the State Attorney General's office based on the review of SURS reports. Any referrals from the SURS unit in fiscal year 2010 originated from public phone calls reporting potential fraud or abuse. The DHS continues to be in noncompliance with Title 42 CFR Part 456.23, which requires the DHS to have a post payment review process that allows DHS personnel to review recipient utilization and provider service profiles and exception criteria to identify and correct misutilization practices of recipients and providers. In June 2010, MQD developed a Data Storage Warehouse to replace the current SURS reports; however, to date adequate training has not yet been provided. Therefore, new system reports to be used for identification of fraud and abuse have not yet been generated.</p> <ul style="list-style-type: none"> <li>• The DHS continues to be in noncompliance with Title 42 CFR Part 455.13 which requires the DHS to have methods for identification, investigation, and referral of fraudulent activity. The Medicaid Investigations Unit (MIU) is an important component of this process. In the past, this unit was comprised of one individual and in June 2008, this individual retired from the DHS and to date the position remains vacant. The DHS currently has almost no formal activities to identify and investigate suspected fraud. As a result, referrals of potential fraudulent activities to the MFCU only originate from complaints received via the MQD phone line. Previous reviews performed by the Centers for Medicare and Medicaid Services (CMS), the U.S. federal agency which administers the Medicaid program, also revealed a lack of communication and coordination of efforts between the DHS and MFCU. During fiscal year 2010, MQD did attend monthly meetings with the State Attorney General's MFCU.</li> <li>• There is no formal ongoing post payment review of a sample of claims. It has been over seven years since the last third party review was performed, which focused on pharmacy claims 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.</li> </ul>	

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
<b>2010-02</b>	<p><b>Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims (Continued)</b></p> <p>As part of our review of internal controls, we performed a test of drug and non-drug claims. Results of prior years' testing identified a provider billing/system error. The errors were identified as a provider billing error of non-emergency transportation services being billed twice which the system improperly overpaid. The error was previously identified by the MQD during fiscal year 2008, however, the HPPMIS system was not corrected until January 2009 and a memo to providers informing them of the proper billing of non-emergency transportation was not sent until January 29, 2009. During October 2010, recovery letters were sent out to Non-emergency Transportation Providers totaling approximately \$1,075,000.</p> <p>Another example of the MQD's inability to implement policy changes or system changes in a timely manner is the system change required by the change in policy for the payment of Medicare crossover claims. The change in policy took effect in fiscal year 2004, and the system change was not completed until fiscal year 2008. As of June 30, 2010, the balance of these provider overpayments was approximately \$1,100,000.</p> <ul style="list-style-type: none"> <li>The DHS has contracted a QIO 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. However, due to a lack of staffing, follow-up activities such as ensuring recovery of overpayments and monitoring of QIO performance is not being performed. For example, the last recoupment of acute and ambulatory surgery service claims found to be at the incorrect level of care or not medically necessary dates back to the fourth quarter of fiscal year 2008. As of June 30, 2010, there were still over 230 days of services that were found to be inappropriate for which no recoveries have been made.</li> </ul>	

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
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**2010-02 Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims (Continued)**

In fiscal year 2010, total federal expenditures by DHS for this program was approximately \$901,000,000. In terms of dollars spent, Medicaid is the largest federal grant program in the United States and is considered a program of higher risk. Therefore, the DHS's inability to effectively implement and operate a system to control utilization and maintain program integrity results in noncompliance with federal guidelines and an increase in risk that fraudulent activity will go undetected and that unallowable costs will be charged to the federal grant.

\$           --          

**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 needs to be made a higher priority. The DHS should consider the following:

- Allocate the necessary resources needed to perform the SURS function and to actively identify and investigate suspected fraud as required by Title 42 CFR Part 456.23 and Title 42 CFR Part 455.13.
- Complete the development of meaningful SURS reports using the Data Storage Warehouse and regularly analyze the reports. The analysis of these reports should help identify exceptions or abnormal patterns of treatment or service and allow for the correction of misutilization practices of recipients and providers. It also serves as an important tool to identify and investigate potential fraudulent behavior.
- 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.
- Take timely corrective action on problems or noncompliance identified by its QIO such as recovery of overpayments and implementation of recommendations issued.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned Costs</b>
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**2010-03 Reconcile Federal Award Drawdowns**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.778  
Medical Assistance Program

The Med-QUEST Division (MQD) administers the Medicaid Program for the State of Hawaii (State). Costs of the Medicaid program are first paid from allotments of State general funds after which MQD requests reimbursements from federal grant awards based on a Federal Participation rate of approximately 64%, which includes enhanced funding under the American Recovery and Reinvestment Act of 2010 (certain expenditures do not qualify for federal reimbursements while other expenditures are reimbursed at higher rates). This cost reimbursement basis is a federal compliance requirement. In complying with this federal requirement, the DHS initially uses its general funds to pay for the federal share of the expenditures and reimburses the general fund once the federal funds are received. The Medicaid Program is the largest federally funded program administered by the DHS (approximately \$900 million in federal funds for the fiscal year ended June 30, 2010) and the amount of federal funding earned by the State is generally based on a Federal Medical Assistance Percentage rate (FMAP) multiplied by the amount of expenditures incurred during the quarter.

