

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

Fiscal Year Ended June 30, 2008

**Submitted by  
The Auditor  
State of Hawaii**



**N&K CPAs, Inc.**

ACCOUNTANTS|CONSULTANTS

AMERICAN SAVINGS BANK TOWER | 1001 BISHOP STREET, SUITE 1700 | HONOLULU, HAWAII 96813-3696

T (808) 524-2255 F (808) 523-2090 | nkcpa.com

March 31, 2009

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

Dear Ms. Higa:

This is our report on the financial audit of the Department of Human Services of the State of Hawaii (DHS) as of and for the fiscal year ended June 30, 2008. Our audit was performed in accordance with the terms of our contract with the Office of the Auditor, State of Hawaii and with the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the *Compliance Supplement for Single Audits of State and Local Governments*.

## OBJECTIVES OF THE AUDIT

The primary purpose of our audit was to form an opinion on the fairness of the presentation of the DHS's basic financial statements as of and for the fiscal year ended June 30, 2008, and to comply with the requirements of OMB Circular A-133, which establishes audit requirements for state and local governments that receive federal financial assistance. More specifically, the objectives of the audit were as follows:

1. To provide a basis for an opinion on the fairness of the DHS's basic financial statements and the schedule of expenditures of federal awards as of and for the fiscal year ended June 30, 2008, in accordance with accounting principles generally accepted in the United States of America.
2. To consider the DHS's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the basic financial statements.

3. To perform tests of the DHS's compliance with laws, regulations, contracts, and grants, including applicable provisions of the Hawaii Public Procurement Code (Chapter 103D and 103F, Hawaii Revised Statutes), that could have a direct and material effect on the determination of financial statement amounts.
4. To consider the DHS's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance.
5. To provide an opinion on the DHS's compliance with applicable laws, regulations, contracts, and grants that could have a direct and material effect on each major program.

## **SCOPE OF THE AUDIT**

Our audit was performed in accordance with auditing standards generally accepted in the United States of America as prescribed by the American Institute of Certified Public Accountants; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the provisions of OMB Circular A-133. The scope of our audit included an examination of the transactions and accounting records of the DHS for the fiscal year ended June 30, 2008.

## **ORGANIZATION OF THE REPORT**

This report is presented in six parts as follows:

- Part I - The basic financial statements and related notes of the DHS as of and for the fiscal year ended June 30, 2008, and our opinion on the basic financial statements and supplementary information.
- Part II - Our report on internal control over financial reporting and on compliance and other matters.
- Part III - Our report on compliance with requirements applicable to each major program and on internal control over compliance.
- Part IV - The schedule of findings and questioned costs.

- Part V - The summary schedule of prior audit findings.
- Part VI - Corrective action plan as provided the Department of Human Services, State of Hawaii.

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

Sincerely,

N&K CPAs, Inc.

A handwritten signature in black ink that reads "Ron Shiigi". The signature is written in a cursive, flowing style with a large initial "R" and a decorative flourish at the end.

Ron Shiigi  
Principal

**DEPARTMENT OF HUMAN SERVICES  
STATE OF HAWAII**

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



## INDEPENDENT AUDITORS' REPORT

To the Auditor  
State of Hawaii

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Department of Human Services of the State of Hawaii (DHS), as of and for the fiscal year ended June 30, 2008, which collectively comprise the DHS's basic financial statements as listed in the foregoing table of contents. These basic financial statements are the responsibility of the DHS's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

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

As discussed in Note A, the financial statements of the DHS are intended to present the financial position and the changes in financial position, where applicable, of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Hawaii that is attributable to the transactions of the DHS. They do not purport to, and do not, present fairly the financial position of the State of Hawaii as of June 30, 2008, and the changes in its financial position, where applicable, for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, based on our audit, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information for the DHS, as of June 30, 2008, and the respective changes in financial position, where applicable, thereof and the respective budgetary comparison for the general and special revenue



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

In accordance with *Government Auditing Standards*, we have also issued our report dated March 30, 2009, on our consideration of the DHS's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

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

*N&K CPAs, Inc.*

Honolulu, Hawaii  
March 30, 2009

**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
Fiscal Year Ended June 30, 2008**

This discussion and analysis of the financial performance of the Department of Human Services (DHS) provides an overview of the financial activities of the DHS for the fiscal year ended June 30, 2008. The intent of this discussion is to allow management to provide an objective and easily readable analysis of the financial activities of the DHS based on currently known facts, decisions, or conditions. Readers are encouraged to consider the information presented here in conjunction with the basic financial statements and other supplementary information.

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

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

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

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

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

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

Department of Human Services  
State of Hawaii  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**  
Fiscal Year Ended June 30, 2008

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS (Continued)**

***Fund Financial Statements***

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

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

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

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

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

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

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

The following table presents a condensed government-wide statement of net assets of the DHS as of June 30, 2008 and 2007.

**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2008**

**FINANCIAL ANALYSIS OF THE GOVERNMENT-WIDE FINANCIAL STATEMENTS  
(Continued)**

**Condensed Statement of Net Assets**

	2008	2007
Current assets	\$ 206,084,724	\$ 169,130,098
Capital assets, net	<u>40,694,125</u>	<u>40,754,826</u>
Total assets	<u>\$ 246,778,849</u>	<u>\$ 209,884,924</u>
Current liabilities	\$ 228,951,037	\$ 215,035,851
Non-current liabilities	<u>10,366,228</u>	<u>9,803,001</u>
Total liabilities	<u>239,317,265</u>	<u>224,838,852</u>
Net assets		
Invested in capital assets	40,694,125	40,754,826
Restricted	1,462,028	1,276,923
Unrestricted deficit	<u>(34,694,569)</u>	<u>(56,985,677)</u>
Total net assets (deficit in)	<u>7,461,584</u>	<u>(14,953,928)</u>
Total liabilities and net assets	<u>\$ 246,778,849</u>	<u>\$ 209,884,924</u>

As noted earlier, an analysis of net assets over time may be a useful indicator of whether a government entity's financial condition is growing stronger or weakening. During the fiscal year ended June 30, 2008, the combined net assets of the DHS increased by approximately \$22.4 million.

The deficit in unrestricted net assets of the DHS was approximately \$34.7 million as of June 30, 2008. This deficit in unrestricted net assets is principally the result of liabilities for program services that were incurred as of June 30, 2008, for which state allotments are not yet available. The largest liability as of June 30, 2008, is the estimated amount of medical assistance service provided as of June 30, 2008, for which the related claims will be processed and paid subsequently. Of the estimated \$109.1 million of medical assistance payable, the state share of these costs is approximately \$47.5 million. The estimated federal share of these claims to be paid in the future was recorded as intergovernmental revenues in the current fiscal year and is included in the balance due from other governments. In addition to the estimated medical assistance payable, the liability for compensated absences totaling \$15.9 million as of June 30, 2008, 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, 2008.

**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2008**

The DHS reported a total of approximately \$40.7 million in net assets invested in capital assets as of June 30, 2008. Although the DHS is not the legal owner of the state buildings that are reported as part of its capital assets, the portion of the state facilities used by the DHS are required to be reported as part of its capital assets. The DHS uses these capital assets to provide services; consequently, these assets are not available for future spending and the related annual depreciation expense of the cost of these facilities is included in the statement of activities for the fiscal year ended June 30, 2008.

