

Financial statements and report of independent certified public accountants

**Department of Human Services, State of Hawaii**

Year ended June 30, 2005

Submitted by  
The Auditor  
State of Hawaii

May 19, 2006

The Auditor  
State of Hawaii

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 year ended June 30, 2005. Our audit was performed in accordance with the terms of our contract with the State of Hawaii and with the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

### **OBJECTIVES OF THE AUDIT**

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the DHS's basic financial statements as of and for the year ended June 30, 2005, and to comply with the requirements of OMB Circular A-133. More specifically, the objectives of the audit were as follows:

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

### **SCOPE OF THE AUDIT**

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the DHS for the year ended June 30, 2005.

### **ORGANIZATION OF THE REPORT**

This report is presented in six parts as follows:

The Auditor  
State of Hawaii  
May 19, 2006



- Part I – The basic financial statements and related notes of the DHS as of and for the year ended June 30, 2005, and our opinion on the basic financial statements.
- 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 internal control over compliance.
- Part IV – Schedule of findings and questioned costs.
- Part V – The summary schedule of prior audit findings.
- Part VI – Response of the affected agency.

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

Very truly yours,

A handwritten signature in black ink that reads "Grant Thornton LLP". The signature is written in a cursive, flowing style.

Department of Human Services  
State of Hawaii

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

Report of Independent Certified Public Accountants

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State of Hawaii

We have audited the accompanying financial statements of the governmental activities and of each major fund of the Department of Human Services, State of Hawaii (DHS), as of and for the year ended June 30, 2005, which collectively comprise the DHS's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the DHS's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the Auditing Standards Board of the American Institute of Certified Public Accountants 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 financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the DHS's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in note A, the financial statements of the DHS are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and of each major fund 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, 2005, and the changes in its financial position, where applicable, for the 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 and of each major fund of the DHS, as of June 30, 2005, and the respective changes in financial position thereof and the respective budgetary comparison for the general and special revenue funds for the year then ended in conformity with accounting principles generally accepted in the United States of America.

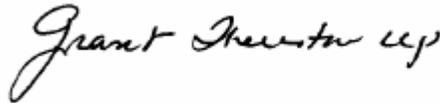
In accordance with *Governmental Auditing Standards*, we have also issued our report dated March 1, 2006, on our consideration of the DHS's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results

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of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Governmental Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 9 through 19 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 required supplementary information. However, we did not audit the information and express no opinion on it.

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



Honolulu, Hawaii  
March 1, 2006

Department of Human Services  
State of Hawaii

MANAGEMENT'S DISCUSSION AND ANALYSIS  
(UNAUDITED)

June 30, 2005

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 year ended June 30, 2005. The intent of this discussion is to allow management to provide an objective and easily readable analysis of the financial activities of the DHS based on currently known facts, decisions, or conditions. Readers are encouraged to consider the information presented here in conjunction with the basic financial statements and other supplementary information.

### **OVERVIEW OF THE FINANCIAL STATEMENTS**

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

#### ***Government-wide Financial Statements***

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

The statement of deficit in 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 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).

#### ***Fund Financial Statements***

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

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

June 30, 2005

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 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 financial decisions. In order to facilitate a comparison between the governmental fund and government-wide financial statements, a reconciliation between the two is provided following each governmental fund financial statement.

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

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

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

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

June 30, 2005

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

The following table presents a condensed government-wide statement of deficit in net assets of the DHS as of June 30, 2005 and 2004.

**Condensed Statement of Deficit in Net Assets**

	2005	2004
Current assets	\$158,018,402	\$133,766,280
Capital assets, net	34,033,068	33,135,378
Total assets	\$192,051,470	\$166,901,658
Current liabilities	\$214,658,566	\$182,518,548
Non-current liabilities	9,615,461	9,683,051
Total liabilities	\$224,274,027	\$192,201,599
Deficit in net assets		
Invested in capital assets	\$ 34,033,068	\$ 33,135,378
Restricted	341,382	1,081,855
Unrestricted deficit	(66,597,007)	(59,517,174)
Total deficit in net assets	\$ (32,222,557)	\$ (25,299,941)

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 year ended June 30, 2005, the deficit in net assets of the DHS increased by approximately \$6.9 million.

The deficit in unrestricted net assets of the DHS was approximately \$66.6 million as of June 30, 2005. This deficit in unrestricted net assets is principally the result of liabilities for program services that were incurred as of June 30, 2005, for which state allotments are not yet available. The largest liability as of June 30, 2005, is the estimated amount of medical assistance service provided as of June 30, 2005, for which the related claims will be processed and paid subsequently. Of the estimated \$159.4 million of medical assistance payable, the state share of these costs is approximately \$66.2 million. The estimated federal share of these claims to be paid in the future was recorded as intergovernmental revenues in the current 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 \$14.7 million as of June 30, 2005, 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, 2005.

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

June 30, 2005

The DHS reported a total of approximately \$34 million in net assets invested in capital assets as of June 30, 2005. 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 year ended June 30, 2005.

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**

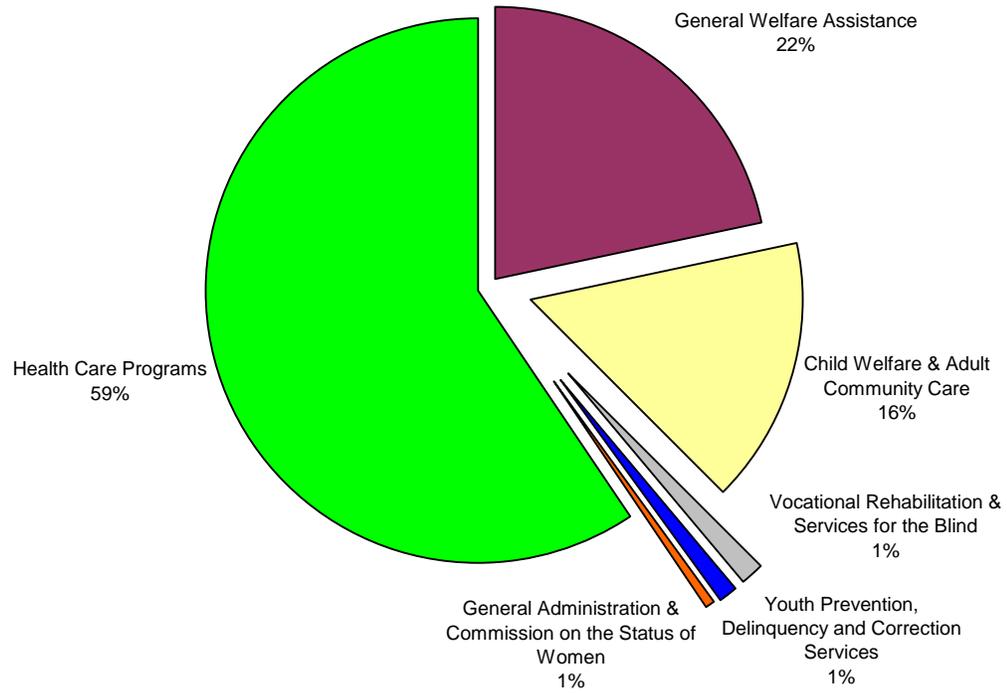
	2005	2004	Percent Change
Revenues			
Program revenues	\$ 994,809,130	\$ 942,785,134	5.52%
General revenues	650,320,174	611,752,571	6.30%
Total revenues	<u>1,645,129,304</u>	<u>1,554,537,705</u>	5.83%
Expenses			
Health care programs	979,995,269	908,437,758	7.88%
General welfare assistance, employment and support services	356,252,392	366,433,649	(2.78)%
Child welfare and adult community care services	264,254,276	239,097,877	10.52%
Vocational rehabilitation and services for the blind	23,451,840	20,496,545	14.42%
Youth prevention, delinquency and correction services	17,215,350	15,785,973	9.05%
General administration	10,876,052	9,408,260	15.60%
Commission on the status of women	6,741	-	0.00%
Total expenses	<u>1,652,051,920</u>	<u>1,559,660,062</u>	5.92%
Change in net assets	<u>\$ (6,922,616)</u>	<u>\$ (5,122,357)</u>	35.15%

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

June 30, 2005

The total cost of all programs and services was approximately \$1.65 billion, a 5.92 % increase from the prior year. Health care and general welfare assistance programs comprised 59 % and 22 %, respectively, of the total costs. The following chart presents each major activity as a percent of the total cost of all DHS activities:



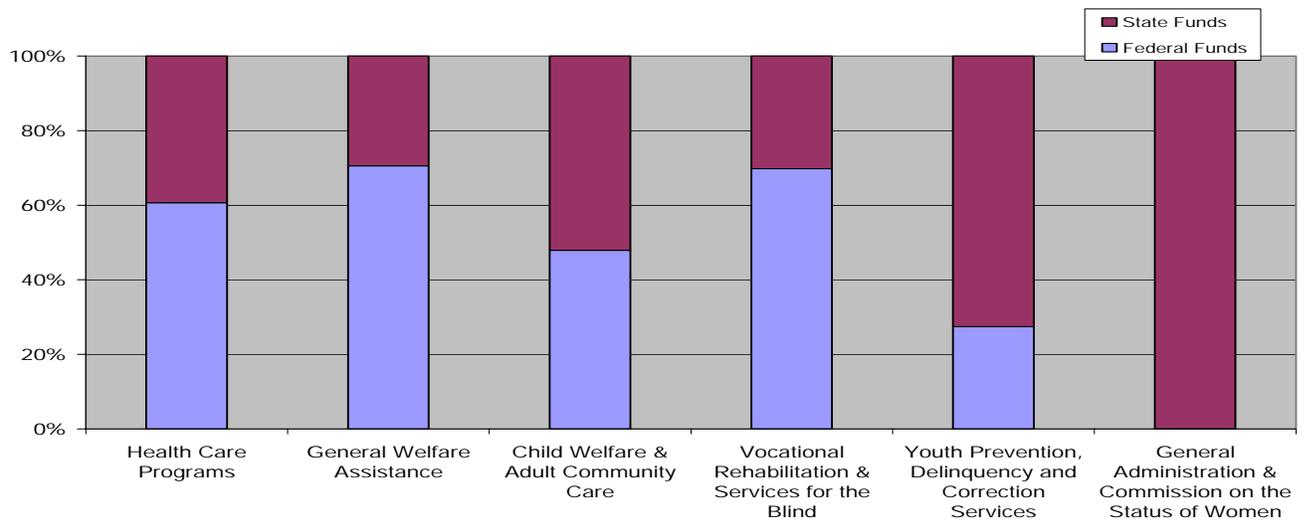
Department of Human Services  
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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

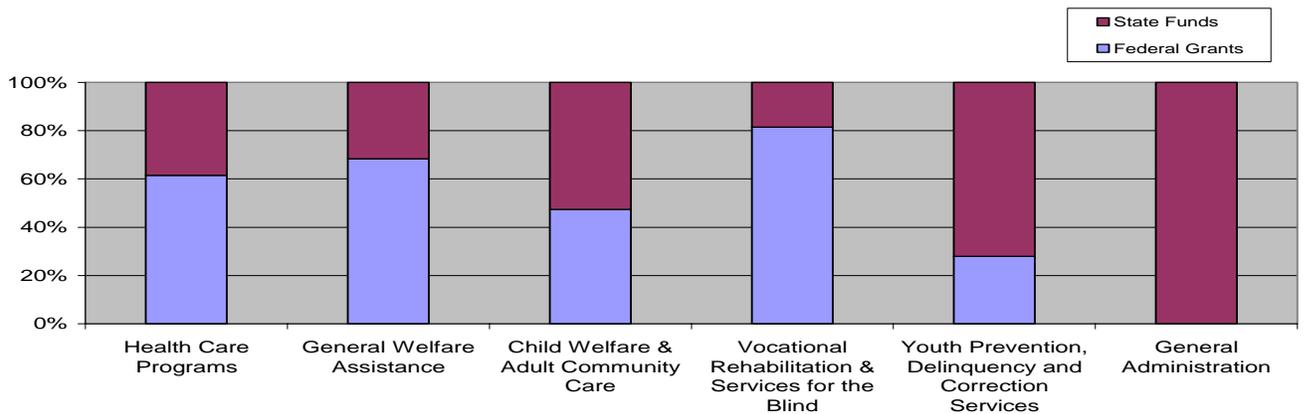
June 30, 2005

Program revenues consist primarily of operating grants from the federal government. Revenues from these federal grants paid for 60.2% 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 years ended June 30, 2005 and 2004:

Year 2005:



Year 2004:



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

June 30, 2005

**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 \$90.6 million over the prior year. This increase is primarily related to health care program costs administered by the DHS which have increased by approximately \$71 million or 7.82 %. In addition, child welfare and adult community care program costs increased by \$ 24.5 million or 10.25 % while general welfare assistance program costs have decreased by \$ (10.5) million or (2.85)%. The increased costs in the health care program is principally due to an increase in recipients and medical assistance costs. The increased costs in the child welfare and adult community care program is principally due to an increase in recipients. The decreased costs in the general welfare assistance program is primarily due to the five-year limit on financial assistance benefits but a large part of it can be attributed to the State's continued improving economy.

At June 30, 2005, the total governmental fund balance of the DHS consisted of a deficit in unreserved fund balance of approximately \$112.9 million. The deficit in the unreserved fund balance of the general fund totaling \$62.9 million is principally comprised of liabilities for program services that were incurred as of June 30, 2005, for which state allotments were not yet available. The deficit in the unreserved fund balance of the special revenue fund totaling \$50 million is principally the result of the encumbrances that were not liabilities as of June 30, 2005 and, therefore, the related intergovernmental revenues were not recorded.