In the fiscal year ended June 30, 2009 audit, we noted that the MQD was overdrawn on their federal grant awards by approximately \$21 million. During the current fiscal year, the overdraw of federal grant awards had increased to as much as \$76 million and at June 30, 2010, the amount had been reduced to approximately \$33.1 million and was fully repaid by the end of the subsequent quarter.

As reported in the prior fiscal year, the lack of ongoing quarterly reconciliations between the earned federal share of expenditures and the amount of federal awards drawn resulted in the MQD's overdrawn status. During the current fiscal year, MQD attempted to perform the reconciliations; however, the MQD did not properly account for adjustments that reduced the federal share of expenditures when drawing down the federal funds, thus placing the MQD into an overdrawn status.

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**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

<b>Ref. <u>No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned <u>Costs</u></b>
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**2010-03 Reconcile Federal Award Drawdowns (Continued)**

**Recommendation**

The MQD should develop a reconciliation process between the quarterly federal reports and the amounts recorded in the DHS's financial records. This process should be done in a timely manner and include a subsequent review and approval of such reconciliations. Management of the DHS should determine whether sufficient and appropriate accounting staffing is available at the MQD to properly complete reconciliations in a timely manner.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned Costs</b>
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**2010-04 Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.778  
Medical Assistance Program

Title 42 CFR Part 435.911 requires the DHS to determine the eligibility of individuals who apply for Medicaid benefits within 45 days from the date of application. Applications that are not reviewed within 45 days are presumed to be eligible, resulting in the risk that ineligible recipients may be receiving Medicaid benefits. Furthermore, Title 42 CFR Part 435.916 also requires annual re-verifications of participant eligibility.

Since June 2008, Medicaid enrollment has increased more than 22% to approximately 211,000 as of June 30, 2010. The MQD has been steadily shifting its Medicaid population from its fee-for-service program where providers are paid directly for their services to its managed care program, QUEST Hawaii (QUEST), where a monthly capitation payment is made for each member enrolled. In February 2009, the DHS implemented its QUEST Expanded Access Program (QExA) for Medicaid members who are 65 years or older or disabled of all ages, which resulted in an additional 40,000 members who were previously receiving services through a fee-for-service system. The increasing QUEST population further heightens the importance of the eligibility process.

The DHS is still behind in its processing of Medicaid applications and annual eligibility re-verifications. The number of applications outstanding longer than 45 days increased to 1,147 as of June 30, 2010, which is an increase of approximately 25% from the overdue applications as of June 30, 2009. The number of overdue annual re-verifications increased to 2,608 as of June 30, 2010, which is an increase of approximately 53% as compared to the overdue re-verifications as of June 30, 2009.

In addition, the most recent Payment Error Rate Measurement (PERM) audit performed by CMS for federal fiscal year 2008, found 113 cases with an eligibility error, 104 of them were classified as undetermined cases due to insufficient documentation. Contributing to the number of errors was the passive renewal process. In response to the large number of past due eligibility re-verifications, the DHS adopted a passive renewal process for all Medicaid cases with children. Under passive renewal, if recipients do not respond to annual re-verification requests they automatically remain eligible because no response is interpreted as no change.

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**Department of Human Services**  
**State of Hawaii**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
**Fiscal Year Ended June 30, 2010**

<b>Ref. <u>No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned <u>Costs</u></b>
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**2010-04 Complete Eligibility Applications and Annual Eligibility Re-  
verifications in a Timely Manner (Continued)**

**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 as required by federal regulations in order to reduce the risk that ineligible recipients are receiving Medicaid benefits. In addition, the DHS should consider eliminating the passive renewal process or at a minimum maintain documentation to support participant eligibility.



**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

<b>Ref. <u>No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
<b>2010-05</b>	<b>Perform ADP System Risk Analysis and System Security Review</b>	
	<p>Federal agency: U.S. Department of Health and Human Services CFDA 93.778 Medical Assistance Program</p> <p>During our review of special test and provisions for the Medicaid Assistance Program, we noted that the last Automatic Data Processing (ADP) system risk analysis and system security review was conducted in April 2008, resulting in noncompliance with federal guidelines governing periodic review of the ADP system.</p> <p>Title 45 CFR Part 95.621 requires the DHS to conduct a review of the ADP system to ensure that appropriate, cost effective safeguards are incorporated into the 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>	\$ <u>          --</u>
	<b>Recommendation</b>	
	To ensure compliance with federal regulations, the DHS should allocate the necessary resources needed to perform the ADP risk analysis and system security review on a biennial basis.	