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

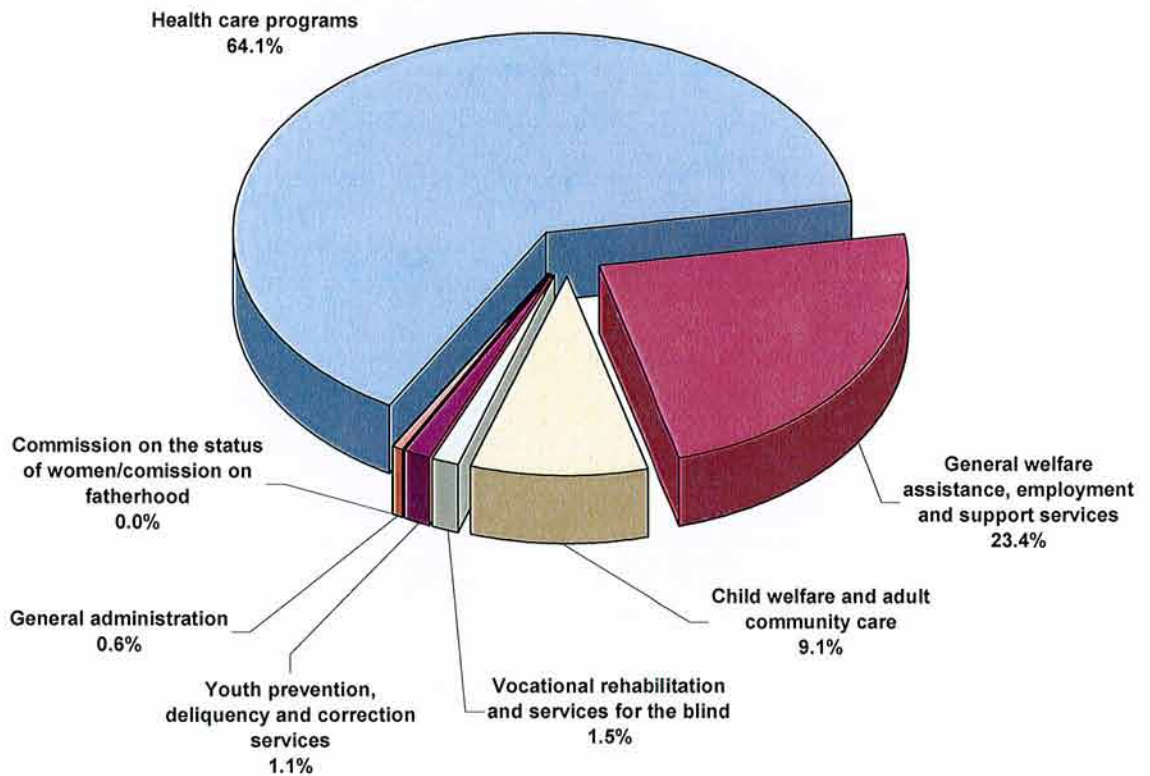
**Changes in Net Assets**

	<u>2008</u>	<u>2007</u>	<u>Percent Change</u>
<b>Revenues</b>			
Program revenues	\$ 1,127,375,107	\$ 1,022,304,629	10.28 %
General revenues	<u>792,666,479</u>	<u>731,104,924</u>	8.42 %
Total revenues	<u>1,920,041,586</u>	<u>1,753,409,553</u>	9.50 %
<b>Expenses</b>			
Health care programs	1,216,926,710	1,042,628,055	16.72 %
General welfare assistance, employment and support services	444,635,264	405,182,367	9.74 %
Child welfare and adult community care services	172,630,298	249,760,689	(30.88) %
Vocational rehabilitation and services for the blind	29,098,769	24,420,402	19.16 %
Youth prevention, delinquency and correction services	22,078,786	19,830,959	11.33 %
General administration	12,068,584	10,985,970	9.85 %
Commission on the status of women/ commission on fatherhood	<u>175,123</u>	<u>112,798</u>	55.25 %
Total expenses	<u>1,897,613,534</u>	<u>1,752,921,240</u>	8.25 %
 Change in net assets, before transfers out	 \$ <u>22,428,052</u>	 \$ <u>488,313</u>	



**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2008**

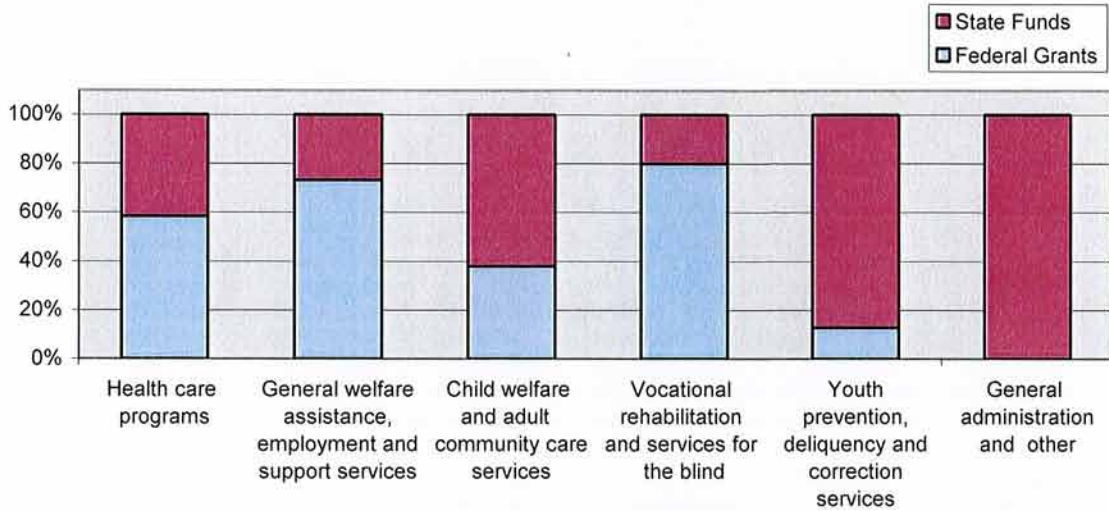
The total cost of all programs and services was approximately \$1.9 billion, an 8.25% increase from the prior fiscal year. Health care and general welfare assistance programs comprised 64.1% and 23.4%, respectively, of the total costs. The following chart presents each major activity as a percent of the total cost of all DHS activities:



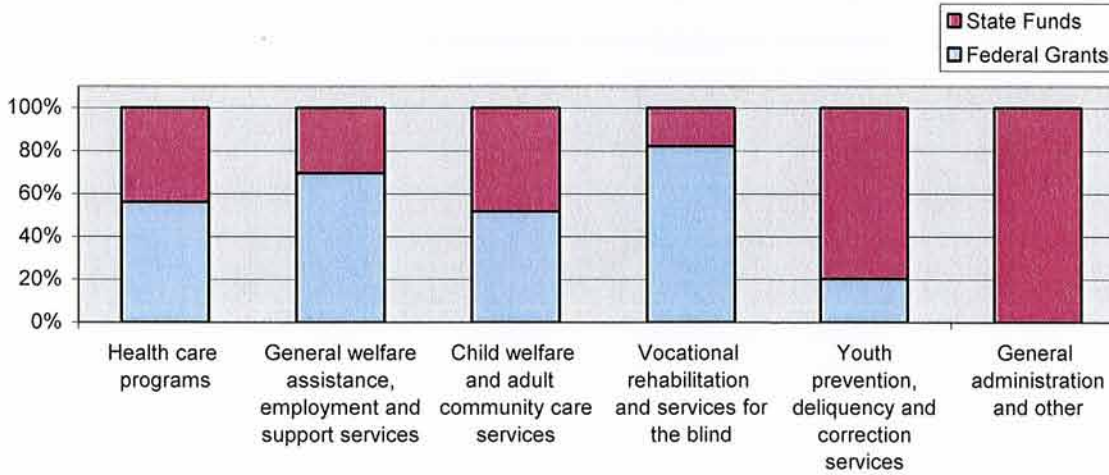
Program revenues consist primarily of operating grants from the federal government. Revenues from these federal grants paid for 59.4% of the cost of all the DHS's activities. The following chart presents the percentage of costs funded by federal grants for each major activity of the DHS for the fiscal years ended June 30, 2008 and 2007:

**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2008**

***Fiscal Year 2008***



***Fiscal Year 2007***



**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2008**

**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 \$145.3 million over the prior fiscal year. This increase is primarily related to health care program costs administered by the DHS which have increased by approximately \$174.1 million or 16.7%. The increased expenditures in this program are principally due to the transfer of the Home and Community Based Services program from the child welfare and adult community care services program to the health care programs. This transfer increased the health care programs' budget by \$89.4 million and decreased the child welfare and adult community care services programs' budget by \$82.7 million. The health care programs also paid approximately \$24.8 million for retroactive increases in the Medicaid fee schedule and \$17.7 million for the Disproportionate Share Hospital payments.

At June 30, 2008, the total governmental fund balance of the DHS consisted of a deficit in unreserved fund balance of approximately \$116.1 million. The deficit in the unreserved fund balance of the general fund totaling \$45.6 million is principally comprised of liabilities for program services that were incurred as of June 30, 2008, for which state allotments were not yet available. The deficit in the unreserved fund balance of the special revenue fund totaling \$70.5 million is principally the result of encumbrances that were not liabilities as of June 30, 2008, and, therefore, the related intergovernmental revenues were not recorded.

Reservations of governmental fund balances for encumbrances totaled approximately \$98.7 million at June 30, 2008. Reservations of governmental fund balances indicate the amount of resources that are not available for new spending because it has been reserved to liquidate purchase and contractual commitments.

The following table presents total revenues and expenditures of the governmental funds of the DHS for the fiscal years ended June 30, 2008 and 2007:

	<u>2008</u>	<u>2007</u>	Percent Change
<b>REVENUES</b>			
State allotted appropriations	\$ 769,603,784	\$ 710,334,497	8.34 %
Intergovernmental revenues	1,127,375,107	1,022,304,629	10.28 %
Non-imposed employee fringe benefits	<u>23,062,695</u>	<u>20,770,427</u>	11.04 %
Total	<u>\$ 1,920,041,586</u>	<u>\$ 1,753,409,553</u>	9.50 %

**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2008**

	<u>2008</u>	<u>2007</u>	Percent Change
<b>EXPENDITURES</b>			
Health care programs	\$ 1,216,613,055	\$ 1,042,507,676	16.70 %
General welfare assistance, employment and support services	444,530,029	404,447,206	9.91 %
Child welfare and adult community care services	172,981,946	250,020,363	(30.81) %
Vocational rehabilitation and services for the blind	28,950,428	24,440,086	18.45 %
Youth prevention, delinquency and correction services	21,306,524	19,047,785	11.86 %
General administration	12,332,501	11,002,800	12.09 %
Commission on the status of women/ commission on fatherhood	<u>175,123</u>	<u>112,798</u>	55.25 %
 Total	 <u>\$ 1,896,889,606</u>	 <u>\$ 1,751,578,714</u>	 8.30 %

**BUDGETARY ANALYSIS**

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

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
Health care programs	\$ 541,397,206	\$ 541,397,206	\$ 496,887,254	\$ 44,509,952
General welfare assistance, employment and support services	118,701,545	118,701,545	115,667,611	3,033,934
Child welfare and adult community care services	103,384,046	102,265,456	101,239,847	1,025,609
Youth prevention, delinquency and correction services	18,454,990	18,624,990	17,648,425	976,565
General administration	9,952,972	9,952,972	9,952,939	33
Vocational rehabilitation and services for the blind	4,132,145	4,132,145	4,132,094	51
Commission on the status of women / Commission on fatherhood	<u>211,796</u>	<u>211,796</u>	<u>174,428</u>	<u>37,368</u>
	<u>\$ 796,234,700</u>	<u>\$ 795,286,110</u>	<u>\$ 745,702,598</u>	<u>\$ 49,583,512</u>

**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2008**

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

Actual expenditures for the health care programs were approximately \$44.3 million less than the amounts budgeted due to a change in the processing of health care payments. Thus the amounts expended in comparison to the amounts budgeted appear favorable.