Reservations of governmental fund balances for encumbrances totaled approximately \$61.5 million at June 30, 2005. 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 years ended June 30, 2005 and 2004:

	2005	2004	Percent Change
Revenues			
State allotted appropriations	\$ 633,024,995	\$ 596,464,254	6.13%
Intergovernmental revenues	991,677,216	942,785,134	5.19%
Non-imposed employee fringe benefits	17,295,179	15,288,317	13.13%
	<u>\$1,641,997,390</u>	<u>\$1,554,537,705</u>	5.63%

Department of Human Services  
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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

June 30, 2005

	2005	2004	Percent Change
Expenditures			
Health care programs	\$ 979,107,355	\$ 908,069,420	7.82%
General welfare assistance, employment and support services	356,024,138	366,475,313	(2.85)%
Child welfare and adult community care services	263,827,305	239,290,609	10.25%
Vocational rehabilitation and services for the blind	23,385,892	20,612,326	13.46%
Youth prevention, delinquency and correction services	16,471,553	15,223,966	8.19%
General administration	10,774,564	9,371,736	14.97%
Commission on the status of women	6,741	-	0.00%
	<u>\$1,649,597,548</u>	<u>\$1,559,043,370</u>	5.81%

**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	\$383,042,496	\$379,990,809	\$372,411,661	\$ 7,579,148
General welfare assistance, employment and support services	117,617,871	116,191,590	115,618,621	572,969
Child welfare and adult community care services	119,749,622	132,712,664	132,130,505	582,159
Vocational rehabilitation and services for the blind	4,819,614	4,860,846	4,311,897	548,949
Youth prevention, delinquency and correction services	10,925,026	12,327,015	11,269,424	1,057,591
General administration	8,090,270	8,946,237	8,870,650	75,587
Commission on the status of women	-	-	18,000	(18,000)
	<u>\$644,244,899</u>	<u>\$655,029,161</u>	<u>\$644,630,758</u>	<u>\$10,398,403</u>

The change from the original to the final budgeted allotments for the child welfare and adult community care program was primarily due to an increase in the Medicaid Waiver Program appropriation of \$9,265,593 for anticipated Developmentally, Disabled, Mentally Retarded (DDMR) claims. Other differences between the original and final budget were due to intrafund transfers communicated through executive memorandums.

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

June 30, 2005

Actual expenditures for the health care and youth prevention, delinquency and correction services programs were approximately \$ 7.6 million and \$ 1.1 million, respectively, less than the amounts budgeted for the anticipated costs of claims for Medicaid clients residing in ICF-MR beds and the Hale Kipa project. Thus, the amounts expended in comparison to the amounts budgeted appear favorable.

**CAPITAL ASSETS**

As of June 30, 2005 and 2004, the cost basis of capital assets, net of accumulated depreciation, used by the DHS are presented in the table below. Approximately \$1,250,000 of capital assets were added in the year ended June 30, 2005. Annual depreciation totaling approximately \$2.2 million decreased the net cost basis during the year ended June 30, 2005.

**Capital Assets, Net of Depreciation**

	<u>2005</u>	<u>2004</u>
State office buildings and improvements	\$17,420,428	\$18,866,969
Buildings and improvements for the Office of Youth Services	<u>15,444,410</u>	<u>12,340,401</u>
Total buildings and improvements	32,864,838	31,207,370
Furniture, equipment and vehicles	1,168,224	1,928,002
Nondepreciable land	<u>6</u>	<u>6</u>
Total	<u>\$34,033,068</u>	<u>\$33,135,378</u>

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

**ECONOMIC FACTORS**

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

Four and one-half years after the events of September 11, 2001, individuals receiving financial assistance in Hawaii in family cases and in individual cases continued to decline from 65,444 individuals in September 2001 to 33,113 individuals in January 2006 or a decrease of 32,331 individuals or 49.4%. Much of this decline is due to the five-year limit on financial assistance benefits for family cases beginning in December 2001 as part of Hawaii's Welfare Reform

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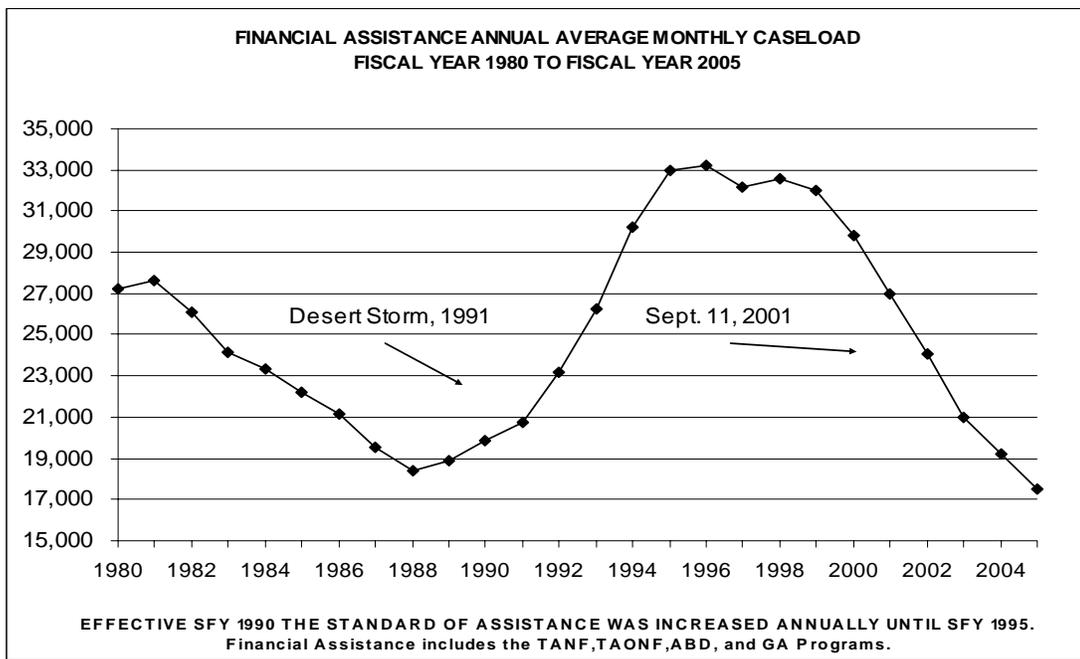
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
(UNAUDITED)

June 30, 2005

Program (started in December 1996) but a large part of it can be attributed to the State's continued improving economy.

The number of individuals in Hawaii receiving Food Stamp benefits also declined since September 11, 2001 from 105,990 individuals in September 2001 to 88,832 individuals in January 2006. This is a decrease of 17,158 individuals or 16.2%. Part of this decline is due to the decrease in the number of individuals receiving financial assistance but part of it may also be attributed to the improving job market in Hawaii.

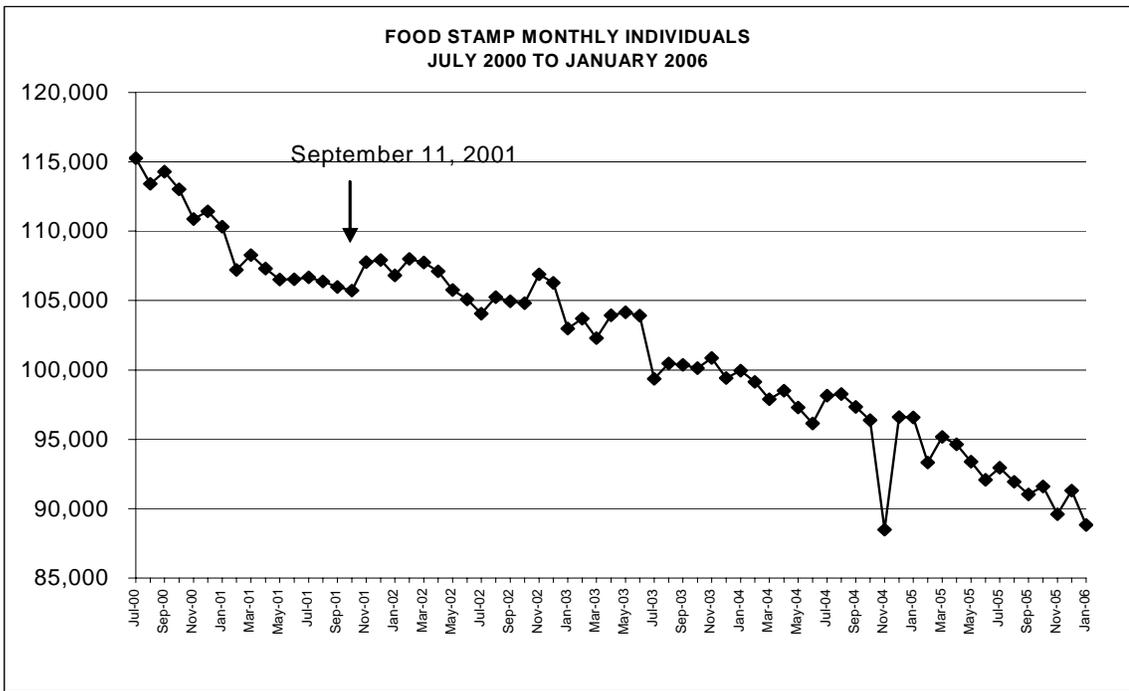
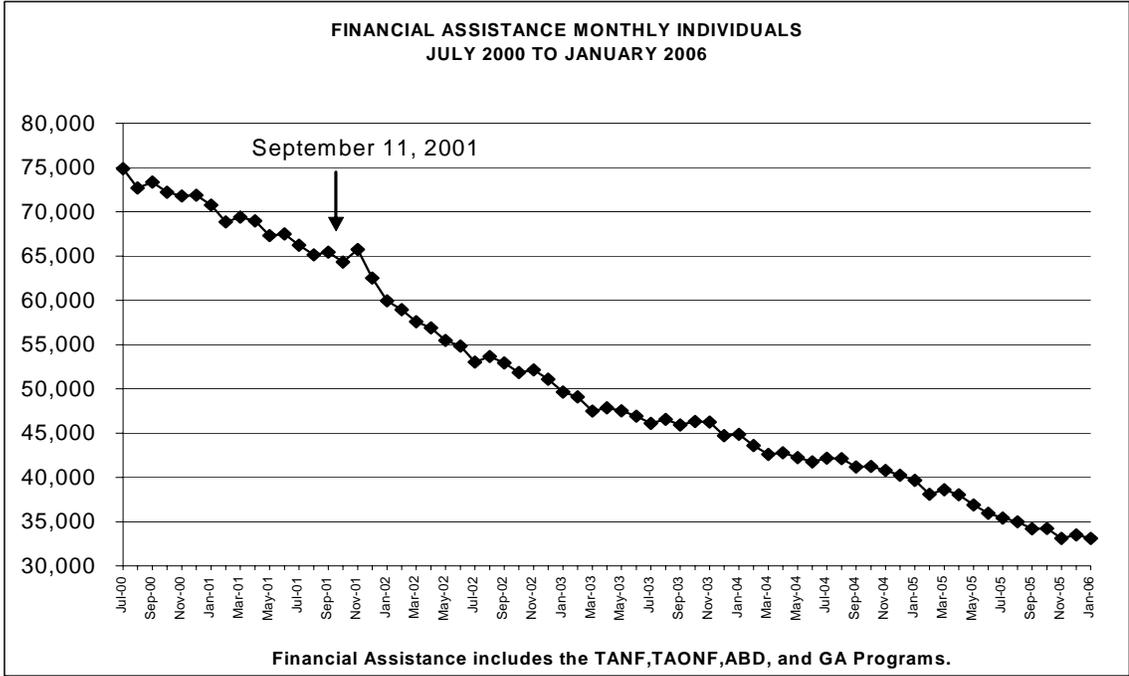
The following charts provide a trend analysis of currently known facts and conditions:



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MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)  
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June 30, 2005



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STATEMENT OF DEFICIT IN NET ASSETS

June 30, 2005

ASSETS	<u>Governmental Activities</u>
<b>CURRENT ASSETS</b>	
Cash	\$ 62,780,999
Receivables	3,425,266
Due from other governments	<u>91,812,137</u>
Total current assets	158,018,402
CAPITAL ASSETS, net of accumulated depreciation	<u>34,033,068</u>
Total assets	<u><u>\$ 192,051,470</u></u>
<b>LIABILITIES AND DEFICIT IN NET ASSETS</b>	
<b>CURRENT LIABILITIES</b>	
Vouchers payable	\$ 11,160,723
Accrued wages and employee benefits payable	9,008,136
Due to State of Hawaii	24,758,727
Due to other State agency	5,055,242
Accrued medical assistance payable	159,380,000
Accrued compensated absences	5,074,000
Workers' compensation liability	<u>221,738</u>
Total current liabilities	214,658,566
ACCRUED COMPENSATED ABSENCES, less current portion	<u>9,615,461</u>
Total liabilities	224,274,027
<b>DEFICIT IN NET ASSETS</b>	
Invested in capital assets	34,033,068
Restricted	341,382
Unrestricted deficit	<u>(66,597,007)</u>
Total deficit in net assets	<u>(32,222,557)</u>
Total liabilities and deficit in net assets	<u><u>\$ 192,051,470</u></u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

STATEMENT OF ACTIVITIES

Year ended June 30, 2005

Functions/Programs	Expenses	Program revenues			Net Expense and Changes in Deficit in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
Governmental activities:					
Health care programs	\$ 979,995,269	\$ -	\$ 593,591,897	\$ -	\$ (386,403,372)
General welfare assistance, employment and support services	356,252,392	-	255,054,084	-	(101,198,308)
Child welfare and adult community care services	264,254,276	-	122,858,864	-	(141,395,412)
Vocational rehabilitation and services for the blind	23,451,840	-	16,157,627	-	(7,294,213)
Youth prevention, delinquency and correction services	17,215,350	-	4,010,199	3,131,914	(10,073,237)
General administration	10,876,052	-	-	-	(10,876,052)
Commission on the status of women	6,741	-	4,545	-	(2,196)
Total	<u>\$ 1,652,051,920</u>	<u>\$ -</u>	<u>\$ 991,677,216</u>	<u>\$ 3,131,914</u>	(657,242,790)
General revenues:					
State allotments					633,024,995
State-provided payroll fringe benefits					<u>17,295,179</u>
Total general revenues					<u>650,320,174</u>
CHANGE IN NET ASSETS					(6,922,616)
Deficit in net assets at July 1, 2004					<u>(25,299,941)</u>
Deficit in net assets at June 30, 2005					<u>\$ (32,222,557)</u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