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned Costs</b>
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**2010-06 Monitor the Medicaid Drug Rebate Program**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.778  
Medical Assistance Program

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

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

While the day-to-day operations of the drug rebate program have been subcontracted to ACS, the DHS is still ultimately accountable for the drug rebate program. Much reliance is placed on ACS to operate the drug rebate program, but there is still no monitoring of subcontractor activities. This lack of oversight of ACS could result in future noncompliance with CMS guidelines such as issues which occurred under the previous fiscal agent. The DHS has completed the reconciliation of past payments and related interest dating as far back as 1991 and determined that remaining outstanding balances should be written-off as these amounts were erroneously posted or have already been collected. The balance remaining on the rebate receivable ledger totaled approximately \$6.3 million. The DHS is currently working with the Attorney General's Office on legal write-offs of uncollectible receivable balances.

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**Recommendation**

The DHS should establish formal procedures to monitor its subcontractor to ensure the drug rebate program operates in compliance with CMS guidelines and help identify issues timely. In addition, the DHS should resolve outstanding issues on a timely basis.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
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**2010-07 Maintain All Required Documentation in Child Care Case Files**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.575, 93.596, and 93.713  
Child Care and Development Block Grant  
Child Care Mandatory and Matching Funds of the Child Care and  
Development Fund  
ARRA – Child Care and Development Block Grant

For the fiscal year 2010, total federal expenditures for the Child Care Cluster by the DHS was approximately \$42,100,000. During our testing of eligibility and allowability, we noted eleven instances in which documentation to support eligibility determinations was not always maintained or supporting documentation for the calculation of child care payments was either missing or incorrect resulting in overpayments totaling \$50,837.

Title 45 CFR Part 98.65(e) requires that appropriate documentation be maintained to allow the verification that child care federal funds are expended in accordance with the statutory and regulatory requirements.

\$ 50,837

**Recommendation**

The DHS should ensure that required documents are maintained in each case file to support the allowability and eligibility of the child care payments claimed for federal reimbursement. The DHS should perform secondary reviews on a sample basis in order to assess case manager performance.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
<b>2010-08</b>	<b>Improve the Accuracy of Child Care Reimbursements</b>	
	<p>Federal agency: U.S. Department of Health and Human Services CFDA 93.575, 93.596, and 93.713 Child Care and Development Block Grant Child Care Mandatory and Matching Funds of the Child Care and Development Fund ARRA - Child Care and Development Block Grant</p> <p>For the fiscal year 2010, total federal expenditures for the Child Care Cluster was approximately \$42,100,000. During our testing of allowability and eligibility for the Child Care payments, we noted four benefit payment errors. The errors were a result of case worker error or oversight such as the incorrect co-pay percentage being applied and the incorrect reimbursement calculation based on the level of child care need. The errors noted resulted in net overpayments totaling \$2,673.</p>	\$ <u><u>2,673</u></u>
	<b>Recommendation</b>	
	<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>	

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2010**

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned Costs</b>
<b>2010-09</b>	<b>Submit Financial Status Report Timely</b>	
	Federal agency: U.S. Department of Health and Human Services CFDA 93.568 Low-Income Housing Energy Assistance Program	
	Federal agency: U.S. Department of Health and Human Services CFDA 93.778 Medical Assistance Program	
	Federal agency: U.S. Department of Health and Human Services CFDA 93.767 Children's Health Insurance Program	
	During our testing of reporting for the Medical Assistance Program, we noted Form CMS-64, Quarterly Medicaid Assistance Expenditures for the Medical Assistance Program and Form CMS-21, Quarterly Children's Health Insurance Program Statement of Expenditures for Title XXI for the quarter ended June 30, 2010, were not submitted until August 5, 2010, resulting in noncompliance with federal guidelines governing timely submission of reports.	
	Title 42 CFR Part 430.30 and Title 42 CFR Part 457.740 requires the DHS to submit Form CMS-64 and CMS-21 no later than 30 days after the end of each quarter to permit accountability of funds to a level of expenditure adequate to establish that such funds have been used within restrictions of the program.	
	During our testing of reporting for the Low-Income Housing Energy Assistance Program (LIHEAP), we noted OMB Standard Form 269A, Financial Status Report (short form) for the federal grant period ended September 30, 2009 was not submitted until December 20, 2010, resulting in noncompliance with federal guidelines governing timely submission of reports.	
	Title 45 CFR Part 96.30 requires the DHS to submit OMB Standard Form 269A within 90 days of the close of the applicable statutory grant periods to permit accountability of funds to a level of expenditure adequate to establish that such funds have been used within restrictions of the program.	\$ <u>          --          </u>

**Recommendation**

The DHS should establish procedures to ensure that the OMB Standard Form 269A, Form CMS-64 and CMS-21 are submitted in a timely manner. The personnel responsible for the preparation and review of the forms should utilize a checklist of reporting due dates as a reminder.