**CAPITAL ASSETS**

As of June 30, 2008 and 2007, the cost basis of capital assets, net of accumulated depreciation, used by the DHS are presented in the table below. Approximately, \$2.1 million of capital assets were added in the fiscal year ended June 30, 2008. Annual depreciation totaling approximately \$2.6 million decreased the net cost basis during the fiscal year ended June 30, 2008.

**Capital Assets, Net of Depreciation**

	2008	2007
State office buildings and improvements	\$ 15,937,021	\$ 16,653,145
Buildings and improvements for the Office of Youth Services	13,331,354	14,035,706
Total buildings and improvements	29,268,375	30,688,851
Furniture, equipment and vehicles	11,425,744	10,065,969
Nondepreciable land	6	6
 Total	 \$ 40,694,125	 \$ 40,754,826

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).

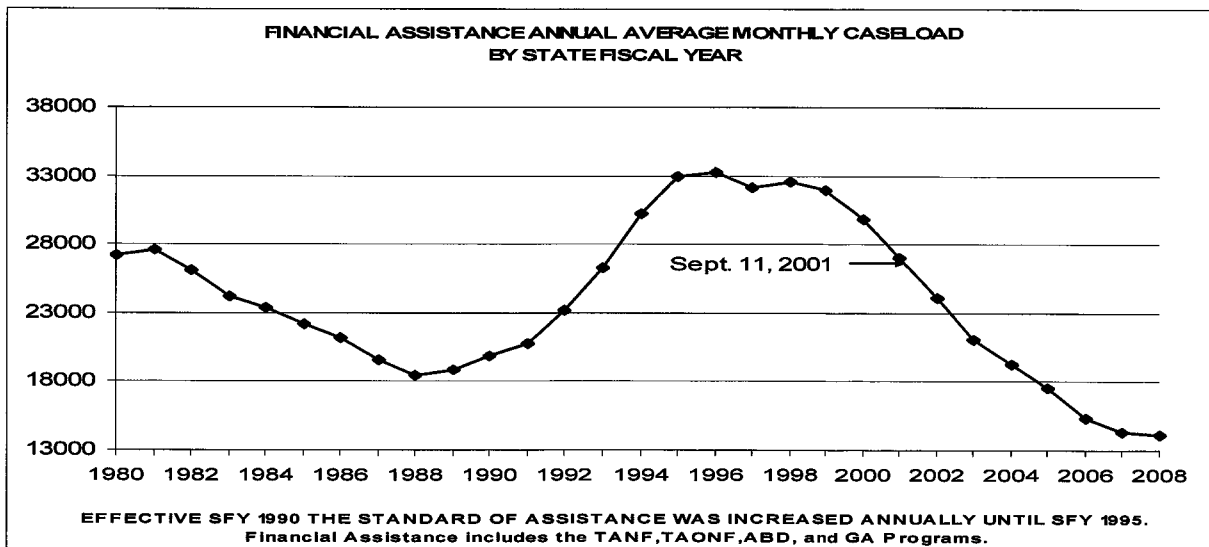


**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2008**

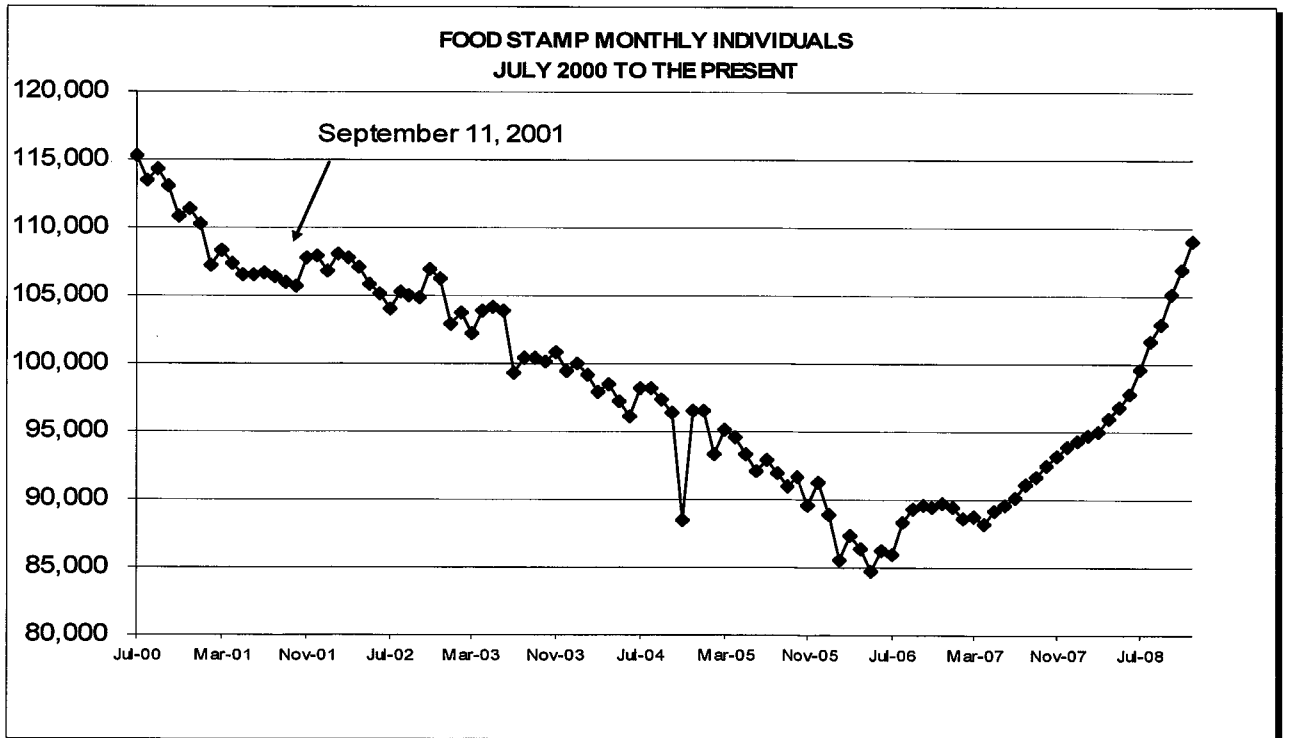
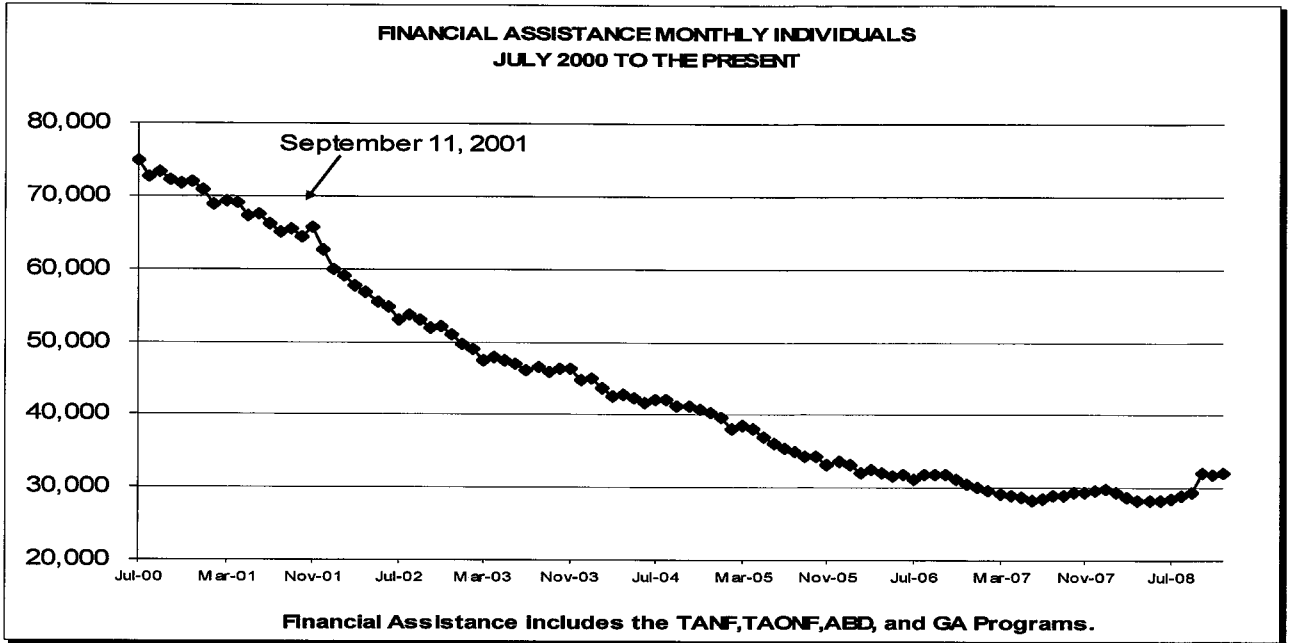
About seven years after the events of September 11, 2001, individuals receiving financial assistance in Hawaii in family cases and in individual cases have been declining from 65,444 individuals in September 2001 to 28,224 individuals in April 2008. But the caseload trend began to increase as of May 2008 and continues to increase in cases and individuals receiving financial assistance as currently indicated in December 2008 with 31,945 individuals. Much of the initial decline was due to the five-year limit on financial assistance benefits for family cases beginning in December 2001 as part of Hawaii's Welcome Reform Program (started in December 1996) and a large part attributed to Hawaii's then strong economy. However, the recent increases in cases are contributed to the nation's high oil prices that put a strain on the State of Hawaii's economy for most of the 2008 year. This strain triggered a ripple effect of fewer consumers spending and traveling, which resulted to closures of businesses, loss of jobs and more individuals seeking financial assistance.