BALANCE SHEET - GOVERNMENTAL FUNDS

June 30, 2005

ASSETS	General	Special Revenue	Total
Cash	\$ 17,876,921	\$ 44,904,078	\$ 62,780,999
Receivables	2,254,757	1,170,509	3,425,266
Due from other funds	18,652,984	-	18,652,984
Due from other State agency	6,353,412	-	6,353,412
Due from other governments	-	91,812,137	91,812,137
	\$ 45,138,074	\$137,886,724	\$183,024,798
Total assets	\$ 45,138,074	\$137,886,724	\$183,024,798
LIABILITIES AND FUND BALANCES			
LIABILITIES			
Vouchers payable	\$ 6,069,188	\$ 5,091,535	\$ 11,160,723
Accrued wages and employee benefits payable	3,584,244	5,423,892	9,008,136
Due to other funds	-	18,652,984	18,652,984
Due to State of Hawaii	20,990,450	3,768,277	24,758,727
Due to other State agency	-	11,408,654	11,408,654
Accrued medical assistance payable	66,180,000	93,200,000	159,380,000
	96,823,882	137,545,342	234,369,224
Total liabilities	96,823,882	137,545,342	234,369,224
FUND BALANCES			
Reserved for encumbrances	11,191,875	50,329,999	61,521,874
Unreserved	(62,877,683)	(49,988,617)	(112,866,300)
	(51,685,808)	341,382	(51,344,426)
Total fund balances (deficit)	(51,685,808)	341,382	(51,344,426)
	\$ 45,138,074	\$137,886,724	\$183,024,798
Total liabilities and fund balances	\$ 45,138,074	\$137,886,724	\$183,024,798

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET  
TO THE STATEMENT OF DEFICIT IN NET ASSETS

June 30, 2005

Total deficit in fund balances - governmental funds		\$ (51,344,426)
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.		
Governmental capital assets	\$ 54,077,876	
Less accumulated depreciation	<u>(20,044,808)</u>	34,033,068
Accrued compensated absences reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds		
		(14,689,461)
Workers' compensation liability reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds		
		<u>(221,738)</u>
Deficit in net assets of governmental activities		<u><u>\$ (32,222,557)</u></u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN  
FUND BALANCES - GOVERNMENTAL FUNDS

Year ended June 30, 2005

	General	Special Revenue	Total
Revenues			
State allotted appropriations	\$ 633,024,995	\$ -	\$ 633,024,995
Intergovernmental revenues	-	991,677,216	991,677,216
Non-imposed employee fringe benefits	17,295,179	-	17,295,179
	650,320,174	991,677,216	1,641,997,390
Expenditures			
Health care programs	385,213,341	593,894,014	979,107,355
General welfare assistance, employment and support services	104,714,917	251,309,221	356,024,138
Child welfare and adult community care services	137,448,531	126,378,774	263,827,305
Vocational rehabilitation and services for the blind	7,067,866	16,318,026	23,385,892
Youth prevention, delinquency and correction services	11,955,899	4,515,654	16,471,553
General administration	10,774,564	-	10,774,564
Commission on the status of women	4,741	2,000	6,741
	657,179,859	992,417,689	1,649,597,548
NET CHANGE IN FUND BALANCES	(6,859,685)	(740,473)	(7,600,158)
Fund balances (deficit) at July 1, 2004	(44,826,123)	1,081,855	(43,744,268)
Fund balances (deficit) at June 30, 2005	\$ (51,685,808)	\$ 341,382	\$ (51,344,426)

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

RECONCILIATION OF THE CHANGE IN FUND BALANCES OF  
GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

Year ended June 30, 2005

Net change in fund balances - total governmental funds			\$ (7,600,158)
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.			
Contributions of capital assets	\$ 3,131,914		
Expenditures for capital assets	1,081,926		
Less current year depreciation and other changes	<u>(3,316,150)</u>	897,690	
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.			1,590
Change in workers' compensation liability reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.			<u>(221,738)</u>
Change in net assets of governmental activities			<u><u>\$ (6,922,616)</u></u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

STATEMENT OF REVENUES AND EXPENDITURES -  
BUDGET AND ACTUAL - GENERAL FUND

Year ended June 30, 2005

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
Revenues				
State allotments	\$644,244,899	\$655,029,161	\$645,402,390	\$ (9,626,771)
Expenditures				
Health care programs	383,042,496	379,990,809	372,411,661	7,579,148
General welfare assistance, employment and support services	117,617,871	116,191,590	115,618,621	572,969
Child welfare and adult community care services	119,749,622	132,712,664	132,130,505	582,159
Vocational rehabilitation and services for the blind	4,819,614	4,860,846	4,311,897	548,949
Youth prevention, delinquency and correction services	10,925,026	12,327,015	11,269,424	1,057,591
General administration	8,090,270	8,946,237	8,870,650	75,587
Commission on the status of women	-	-	18,000	(18,000)
	<u>644,244,899</u>	<u>655,029,161</u>	<u>644,630,758</u>	<u>10,398,403</u>
 EXCESS OF REVENUES OVER EXPENDITURES	 <u>\$ -</u>	 <u>\$ -</u>	 <u>\$ 771,632</u>	 <u>\$ 771,632</u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

STATEMENT OF REVENUES AND EXPENDITURES -  
BUDGET AND ACTUAL - SPECIAL REVENUE FUNDS

Year ended June 30, 2005

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
Revenues				
Intergovernmental revenues	\$860,823,955	\$860,823,955	\$821,177,799	\$ (39,646,156)
Expenditures				
Health care programs	564,650,983	564,650,983	559,156,874	5,494,109
General welfare assistance, employment and support services	141,006,724	141,006,724	101,986,422	39,020,302
Child welfare and adult community care services	127,749,755	127,749,755	126,813,483	936,272
Vocational rehabilitation and services for the blind	18,594,875	18,594,875	15,567,594	3,027,281
Youth prevention, delinquency and correction services	7,253,761	7,253,761	4,319,212	2,934,549
General administration	1,567,857	1,567,857	1,567,856	1
Commission on the status of women	-	-	-	-
	<u>860,823,955</u>	<u>860,823,955</u>	<u>809,411,441</u>	<u>51,412,514</u>
EXCESS OF REVENUES OVER EXPENDITURES	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 11,766,358</u>	<u>\$ 11,766,358</u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

STATEMENT OF ASSETS AND LIABILITIES - AGENCY FUNDS

June 30, 2005

ASSETS

Cash	\$ 1,080,964
Total assets	<u>\$ 1,080,964</u>

LIABILITIES

Due to individuals	\$ 736,276
Due to others	<u>344,688</u>
Total liabilities	<u>\$ 1,080,964</u>

The accompanying notes are an integral part of this statement.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS

June 30, 2005

**NOTE A – FINANCIAL REPORTING ENTITY**

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

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

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

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

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

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

**Vocational Rehabilitation and Services for the Blind:** The activities of the Vocational Rehabilitation and Services for the Blind division of the DHS provide for the rehabilitation needs of those disabled persons who cannot meet their vocational needs without assistance. The goal of those services, which are provided to mentally, physically and visually handicapped individuals, is to assist recipients toward employment and the enjoyment of full and independent lives. Its operations are reported in the general, special revenue, and agency funds.

**Youth Prevention, Delinquency and Correction Services:** The activities of the Office of Youth Services of the DHS include developing and administering programs for preventing, rehabilitating and treating juvenile delinquency in the State. Its operations are reported in the general, special revenue, and agency funds.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE A – FINANCIAL REPORTING ENTITY (continued)**

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

**Commission on the Status of Women:** The activities of the Commission on the Status of Women of the DHS include promoting awareness of women in the State's society.

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' financial statements to be misleading or incomplete. GASB has set forth criteria to be considered in determining financial accountability.

**NOTE B – SIGNIFICANT ACCOUNTING POLICIES**

1. Basis of Presentation

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

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

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

a. Governmental Fund Types

**General Fund –** The general fund is the general operating fund of the DHS. It is used to account for all financial activities except those required to be accounted for in another fund. The annual operating budget as authorized by the State Legislature provides the basic framework within which the resources and obligations of the general fund are accounted.

**Special Revenue Funds –** Special revenue funds are used to account for the proceeds of specific revenue sources that are legally or contractually restricted to expenditures for specified purposes.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)**

1. Basis of Presentation (continued)

b. Fiduciary Fund Type

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

2. Measurement Focus and Basis of Accounting

a. Government-wide Financial Statements

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

b. Governmental Funds

All governmental funds are accounted for using a current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the accounting period when they become both measurable and available. Measurable means that the amount of the transaction can be determined. Available means that the amount is collected in the current fiscal year or soon enough after fiscal year end (60 days) to liquidate liabilities existing at the end of the fiscal year. Revenues susceptible to accrual include federal grants and funds appropriated by the State Legislature and allotted by the Governor. Expenditures are generally recorded when the related fund liabilities are incurred.

c. Agency Funds

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

3. Use of Estimates

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

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)**

4. Receivables

Receivables in the general and special revenue funds consist primarily of amounts due from recipients of welfare benefit overpayments. The amounts reported as net receivables were established based on management's estimate of amounts collectible.

5. Capital Assets

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

When capital assets are purchased, they are capitalized and depreciated using the straight-line method over their estimated useful lives in the government-wide financial statements. Capital asset purchases are recorded as expenditures of the period purchased in the governmental fund financial statements.

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

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

The State has adopted the following capitalization policy:

<u>Asset type</u>	<u>Minimum capitalization amount</u>	<u>Estimated useful life</u>
Land	All	Not applicable
Land improvements	\$100,000	15 years
Buildings and improvements	\$100,000	30 years
Furniture and equipment	\$5,000	7 years
Motor vehicles	\$5,000	5 years

6. Accumulated Vacation

Employees are credited with vacation at the rate of 168 hours per calendar year. Accumulation of such vacation credits is limited to 720 hours at calendar year end and is convertible to pay upon termination of employment. Such accumulated vacation has been accrued and reflected in the statement of net assets.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE B – SIGNIFICANT ACCOUNTING POLICIES (continued)**

7. Due to Individuals

Due to individuals represents assets held by the DHS primarily in an agent capacity and is available to individuals receiving benefits under various programs primarily through the Electronic Benefits Transfer System.

8. Appropriations

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

9. Operating and Capital Grants and Contributions

Federal grants and assistance awards are recorded as intergovernmental receivables and revenues when all eligibility requirements have been satisfied.

10. Intrafund and Interfund Transactions

Significant transfers of financial resources between activities included within the same fund are offset within that fund.

11. Risk Management

The DHS is exposed to various risks for losses related to torts; theft of, damage to, or destruction of assets; errors or omissions; natural disasters; and injuries to employees. A liability for a claim for a risk of loss is established if information indicates that it is probable that a liability has been incurred at the date of the basic financial statements and the amount of the loss is reasonably estimable.

**NOTE C – BUDGETING AND BUDGETARY CONTROL**

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

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

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE C – BUDGETING AND BUDGETARY CONTROL (continued)**

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

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the year ended June 30, 2005.

	General	Special Revenue
Excess of revenues over expenditures – actual on a budgetary basis	\$ 771,632	\$ 11,766,358
Reserved for encumbrances at year end	11,191,875	50,329,999
Expenditures for liquidation of prior year encumbrances	(12,819,261)	(37,539,693)
Net change in unreserved liabilities	(3,612,390)	(22,699,468)
Accruals related to federal reimbursements for program expenditures	–	(16,157,283)
Net change in other receivables	(47,408)	64,599
Difference for revenues recognized for GAAP purposes	(2,344,133)	13,495,015
Net change in fund balance	\$ (6,859,685)	\$ (740,473)

**NOTE D – CASH**

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

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE D – CASH (continued)**

The DHS also maintains cash in banks which are held separately from cash in the State Treasury. As of June 30, 2005, the carrying amount of total bank deposits was approximately \$885,000 and the corresponding bank balances which are represented were approximately \$1,432,000.