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

**Department of Human Services  
State of Hawaii  
STATUS REPORT  
Fiscal Year Ended June 30, 2010**

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, 2009, dated March 30, 2010.

**SECTION II - FINANCIAL STATEMENT FINDINGS**

<b>Recommendations</b>					<b>Status</b>
<b>2009-01</b>	<b>Reconcile</b>	<b>Federal</b>	<b>Award</b>	<b>Drawdowns</b>	
	<b>(pages 63-64)</b>				
	The MQD should develop a reconciliation process between the quarterly federal reports and the amounts recorded in the DHS's financial records. This process should be done in a timely manner and include a subsequent review and approval of such reviews. Management of the DHS should determine whether sufficient and appropriate accounting staffing is available at the MQD to properly complete reconciliations in a timely manner.				Not accomplished. See Reference No. 2010-03.
<b>2009-02</b>	<b>Properly Record All Capital Assets in the State Property Inventory Records (page 65)</b>				
	To ensure that the state property inventory records are complete and accurate, the DHS should implement monitoring procedures to ensure that all appropriate personnel accurately report all fixed asset acquisitions and dispositions to the State Procurement Office on a quarterly basis. The DHS should also implement a process to review, in a timely manner, the transactions that are posted to the department property inventory records to ensure that acquisitions and dispositions were properly posted to the state property inventory records.				Not accomplished. See Reference No. 2010-01

**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2010**

**SECTION II - FINANCIAL STATEMENT FINDINGS  
(Continued)**

<u>Recommendations</u>	<u>Status</u>
<p><b>2009-03    Maintain Vacation and Sick Leave Records Properly (page 66)</b></p> <p>We recommend that the amounts of vacation and sick leave balance being reported are validated against personnel and payroll records to ensure accuracy and completeness before reporting the balance to the State Comptroller. The DHS should also increase the number of random quality control reviews of leave records to ensure that vacation and sick leave records are accurately maintained on a timely basis.</p>	<p>Accomplished.</p>
<p><b>2009-04    Reconcile EBT Benefits Available and Cash Balance (page 67)</b></p> <p>The DHS should reconcile benefits available per the JP Morgan statement and the cash balance in the local bank account on a monthly basis for both JP Morgan accounts. The monthly reconciliation will ensure that the amounts due to individuals have been properly recorded and supported.</p>	<p>Accomplished.</p>



**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2010**

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

<u>Recommendations</u>	<u>CFDA Number</u>	<u>Status</u>
<b>2009-05 Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims (pages 68 - 72)</b>	<b>93.778</b>	Not accomplished. See Reference No. 2010-02.
<p>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 consider the following:</p> <ul style="list-style-type: none"> <li>• Allocate the necessary resources needed to perform the SURS function and actively identify and investigate suspected fraud as required by Title 42 CFR Part 456.23 and Title 42 CFR Part 455.13.</li> <li>• Complete the development of meaningful SURS reports and regularly analyze the reports. The analysis of these reports should help identify exceptions or abnormal patterns of treatment or service and allow for the correction of misutilization practices of recipients and providers. It also serves as an important tool to identify and investigate potential fraudulent behavior.</li> <li>• Given the high percentage of claims submitted via electronic media, the DHS should reinstitute the electronic media claims (EMC) audits performed by third parties. EMC audits increase controls over the accuracy of claims and provides an opportunity to increase provider education that reduces risks of unintentional errors in future claims. It may also serve as a valuable referral source of potential fraud to the MIU.</li> <li>• Perform regular post payment reviews on a sample of drug and non-drug claims paid to detect processing errors and identify ways to improve the claims processing system and procedures.</li> <li>• Implement proper corrective action on problems or noncompliance identified by its QIO such as recovery of overpayments and implementation of recommendations issued.</li> </ul>		

**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2010**

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

<u>Recommendations</u>	<u>CFDA Number</u>	<u>Status</u>
<p><b>2009-06 Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner (page 73)</b></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 as required by federal regulations in order to reduce the risk that ineligible recipients are receiving Medicaid benefits.</p>	<b>93.778</b>	Not accomplished. See Reference No. 2010-04.
<p><b>2009-07 Monitor the Medicaid Drug Rebate Program (page 74)</b></p> <p>The DHS should establish formal procedures to monitor its subcontractor to ensure the drug rebate program operates in compliance with CMS guidelines and help identify issues timely. In addition, the DHS should resolve outstanding issues on a timely basis.</p>	<b>93.778</b>	Not accomplished. See Reference No. 2010-06.
<p><b>2009-08 Maintain All Required Documentation in Child Care Case Files (page 75)</b></p> <p>The DHS should ensure that all 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>	<b>93.575 93.596</b>	Not accomplished. See Reference No. 2010-07.