The number of individuals in Hawaii receiving Supplemental Nutrition Assistance Program (SNAP), formerly known as the Food Stamp Program, benefits have been on a declining trend since September 11, 2001 from 105,990 individuals in September 2001 to the end of fiscal year 2007 at 89,646 individuals. However, the number of individuals receiving SNAP benefits from fiscal year 2008 and throughout fiscal year 2009 is on an upward trend and continues to increase from 105,990 individuals in September 2001 to 108,972 individuals in December 2008. This is an increase of 2,982 individuals or 3%. The increase in individuals receiving Food Stamp benefits has contributed to Hawaii's declining economy, steadily rising unemployment rates and a challenging and highly competitive Hawaii job market.

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



**Department of Human Services  
State of Hawaii  
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)  
Fiscal Year Ended June 30, 2008**



**Department of Human Services  
State of Hawaii  
STATEMENT OF NET ASSETS  
June 30, 2008**

	<u>Governmental Activities</u>
<b>ASSETS</b>	
Cash and cash equivalents	\$ 67,909,972
Receivables	10,835,877
Due from other governments	<u>127,338,875</u>
Total current assets	206,084,724
Capital assets, net of accumulated depreciation	<u>40,694,125</u>
Total assets	\$ <u><u>246,778,849</u></u>
<b>LIABILITIES</b>	
Vouchers payable	\$ 9,698,741
Accrued wages and employee benefits payable	9,629,971
Due to State general fund	43,997,943
Due to other state agencies	38,513,198
Deferred revenues	12,521,184
Accrued medical assistance payable	109,090,000
Accrued compensated absences	<u>5,500,000</u>
Total current liabilities	228,951,037
Accrued compensated absences, less current portion	<u>10,366,228</u>
Total liabilities	<u><u>239,317,265</u></u>
<b>NET ASSETS</b>	
Invested in capital assets, net of related debt	40,694,125
Restricted	1,462,028
Unrestricted (deficit)	<u>(34,694,569)</u>
Total net assets	<u><u>7,461,584</u></u>
Total liabilities and net assets	\$ <u><u>246,778,849</u></u>

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
STATEMENT OF ACTIVITIES  
Fiscal Year Ended June 30, 2008**

	Functions/Programs			Program Revenues			Net (Expenses) Revenue and Changes in Net Assets	
	Expenses	Charges for		Operating		Governmental Activities		
		Services	Contributions	Grants and	Contributions			
<b>Governmental activities:</b>								
Health care programs	\$ 1,216,926,710	\$ --	\$ --	\$ 709,714,085		\$ (507,212,625)		
General welfare assistance, employment and support services	444,635,264	--	--	325,906,270		(118,728,994)		
Child welfare and adult community care services	172,630,298	--	--	65,754,305		(106,875,993)		
Vocational rehabilitation and services for the blind	29,098,769	--	--	23,248,255		(5,850,514)		
Youth prevention, delinquency and correction services	22,078,786	--	--	2,750,700		(19,328,086)		
General administration	12,068,584	--	--	--		(12,068,584)		
Commission on the status of women / Commission on fatherhood	175,123	--	--	1,492		(173,631)		
<b>Total governmental activities</b>	<b>\$ 1,897,613,534</b>	<b>\$ --</b>	<b>\$ --</b>	<b>\$ 1,127,375,107</b>		<b>\$ (770,238,427)</b>		
<b>General revenues:</b>								
State allotments, net of lapsed appropriations						769,603,784		
Nonimposed employee fringe benefits						23,062,695		
Transfers out						(12,540)		
<b>Total general revenues</b>						<b>792,653,939</b>		
<b>Change in net assets</b>						<b>22,415,512</b>		
<b>Deficit in net assets at July 1, 2007</b>						<b>(14,953,928)</b>		
<b>Net assets at June 30, 2008</b>						<b>\$ 7,461,584</b>		

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
BALANCE SHEET  
GOVERNMENTAL FUNDS  
June 30, 2008**

	<u>General</u>	<u>Med-Quest Special Revenue Fund</u>	<u>Human Services Special Revenue Fund</u>	<u>Total</u>
<b>ASSETS</b>				
Cash and cash equivalents	\$ 36,506,802	\$ 1,316,309	\$ 30,086,861	\$ 67,909,972
Receivables	5,267,522	4,486,355	1,082,000	10,835,877
Due from other funds	42,144,552	--	--	42,144,552
Due from other governments	<u>--</u>	<u>127,338,875</u>	<u>--</u>	<u>127,338,875</u>
 Total assets	 <u>\$ 83,918,876</u>	 <u>\$ 133,141,539</u>	 <u>\$ 31,168,861</u>	 <u>\$ 248,229,276</u>
 <b>LIABILITIES AND FUND BALANCES</b>				
<b>LIABILITIES</b>				
Vouchers payable	\$ 5,896,750	\$ 658,957	\$ 3,143,034	\$ 9,698,741
Accrued wages and employee benefits payable	5,362,524	784,222	3,483,225	9,629,971
Deferred revenues	--	--	12,521,184	12,521,184
Due to other funds	--	31,585,162	10,559,390	42,144,552
Due to other state agencies	--	38,513,198	--	38,513,198
Due to State general fund	43,997,943	--	--	43,997,943
Accrued medical assistance payable	<u>47,490,000</u>	<u>61,600,000</u>	<u>--</u>	<u>109,090,000</u>
 Total liabilities	 <u>102,747,217</u>	 <u>133,141,539</u>	 <u>29,706,833</u>	 <u>265,595,589</u>
 <b>FUND BALANCES</b>				
Reserved for encumbrances	26,758,744	17,050,166	54,909,114	98,718,024
Unreserved	<u>(45,587,085)</u>	<u>(17,050,166)</u>	<u>(53,447,086)</u>	<u>(116,084,337)</u>
 Total fund balances (deficit)	 <u>(18,828,341)</u>	 <u>--</u>	 <u>1,462,028</u>	 <u>(17,366,313)</u>
 Total liabilities and fund balances	 <u>\$ 83,918,876</u>	 <u>\$ 133,141,539</u>	 <u>\$ 31,168,861</u>	 <u>\$ 248,229,276</u>

See accompanying notes to the basic financial statements.



**Department of Human Services**  
**State of Hawaii**  
**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET**  
**TO THE STATEMENT OF NET ASSETS**  
**June 30, 2008**

<b>Total deficit in fund balances - governmental funds</b>		<b>\$ (17,366,313)</b>
 <b>Amounts reported for governmental activities in the statement of net assets are different because:</b>		
 Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.		
 Capital Assets		
Governmental capital assets	\$ 88,846,928	
Less accumulated depreciation	<u>(48,152,803)</u>	40,694,125
 Accrued compensated absences liability is not due in the current period and therefore are not reported in the governmental funds.		
		<u>(15,866,228)</u>
 <b>Net assets of governmental activities</b>		 <b>\$ <u>7,461,584</u></b>

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES  
GOVERNMENTAL FUNDS  
Fiscal Year Ended June 30, 2008**

	<u>General</u>	<u>Med-Quest Special Revenue Fund</u>	<u>Human Services Special Revenue Fund</u>	<u>Total</u>
<b>REVENUES</b>				
State-allotted appropriations	\$ 769,603,784	\$ --	\$ --	\$ 769,603,784
Intergovernmental	--	709,714,085	417,661,022	1,127,375,107
Nonimposed employee fringe benefits	<u>23,062,695</u>	--	--	<u>23,062,695</u>
	<u>792,666,479</u>	<u>709,714,085</u>	<u>417,661,022</u>	<u>1,920,041,586</u>
<b>EXPENDITURES</b>				
Health care programs	506,898,970	709,714,085	--	1,216,613,055
General welfare assistance, employment and support services	118,613,604	--	325,916,425	444,530,029
Child welfare and adult community care services	107,348,483	--	65,633,463	172,981,946
Vocational rehabilitation and services for the blind	5,787,639	--	23,162,789	28,950,428
Youth prevention, delinquency and correction services	18,555,824	--	2,750,700	21,306,524
General administration	12,332,501	--	--	12,332,501
Commission on the status of women/ Commission on fatherhood	<u>175,123</u>	--	--	<u>175,123</u>
	<u>769,712,144</u>	<u>709,714,085</u>	<u>417,463,377</u>	<u>1,896,889,606</u>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	22,954,335	--	197,645	23,151,980
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers out	<u>--</u>	<u>--</u>	<u>(12,540)</u>	<u>(12,540)</u>
<b>NET CHANGE IN FUND BALANCES</b>	22,954,335	--	185,105	23,139,440
<b>FUND BALANCES (DEFICIT) AT JULY 1, 2007</b>	<u>(41,782,676)</u>	<u>--</u>	<u>1,276,923</u>	<u>(40,505,753)</u>
<b>FUND BALANCES (DEFICIT) AT JUNE 30, 2008</b>	\$ <u>(18,828,341)</u>	\$ <u>--</u>	\$ <u>1,462,028</u>	\$ <u>(17,366,313)</u>

See accompanying notes to the basic financial statements.