**NOTE E – RECEIVABLES**

Receivables of the DHS, net of an allowance for doubtful accounts, consisted of the following at June 30, 2005:

	General	Special Revenue
Welfare benefit overpayments	\$20,217,570	\$24,755,430
QUEST premiums receivable	1,370,490	1,929,510
Social Security interim assistance loans	1,252,000	–
CSEA receivable	54,266	–
	22,894,326	26,684,940
Less allowance for doubtful accounts:		
Welfare benefit overpayments	19,318,500	23,654,500
QUEST premiums receivable	1,321,069	1,859,931
	20,639,569	25,514,431
Receivables – net	\$ 2,254,757	\$ 1,170,509

**NOTE F – CAPITAL ASSETS**

The changes in capital assets were as follows:

	Governmental Activities					Balance June 30, 2005
	Balance July 1, 2004	Additions	Disposals	Net Transfers	Other	
Depreciable assets						
Buildings and improvements	\$43,376,384	\$ 169,403	\$ –	\$ –	\$2,639,566	\$46,185,353
Furniture, equipment and vehicles	7,575,914	1,081,926	(534,794)	(38,978)	(191,551)	7,892,517
Nondepreciable assets						
Land	6	–	–	–	–	6
Total at historical cost	50,952,304	1,251,329	(534,794)	(38,978)	2,448,015	54,077,876
Less accumulated depreciation for:						
Buildings and improvements	12,169,014	1,533,553	–	–	(382,052)	13,320,515
Furniture, equipment and vehicles	5,647,912	710,015	(355,995)	(35,357)	757,718	6,724,293
Total accumulated depreciation	17,816,926	2,243,568	(355,995)	(35,357)	375,666	20,044,808
Total capital assets – net	\$33,135,378	\$ (992,239)	\$(178,799)	\$ (3,621)	\$2,072,349	\$34,033,068

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE F – CAPITAL ASSETS (continued)**

Depreciation expense was charged to functions as follows:

	Governmental Activities
Health care programs	\$ 707,658
General welfare assistance, employment and support services	492,791
Child welfare and adult community care services	128,115
Vocational rehabilitation and services for the blind	84,443
Youth prevention, delinquency and correction services	779,301
General administration	51,260
	\$2,243,568

**NOTE G – RELATED PARTY TRANSACTIONS**

The DHS had various amounts due to the State totaling \$24,758,727 as of June 30, 2005, which included federal reimbursements for program expenditures totaling \$18,652,984, an advance totaling \$3,768,277, receivables totaling \$2,151,070, and cash held outside of the State Treasury totaling \$186,396. The DHS repaid the advance to the State in July 2005.

The DHS receives transfers from the State Department of Health (DOH) for the State share of Developmentally, Disabled, Mentally Retarded (DDMR) Medicaid waiver claims and claims for Medicaid clients residing in ICF-MR beds. The DHS had a receivable due from the DOH for these claims which totaled \$6,353,412 as of June 30, 2005. The DHS transfers funds to the DOH for the federal share of Medicaid rehab option claims. The DHS had a liability due to the DOH for these claims which totaled \$11,408,654 as of June 30, 2005.

The DHS leases office space from a State agency. The DHS's general fund share of the lease costs is paid from the State General Fund. The DHS's federal share of rent expense paid to the State agency amounted to \$619,958 for the year ended June 30, 2005.

**NOTE H – ACCRUED COMPENSATED ABSENCES**

Accrued compensated absences is not reported in the governmental fund financial statements as that amount is not expected to be paid with current funds. The government-wide financial statements present the cost of accumulated unpaid compensated absences as a liability. A reconciliation of changes in the accrued compensated absences liability during the year ended June 30, 2005 was as follows:

	Amount
Balance at July 1, 2004	\$14,691,051
Additions	8,239,478
Reductions	(8,241,068)
Balance at June 30, 2005	14,689,461
Less current portion	(5,074,000)
	\$ 9,615,461

The compensated absences liability has been paid primarily by the general fund in the past.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE I – INSURANCE**

Insurance coverage is maintained at the State level. The State is substantially self-insured for all perils including workers' compensation. Expenditures for workers' compensation and other insurance claims are appropriated annually from the State General Fund.

Under the provisions of GASB Statement No. 10, liabilities related to certain types of losses (including torts, theft of, damage to, or destruction of assets, errors or omissions, natural disasters and injuries to employees), are reported when it is probable that the losses have occurred and the amount of those losses can be reasonably estimated.

During the year ended June 30, 2005, the DHS was covered by the State's self-insured workers' compensation program for medical expenses of the injured DHS employees. However, the DHS was required to pay Temporary Total Disability (TTD) and Temporary Partial Disability (TPD) benefits for employees on the DHS' payroll. Claims expenditures and liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

A reconciliation of changes in the workers' compensation liability during the year ended June 30, 2005 was as follows:

	<u>Amount</u>
Balance at July 1, 2004	\$ -
Additions	352,845
Reductions	<u>(131,107)</u>
Balance at June 30, 2005	<u>\$ 221,738</u>

**NOTE J – NON-IMPOSED EMPLOYEE FRINGE BENEFITS**

Payroll fringe benefit costs of the DHS's employees that are funded by state appropriations (general fund) are assumed by the State and are not charged to the DHS's operating funds. These costs, totaling approximately \$17,295,000 for the year ended June 30, 2005 have been reported as revenues and expenditures in the general fund of the DHS.

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

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE K – FUND BALANCE DEFICITS**

The general and special revenue funds of the DHS have deficits in the unreserved fund balances at June 30, 2005 aggregating to \$62,877,683 and \$49,988,617, respectively. The general fund deficit resulted primarily from expenditures being recorded when incurred, and revenues being recognized only when corresponding funds are measurable and available. The special revenue fund deficit is because the encumbrances at June 30, 2005 were not liabilities and therefore the related revenues were not recorded.

**NOTE L – LEASE COMMITMENTS**

The DHS leases various office facilities on a long term basis 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 funds of the DHS. The following is a schedule of the federal share of minimum future rentals on noncancelable operating leases at June 30, 2005:

	<u>Amount</u>
Year ending June 30,	
2006	\$ 881,000
2007	856,000
2008	780,000
2009	655,000
2010	437,000
2011 – 2015	1,965,000
2016 – 2020	2,278,000
2021 – 2023	<u>1,096,000</u>
	<u>\$8,948,000</u>

The DHS's federal share of rent expense associated with operating leases for the year ended June 30, 2005 was approximately \$947,000 and is included in the accompanying financial statements.

**NOTE M – RETIREMENT BENEFITS**

1. Employees' Retirement System

Plan Description

All eligible employees of the State are required by Chapter 88 of the Hawaii Revised Statutes to become members of the Employees' Retirement System of the State of Hawaii (ERS), a cost-sharing multiple-employer public employee retirement plan. The ERS provides retirement benefits as well as death and disability benefits. The ERS issues a publicly available comprehensive annual financial report that includes

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE M – RETIREMENT BENEFITS (continued)**

1. Employees' Retirement System (continued)

Plan Description (continued)

financial statements and required supplementary information for ERS. That report may be obtained by writing to the ERS, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

The ERS consists of a contributory plan and a noncontributory plan. Employees covered by Social Security on June 30, 1984 were given the option of joining the noncontributory plan or remaining in the contributory plan. All new employees hired after June 30, 1984, who are covered by Social Security, are generally required to join the noncontributory plan. 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 payment of salary in lieu of vacation, if the employee became a member prior to January 1, 1971. The AFC for members hired on or after this date is based on the three highest paid years of service excluding the payment of salary in lieu of vacation. Vesting requirements for the contributory and noncontributory plans are five years and ten years, respectively. All contributions, benefits and eligibility requirements are governed by Chapter 88.

Funding Policy

Most covered employees of the contributory plan are required to contribute 7.8% of their salary. Police officers, firefighters, investigators of the department of the prosecuting attorney and the attorney general, narcotics enforcement investigators, and public safety investigators are required to contribute 12.2% of their salary. The actuarial cost or funding method used to calculate the total employer contribution required is the entry age normal actuarial cost method. Under this method, the total employer contributions to the ERS is comprised of normal cost plus level annual payments required to amortize the unfunded actuarial accrued liability over the closed period ending June 30, 2029.

The contribution requirement for all employers as of June 30, 2005, 2004, and 2003 were approximately \$252 million, \$182 million, and \$159 million, respectively. The State contributed 100% of its required contributions for those years.

2. Post-Retirement Health Care and Life Insurance Benefits

In addition to providing pension benefits, the State, pursuant to HRS Chapter 87, provides certain health care and life insurance benefits to all qualified employees.

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

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE M – RETIREMENT BENEFITS (continued)**

2. Post-Retirement Health Care and Life Insurance Benefits (continued)

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

For employees hired after June 30, 2001, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the retired employees' monthly Medicare or non-Medicare premium based on the self plan. For employees hired after June 30, 2001, and who retire with at least 15 years but fewer than 25 years of service, the State pays 75% of the retired employees' monthly Medicare or non-Medicare premium based on the self plan; for those retiring with over 25 years of service, the State pays the entire health care premium based on the self plan.

For active employees, the employer's contributions are based upon negotiated collective bargaining agreements, and are funded by the State as accrued on a pay-as-you-go basis.

3. Cost of Retirement Benefits

The DHS's general fund share of the expense for pension benefits for the year ended June 30, 2005 was paid from the State General Fund and approximate \$4,763,300. The DHS's federal share of the pension benefits expense for the year ended June 30, 2005 was approximately \$2,306,400. The employer contribution rate for the year ended June 30, 2005 was 8.87%.

The DHS's general fund share of the expense for post-retirement benefits for the year ended June 30, 2005 was paid from the State General Fund and approximates \$3,725,300. The DHS's federal share of the post-retirement benefits expense for the year ended June 30, 2005 was approximately \$1,803,700.

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

4. 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.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE M – RETIREMENT BENEFITS (continued)**

4. Deferred Compensation Plan (continued)

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

**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 generally is at risk for the first \$250,000 per occurrence of property and crime losses and the first \$3 million with respect to general liability claims. Losses in excess of these retention amounts are insured with commercial insurance carriers. The limit per occurrence for property losses is as follows: \$100 million for named hurricane, \$50 million for terrorism, and \$25 million for flood and earthquake. The annual aggregate for general liability and crime losses per occurrence is \$10 million.

**NOTE O – COMMITMENTS AND CONTINGENCIES**

1. Accumulated Sick Leave

Employees earn sick leave credits at the rate of one and three-quarters working days for each month of service. Sick leave credits may be accumulated without limit, but can be taken only in the event of illness and is not convertible to pay upon termination of employment. Accordingly, no liability for unpaid sick leave credits is reported in the accompanying financial statements. However, a DHS employee who retires or leaves government service in good standing with sixty days or more of unused sick leave is entitled to additional service credit in the ERS. Accumulated sick leave as of June 30, 2005, amounted to approximately \$43,644,000.

2. Medicaid Program

In June 2000, the U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services (CMS), informed the DHS of its preliminary conclusion that the State's nursing facility tax program resulted in a disallowance of approximately \$17,750,950 of federal financial participation in the Medical Assistance Program for the period from July 1, 1993 through June 30, 1997. The CMS concluded that state income tax credits made available to private pay patients were associated with nursing facility taxes assessed and collected by the State and violated Section 1903(w)(4)(A) and (C) of the Social Security Act and 42 CFR Part 433.68(f), which specifies that a hold harmless provision exists when a state imposing the tax provides for a payment to taxpayers and the amount of such payment is positively correlated either to the amount of such tax or the difference between the amount of the tax and the amount of payment under the state plan.

Department of Human Services  
State of Hawaii

NOTES TO FINANCIAL STATEMENTS (continued)

June 30, 2005

**NOTE O – COMMITMENTS AND CONTINGENCIES (continued)**

2. Medicaid Program (continued)

In January 2001, the CMS reached a final decision and issued a notice of disallowance in the amount of \$17,750,950. The CMS instructed the DHS to reduce future federal financial participation awards by the amount of disallowance. The DHS appealed the final decision of the Regional Administrator with the Department Appeals Board under 45 CFR Part 16.

In June 2005, the CMS made a decision in response to the appeal and reversed the disallowance in the amount of \$17,750,950 for the DHS since there is no basis in the record for determining that there was a hold harmless provision in effect in Hawaii during the disallowance period.

In the normal course of operating the Medical Assistance Program, the DHS reimburses providers of medical services to Medicaid recipients under a Prospective Payment System (PPS). Under PPS, standard costs and rates are negotiated between the DHS and the State's Medicaid providers in advance. PPS allows providers to file for standard cost and rate adjustments up to five years subsequent to the rendering of those services. The amount of future adjustments, if any, to be made for services provided through June 30, 2005, cannot be determined at this time. Any adjustments would be funded from future appropriations.

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

3. Litigation

The DHS is a party to various legal proceedings, most of which normally occur in governmental operations. 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 legislature. However, it is not known if this practice will continue or whether the legislature will adjust, either directly or indirectly, the DHS's budget in light of a settlement or judgment against the DHS.