**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2010**

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

<u>Recommendations</u>	<u>CFDA Number</u>	<u>Status</u>
<b>2009-09 Improve the Accuracy of Child Care Reimbursements (page 76)</b>	<b>93.575 93.596</b>	
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.		Not accomplished. See Reference No. 2010-08.

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

NEAL ABERCROMBIE  
GOVERNOR



PATRICIA MCMANAMAN  
DIRECTOR

PANKAJ BHANOT  
DEPUTY DIRECTOR

STATE OF HAWAII  
**DEPARTMENT OF HUMAN SERVICES**

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

March 28, 2011

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

Dear Mr. Shiigi:

Attached are the Department of Human Services' responses and corrective action plans related to your fiscal year 2010 audit report findings and recommendations. We appreciate the opportunity to comment on the audit report.

Sincerely,

A handwritten signature in black ink, appearing to be "Patricia McManaman", written over a horizontal line.

Patricia McManaman  
Director

Attachment

AN EQUAL OPPORTUNITY AGENCY

**Ref. No. 2010-01**

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

**Auditor's  
Recommendation:**

To ensure that the state property inventory records are complete and accurate, the DHS should implement a process to review, in a timely manner, the transactions that are posted to the department property inventory records to ensure that acquisitions and dispositions were properly posted to the state property inventory records and included in the capital asset listings used for financial reporting.

**Corrective Action  
Taken or Planned:**

The Department uses the detailed procedures outlined in the Department of Accounting and General Services (DAGS) Inventory System Manual and the Hawaii Administrative Rules (HAR) to provide instructions and guidelines for all DHS offices with inventory responsibilities. In addition, the department issues internal circulars and memorandums that serve to update any inventory changes, any changes to the HAR, and to provide clarification or information that is necessary for proper inventory reporting. The Inventory System Manual, the HAR, the FMO Circulars and memorandums all serve to provide guidelines and procedures for proper and timely inventory reporting. As such, all departmental personnel with inventory responsibilities are made knowledgeable of the proper inventory procedures and reporting requirements

In March 2003, stricter departmental inventory procedures were issued establishing each employee as being responsible and accountable for maintaining and safeguarding inventory assigned to the individual. In addition, property custodians are assigned to each office/unit and are responsible for fixed assets under their management. The statewide inventory system reports and distributes information for all transactions that have not posted properly to the state inventory. These transaction registers are distributed regularly after each inventory period (i.e. quarterly) to be reviewed by the affected offices. The transactions must be corrected and submitted to ensure that the transactions are properly posted.

The Department is also required and continues to reconcile on a quarterly basis, the State Procurement Office (SPO)-Inventory Management Branch (IMB) report, Reconciliation of FAMIS Expenditures for State Property. This report requests verification that the Department's FAMIS (Financial and Accounting Management Information System) expenditure transactions for state properties are recorded in the DAGS, Fixed Asset Inventory System (FAIS). This statewide monitoring and reconciliation process was implemented to strengthen the financial reporting integrity of the FAIS.

DAGS-IMB recognizes that the FAIS needs to be modified in order to provide the necessary financial reporting capabilities relative to GASB Statement 34 and other related requirements. The development of a new comprehensive FAIS will require funding and resources.

Concerning the reporting of repairs and maintenance expenditures, the Department's Accounting Staff will review expenditures in this class to assist the purchasing offices in the appropriate coding of these transactions for financial reporting purposes.

Furthermore, the Department will coordinate with DAGS on any data irregularities and issue additional departmental procedures on the reporting requirements for capital assets. Some acquisitions may have not been included in the capital assets listing due to incorrect classification codes used for FAIS inventory reporting.

End Date: Ongoing

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

**Ref. No. 2010-02      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 needs to be made a higher priority. The DHS should consider the following:

- Allocate the necessary resources needed to perform the SURS function and to actively identify and investigate suspected fraud as required by Title 42 CFR Part 456.23 and Title 42 CFR Part 455.13.
- Complete the development of meaningful SURS reports using the Data Storage Warehouse and regularly analyze the reports. The analysis of these reports should help identify exceptions or abnormal patterns of treatment or service and allow for the correction of misutilization practices of recipients and providers. It also serves as an important tool to identify and investigate potential fraudulent behavior.
- 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.