**Department of Human Services**  
**State of Hawaii**  
**RECONCILIATION OF THE CHANGE IN FUND BALANCES OF**  
**GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES**  
**Fiscal Year Ended June 30, 2008**

<b>Net change in fund balances - total governmental funds</b>		<b>\$ 23,139,440</b>
<b>Amounts reported for governmental activities in the statement of activities are different because:</b>		
<p>Governmental funds report capital outlays as expenditures, however, in the statement of activities the cost of those assets are depreciated over their estimated useful lives as depreciation expense.</p>		
Expenditures for capital assets	\$ 2,128,841	
Less current year depreciation and other changes	<u>(2,189,542)</u>	(60,701)
Change in long-term compensated absences reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.		<u>(663,227)</u>
<b>Change in net assets of governmental activities</b>		<b>\$ <u>22,415,512</u></b>

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
STATEMENT OF REVENUES AND EXPENDITURES -  
BUDGET AND ACTUAL - GENERAL FUND  
Fiscal Year Ended June 30, 2008**

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
<b>REVENUES</b>				
State allotments	\$ 796,234,700	\$ 795,286,110	\$ 769,603,784	\$ (25,682,326)
<b>EXPENDITURES</b>				
Health care programs	541,397,206	541,397,206	496,887,254	44,509,952
General welfare assistance, employment and support services	118,701,545	118,701,545	115,667,611	3,033,934
Child welfare and adult community care services	103,384,046	102,265,456	101,239,847	1,025,609
Youth prevention, delinquency and correction services	18,454,990	18,624,990	17,648,425	976,565
General administration	9,952,972	9,952,972	9,952,939	33
Vocational rehabilitation and services for the blind	4,132,145	4,132,145	4,132,094	51
Commission on the status of women / commission on fatherhood	<u>211,796</u>	<u>211,796</u>	<u>174,428</u>	<u>37,368</u>
	<u>796,234,700</u>	<u>795,286,110</u>	<u>745,702,598</u>	<u>49,583,512</u>
<b>EXCESS OF REVENUES OVER EXPENDITURES</b>	\$ <u>          --</u>	\$ <u>          --</u>	\$ <u>23,901,186</u>	\$ <u>23,901,186</u>

See accompanying notes to the basic financial statements.

**Department of Human Services**  
**State of Hawaii**  
**STATEMENT OF REVENUES AND EXPENDITURES -**  
**BUDGET AND ACTUAL - SPECIAL REVENUE FUNDS**  
**Fiscal Year Ended June 30, 2008**

	Original	Final	Actual on Budgetary Basis		Variance Favorable (Unfavorable)
			Med-Quest Special Revenue Fund	Human Services Special Revenue Fund	
<b>REVENUES</b>					
Intergovernmental revenues					
Med-Quest	\$ 754,193,653	\$ 754,193,653	\$ 734,755,284	\$ --	\$ (19,438,369)
Human services	<u>276,411,683</u>	<u>276,411,683</u>	<u>--</u>	<u>254,382,900</u>	<u>(22,028,783)</u>
	<u>1,030,605,336</u>	<u>1,030,605,336</u>	<u>734,755,284</u>	<u>254,382,900</u>	<u>(41,467,152)</u>
<b>EXPENDITURES</b>					
Health care programs	754,193,653	754,193,653	739,497,826	--	14,695,827
General welfare assistance, employment and support services	176,699,474	176,699,474	--	162,309,447	14,390,027
Child welfare and adult community care services	66,525,681	66,525,681	--	61,088,567	5,437,114
Vocational rehabilitation and services for the blind	25,908,316	25,908,316	--	21,502,230	4,406,086
Youth prevention, delinquency and correction services	5,176,608	5,176,608	--	3,267,221	1,909,387
General administration	<u>2,101,604</u>	<u>2,101,604</u>	<u>--</u>	<u>1,907,781</u>	<u>193,823</u>
	<u>1,030,605,336</u>	<u>1,030,605,336</u>	<u>739,497,826</u>	<u>250,075,246</u>	<u>41,032,264</u>
Excess of revenues over (under) expenditures	<u>--</u>	<u>--</u>	<u>(4,742,542)</u>	<u>4,307,654</u>	<u>(434,888)</u>
<b>OTHER FINANCING USES</b>					
Operating transfers in	--	--	--	5,818,578	5,818,578
Operating transfers out	<u>--</u>	<u>--</u>	<u>(5,818,578)</u>	<u>(12,540)</u>	<u>(5,831,118)</u>
	<u>--</u>	<u>--</u>	<u>(5,818,578)</u>	<u>5,806,038</u>	<u>(12,540)</u>
<b>EXCESS OF REVENUES OVER (UNDER)</b>					
<b>EXPENDITURES AND OTHER USES</b>	\$ <u>--</u>	\$ <u>--</u>	\$ <u>(10,561,120)</u>	\$ <u>10,113,692</u>	\$ <u>(447,428)</u>

See accompanying notes to the basic financial statements.

**Department of Human Services  
State of Hawaii  
STATEMENT OF FIDUCIARY NET ASSETS - FIDUCIARY FUNDS  
June 30, 2008**

	Agency Funds	Private Purpose Trust Funds
<b>ASSETS</b>		
Cash	\$ <u>1,170,226</u>	\$ <u>10,994</u>
Total assets	\$ <u>1,170,226</u>	\$ <u>10,994</u>
<b>LIABILITIES</b>		
Due to individuals	\$ 848,226	\$ --
Due to others	<u>322,000</u>	<u>--</u>
Total liabilities	\$ <u>1,170,226</u>	<u>--</u>
Net assets - held in trust		\$ <u>10,994</u>

See accompanying notes to the basic financial statements.

**Department of Human Services**  
**State of Hawaii**  
**STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS - FIDUCIARY FUNDS**  
**Fiscal Year Ended June 30, 2008**

	<u>Private Purpose Trust Funds</u>
<b>ADDITIONS</b>	
Donations	\$ <u>          --</u>
Total additions	<u>          --</u>
<b>DEDUCTIONS</b>	
Other	<u>          --</u>
Total deductions	<u>          --</u>
<b>CHANGE IN NET ASSETS</b>	<u>          --</u>
Net assets at July 1, 2007	<u>          10,994</u>
Net assets at June 30, 2008	\$ <u>          10,994</u>



**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2008**

**NOTE A - FINANCIAL REPORTING ENTITY**

The Hawaii State Government Reorganization Act of 1959 (Act 1, Second Special Session Laws of Hawaii 1959) created the Department of Social Services and Housing. In 1987, the name was changed to the Department of Human Services (DHS). The DHS's mission is to direct its resources toward protecting and helping those least able to care for themselves and to provide services designed toward achieving self sufficiency for clients as quickly as possible. The DHS is committed to maintaining a high level of quality, efficiency, and effectiveness in its services.

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

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

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

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

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2008**

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

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

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

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

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2008**

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

immediate intervention services; non-residential and in-community aftercare services to prevent further incarceration; and community based residential services as an alternative to incarceration. OYS also manages and operates the Hawaii Youth Correctional Facility (HYCF) to provide safe and secure housing for the most violent and dangerous juvenile offenders. Although a core responsibility of OYS is to manage and operate HYCF, the agency places great emphasis on providing and supporting “front end” prevention, diversion, and intervention services. Incarcerated youth are provided counseling, treatment, and educational services for redirection and rehabilitation. The Division’s operations are reported in the general, special revenue, and agency funds.

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

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

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2008**

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

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

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

**NOTE B - SIGNIFICANT ACCOUNTING POLICIES**

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

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

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

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

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

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

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

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

**Governmental Fund Types**

The DHS reports the following major governmental funds:

***General Fund***

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

***Special Revenue Funds***

The Special Revenue Funds are used to account for the proceeds of specific revenue sources that are legally restricted for specific purposes. The Special Revenue Funds are as follows:

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

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

**Fiduciary Fund Type**

***Trust and Agency Funds***

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

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

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

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

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

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

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

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

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

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

- (3) **Use of Estimates** - The preparation of the basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.
- (4) **Receivables** - Receivables in the general and special revenue funds consist primarily of amounts due from Medicaid providers for a retroactive adjustment to previously made payments and recipients of welfare benefit overpayments. The amounts reported as net receivables were established based on management's estimate of amounts collectible.
- (5) **Capital Assets** - Capital assets include land and land improvements, infrastructure assets, buildings and improvements, equipment, and all other tangible and intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Capital assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at their estimated fair market value at the date of donation.