SUPPLEMENTARY INFORMATION

Department of Human Services  
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year ended June 30, 2005

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		\$ 2,040,097	\$ -
Temporary Assistance for Needy Families (TANF)	93.558		50,175,150	-
Low-Income Home Energy Assistance	93.568		1,931,780	-
Child Care and Development Block Grant	93.575		17,491,345	-
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		17,181,253	-
Chafee Education and Training Vouchers Program (ETV)	93.599		288,274	-
Head Start	93.600		177,378	-
Children's Justice Grants to States	93.643		111,288	-
Child Welfare Services - State Grants	93.645		762,958	-
Foster Care - Title IV-E	93.658		23,363,805	-
Adoption Assistance (Title IV-E)	93.659		9,478,610	-
Social Services Block Grant	93.667		13,091,196	1,982,408
Child Abuse and Neglect State Grants	93.669		130,699	-
Family Violence Prevention and Services/Grants for Battered Women's Shelters_Grants to States and Indian Tribes	93.671		864,740	-
Chafee Foster Care Independence Program	93.674		420,234	-
State Children's Insurance Program (SCHIP)	93.767		13,019,855	-
State Survey and Certification of Health Care Providers and Suppliers	93.777		420,986	-
Medical Assistance Program (Medicaid; Title XIX)	93.778		635,831,606	-
Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	93.779		206,127	-
Pass-through State Department of Labor and Industrial Relations Refugee and Entrant Assistance - State Administered Programs	93.566		14,492	-
Pass-through Partners In Development Native American Programs	93.612	90NA7748/01	22,556	-
<b>Total U.S. Department of Health and Human Services</b>			787,024,429	1,982,408
<b>U.S. Department of Agriculture</b>				
Food Stamps <sup>2</sup>	10.551		157,004,403	-
State Administrative Matching Grants for Food Stamp Program	10.561		10,141,944	-
<b>Total U.S. Department of Agriculture</b>			\$167,146,347	\$ -

Department of Human Services  
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2005

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 Justice</b>				
Juvenile Accountability Incentive Block Grants	16.523		\$ 1,087,401	\$ 942,193
Juvenile Justice and Delinquency Prevention_Allocation to States	16.540		984,509	822,868
Title V_Delinquency Prevention Program	16.548		114,990	114,808
Part E_State Challenge Activities	16.549		18,078	17,636
Byrne Formula Grant Program	16.579		263,714	-
<b>Total U.S. Department of Justice</b>			2,468,692	1,897,505
<b>U.S. Department of Labor</b>				
Pass-through State Department of Labor and Industrial Relations				
Senior Community Service Employment Program	17.235	PY02-SCSEP-CC-DHS	218,779	-
Work Incentives Grant	17.266	WI-13249-03-60	317,969	-
<b>Total U.S. Department of Labor</b>			536,748	-
<b>U.S. Department of Education</b>				
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126		9,817,842	852,466
Rehabilitation Long - Term Training	84.129		134,378	-
Independent Living_State Grants	84.169		248,633	201,383
Rehabilitation Services_Independent Living Services for Older Individuals Who are Blind	84.177		282,170	-
Supported Employment Services for Individuals with Severe Disabilities	84.187		170,140	170,140
Assistive Technology	84.224		356,732	325,731
Projects with Industry	84.234		137,688	-
Rehabilitation Services Demonstration and Training Programs	84.235		179,530	-
Rehabilitation Training_State Vocational Rehabilitation Unit In-Service Training	84.265		18,108	-
Safe and Drug-Free Schools and Communities_State Grants (Title IV, Part A, Subpart 1 of ESEA)	84.186		557,615	547,866
<b>Total U.S. Department of Education</b>			\$ 11,902,836	\$ 2,097,586

Department of Human Services  
State of Hawaii

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (continued)

Year ended June 30, 2005

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>Corporation for National and Community Service</b>				
Foster Grandparent Program	94.011		\$ 473,563	\$ -
Senior Companion Program	94.016		411,482	-
<b>Total Corporation for National and Community Service</b>			885,045	-
<b>Social Security Administration</b>				
Social Security - Disability Insurance (DI)	96.001		4,940,176	-
<b>Total Social Security Administration</b>			4,940,176	-
<b>TOTAL FEDERAL EXPENDITURES</b>			<b>\$974,904,273</b>	<b>\$ 5,977,499</b>

<sup>1</sup>The accompanying schedule of expenditures of federal awards is prepared on the cash basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

<sup>2</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**

Report of Independent Certified Public Accountants on  
Compliance and on Internal Control over Financial Reporting Based  
on an Audit of Financial Statements Performed in Accordance  
with *Government Auditing Standards*

The Auditor  
State of Hawaii

We have audited the financial statements of the Department of Human Services, State of Hawaii (DHS) as of and for the year ended June 30, 2005, and have issued our report thereon dated March 1, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America as established by the Auditing Standards Board of the American Institute of Certified Public Accountants 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 in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Accordingly, we express no such opinion. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the DHS's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 05-1 and 05-2.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

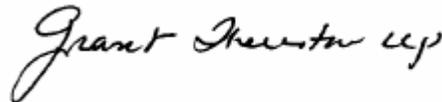
The Auditor  
State of Hawaii

**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 the laws, regulations, contracts, and grant agreements including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D of the Hawaii Revised Statutes) and procurement rules, directives and circulars, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We also noted certain additional matters that we reported to management of DHS in a separate letter dated March 1, 2006.

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



Honolulu, Hawaii  
March 1, 2006

**PART III**

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

Report of Independent Certified Public Accountants on Compliance  
with Requirements Applicable to each Major Program and on Internal Control  
over Compliance in Accordance with OMB Circular A-133

The Auditor  
State of Hawaii

**Compliance**

We have audited the compliance of the Department of Human Services, State of Hawaii (DHS) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2005. 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 as established by the Auditing Standards Board of the American Institute of Certified Public Accountants; 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 05-03 to 05-16 in the accompanying schedule of findings and questioned costs, the DHS did not comply with the following requirements:

CFDA number	Name of federal program	Type of compliance requirement	Ref. no.
95.558	Temporary Assistance to Needy Families (TANF)	Allowable Costs/Cost Principles	05-03
93.777 and 93.778	Medicaid Cluster	Activities Allowed or Unallowed, Allowable Costs/Cost Principles, Eligibility, Special Tests and Provisions	05-4, 05-5, 05-6, 05-7, 05-8, 05-9
93.659	Adoption Assistance (Title IV-E)	Activities Allowed or Unallowed, Eligibility	05-10
93.575 and 93.596	Child Care Cluster	Activities Allowed or Unallowed, Eligibility, Subrecipient Monitoring	05-11, 05-12
96.001	Social Security – Disability Insurance (DI)	Reporting	05-13
93.658	Foster Care – Title IV-E	Activities Allowed or Unallowed, Eligibility	05-14, 05-15
84.126	Rehabilitation Services – Vocational Rehabilitation Grants to States	Eligibility	05-16

The Auditor  
State of Hawaii

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 requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2005.

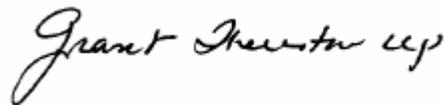
### **Internal Control Over Compliance**

The management of the DHS is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the DHS's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133 and not to provide an opinion on the internal control over compliance. Accordingly, we express no such opinion.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the DHS's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts, and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs as items 05-3 to 05-16.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with the applicable requirements of laws, regulations, contracts, and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 05-03 through 05-16 to be material weaknesses. We also noted other matters involving internal control over compliance that we have reported to management of the DHS in a separate letter dated March 1, 2006.

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



Honolulu, Hawaii  
March 1, 2006

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

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

For the year ended June 30, 2005

Section I – Summary of Auditor’s Results

Our report dated March 1, 2006 on the basic financial statements of the Department of Human Services, State of Hawaii, as of and for the year ended June 30, 2005, contained an unqualified opinion.

*Financial Statements*

Type of auditor’s report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? \_\_\_ yes      √ no
- Reportable condition(s) identified that are not considered to be material weaknesses? √ yes      \_\_\_ none reported
- Noncompliance material to financial statements noted? \_\_\_ yes      √ no

*Federal Awards*

Internal control over major programs:

- Material weakness(es) identified? √ yes      \_\_\_ no
- Reportable condition(s) identified that are not considered to be material weakness(es)? \_\_\_ yes      √ none reported

Type of auditor’s 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 Circular A-133, Section .510(a)?

√ yes      \_\_\_ no

Identification of major programs:

<u>CFDA</u> <u>Number(s)</u>	<u>Name of Federal Program</u>
93.575	Child Care and Development Block Grant
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund
93.659	Adoption Assistance (Title IV-E)
93.777	State Survey Certification of Health Care Providers and Suppliers
93.778	Medical Assistance Program (Medicaid; Title XIX)
96.001	Social Security – Disability Insurance (DI)
93.658	Foster Care – Title IV-E
84.126	Rehabilitation Services – Vocation Rehabilitation Grants to States

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2005

Dollar threshold used to distinguish between Type A and Type B programs: \$3,000,000

Auditee qualified as low-risk auditee?       yes       no

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Section II – Financial Statement Findings

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**Ref.**  
**no. Internal Control Findings**

**05-1 Properly Record All Fixed Assets in the State Property Inventory Records**

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

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

Although the DHS has implemented stricter departmental inventory procedures to properly report fixed asset purchases to the State Procurement Office, personnel did not always adhere to the established procedures.

The Department of Accounting and General Services (DAGS) uses the information from the state property inventory records to assist the DHS in compiling the department's fixed assets and depreciation information for the year. Based on this information, we noted the following conditions:

- The DHS changed the carrying value of items that were acquired in previous years to correctly state the cost of the assets. There were several instances where the items' carrying value was corrected with a net change to the fixed asset listing of \$(709,931).

The finding described above was primarily due to clerical error/oversight.

- There were several instances where the DHS did not perform inventory procedures on furniture and equipment items, resulting in an understatement to the fixed asset listing of \$(558,179).

The finding described above was due to a misunderstanding of whether the purchasing unit or the unit that maintains the items was responsible for performing inventory procedures.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Internal Control Findings (continued)**

- The State Department of Accounting and General Services (DAGS) Public Works Division is responsible for managing the capital improvement projects at the DHS's Office of Youth Services (OYS). The funding for these projects is budgeted for under the DAGS. The DAGS provides the OYS with a report on a monthly basis that includes the total expenditures incurred and the remaining allotment and encumbrance balances, by project, as of the month end. When the encumbrance balance for a project has been totally expended, the project has been completed and should be added to inventory. The OYS added Hawaii Youth Correctional Facility (HYCF) building and land improvement projects that were completed in prior years totaling \$2,430,266 to inventory. This resulted in an understatement to the fixed asset listing in prior years.

The finding described above was due to the oversight of the employee responsible for performing the inventory procedures.

**Recommendation**

To ensure that the state property inventory records are complete and accurate, the DHS should implement monitoring procedures to ensure that all appropriate personnel properly and accurately report all fixed asset acquisitions and dispositions to the State Procurement Office on a quarterly basis. The DHS should implement a process to review, in a timely manner, the transactions that are posted to the department property inventory records to ensure that the transactions were properly posted to the state property inventory records. The DHS's Property and Procurement Office issued an internal communication memorandum in November 2005 stating the purchasing unit of fixed asset items should be responsible for performing inventory procedures unless otherwise agreed upon.

**05-2 Maintain Vacation and Sick Leave Records Properly**

The DHS prepared a summary leave schedule to determine the amount of its accrued compensated absences liability and reported the liability to the State Comptroller. The liability was based on the balance of earned hours per individual leave records (Form DPS-7) multiplied by each employee's hourly salary rate. During our review of 44 leave records and one month of Form G-1, *Application for Leave of Absence*, we noted the following conditions:

- There were 9 instances where the accrued vacation leave hours on the summary leave schedule did not agree to the individual Form DPS-7. This resulted in an overstatement of accrued vacation leave totaling 140 hours or \$2,712.
- There were 5 instances where the accumulated sick leave hours on the summary leave schedule did not agree to the individual Form DPS-7. This resulted in an understatement and overstatement of accumulated sick leave totaling (11) hours or \$330, respectively.

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SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Internal Control Findings (continued)**

- There was 1 instance where the accrued compensatory time hours on the summary leave schedule did not agree to the individual Form DPS-7. This resulted in an understatement of accrued compensatory time totaling (1) hour or \$(25).
- There was 1 instance where an employee's accrued vacation leave hours carried forward from their 2004 to 2005 leave record exceeded the 720 hour limit. This resulted in an overstatement of accrued vacation leave totaling 20 hours or \$539.
- There were 23 instances where the Form G-1, *Application for Leave of Absence*, was authorized after the employee took vacation.
- There was 1 instance where there was no supervisor approval indicated on the Form G-1, *Application for Leave of Absence*.
- There were 2 instances where there was no supervisor approval date indicated on the Form G-1, *Application for Leave of Absence*.

The findings described above are primarily due to clerical error/oversight.

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

**Recommendation**

We recognize that approvals of vacation could occur after the fact, such as when an employee must care for a dependent who becomes ill the night before. In those instances, we recommend that the employee's record be annotated to reflect that telephonic approval was given.

The DHS should increase the number of random quality control reviews of leave records and perform them periodically throughout the year to ensure that vacation and sick leave and compensatory time records are accurately maintained and reviewed on a timely basis. The reviews should include ensuring that there is a secondary review performed on the leave records by the supervisor of the employee responsible for maintaining the records. In addition, a secondary review of the summary leave schedule should be performed before reporting the balances to the State Comptroller, including ensuring that the beginning balances are correct.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2005

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Section III – Federal Award Findings and Questioned Cost

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**Ref.**

**no. Compliance and Internal Control Findings**

**05-3 Allocate Costs Properly**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.558, Temporary Assistance to Needy Families (TANF)

The DHS prepares a departmental cost allocation on a quarterly basis which allocates costs that are not directly chargeable to one specific program based on allocation methods contained in its cost allocation plan which is approved by the Director of the U.S. Department of Health and Human Services Division of Cost Allocation.

In accordance with DHS's approved cost allocation plan, the DHS allocates costs incurred by the Management Services Office (MSO) Quality Control (QC) unit based on the actual number of cases worked on, by program, for the quarter. The supervisor of the MSO QC unit prepares a memorandum which summarizes the percentage of cases worked on, by program, for the cost allocation accountant to allocate the costs accordingly.

During our review of the quarter end December 31, 2004 cost allocation, we noted costs incurred by the MSO QC unit totaling \$21,087 was erroneously charged to the TANF grant. The finding was due to the misunderstanding of the proper grant to charge by the MSO QC supervisor.

**Recommendation**

To ensure that the costs contained in the DHS's departmental cost allocation are allocated properly, all employees responsible for preparing supporting cost allocation documents should seek guidance regarding the proper grant to charge if they are unsure. The error was corrected on the quarter end September 30, 2005 and December 31, 2005 cost allocations.

**05-4 Improve Utilization Controls over Medicaid Claims**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

The Hawaii Prepaid Medical Management Information System (HPMMIS) was implemented and is being operated and maintained by the Arizona Health Care Cost Containment System (AHCCCS). In addition, the management and processing of pharmacy benefits was contracted to Affiliated Computer Services (ACS).

As discussed in the prior year's auditors' report, the HPMMIS was not able to produce the Surveillance and Utilization Review reports. In addition, post payment reviews of electronic media claims was not being

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

performed and the use of a third party healthcare auditing and consulting company to audit the pharmacy benefits manager's operations was discontinued.

Due to the complexity of the Medicaid processing function and the large volume of Medicaid transactions, it is imperative for DHS to obtain these necessary HPMMIS reports to ensure compliance with federal regulations.