- Take timely corrective action on problems or noncompliance identified by its QIO such as recovery of overpayments and implementation of recommendations issued.

Corrective Action  
Taken or Planned:

**Allocate necessary resources to perform the SURS function.**

- Will work towards Program Integrity's (PI) having a vital role in the MQD. PI continues to be necessary even though the MQD is primarily managed care. Request will be made to re-establish and fill the SURS nurse position that was eliminated in the reduction-in-force in 2009.
- CMS has created the Medicaid Integrity Institute (MII) located at the Dept of Justice, National Advocacy Center to provide training on Fraud and Abuse related topics to State Medicaid program integrity staff. The SURS/program integrity staffs have taken courses from the MII and will continue to attend training courses to gain the knowledge on the best ways to fight Medicaid fraud and abuse.
- Medicaid program has hired an investigator as of January 2011. The investigator will identify and investigate suspected fraud as required by CFR.
- There have been ongoing monthly meetings for case discussion and the exchange of information between the Medicaid Fraud Control Unit (MFCU) and the SURS unit. There also have been ongoing phone calls/interactions between the two departments to discuss ongoing cases.
- SURS staff has assisted in the PERM and Medicaid Integrity Contractors audits, which are a form of post-payment reviews done by CMS. This has helped the State to identify areas of potential fraud and abuse for investigation.

**Complete the development of meaningful SURS reports.**

- Will recommend creating a data analyst position giving priority to the Finance Office and Financial Integrity Staff. This position will utilize the DSW and the SURS system to generate and analyze reports specifically for the SURS staff. In addition, this position will be tasked with designing and drafting ad hoc reports from the DSW as required by the investigator, SURS staff, TPL & FO staff.
- Arizona has recently awarded a contract for a SURS subsystem that would be able to produce meaningful reports from the data storage warehouse. Training to be provided to SURS staffs on how to obtain meaningful reports from the data storage warehouse and SURS subsystem. A data analyst would then be able to analyze



and identify provider exemptions or abnormal patterns of treatment of services from the reports obtained from the SURS subsystem. The development of new meaningful SURS reports will help SURS staff to identify provider aberrances or abnormal patterns of treatment or services.

- Although there were no referrals to Medicaid Fraud Control Unit (MFCU) that resulted in criminal/civil prosecution from the current SURS reports, post payment reviews that were done by SURS staff have resulted in the following: recoupment of overpayments from providers, provider education for incorrect billing via provider memos and letters, changes to claims system with new systems edits in place, and changes to strengthen the language in the Medicaid provider manual. Newly created reports that identify provider exemptions or abnormal patterns of treatment of services will increase the number of referrals to MFCU.

#### **Perform regular post payment reviews.**

- The State is currently working on a request for proposal for a recovery audit contractor (RAC) as required by CMS. The RFP to include the RAC contractor to perform post payment reviews on a sample of non-drug claims to detect processing errors and to identify ways to improve the claims processing system. ACS PBM to perform post payment reviews on drug claims.
- Also refer to the CAP plan under the first recommendation since SURS activities are viewed as a post-payment review.

#### **Timely Corrective Action on Problems or Noncompliance - Peer Review Organization (PRO)**

##### **1. Recovery of Recoupment**

MQD is drafting recovery letters for 230 days of inappropriate services for signature by Med-QUEST Division (MQD) Administrator. MQD will require that providers submit payments to the Department of Human Services (DHS) within thirty (30) days of receipt for recoupment.

Completion date for sending letters: May 15, 2011

Completion date for recoveries: June 30, 2011

##### **2. Quality Oversight**

MQD has contracted a Peer Review Organization (PRO), Health Services Advisory Group (HSAG), to perform utilization control activities such as acute hospital reviews, pre-admission screening and resident reviews (PASRR) for nursing facilities (long-term care) level of care (NF LOC) determinations. DHS conducted a comprehensive audit in 2007. A corrective action plan (CAP) was required based

upon the audit results. HSAG finalized all of their CAP requirements and the DHS closed the CAP in 2009. MQD provides continual oversight of HSAG to include formal discussions, written documentation and mandated Inter-rater Reliability Reviews (IRR) on all PRO activities.