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

The State has adopted the following capitalization policy:

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

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



**Department of Human Services  
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**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) ***Deferred revenue*** - Deferred revenue at the fund and government-wide level arise when the DHS receives resources before it has a legal claim to them. In subsequent periods, when the revenue recognition criteria is met, or when the DHS has a legal claim to the resources, the liability for deferred revenue is removed from the statement of net assets and balance sheet, and revenue is recognized. Deferred revenue at June 30, 2008 consists primarily of federal grant funds for which all eligibility requirements have not yet been met.
- (9) ***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.
- (10) ***Operating Grants and Contributions*** - Federal grants and assistance awards are recorded as intergovernmental receivables and revenues when all eligibility requirements have been satisfied.
- (11) ***Intrafund and Interfund Transactions*** - Significant transfers of financial resources between activities included within the same fund are offset within that fund.
- (12) ***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.
- (13) ***Deferred Compensation Plan*** - The State offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

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

**Department of Human Services  
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**NOTE C - BUDGETING AND BUDGETARY CONTROL**

Revenue estimates are provided to the State Legislature at the time of budget consideration and are revised and updated periodically during the fiscal year. Amounts reflected as budgeted revenues in the statement of revenues and expenditures - budget and actual (budgetary basis) - are derived primarily from acts of the State Legislature and from other authorizations contained in other specific appropriation acts in various Session Laws of Hawaii (SLH). Budgeted expenditures are derived primarily from the General Appropriations Act of 2007 (Act 213, SLH 2007), and from other authorizations contained in the State Constitution, HRS, and other specific appropriation acts in various SLH.

All expenditures of these appropriated funds are made pursuant to the appropriations in the fiscal 2008 - 2009 biennial budget. The general and special revenue funds have legally appropriated annual budgets.

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

The legal level of budgetary control is maintained at the appropriation line item level by department, program, and source of funds as established in the appropriations act. The Governor is authorized to transfer appropriations between programs within the same department and source of funds; however, transfers of appropriations between departments generally require legislative authorization. Records and reports reflecting the detail level of control are maintained by and are available at the State Department of Accounting and General Services. During the fiscal year ended June 30, 2008, there were no expenditures in excess of appropriations in the individual funds.

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

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

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the fiscal year ended June 30, 2008.

**Department of Human Services  
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**NOTE C - BUDGETING AND BUDGETARY CONTROL (Continued)**

	<u>General</u>	<u>Med-Quest</u>	<u>Human Services</u>
Excess of revenues over expenditures and other uses - actual on a budgetary basis	\$ 23,901,186	\$ (10,561,120)	\$ 10,113,692
Reserved for encumbrances at fiscal year-end	26,758,744	17,050,166	54,909,114
Expenditures for liquidation of prior fiscal year encumbrances	(4,841,701)	(10,925,087)	(41,090,380)
Net changes in unreserved liabilities	1,185,754	11,760,894	(13,355,689)
Net change in accrued medical assistance payable	(994,174)	(1,640,384)	--
Accruals related to federal reimbursements for program expenditures	(25,529,522)	18,894,025	2,139,960
Net change in other receivables	2,474,048	4,321,568	(15,750)
Difference for revenues recognized for GAAP purposes	<u>--</u>	<u>(28,900,062)</u>	<u>(12,515,842)</u>
Excess of revenues and other financing			
Net change in fund balance - GAAP basis	\$ <u>22,954,335</u>	\$ <u>--</u>	\$ <u>185,105</u>

**NOTE D - CASH AND CASH EQUIVALENTS**

The State Director of Finance is responsible for the safekeeping of all monies paid into the State Treasury. The State Director of Finance pools and invests any monies of the State, which in the Director's judgment, are in excess of amounts necessary for meeting the immediate requirements of the State. Legally authorized investments include obligations of, or guaranteed by, the U.S. Government, obligations of the State, federally-insured savings and checking accounts, time certificates of deposit, and repurchase agreements with federally-insured financial institutions.

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

**Interest Rate Risk**

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

**Credit Risk**

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

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

**Custodial Credit Risk**

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

**Concentration of Credit Risk**

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

**Cash in Bank**

The DHS maintains cash in banks which are held separately from cash in the State Treasury. As of June 30, 2008, the carrying amount of total bank deposits was approximately \$449,000 and the corresponding bank balances which are represented were approximately \$956,000.

**NOTE E - RECEIVABLES**

Receivables of the DHS, net of an allowance for doubtful accounts, consisted of the following at June 30, 2008:

	<u>General</u>	<u>Med-Quest</u>	<u>Human Services</u>
Welfare benefit overpayments	\$ 24,230,322	\$ 2,081,500	\$ 23,355,250
Medicaid providers receivable	3,370,316	4,377,538	--
QUEST premiums receivable	1,740,000	2,260,000	--
Social Security interim assistance loans	449,000	--	--
CSEA receivable	316,223	--	--
	<u>30,105,861</u>	<u>8,719,038</u>	<u>23,355,250</u>
Less allowance for doubtful accounts:			
Welfare benefit overpayments	23,107,822	1,985,000	22,273,250
QUEST premiums receivable	1,730,517	2,247,683	--
	<u>24,838,339</u>	<u>4,232,683</u>	<u>22,273,250</u>
Receivables, net	\$ <u>5,267,522</u>	\$ <u>4,486,355</u>	\$ <u>1,082,000</u>

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**NOTE F - CAPITAL ASSETS**

For the fiscal year ended June 30, 2008, capital assets activity for the DHS was as follows:

	Governmental Activities					Balance June 30, 2008
	Balance	Additions	Disposals	Net	Other	
	July 1, 2007			Transfers		
<b>Depreciable Assets</b>						
Building and improvements	\$ 46,438,075	\$ --	\$ --	\$ --	\$ 192,917	\$ 46,630,992
Furniture and equipment	38,288,034	2,018,804	237,383	(20,775)	356,713	40,405,393
Motor vehicles	1,794,424	110,038	106,174	(9,000)	21,249	1,810,537
<b>Non-Depreciable Assets</b>						
Land	6	--	--	--	--	6
Total at historical cost	<u>86,520,539</u>	<u>2,128,842</u>	<u>343,557</u>	<u>(29,775)</u>	<u>570,879</u>	<u>88,846,928</u>
<b>Less Accumulated Depreciation:</b>						
Building and Improvements	15,749,224	1,542,349	--	--	71,043	17,362,616
Furniture and Equipment	28,334,223	1,031,551	203,744	(1,484)	(17,616)	29,142,930
Motor Vehicles	1,682,266	64,712	103,174	(9,000)	12,453	1,647,257
Total accumulated depreciation	<u>45,765,713</u>	<u>2,638,612</u>	<u>306,918</u>	<u>(10,484)</u>	<u>65,880</u>	<u>48,152,803</u>
Capital Assets, Net	<u>\$ 40,754,826</u>	<u>\$ (509,770)</u>	<u>\$ 36,639</u>	<u>\$ (19,291)</u>	<u>\$ 504,999</u>	<u>\$ 40,694,125</u>

Depreciation expense for the fiscal year ended June 30, 2008 was charged to functions/programs of the DHS as follows:

	Governmental Activities
Health care programs	\$ 233,094
General welfare assistance, employment and support services	1,153,109
Child welfare and adult community care services	296,414
Vocational rehabilitation and services for the blind	82,190
Youth prevention, delinquency and correction services	776,278
General administration	<u>97,527</u>
	<u>\$ 2,638,612</u>

**NOTE G - ACCRUED COMPENSATED ABSENCES**

The only long-term liability of the DHS for governmental activities is for accrued compensated absences. The change in the long-term liability during the fiscal year ended June 30, 2008, was as follows:

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

	<u>Amount</u>
Balance at July 1, 2007	\$ 15,203,001
Additions	7,897,768
Reductions	<u>(7,234,541)</u>
Balance at June 30, 2008	15,866,228
Less current portion	<u>(5,500,000)</u>
	<u>\$ 10,366,228</u>

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

The agency funds are purely custodial (assets equal liabilities) and thus do not involve the measurement of results of operations. The changes in assets and liabilities of the agency funds for the fiscal year ended June 30, 2008, were as follows:

	<u>Balance July 1, 2007</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2008</u>
<b>ASSETS</b>				
Cash	\$ <u>1,044,067</u>	\$ <u>146,090,719</u>	\$ <u>145,964,560</u>	\$ <u>1,170,226</u>
<b>LIABILITIES</b>				
Due to individuals and others	\$ <u>1,044,067</u>	\$ <u>146,090,719</u>	\$ <u>145,964,560</u>	\$ <u>1,170,226</u>

**NOTE I - NONIMPOSED EMPLOYEE FRINGE BENEFITS**

Payroll fringe benefit costs of the DHS's employees that are funded by state appropriations (general fund) are assumed by the State and are not charged to the DHS's operating funds. These costs, totaling approximately \$23,063,000 for the fiscal year ended June 30, 2008, have been reported as revenues and expenditures in the general fund of the DHS.