Based on our discussion with DHS personnel, we noted that DHS has been working with AHCCCS on obtaining these necessary HPMMIS reports. Meanwhile, the MQD continues to review claims payment on an ad hoc basis when payment issues are reported by DHS staff, ACS staff or providers.

**Recommendation**

DHS should obtain the necessary HPMMIS management reports to allow post payment review of recipient utilization and provider service profiles and exception criteria based on parameters set by the MQD.

**05-5 Improve Accuracy of Medicaid Claims Processing**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Due to the complexity of the Medicaid processing function and the large volume of Medicaid transactions, it is imperative for DHS to perform regular post payment reviews on sample claims to detect processing errors and identify ways to improve the claims processing systems and procedures.

During our review of 120 claims (60 drug and 60 non-drug), we noted the following:

- 2 drug claims in which there was an aggregate overpayment of \$21,287.

DHS contracted Heritage Information Systems, Inc. to perform pharmacy claims audits. The audit results will be used to correct and collect overpayments made by the ACS pharmacy benefits manager.

**Recommendation**

DHS should perform regular post payment reviews on a sample of claims to detect processing errors and identify ways to improve the claims processing system and procedures.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2005

**Ref.**  
**no.**    **Compliance and Internal Control Findings (continued)**

**05-6    Improve Controls over the Medicaid Drug Rebate Program**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

The Centers for Medicare and Medicaid (CMS) program release No. 29 requires that interest must be collected and cannot be disregarded as part of the dispute resolution process by either the manufacturer or the State. CMS program release No. 65 further clarifies that although the obligation for calculating the interests due to the States on late rebate payments rests with the manufacturer, it is the State's responsibility to track the collection of interest due, and report those amounts to CMS.

Med-Quest Division (MQD) contracts with Affiliated Computer Services, Inc. (ACS) to perform the daily operations of the drug rebate program including billing, collection, accounting and dispute resolution. On a quarterly basis, the MQD reports the drug rebate collections including any interest received on Form CMS 64.9R. This amount is used to reduce the amount to be reimbursed by the federal agency for the federal share of expenditures for the Medicaid Program. As discussed in prior year's audit, the MQD did not have adequate controls to verify if rebate interest payments were collected. During our review of the drug rebate collection supporting schedules, we noted only minimal voluntary interest being collected. As a result, the federal agency may be overcharged for the federal share of expenditures.

**Recommendation**

DHS should establish procedures to monitor their subcontractor to ensure rebate interest payments are collected and not disregarded as part of the dispute resolution process by either the manufacturer or the DHS.

**05-7    Maintain All Required Documentation in Medicaid Case Files**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

During our review of 40 case files, we noted 7 case files in which application, renewal and/or eligibility determination forms were missing or not properly completed.

Often a lack of time and resources as well as clerical error/oversight have contributed to the findings described above. In addition, we also noted a higher priority is placed on updating the information in the database rather than completing the forms in the case files.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2005

**Ref.**  
**no.**    **Compliance and Internal Control Findings (continued)**

**Recommendation**

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

**05-8    Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Title 42 CFR Part 435.911 requires the determination of eligibility to be made within 45 days from the date of application for all applicants except for applications made on the basis of disability in which it is 60 days. In order to reduce the backlog of applications, the DHS MQD Eligibility Branch (EB) adopted policies of presumptive eligibility and client self-declaration.

Presumptive eligibility requires that applicants receive services if a decision on eligibility has not been made within the above specified timeframe. Self-declaration requires eligibility determinations to be based on the information provided on the application form. Self-declared information is supposed to be verified by the EB whenever possible; however, such verification is often not performed until the annual eligibility review for redetermination.

While these procedural changes have reduced the backlog of outstanding applications, they have increased the likelihood that ineligible persons may be receiving benefits and also placed more reliance on subsequent eligibility re-verifications to verify clients remain eligible to receive benefits.

During our review of 40 case files, we noted 1 case file in which the redetermination was not made in a timely manner.

As of June 30, 2005, we found approximately 675 applications outstanding greater than 45 days for the MQD. In addition, the number of overdue annual re-verifications for MQD was approximately 1004 as of June 30, 2005. While the number of applications outstanding greater than 45 days decreased, the number of overdue annual re-verifications for MQD increased. Staffing problems continue to contribute to the backlog of applications, pending eligibility determinations, and overdue annual re-verifications.

In June 2004, the EB introduced passive renewals for families with children in an attempt to reduce the number of overdue annual re-verifications, however, the number of overdue annual re-verifications for MQD as of June 30, 2005 increased compared to the prior year.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**Recommendation**

DHS should assess the staffing needs at the EB and make every effort to ensure each unit is fully staffed with trained personnel in order to timely process applications and perform annual re-verifications. Adequate staffing would likely reduce the backlog of applications, pending eligibility determinations, and overdue annual re-verifications and also minimize the risk that ineligible recipients are receiving Medicaid benefits.

**05-9 Maintain All Required Provider Documentation**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

In order to participate in the Medicaid program, providers are required to have a current and valid written agreement on file with MQD except for providers for the Social Services Division and State of Hawaii Department of Health, Adult Mental Health Division which use contracts in place of provider agreements. A completed and signed Provider Information Form (Form 1139) constitutes the full written agreement. Title 42 CFR part 455, subpart B also requires providers to make certain required disclosures to the State. These required disclosures are included in the Provider Information Form and contracts.

In our review of 32 MQD provider files, we noted the following:

- 1 case where the provider agreement was not present.
- 5 cases where the supplemental attachments of the provider agreements were not signed.

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

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

**05-10 Maintain All Required Documentation in Adoption Assistance Case Files**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.659, Adoption Assistance (Title IV-E)

During our review of 30 case files, we noted 13 case files in which required forms were missing or not properly completed including the amount, duration of payment, etc.

The findings described above are primarily due to clerical error/oversight.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2005

**Ref. no. Compliance and Internal Control Findings (continued)**

The effective dates of the adoption assistance agreements for the case files selected for testing ranged from 1995 to 2005.

**Recommendation**

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

**05-11 Maintain All Required Documentation in Child Care Case Files**

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

During our review of 40 case files, we noted the following:

- 2 case files were missing required documentation supporting eligibility determinations. These include children's birth certificates, baptismal or hospital certificates, or court decree.
- 2 case files were missing required documentation supporting \$576 in child care benefit payments. These include child care receipt and verification of service forms.
- 8 case files in which redeterminations were not made in a timely manner.
- In addition, we also noted several case files in which the application forms and/or other forms were missing or not properly completed.

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

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

**05-12 Ensure All Subrecipients are Identified for Subrecipient Monitoring**

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

OMB Circular A-133 provides guidance to grantees who provide funds to subrecipients. Section 210 of the circular also provides guidance in assisting grantees in differentiating between a subrecipient and a vendor.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2005

**Ref.**  
**no.**    **Compliance and Internal Control Findings (continued)**

In October of each year, the department's Management Services Office (MSO) sends a memo to the divisions requesting a list of subrecipients that were contracted during the previous year. The listing is used to identify the subrecipients for monitoring purposes.

During the prior-year audit, we noted that while MSO performed subrecipient monitoring for the different programs, no monitoring was done in 2004 on any of the subrecipients who received Child Care funds in 2003. Upon inquiry, we were informed that the program had not provided the names of these entities to the MSO because the program had considered the entities to be vendors and not subrecipients.

We recommended that the program seek guidance from the federal cognizant agency, oversight agency or the federal awarding agency as to the attributes of a subrecipient versus a vendor relationship as they relate to this specific program. Once such guidance is received, the program should evaluate each of its agreements and document the rationale for its decision.

In October 2005, the program received guidance from the Federal Agency indicating that they would consider the providers under the program's service agreements to be subrecipients. Accordingly, the program will consider these providers to be subrecipients in future contracts and supplemental agreements and comply with the applicable subrecipient monitoring requirements prospectively.

**Recommendation**

We recommend that the program evaluate each of its agreements, document the rationale for its decision and provide the names of the entities determined to be subrecipients to MSO to perform subrecipient monitoring in order to comply with the subrecipient monitoring requirements.

**05-13    Improve the Accuracy of Reports**

Federal agency: Social Security Administration  
CFDA 96.001, Social Security – Disability Insurance (DI)

According to POMS DI 36506.230, the Form SSA-4514, Time Report of Personnel Services, is due quarterly to account for employee time. During our review of the quarterly reports, we noted that 2 out of 4 reports submitted during the year presented incorrect information.

- One report included additional overtime hours.
- One report did not include additional overtime hours as provided for in supporting documents.

The findings described above are primarily due to clerical error/oversight.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2005

**Ref.**  
**no.**    **Compliance and Internal Control Findings (continued)**

**Recommendation**

We recommend that DHS implement review procedures to ensure that information presented on required reports is complete and accurate before it is submitted to the Federal oversight agency.

**05-14    Improve Accuracy of Foster Care Maintenance Payments**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.658, Foster Care – Title IV-E

According to USC 672(b)(1) and (2), and 675(4), Foster Care maintenance payments may be made on behalf of eligible children to individuals serving as foster family homes. During our review of 40 Foster Care maintenance payments, we noted the following:

- 1 instance where an incorrect amount was paid to foster parents.
- 1 instance where the maintenance payments were not supported by required documentation.
- 1 instance of an overclaim for maintenance payments.

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the foster care maintenance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed and foster care maintenance payments are the correct amount.

**05-15    Maintain All Required Documentation in Foster Care Files**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.658, Foster Care – Title IV-E

According to 42 USC 672(a), the child must meet the eligibility requirements of the former Aid to Families with Dependent Children (AFDC) program. To meet this requirement, the Department uses Form DHS 1577D, "Certification of Initial Eligibility for Title IV-E Foster Care," to document eligibility determinations. During our review of 40 Foster Care files, we noted 1 instance in which the Form 1577D was not properly completed as there was no indication if the child was deprived of parental support or care. In addition, we also noted that the foster parent's licensing file did not contain supporting documentation to verify a marriage. According to 45 CFR 1356.30(a) and (b), the foster family home provider must have satisfactorily met a criminal records check.

Department of Human Services  
State of Hawaii

SCHEDULE OF FINDINGS AND QUESTIONED COSTS (continued)

Year ended June 30, 2005

**Ref.**  
**no.**    **Compliance and Internal Control Findings (continued)**

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the foster care maintenance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

**05-16    Maintain All Required Documentation in Case Files**

Federal agency: U.S. Department of Education  
CFDA 84.126, Rehabilitation Services – Vocation Rehabilitation Grants to States

According to 29 USC 722(a)(3), an individual who is a beneficiary of Social Security Disability Insurance (SSDI) or Supplemental Security Income (SSI) is presumed to be eligible for vocational rehabilitation services. During our review of 30 case files, we noted 6 instances where the case files did not contain proper supporting documentation to confirm whether the individuals were recipients of SSDI or SSI, but they were determined to be eligible.

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the eligibility of the individuals who are provided with vocational rehabilitation services. A secondary review would help to ensure all required documents are properly completed.

**PART V**

**SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS**

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Year ended June 30, 2005

This section contains the current status of prior audit recommendations. The recommendations are referenced to the pages of the previous audit report for the fiscal year ended June 30, 2005, dated April 14, 2005.

**Ref.**

**no. Internal Control Findings**

**04-1 Properly Record All Fixed Assets in the State Property Inventory Records (page 54)**

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

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

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

The Department of Accounting and General Services (DAGS) uses the information from the state property inventory records to assist the DHS in compiling the department's fixed assets and depreciation information for the year. We noted that during the current year, the DHS changed the carrying value of items that were acquired in previous years to correctly state the cost of the assets.

We noted several instances where the items' carrying value was corrected with a net change to the fixed asset listing of approximately \$82,000.

**Recommendation**

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

**Status**

Not accomplished. See reference No. 05-1.

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Internal Control Findings (continued)**

**04-2 Maintain Vacation and Sick Leave Records Properly (page 55)**

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

- There were numerous instances where the Form G-1, *Application for Leave of Absence*, was authorized after the employee took vacation.
- There were numerous instances where the accrued vacation and sick leave hours on the summary leave schedule did not agree to the individual Form DPS-7.
- There were two instances where sick leave taken and approved on Form G-1, *Application for Leave of Absence*, was not recorded on the employee's Form DPS-7. This resulted in an overstatement of sick leave totaling 59 hours or \$1,136.

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

**Recommendation**

We recognize that approvals of vacation could occur after the fact, such as when an employee must care for a dependent who becomes ill the night before. In those instances, we recommend that the employee's record be annotated to reflect that telephonic approval was given.

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

**Status**

Not accomplished. See reference No. 05-2.

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Compliance and Internal Control Findings**

**04-3 Improve Utilization Controls over Medicaid Claims (page 56)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

In the prior year, the Hawaii Prepaid Medical Management Information System (HPMMIS) was implemented and is being operated and maintained by the Arizona Health Care Cost Containment System (AHCCCS). In addition, the management and processing of pharmacy benefits was contracted to Affiliated Computer Services (ACS).

As discussed in the prior year's auditors' report, the HPMMIS was not able to produce the Surveillance and Utilization Review reports. In addition, post payment reviews of electronic media claims was not being performed and the use of a third party healthcare auditing and consulting company to audit the pharmacy benefits manager's operations was discontinued.

Due to the complexity of the Medicaid processing function and the large volume of Medicaid transactions, it is imperative for DHS to obtain these necessary HPMMIS reports to ensure compliance with federal regulations.

Based on our discussion with DHS personnel, we noted that DHS has been working with AHCCCS on obtaining these necessary HPMMIS reports. Meanwhile, the MQD continues to review claims payment on an ad hoc basis when payment issues are reported by DHS staff, ACS staff or providers.

**Recommendation**

DHS should obtain the necessary HPMMIS management reports to allow post payment review of recipient utilization and provider service profiles and exception criteria based on parameters set by the MQD.