Below describes the frequency of HSAG reporting as well as the steps taken by MQD regarding the reports:

- Monthly
  - Status update on the data elements associated with all of their utilization review areas (acute hospital, PASRR, and LTC LOC reviews)
  - Monthly report listing noncompliant facilities reviewed for the PASRR process
  - Monthly meeting with MQD to review the report information
  - Full-access to all of the NF LOC software (called HI-LOC)
- Quarterly
  - Status update on the data elements associated with all of their utilization review areas
  - IRR is performed by a Registered Nurse on the acute hospital, NF LOC, and PASRR elements
  - IRR is performed by a physician on the acute reviews and NF LOC elements
  - MQD performs additional IRR on a sample of the LTC LOC determinations made by HSAG's physician advisor
- Annual
  - In October of each year, an annual report is provided to MQD outlining their reviews of PASSR, NF LOC and acute hospital reviews and compiling that data into one report
  - This report is reviewed by the Nurse Consultant responsible for contract oversight
  - This report is also reviewed by the Contract & Compliance Monitoring Section Administrator and the Health Care Services Branch Administrator
  - The report is used to identify any area for improvement of performance that is provided to HSAG's company President

Corrective action for quality oversight has been completed.

End Date: Ongoing

Responding Person: Ann Kinningham, MQD Finance Officer; Patricia Bazin, HCSB Administrator,  
Phone: (808) 692-7956; (808) 692-8083

**Ref. No. 2010-03****Reconcile Federal Award Drawdowns****Auditor's  
Recommendation:**

The MQD should develop a reconciliation process between the quarterly federal reports and the amounts recorded in the DHS's financial records. This process should be done in a timely manner and include a subsequent review and approval of such reconciliations. Management of the DHS should determine whether sufficient and appropriate accounting staffing is available at the MQD to properly complete reconciliations in a timely manner.

**Corrective Action  
Taken or Planned:**

A reconciliation process has been implemented for every drawdown of federal funds. Subsequent review and approval is done by the supervising Accountant or Finance Officer to verify the drawdown. This process ensures the proper drawdown of federal funds based on the DATAMART reports of the 100% general fund expenditures that are being reimbursed with the federal funds. A schedule of drawdowns is maintained to also reconcile the drawdowns against the current quarterly grant award. The total quarterly drawdowns are reconciled with the final CMS 64 filed after the quarter ends. Any overdraw that results from adjustments to the CMS 64 expenditures that are deferred or disapproved are corrected in the subsequent quarter.

**End Date:**

Ongoing

**Responding Person:**

Ann Kinningham, MQD Finance Officer  
Phone: (808) 692-7956

**Ref. No. 2010-04****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 as required by federal regulations in order to reduce the risk that ineligible recipients are receiving Medicaid benefits. In addition, the DHS should consider eliminating the passive renewal process or at a minimum maintain documentation to support participant eligibility.

**Corrective Actions  
Taken or Planned:**

The DHS is working with existing staff to address the backlogs of work at each unit with approved overtime.

The Eligibility Branch is utilizing temporary 89-day appointments to fill two vacant Office Assistant III positions. These two positions were redescribed from vacant Eligibility Worker positions to address the severe shortage of clerical support positions on Oahu.

The Branch is requesting approval to recruit and fill forty vacant and abolished positions statewide. All efforts will be made to expedite recruitment of vacancies within the Branch as the Branch is now exempt from the hiring freeze. Continuous recruitment to fill vacant Eligibility Worker and Office Assistant III positions has been reinstated. Request for Governor's approval to recruit and fill vacant Eligibility Worker V, IV positions and Secretary I positions will be submitted.

As positions are filled, the Branch will shift from a case-based to a function-based operational organization. Having additional office assistants and eligibility workers dedicated to interacting with the public will minimize interruptions for other workers who will be able to focus on making eligibility determinations.

The Branch continues to work with the Honolulu Community Action Program's Senior Community Service Employment Program to recruit seniors to work part time in assisting with clerical support duties.

Regarding passive renewal, MQD had tried to stop this, but was required by the federal Centers for Medicare and Medicaid Services (CMS) to continue passive renewal as a maintenance of effort (MOE) issue under the American Recovery and Reinvestment Act (ARRA). The Affordable Care Act (ACA) to a large extent extends the ARRA MOE requirements; however, MQD has again contacted CMS to seek current guidance under ACA whether ending passive renewal can be approved for program integrity purposes.

End Date: Ongoing

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

**Ref. No. 2010-05      Perform ADP System Risk Analysis and System Security Review**

Auditor's Recommendation: To ensure compliance with federal regulations, 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: At this time, the MQD Systems Office does not have the staff to perform this review. To immediately address this finding, the MQD will utilize a sub-contractor through an existing contract to provide this system risk analysis and security review of the ADP system. However, MQD will wait to commence this until after receipt of the assessment from a recent federal review to ensure that the risk analysis and system security review are comprehensive and address all findings.

Once staff resources are available, the MQD will perform Automated Data Processing (ADP) biennial reviews including a risk analysis and review of the physical and data security operating procedures and personnel practices.

End Date: June 30, 2011 and on-going biennial reviews

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

**Ref. No. 2010-06      Monitor the Medicaid Drug Rebate Program**

Auditor's Recommendation: The DHS should establish formal procedures to monitor its subcontractor to ensure the drug rebate program operates in compliance with CMS guidelines and help identify issues timely. In addition, the DHS should resolve outstanding issues on a timely basis.