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

**NOTE J - FUND BALANCE DEFICITS**

The general, Med-Quest and Human Services special revenue funds of the DHS have deficits in the unreserved fund balances at June 30, 2008, aggregating to \$45,587,085, \$17,050,166 and \$53,447,086, respectively. Those deficits resulted primarily from expenditures being recorded on the accrual basis when incurred, and revenues being recognized only when corresponding funds are measurable and available.

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**NOTE K - INTERFUND RECEIVABLE AND PAYABLE**

The general fund had a receivable due from the special revenue fund totaling \$42,144,552 as of June 30, 2008, for federal reimbursements of program expenditures.

**NOTE L - LEASES**

The DHS leases office facilities and equipment under various operating leases expiring through 2023. Certain leases include renewal and escalation clauses. The DHS's general fund share of lease costs is paid from the State General Fund. The federal share of these lease costs allocable to programs is reported in the special revenue fund of the DHS. The following is a schedule of the federal share of minimum future lease commitments for noncancelable operating leases as of June 30, 2008:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2009	\$ 1,754,000
2010	1,683,000
2011	1,281,000
2012	680,000
2013	639,000
2014 - 2018	2,821,000
2019 - 2023	<u>1,833,000</u>
	<u>\$ 10,691,000</u>

The DHS's federal share of rent expenditures for operating leases for the fiscal year ended June 30, 2008, amounted to approximately \$1,673,000, and is included in the accompanying financial statements.

**NOTE M - RETIREMENT BENEFITS**

**Employees' Retirement System**

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



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

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

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

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

Members of the ERS belong to either a contributory or noncontributory option. Only employees of the DHS hired on or before June 30, 1984, are eligible to participate in the contributory option. Members are required by state statute to contribute 7.8% of their salary to the contributory option and the DHS is required to contribute to both options at an actuarially determined rate.

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

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

In addition to providing pension benefits, the State of Hawaii Employer-Union Health Benefits Trust Fund (EUTF), an agent multiple-employer plan provides certain health care (medical, prescription, vision and dental) and life insurance benefits for retired State

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

employees. Act 88 established the EUTF during the 2001 legislative session and is codified in HRS 87A. Contributions are based on negotiated collective bargaining agreements and are limited by State statute to the actual cost of benefit coverage. The DHS's share of the expense for post-retirement health care and life insurance benefits for the fiscal year ended June 30, 2008, was approximately \$7,459,000.

For employees hired before July 1, 1996, the State pays 100% of the monthly health care premium for employees retiring with 10 or more years of credited service, and 50% of the monthly premium for employees retiring with fewer than ten years of credited service.

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

For employees hired after June 30, 2001 and retiring with over 25 years of service, the State pays 100% of the monthly premium based on the self plan. For those 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 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 those retiring with fewer than 10 years of service, the State makes no contributions.

The State also reimburses 100% of Medicare premium costs for retirees and qualified dependents, who are at least 65 years of age and have at least 10 years of service.

The State implemented GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postretirement Benefits Other Than Pensions* prospectively for the fiscal year ended June 30, 2008. The State is required to contribute the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

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

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

The EUTF issues a stand-alone financial report that includes financial statements and required supplementary information, which may be obtained at the following address: State of Hawaii Employer-Union Health Benefits Trust Fund, 201 Merchant Street, Suite 1520, Honolulu, Hawaii 96813.

**Cost of Retirement Benefits**

The DHS's general fund share of the expense for pension benefits for the fiscal year ended June 30, 2008, 2007, and 2006 was paid from the State General Fund and totaled approximately \$6,855,000, \$6,698,000, and \$7,553,000, respectively. The DHS's federal share of pension benefits expense for the fiscal year ended June 30, 2008, 2007, 2006, was approximately \$5,083,000, \$4,657,000, and \$3,442,000, respectively. The employer contribution rate for the fiscal years ended June 30, 2008, 2007, 2006 was 13.42%, 13.39%, and 13.41%, respectively.

The DHS's general and federal share of pension and post-retirement benefit expenses are included in the accompanying 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 records a liability for risk financing and insurance related losses if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. The excess layers insured with commercial insurance companies are consistent with the prior fiscal year. Settled claims have not exceeded the coverage provided by commercial insurance companies in any of the past three fiscal years. A summary of the State's underwriting risks is as follows:

**Property Insurance**

The State has an insurance policy with a variety of insurers in a variety of layers for property coverage. The deductible for coverage is 3% of loss subject to a \$1 million per occurrence minimum. This policy includes windstorm, earthquake, flood damage, tsunami, and volcanic action coverage. The limit of loss per occurrence is \$175 million, except for terrorism which is \$50 million per occurrence.

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

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2008**

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

**General Liability (including torts)**

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

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

**Self-Insured Risks**

The State generally self-insures its automobile no-fault and workers' compensation losses. Automobile losses are administered by third-party administrators. The State administers its workers' compensation losses. The State records a liability for risk financing and insurance related losses, including incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated.

At June 30, 2008, the State recorded an estimated loss for workers' compensation, automobile and general liability claims as long-term debt as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's General Fund. The DHS's portion of the State's workers' compensation expense for the fiscal year ended June 30, 2008, was approximately \$293,000.

**NOTE O - COMMITMENTS AND CONTINGENCIES**

**Accumulated Sick Leave**

Sick leave accumulates at the rate of one and three-quarters working days for each month of service without limit, but may be taken only in the event of illness and is not convertible to pay upon termination of employment. However, a DHS employee who retires or leaves government service in good standing with 60 days or more of unused sick leave is entitled to additional service credit in the ERS. At June 30, 2008, accumulated sick leave was approximately \$50 million.

**Litigation**

From time to time, the DHS is named as a defendant in various legal proceedings. Although the DHS and its counsel are unable to express opinions as to the outcome of the litigation, it has been the State's historical practice that certain types of judgments and settlements against an agency of the State are paid from the State General Fund through an appropriation bill which is submitted annually by the Department of the Attorney General to the State Legislature.

**Department of Human Services  
State of Hawaii  
NOTES TO THE BASIC FINANCIAL STATEMENTS  
June 30, 2008**

**NOTE P - RELATED PARTY TRANSACTIONS**

The DHS had various amounts due to the State totaling \$43,997,943 as of June 30, 2008, which included federal reimbursements for program expenditures totaling \$42,144,552, receivables totaling \$1,571,500, and cash held outside of the State Treasury totaling \$281,891

The State Department of Health (DOH) administers Medicaid Waiver programs that qualify for federal reimbursement under the Medical Assistance Program. Effective July 1, 2005, the DOH is responsible for paying providers for these claims and the DHS is responsible for transferring funds to the DOH for the federal share of these claims. At June 30, 2008, the estimated amount due to DOH for claims qualifying for federal reimbursement (including an estimated amount of claims incurred but not reported) totaled \$38,513,198.

**NOTE Q - RESTATEMENTS**

Subsequent to the issuance of the DHS' fiscal year 2007 financial statements, management determined that the financial statements were misstated. As a result, certain amounts in the government-wide financial statements and fund financial statements have been restated from the amounts previously reported. The restatement adjustment increased the receivable from the federal government in the special revenue fund and increased the amount due to the general fund and to the State treasury. There is no effect to the DHS' fund and net asset balances at June 30, 2007, because the receivable from the federal government is a reimbursement of previously expended State funds that were earned in the 2007 fiscal year, and therefore is due back to the State Treasury.

## **SUPPLEMENTARY INFORMATION**

**Department of Human Services  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
Fiscal Year Ended June 30, 2008**

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		\$ 1,818,510	\$ --
Temporary Assistance for Needy Families <sup>2</sup>	93.558		101,982,069	19,350,933
Low-income Home Energy Assistance	93.568		2,057,935	--
Child Care and Development Block Grant <sup>2</sup>	93.575		22,364,577	3,034,712
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		11,903,900	--
Chaffee Education and Training Vouchers Program (ETV)	93.599		255,944	--
Head Start	93.600		97,694	--
Children's Justice Grants to States	93.643		93,356	--
Child Welfare Services - State Grants	93.645		1,410,110	--
Foster Care - Title IV-E	93.658		21,723,679	--
Adoption Assistance	93.659		13,847,475	--
Adoption Incentive Payments	93.603		427,325	--
Social Services Block Grant <sup>2</sup>	93.667		16,699,589	1,519,778
Child Abuse and Neglect State Grants	93.669		121,724	--
Family Violence Prevention and Services/Grants for Battered Women's Shelters - Grants to States and Indian Tribes	93.671		800,236	--
Chafee Foster Care Independence Program	93.674		1,045,040	--
State Survey and Certification of Health Care Providers and Suppliers	93.777		494,486	--
Medical Assistance Program	93.778		693,905,260	--
State Children's Insurance Program	93.767		17,443,305	--
Medicaid Transformation Grants	93.793		49,220	--
Demonstration to Maintain Independence and Employment	93.769		1,996,810	--
Pass-through State Department of Labor and Industrial Relations				
Refugee and Entrant Assistance - State Administered Programs	93.566		47,506	--
<b>Total U.S. Department of Health and Human Services</b>			<b>\$ 910,585,750</b>	<b>\$ 23,905,423</b>