**Status**

Not accomplished. See reference No. 05-4.

**04-4 Improve Accuracy of Medicaid Claims Processing (pages 56-57)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

Due to the complexity of the Medicaid processing function and the large volume of Medicaid transactions, it imperative for DHS to perform regular post payment reviews on sample claims to detect processing errors and identify ways to improve the claims processing systems and procedures.

During our review of 120 claims (60 drug and 60 non-drug), we noted the following:

- 5 non-drug claims in which there was a net aggregate overpayment of \$7,586. Approximately \$5,100 was related to a nursing facility services claim in which there was no prior authorization for the specified period. There was authorization for the periods prior and subsequent to the specified period.

DHS contracted Heritage Information Systems, Inc. to perform pharmacy claims audits. The audit results will be used to correct and collect overpayments made by the ACS pharmacy benefit manager.

**Recommendation**

DHS should perform regular post payment reviews on a sample of claims to detect processing errors and identify ways to improve the claims processing system and procedures.

**Status**

Not accomplished. See reference No. 05-5.

**04-5 Implement Controls To Ensure the Medicaid Program is Credited Timely for Outstanding or Uncashed Checks (page 57)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

CFR Title 42, Section 433.40(c) requires the State to credit the Medicaid program for checks that are outstanding or uncashed beyond 180 days of issuance. If the State has claimed and received Federal Financial Participation (FFP) for the amount of the uncashed check, it must refund the amount of FFP received. At the end of each calendar quarter, the State must identify those checks which remain uncashed beyond a period of 180 days after issuance. The State must refund all FFP that it received for uncashed checks by adjusting the Quarterly Statement of Expenditures for that quarter.

Med-Quest Division (MQD) contracts with Affiliated Computer Services, Inc. (ACS) to serve as the Medicaid fiscal agent. ACS is responsible for paying fee-for-service claims. During our audit, we noted MQD did not have adequate controls to monitor ACS's monthly bank reconciliations to properly credit the Medicaid program for checks that are outstanding or uncashed beyond 180 days of issuance. As a result, the federal agency may be overcharged for the federal share of expenditures.

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

While MQD did not adhere to the Federal regulations concerning outstanding or uncashed checks beyond 180 days of issuance, we noted that they did have controls in place to properly credit the Medicaid program for interest earned on the FFP portion.

**Recommendation**

DHS should implement controls to adequately monitor ACS's monthly bank reconciliations to properly credit the Medicaid program for checks that are outstanding or uncashed beyond 180 days of issuance.

**Status**

Accomplished.

**04-6 Improve Controls over the Medicaid Drug Rebate Program (page 58)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

The Centers for Medicare and Medicaid (CMS) program release No. 29 requires that interest must be collected and cannot be disregarded as part of the dispute resolution process by either the manufacturer or the State. CMS program release No. 65 further clarifies that although the obligation for calculating the interests due to the States on late rebate payments rests with the manufacturer, it is the State's responsibility to track the collection of interest due, and report those amounts to CMS.

Med-Quest Division (MQD) contracts with Affiliated Computer Services, Inc. (ACS) to perform the daily operations of the drug rebate program including billing, collection, accounting and dispute resolution. On a quarterly basis, the MQD reports the drug rebate collections including any interest received on Form CMS 64.9R. This amount is used to reduce the amount to be reimbursed by the federal agency for the federal share of expenditures for the Medicaid Program. MQD did not have adequate controls to verify if rebate interest payments were collected. During our review of the ACS Drug Rebate reports, we noted only minimal voluntary interest being collected. As a result, the federal agency may be overcharged for the federal share of expenditures.

In a report dated July 28, 2003, the U.S. Department of Health and Human Services, Office of the Inspector General reported similar findings and recommendations from an audit of the Hawaii Medicaid Drug Rebate program for the year ended June 30, 2002.

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

We also noted a section regarding the calculation of interest on disputed or unpaid amounts and late drug rebate payments in ACS's Drug Rebate Policies and Procedures dated March 2005.

**Recommendation**

DHS should ensure rebate interest payments are collected and not disregarded as part of the dispute resolution process by either the manufacturer or the DHS.

**Status**

Not accomplished. See reference No. 05-6.

**04-7 Maintain All Required Documentation in Medicaid Case Files (pages 58-59)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

During our review of 30 case files, we noted 17 case files in which application, renewal and/or eligibility determination forms were missing or not properly completed.

Often a lack of time and resources as well as clerical error/oversight have contributed to the findings described above. In addition, we also noted a higher priority is placed on updating the information in the database rather than completing the forms in the case files.

**Recommendation**

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

**Status**

Not accomplished. See reference No. 05-7.

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**04-8 Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner (pages 59-60)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

Title 42 CFR Part 435.911 requires the determination of eligibility to be made within 45 days from the date of application for all applicants except for applications made on the basis of disability in which it is 60 days. In order to reduce the backlog of applications, the DHS MQD Eligibility Branch (EB) adopted policies of presumptive eligibility and client self-declaration.

Presumptive eligibility requires that applicants receive services if a decision on eligibility has not been made within the above specified timeframe. Self-declaration requires eligibility determinations to be based on the information provided on the application form. Self-declared information is supposed to be verified by the EB whenever possible; however, such verification is often not performed until the annual eligibility review for redetermination.

While these procedural changes have reduced the backlog of outstanding applications, they have increased the likelihood that ineligible persons may be receiving benefits and also placed more reliance on subsequent eligibility re-verifications to verify clients remain eligible to receive benefits.

During our review of 30 case files, we noted 4 case files in which redeterminations were not made in a timely manner.

As of June 30, 2004, we found approximately 760 applications outstanding greater than 45 days. In addition, the number of overdue annual re-verifications for MQD was approximately 850 as of June 30, 2004. Staffing problems continue to contribute to the backlog of applications, pending eligibility determinations, and overdue annual re-verifications.

In June 2004, the EB introduced passive renewals for families with children in an attempt to reduce the number of overdue annual re-verifications.

**Recommendation**

DHS should assess the staffing needs at the EB and make every effort to ensure each unit is fully staffed with trained personnel in order to timely process applications and perform annual re-verifications. Adequate staffing would likely reduce the backlog of applications, pending eligibility determinations, and overdue annual re-verifications and also minimize the risk that ineligible recipients are receiving Medicaid benefits.

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2005

**Ref. no.** **Compliance and Internal Control Findings (continued)**

**Status**

Not accomplished. See reference No. 05-8.

**04-9 Maintain All Required Provider Documentation (page 60)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.777, State Survey Certification of Health Care Providers and Suppliers  
CFDA 93.778, Medical Assistance Program (Medicaid; Title XIX)

In order to participate in the Medicaid program, providers are required to have a current and valid written agreement on file with MQD except for providers for the Social Services Division which uses contracts in place of provider agreements. A completed and signed Provider Information Form (Form 1139) constitutes the full written agreement. Title 42 CFR part 455, subpart B also requires providers to make certain required disclosures to the State. These required disclosures are included in the Provider Information Form and contracts.

In our review of 32 provider files, we noted the following:

- 3 cases where the provider agreement was not present
- 1 case where the provider agreement was not signed

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

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

**Status**

Not accomplished. See reference No. 05-9.

**04-10 Maintain All Required Documentation in Adoption Assistance Case Files (pages 60-61)**

Federal agency: U.S. Department of Health and Human Services  
CFDA 93.659, Adoption Assistance (Title IV-E)

During our review of 30 case files, we noted several case files in which required forms were missing or not properly completed including the amount, duration of payment, authorizing signature, etc.

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

The findings described above are primarily due to clerical error/oversight.

The effective dates of the adoption assistance agreements for the case files selected for testing ranged from 1991 to 2003.

**Recommendation**

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

**Status**

Not accomplished. See reference No. 05-10.

**04-11 Maintain All Required Documentation in Child Care Case Files (page 61)**

Federal agency: U.S. Department of Health and Human Services

CFDA 93.575, Child Care and Development Block Grant

CFDA 93.596, Child Care Mandatory and Matching Funds of the Child Care and Development Fund

During our review of 30 case files, we noted the following:

- 5 case files were missing required documentation supporting \$1,621 in child care benefit payments. These include child care receipt and verification of service forms.
- 9 case files in which redeterminations were not made in a timely manner.
- In addition, we also noted several case files in which the application forms and/or other forms were missing or not properly completed.

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

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

**Status**

Not accomplished. See reference No. 05-11.

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

**04-12 Improve the Accuracy of Child Care Reimbursements (pages 61-62)**

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

During our review of 30 case files, we noted the following:

- 4 case files in which there was a net aggregate overpayment of \$902.

The findings described above are primarily due to clerical error/oversight.

**Recommendation**

The DHS should ensure that reimbursements to child care program participants are calculated properly in accordance with program policies and procedures.

**Status**

Accomplished.

**04-13 Ensure All Subrecipients are Identified for Subrecipient Monitoring (page 62)**

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

OMB Circular A-133 provides guidance to grantees who provide funds to subrecipients. Section 210 of the circular also provides guidance in assisting grantees in differentiating between a subrecipient and a vendor.

In October of each year, the department's Management Services Office (MSO) sends a memo to the divisions requesting a list of subrecipients that were contracted during the previous year. The listing is used to identify the subrecipients for monitoring purposes.

While MSO performs subrecipient monitoring for the different programs, no monitoring was done in 2004 on any of the subrecipients who received Child Care funds in 2003. Our review of MSO's list of 2003 subrecipients did not disclose any subrecipients relating to the Child Care program.

However, our discussion with the Child Care program accountant indicated that there were several not-for-profit and governmental organizations that did receive funds in 2003 and provided services for the program.

Department of Human Services  
State of Hawaii

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS (continued)

Year ended June 30, 2005

**Ref.  
no.**

**Compliance and Internal Control Findings (continued)**

Upon inquiry, we were informed that the program had not provided the names of these entities to the MSO because the program had considered the entities to be vendors and not subrecipients.

**Recommendation**

We recommend that the program seek guidance from the federal cognizant agency, oversight agency or the federal awarding agency as to the attributes of a subrecipient versus a vendor relationship as they relate to this specific program. Once such guidance is received, the program should evaluate each of its agreements and document the rationale for its decision.

**Status**

Not accomplished. See reference No. 05-12.

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

LINDA LINGLE  
GOVERNOR



LILLIAN B. KOLLER, ESQ.  
DIRECTOR

HENRY OLIVA  
DEPUTY DIRECTOR

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

May 19, 2006

Mr. Howard Hanada  
Grant Thornton LLP  
1132 Bishop Street, Suite 1000  
Honolulu, Hawaii 96813

Dear Mr. Hanada:

Attached are the Department of Human Services' responses and corrective action plans related to your fiscal year 2005 audit report findings and recommendations. We appreciate the opportunity to comment on the audit report.

Sincerely,

A handwritten signature in black ink, appearing to read "Lillian B. Koller".

Lillian B. Koller, Esq.  
Director

Attachment

**Ref. no. 05-1**

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

Auditor's  
Recommendation:

To ensure that the state property inventory records are complete and accurate, the DHS should implement monitoring procedures to ensure that all appropriate personnel properly and accurately report all fixed asset acquisitions and dispositions to the State Procurement Office on a quarterly basis. The DHS should implement a process to review, in a timely manner, the transactions that are posted to the department property inventory records to ensure that the transactions were properly posted to the state property inventory records. The DHS's Property and Procurement Office issued an internal communication memorandum in November 2005 stating the purchasing unit of fixed asset items should be responsible for performing inventory procedures unless otherwise agreed upon.

Corrective Action  
Taken or Planned:

In March 2003, stricter departmental inventory procedures were issued establishing each employee as being responsible and accountable for maintaining and safeguarding 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 been 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 to respond to and reconcile a Department of Accounting and General Services (DAGS) - Inventory Management Branch Report called the FAMIS Expenditures for State Property. This report requests verification that the department's FAMIS payment transactions for state properties are recorded in the DAGS Fixed Asset Inventory System (FAIS). This statewide monitoring and reconciliation process was implemented to preserve the financial reporting integrity of the FAIS. As such, monitoring procedures are in place on a statewide basis.

In November 2005, a DHS memorandum, FMO Circular 05-05 was issued to clarify the responsibility of inventory reporting, to address situations in which it is uncertain as to who is the responsible reporting office.

The department uses the detailed procedures outlined in the DAGS Inventory System Manual and the Hawaii Administrative Rules (HAR) to provide instructions and guidelines for all DHS offices with inventory responsibilities. In addition, the department

issues internal circulars and memorandums that serve to update any procedural 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, minimizing any human/clerical errors and oversights.

The department has also provided inventory training in partnership with DAGS Inventory Management Branch and plans to conduct refresher training sessions in the near future. The Fiscal Management Office, Property & Procurement Staff (FMO/PP) is currently in the process of developing a training curriculum and training materials and has plans to conduct the sessions in the next few months. Department offices are also encouraged to consult with FMO/PP as necessary, whenever questions arise, thus providing "on-the-job" training.

Start Date: Ongoing

End Date: Ongoing

Responding Person: Susy Kawamoto, Property & Procurement Staff Supervisor;  
Fiscal Management Office (FMO)

**Ref. no. 05-2**

**Maintain Vacation and Sick Leave Records Properly**

Auditor's Recommendation: We recognize that approvals of vacation could occur after the fact, such as when an employee must care for a dependent who becomes ill the night before. In those instances, we recommend that the employee's record be annotated to reflect that telephonic approval was given.

The DHS should increase the number of random quality control reviews of leave records and perform them periodically throughout the year to ensure that vacation and sick leave and compensatory time records are accurately maintained and reviewed on a timely basis. The reviews should include ensuring that there is a secondary review performed on the leave records by the supervisor of the employee responsible for maintaining the records. In addition, a secondary review of the summary leave schedule should be performed before reporting the balances to the State Comptroller, including ensuring that the beginning balances are correct.