Corrective Action Taken or Planned: The DHS will establish more detailed procedures to monitor its contractor to ensure the drug rebate program is properly operating to provide Hawaii all required drug rebates. Monthly calls are held by MQD's Clinical Standards Office and the contractor to discuss reports, any problems or issues for resolution. The MQD is working with the Attorney General's Office to write off the remaining balance of approximately \$2.8 M on the drug rebate receivable ledger from the 1991 – 2001 period that has been extensively researched for updates and corrections of the drug manufacturer old accounts.

End Date: No later than June 30, 2011

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

**Ref. No. 2010-07      Maintain All Required Documentation in Child Care Case Files**

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

Corrective Actions Taken or Planned: Sample case reviews are conducted regularly for child care cases maintained through the Child Care Connection Hawaii program. For cases maintained through the First-To-Work program, the Child Care Program Office will work with the Employment & Training Program Office to develop a plan to conduct sample case reviews of the child care subsidies issued as a support service payment.

The majority of the missing documentation was due to a lack of child care receipts in the case record. The Child Care Program Office has submitted a system modification request to add an additional page on the Simplified Report Form to create a specific section for the child care receipt to be attached. This modification would highlight to both the client and case worker the requirement of a child care receipt for all children who receive subsidies, thereby reducing or eliminating the error.

The Child Care Program Office will continue to determine where system modifications may be helpful in reducing or eliminating errors. Implementation of system modifications will be determined by availability of funding for development of the modification.

Also, the Child Care Program Office will continue to work with Staff Development to emphasize the need for appropriate documentation and case record maintenance in staff trainings.

End Date: Ongoing

Responding Person: Julie Morita, BESSD CCP Administrator  
Phone (808) 586-7187

**Ref. No. 2010-08      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: Sample case reviews are conducted regularly for child care cases maintained through the Child Care Connection Hawaii program. For cases maintained through the First-To-Work program, the Child Care Program Office will work with the Employment & Training Program Office to develop a plan to conduct sample case reviews of the child care subsidies issued as a support service payment.

Also, a system modification was implemented in January 2011 that requires workers to input the caretaker's actual activity hours and the hours that a child is cared for. The system then automatically calculates the eligible hours that the family qualifies for. Having the system calculate the eligible hours will reduce the errors in the calculation of payments.

The Child Care Program Office will continue to determine where system modifications may be helpful in reducing or eliminating errors. Implementation of system modifications will be

determined by availability of funding for development of the modification.

The Child Care Program Office will continue to work with Staff Development to emphasize the need for appropriate documentation and case record maintenance in staff trainings.

End Date: Ongoing

Responding Person: Julie Morita, BESSD CCP Administrator  
Phone (808) 586-7187

**Ref. No. 2010-09      Submit Financial Status Report Timely**

Auditor's Recommendation: The DHS should establish procedures to ensure that the OMB Standard Form 269A, Form CMS-64 and CMS-21 are submitted in a timely manner. The personnel responsible for the preparation and review of the forms should utilize a checklist of reporting due dates as a reminder.

Corrective Action Taken or Planned: The MQD has hired a new Accountant III effective February 2011. This Accountant in the Fiscal Staff section is assigned to work on, among other duties, the federal financial reports, including the SF 269A, Form 64 and CMS 21. MQD Finance Office staff works closely with the Systems Office staff to receive required capitation, claims files, and other financial reports as soon as available to complete the federal reports. Work on automating these reports using the Data Warehouse is also progressing with the capitation report currently in test mode, and planned to move into production by June 2011. This automation of reports will assist the FO in meeting reporting deadlines. A checklist of due dates will also be useful as well as training of the new Accountant to assist with work papers and schedules, gathering of expenditure data, and gaining familiarity with the on-line inputting of the federal report system to meet required deadlines.

BESSD has established procedures with the fiscal management office to ensure Form 269A for the LIHEAP will be submitted timely.

Financial Status Report (269A) was not submitted because it appeared the previous LIHEAP program specialist was of the understanding that the completion of the Carryover and Reallotment Report (OMB Control No. 0970-0106) in August of each year was sufficient. The Carryover and Reallotment Report was completed by the specialist every year. As advised by the Federal government, the Financial Status Report (269A) for FY 2008, FY 2009 and FY 2010 was submitted on 12/20/10 and will

continue to be completed and submitted by the last calendar day of each year.

End Date: Ongoing

Responding Person: Ann Kinningham, MQD Finance Officer  
Phone: (808) 692-7956  
Doreen Harada, LIHEAP Coordinator  
Phone: (808) 586-5734