Corrective Action Taken or Planned: The DHS will continue random audits of leave records, training of staff personnel assigned the duties of maintaining the leave records, and training of supervisory personnel on leave records.

The DHS will review departmental procedures governing the process of approving leave requests. The department will also consult with the appropriate agencies to ensure that the procedures comply with the collective bargaining units.

To improve the accuracy of the summary leave schedule, the FMO Pre-Audit Staff (FMO/PA) plans to increase the number of random reviews of the summary leave schedule to 10% of the approximately 2,000 employees. In addition, the beginning balances will also be reviewed to ensure that the correct balances are being reported on the summary leave schedule.

Start Date: Ongoing

End Date: Ongoing

Responding Persons: Edwin Nose, Personnel Officer; Personnel Office (PERS)  
Eloise Uehara, Pre-Audit Staff Supervisor; FMO

**Ref. no. 05-3                      Allocate Costs Properly**

Auditor's Recommendation: To ensure that the costs contained in the DHS's departmental cost allocation are allocated properly, all employees responsible for preparing supporting cost allocation documents should seek guidance regarding the proper grant to charge if they are unsure. The error was corrected on the quarter end September 30, 2005 and December 31, 2005 cost allocations.

Corrective Action Taken or Planned: The MSO/QC supervisor responsible for submitting the quarterly cost allocation report will seek clarification from the FMO Accounting Staff (FMO/ACCTG) whenever there is a question regarding the appropriate grant or funding source to use for any new or different federal programs in relation to MSO/QC activities.

FMO/ACCTG will review the cost allocation results and check for any discrepancies or anomalies, such as by comparison with prior quarters. If there are any significant discrepancies, FMO/ACCTG will serve as the central office to notify MSO/QC and implement the necessary corrective actions. This procedure is applicable for all departmental programs.

Start Date: Ongoing  
End Date: Ongoing  
Responding Persons: John Kapanui, QC Supervisor; MSO  
Emily Ung, Accounting Staff Supervisor; FMO

**Ref. no. 05-4                      Improve Utilization Controls over Medicaid Claims**

Auditor's Recommendation: DHS should obtain the necessary HPMMIS management reports to allow post-payment review of recipient utilization and provider service profiles and exception criteria based on parameters set by the Med-QUEST Division (MQD).

Corrective Action Taken or Planned: Some of the reports have been generated. However, due to staffing shortages these reports have not been reviewed to ensure that they have been correctly programmed. At the end of May 2006, all nursing positions will be filled. The Medical Standards Branch plans to do the following:

- Reassign functions to persons currently covering for more than one position so that nurses assigned to SURS will be able to devote some time for the review of these reports
- Establish a plan and set up the criteria for the review of the reports for completeness and, based on online claims history, verify that these reports are correctly programmed
- Prioritize the reports
- Develop a timetable for periodic review of the reports and criteria for more detailed review of certain cases
- Initiate the review process

Start Date: Ongoing  
End Date: Ongoing  
Responding Person: Angelina Payne, Acting MQD Administrator; MQD

**Ref. no. 05-5                      Improve Accuracy of Medicaid Claims Processing**

Auditor's Recommendation: DHS should perform regular post payment reviews on a sample of claims to detect processing errors and identify ways to improve the claims processing system and procedures.

Corrective Action Taken or Planned: For drug claims paid by ACS-PBM on behalf of the DHS, Heritage continues to perform regular post payment reviews. It also conducts reviews to ensure that claims submitted by pharmacies meet federal and state pharmacy requirements and that quantities and price extensions are correct. The DHS is reviewing the PBM audit RFP for this utilization review function.

The DHS receives utilization management reports from ACS-PBM. DHS staff review these reports and instruct ACS-PBM to recover overpayments.

ACS-PBM will be implementing a revised version of its claims processing system in the summer of 2006. This revision will allow ACS-PBM to identify and correct errors in programming much more quickly and will promote more accurate claims payment.

Many errors are committed during data entry. One project the fiscal agent and DHS are working on is to implement a process to scan in claims rather than having to data enter each line of a claim thereby decreasing the data input error rate. This system is projected to go live in June 2006.

The DHS and the Fiscal Agent are also working on revising and updating the Provider Manual and the operational procedure manual to assure consistency in operations.

The DHS will be reviewing incentives that are paid to the fiscal agent and include penalties for claim processing errors. As part of the incentive/penalty a post-payment review process for claims will be developed.

Start Date: Ongoing

End Date: Ongoing

Responding Person: Angelina Payne, Acting MQD Administrator; MQD

**Ref. no. 05-6 Improve Controls over the Medicaid Drug Rebate Program**

Auditor's Recommendation: DHS should establish procedures to monitor their subcontractor to ensure rebate interest payments are collected and not disregarded as part of the dispute resolution process by either the manufacturer or the DHS.

Corrective Action Taken or Planned: DHS has decided to use a contractor to do this and has written an RFP for the audit of various aspects of the PBM including the drug rebate. This RFP is currently under review.

Start Date: May 2005  
End Date: Ongoing  
Responding Person: Brian Pang, Finance Officer; MQD

**Ref. no. 05-7                      Maintain All Required Documentation in Medicaid Case Files**

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

Corrective Action Taken or Planned: The importance of properly completing and filing required departmental forms has been emphasized to the MQD Eligibility Branch Supervisors and Eligibility Workers. Supervisory case reviews will include evaluation of proper documentation and case record maintenance.

MQD will work with the Benefit, Employment and Support Services Division (BESSD) to establish procedures to ensure that medical case records include the required documentation in instances when medical assistance is continued following the closure of financial assistance programs.

Understaffing and staff turnovers have caused deficiencies in case record documentation and maintenance. Efforts are made to fill vacancies expeditiously and additional staffing will be sought within available resources.

Two of the seven cases with errors were maintained by BESSD. At the Branch Administrators' meeting, administrators will be notified of findings and asked to remind staff of the importance of completing and signing all forms.

Start Date: Ongoing  
End Date: Ongoing  
Responding Persons: Alan Takahashi, Eligibility Branch Administrator; MQD  
Kristine M. Foster, Financial Assistance Program Administrator;  
BESSD

**Ref. no. 05-8**

**Complete Eligibility Applications and Annual Eligibility Re-  
verifications in a Timely Manner**

Auditor's  
Recommendation:

DHS should assess the staffing needs at the EB and make every effort to ensure each unit is fully staffed with trained personnel in order to timely process applications and perform annual re-verifications. Adequate staffing would likely reduce the backlog of applications, pending eligibility determinations, and overdue annual re-verifications and also minimize the risk that ineligible recipients are receiving Medicaid benefits.

Corrective Action  
Taken or Planned:

The EB will request additional positions in the Biennium Budget for submission to the 2007 State Legislature.

All efforts will be made to expedite the recruitment process to fill vacancies within the EB. Recruitment efforts will be initiated immediately upon news of any anticipated vacancies.

The EB is utilizing temporary 89-day appointments to fill vacant eligibility worker and clerical support positions. The EB is also utilizing volunteer assistance from the BESSD/First To Work Program to assist with clerical support duties.

Additionally, the Branch is working with the Honolulu Community Action Program's Senior Community Service Employment Program to recruit seniors to work part-time in clerical support duties.

Start Date:

Ongoing

End Date:

Ongoing

Responding Person:

Alan Takahashi, Eligibility Branch Administrator; MQD

**Ref. no. 05-9**

**Maintain All Required Provider Documentation**

Auditor's  
Recommendation:

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

Corrective Action  
Taken or Planned:

DHS is in the process of merging provider agreements from the former Fiscal Agent with DHS files to have one complete provider file. The agreements date back to as far back as the 1970's.

Once the merging has been completed, correspondence will be sent to have providers submit missing documents and update their provider agreements. This is planned to be completed this calendar year.

On an ongoing basis providers will be required to update their provider agreements when they make changes to their provider profiles (i.e. address change, Tax ID change, etc.) and indicate the update in our database.

Provider agreements are sent to our new fiscal agent for imaging and can be easily accessed over the computer by authorized MQD staff.

Start Date: Ongoing

End Date: Ongoing

Responding Person: Leslie K. Tawata, Acting Health Coverage Management Branch Administrator; MQD

**Ref. no. 05-10                      Maintain All Required Documentation in Adoption Assistance Case Files**

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

Corrective Action Taken or Planned: In June 2005, Child Welfare Services (CWS) sections were informed via email of the required documents to be filed and maintained in the adoption assistance payment case and were asked to provide feedback.

In June 2005, CWS sections agreed to the list of required documents to be filed and maintained in the adoption assistance payment cases. They also recommended updating the Adoption Assistance Payment Cases Checklist to list the required forms. The Program Development staff began revision of the checklist.

In June 2005, permanency supervisors were instructed to conduct monthly reviews of five (5) randomly selected adoption assistance payment cases to ensure that the required documentation is filed and maintained in the adoption assistance payment cases.

In April 2006, an internal communication was sent to CWS sections to provide instructions regarding the required documentation and to also clarify when the biennial reviews are due. The revised Adoption Assistance Payment Cases Checklist and the revised Adoption Assistance Review form will also be distributed to the sections.

Start Date: June 2005  
End Date: Ongoing  
Responding Person: Susan Ogami-Van Camp, Assistant Program Administrator;  
CWS, Social Services Division (SSD)

**Ref. no. 05-11                      Maintain All Required Documentation in Child Care Case Files**

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

Corrective Action Taken or Planned: To correct this problem, DHS is taking the following actions:

- 1) There will be written procedures for line staff that address the filing of documents in the physical case records.
- 2) There will be a written plan for reviewing case records on a random basis which should point out further training needs for staff who implement the program.
- 3) There will be a checklist developed to assist in case record reviews to ensure consistency in the review process.

The Staff Development Staff will continue to train the Eligibility Workers on child care policies and procedures with emphasis on proper eligibility determination and maintenance of documentation in the case records.

The foregoing corrective action plan should decrease clerical errors/oversight while authorizing child care payments.

Start Date: April 2006  
End Date: Ongoing  
Responding Person: Pankaj Bhanot, Employment & Child Care Program (ECCP) Administrator; BESSD

**Ref. no. 05-12                      Ensure All Subrecipients are Identified for Subrecipient Monitoring**

Auditor's We recommend that the program evaluate each of its agreements, document the rationale for its decision and provide

Recommendation: the names of the entities determined to be subrecipients to MSO to perform subrecipient monitoring in order to comply with the subrecipient monitoring requirements.

Corrective Action Taken or Planned: ECCP has evaluated each of its agreements and identified the entities that are determined to be subrecipients in accordance with the Federal clarification from ACF/DHHS, dated October 24, 2005, and the OMB Circular A-133. The names of the subrecipients will be forwarded to the Management Services Office (MSO) in the near future to facilitate the audit for the fiscal year ending June 30, 2006.

Start Date: April 2006

End Date: Ongoing

Responding Person: Pankaj Bhanot, ECCP Administrator; BESSD

**Ref. no. 05-13                      Improve the Accuracy of Reports**

Auditor's Recommendation: We recommend that DHS implement review procedures to ensure that information presented on required reports is complete and accurate before it is submitted to the Federal oversight agency.

Corrective Action Taken or Planned: The Vocational Rehabilitation and Services to the Blind Division (VRSBD) Disability Determination Branch (DDB) Office and Section supervisors will review the accuracy of SSA-4514 forms prior to authorization by the DDB Administrator and prior to submittal to the Federal oversight agency.

Start Date: April 2006

End Date: Ongoing

Responding Person: Guy Tagomori, Program Staff Specialist; VRSBD

**Ref. no. 05-14                      Improve Accuracy of Foster Care Maintenance Payments**

Auditor's Recommendation: We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the foster care maintenance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed and foster care maintenance payments are the correct amount.

Corrective Action Taken or Planned: In December 2005, the Program Development Staff (PDS) discussed the specific error and missing documentation with the unit supervisors involved. The unit supervisors will closely monitor their unit's compliance with policies and procedures regarding foster care payments and difficulty of care payments. The section administrators have been informed about the errors found in their units' cases.

The system error that resulted in claiming three extra days as Title IV-E has been corrected. The over claimed amount has been reconciled.

Start Date: December 2005

End Date: Ongoing

Responding Person: Susan Ogami-Van Camp, Assistant Program Administrator; CWS, SSD

**Ref. no. 05-15                      Maintain All Required Documentation in Foster Care Files**

Auditor's Recommendation: We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the allowability and eligibility of the foster care maintenance payments being claimed for federal reimbursements. A secondary review would help to ensure all required documents are properly completed.

Corrective Action Taken or Planned: The section administrators and the two unit supervisors, of the two cases that had missing documents, will be reminded to monitor their staff's compliance with the department's policies and procedures covering the proper completion of required documents.

Start Date: April 2006

End Date: Ongoing

Responding Person: Susan Ogami-Van Camp, Assistant Program Administrator; CWS, SSD

**Ref. no. 05-16**

**Maintain All Required Documentation in Case Files**

Auditor's  
Recommendation:

We recommend that program staff ensure that all required documents are properly completed and maintained in each case file to support the eligibility of the individuals who are provided with vocational rehabilitation services. A secondary review would help to ensure all required documents are properly completed.

Corrective Action  
Taken or Planned:

VRSD will issue instructions to staff to file in the individual case record a copy of the appropriate Hawaii Automated Welfare Information (Systems) page that confirms the individual is a beneficiary of Social Security Disability Insurance (SSDI) benefits and/or recipient of Supplemental Security Income (SSI) payments to support the presumptive vocational rehabilitation eligibility.

Start Date:

April 2006

End Date:

Ongoing

Responding Person:

Guy Tagomori, Program Staff Specialist; VRSD