**Department of Human Services  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2008**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures <sup>1</sup>	Amount Provided to Subrecipient
<b>U.S. Department of Agriculture</b>				
Supplemental Nutrition Assistance Program <sup>3</sup>	10.551		\$ 175,793,964	\$ --
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	10.561		<u>12,467,738</u>	<u>569,419</u>
<b>Total U.S. Department of Agriculture</b>			<u>188,261,702</u>	<u>569,419</u>
<b>U.S. Department of Justice</b>				
Juvenile Justice and Delinquency Prevention - Allocation to States	16.540		255,118	150,673
Title V - Delinquency Prevention Program	16.548		132,437	127,475
Juvenile Accountability Block Grant	16.523		377,719	376,514
Crime Victim Assistance	16.575		<u>183,527</u>	<u>--</u>
<b>Total U.S. Department of Justice</b>			<u>948,801</u>	<u>654,662</u>
<b>U.S. Department of Labor</b>				
Pass-through State Department of Labor and Industrial Relations Senior Community Service Employment Program	17.235	PY06-SCSEP-CC-DHS	<u>277,642</u>	<u>--</u>
<b>Total U.S. Department of Labor</b>			<u>277,642</u>	<u>--</u>
<b>U.S. Department of Education</b>				
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126		15,397,757	1,195,062
Rehabilitation Services Demonstration and Training Programs	84.235		244,516	--
Independent Living - State Grants	84.169		281,557	240,969
Rehabilitation Services - Independent Living Services for Older Individuals Who are Blind	84.177		163,193	--
Supported Employment Services for Individuals with Significant Disabilities	84.187		234,100	218,678
Assistive Technology	84.224		467,940	447,940
Rehabilitation Training - State Vocational Rehabilitation Unit In-Service Training	84.265		29,600	--
Rehabilitation Long-Term Training	84.129		141,530	--
Safe and Drug-Free Schools and Communities - State Grants	84.186		<u>400,476</u>	<u>387,871</u>
<b>Total U.S. Department of Education</b>			<u>\$ 17,360,669</u>	<u>\$ 2,490,520</u>

**Department of Human Services  
State of Hawaii  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)  
Fiscal Year Ended June 30, 2008**

<u>Federal Grantor/Pass-through Grantor and Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Federal Expenditures<sup>1</sup></u>	<u>Amount Provided to Subrecipient</u>
<b>Corporation for National and Community Service</b>				
Foster Grandparent Program	94.011		\$ 477,494	\$ --
Senior Companion Program	94.016		381,742	--
Retired and Senior Volunteer Program	94.002		<u>103,440</u>	<u>--</u>
<b>Total Corporation for National and Community Service</b>			<u>962,676</u>	<u>--</u>
<b>Social Security Administration</b>				
Social Security - Disability Insurance	96.001		<u>5,638,554</u>	<u>--</u>
<b>Total Social Security Administration</b>			<u>5,638,554</u>	<u>--</u>
<b>TOTAL FEDERAL EXPENDITURES</b>			<b>\$ <u>1,124,035,794</u></b>	<b>\$ <u>27,620,024</u></b>

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

<sup>2</sup> Grant awards totaling \$29,790,000 were transferred from CFDA 93.558 Temporary Assistance for Needy Families to CFDA 93.667 Social Services Block Grant (\$9,890,000) and to CFDA 93.575 Child Card Development Block Grant (\$19,900,000).

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

**PART II**

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

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

To the Auditor  
Office of the Auditor  
State of Hawaii

We have audited the financial statements of the governmental activities and each major fund of the Department of Human Services of the State of Hawaii (DHS), as of and for the fiscal year ended June 30, 2008, which collectively comprise the DHS's basic financial statements and have issued our report thereon dated March 30, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

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

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the DHS's ability to initiate, authorize, record, process, or report financial data reliably in



accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the DHS's financial statements that is more than inconsequential will not be prevented or detected by the DHS's internal control. We consider the deficiencies described in items 2008-01 to 2008-05 in the accompanying schedule of findings and questioned costs to be significant deficiencies in internal control over financial reporting.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider item 2008-01 to be a material weakness.

### **Compliance and Other Matters**

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

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

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

*N&K CPAs, Inc.*

Honolulu, Hawaii  
March 30, 2009

**PART III**

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

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH  
REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE  
WITH OMB CIRCULAR A-133**

To the Auditor  
Office of the Auditor  
State of Hawaii

**Compliance**

We have audited the compliance of the Department of Human Services of the State of Hawaii (DHS) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the fiscal year ended June 30, 2008. The DHS's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the DHS's management. Our responsibility is to express an opinion on the DHS's compliance based on our audit.

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



As described in items 2008-06 to 2008-12 in the accompanying schedule of findings and questioned costs, the DHS did not comply with the following requirements:

CFDA Number	Name of Federal Program	Type of Compliance Requirement	Ref. No.
93.778	Medical Assistance Program	Activities Allowed, Allowable Costs, Eligibility, and Special Tests and Provisions	2008-06 - 2008-10
93.575 and 93.596	Child Care Cluster	Activities Allowed and Eligibility	2008-11, 2008-12

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

In our opinion, except for the noncompliance described in the preceding paragraph, the DHS complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the fiscal year ended June 30, 2008.

### Internal Control Over Compliance

The management of the DHS is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the DHS's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the DHS's internal control over compliance.

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

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



a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2008-06 to 2008-12 to be significant deficiencies.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control. Of the significant deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs, we consider items 2008-06 to 2008-12 to be material weaknesses.

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

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

*N&K CPAs, Inc.*

Honolulu, Hawaii  
March 30, 2009

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

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
Fiscal Year Ended June 30, 2008**

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

**Financial Statements**

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

Material weakness(es) identified?  yes  no

Significant deficiencies identified that are not considered to be material weaknesses?  yes  none reported

Noncompliance material to the financial statements noted?  yes  no

**Federal Awards**

Internal control over major program:

Material weakness(es) identified?  yes  no

Significant deficiencies identified that are not considered to be material weaknesses?  yes  none reported

Type of auditors' report issued on compliance for major programs: Qualified

Any audit findings disclosed that are required to be reported in accordance with section .510(a) of OMB Circular A-133?  yes  no

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
93.558	Temporary Assistance for Needy Families
96.001	Social Security - Disability Insurance
93.575	Child Care and Development Block Grant
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund
93.767	State Children's Insurance Program
93.777	State Survey and Certification of Health Care Providers and Suppliers
93.778	Medical Assistance Program

Dollar threshold used to distinguish between Type A and Type B programs: \$ 3,372,107

Auditee qualified as a low-risk auditee?  yes  no

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

**SECTION II - FINANCIAL STATEMENT FINDINGS**

**Ref.  
No. Internal Control Findings**

**2008-01 Revise Federal Award Reimbursement Process**

We identified an accounting error in the DHS basic financial statements as of and for the fiscal years ended June 30, 2008 and 2007. The Med-QUEST Division (MQD) understated the amount receivable from the federal government by approximately \$33.6 million and \$41.2 million as of June 30, 2008 and 2007, respectively. There was no effect on the previously reported fund and net asset balances of the DHS as of June 30, 2007 because the receivable from the federal government was a reimbursement of previously expended State funds that were earned in the 2007 fiscal year and therefore was due back to the State Treasury. The understatement in the fiscal year 2008 financial statements was identified and subsequently adjusted for. The error occurred due to a lack of periodic reconciliations of the DHS revenue and expenditure accounts to the amounts of federal awards that were drawn down.

The MQD administers the Medicaid Program for the State of Hawaii. Costs of the Medicaid program are first paid from allotments of State general funds after which MQD requests reimbursements from federal grant awards based on a Federal Participation rate of approximately 58% (Certain expenditures do not qualify for federal reimbursements while other expenditures are reimbursed at higher rates). This cost reimbursement basis is a federal compliance requirement. In complying with this federal requirement, the DHS initially uses its general funds to pay for the federal share of the expenditures and reimburses the general fund once the federal funds are received.

The Medicaid program is the largest federally funded program administered by the DHS (approximately \$730 million in federal funds for the fiscal year ended June 30, 2008) and the amount of federal funding earned by the State is generally based on a Federal Medical Assistance Percentage rate (FMAP) multiplied by the amount of expenditures incurred during the quarter. The Medicaid program awards the MQD an estimated federal award at the beginning of each quarter based on the MQD's request for funding. Subsequent to filing the quarterly federal reports, supplemental federal awards are granted to increase or decrease the total federal award to equal the amount of federal reimbursements earned based on reports of actual expenditures made. At times, these supplemental awards may not be made available to the DHS to draw down and receive the reimbursement until three to six months following the end of a quarterly reporting period. If the initial quarterly award is not sufficient to cover the federal share of expenditures, MQD continues to use its State general funds to advance the federal share of the expenditures until federal funds become available.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

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

**2008-01 Revise Federal Award Reimbursement Process (Continued)**

We noted that during the fiscal year ended June 30, 2008, the MQD received approximately \$18.6 million more in federal reimbursements during the year than what it reported as earned for the current fiscal year. Upon further investigation, it was determined that the funding received was for federal reimbursements earned in the prior fiscal years. A reconciliation of federal awards drawn down during the past two fiscal years to the amount of federal revenues recognized during that period was performed and it was determined that the approximately \$33.3 million and \$53.3 million was receivable from the federal government as of June 30, 2008 and 2007, respectively.

The lack of quarterly reconciliations, including a complete review and approval of such reconciliations, affected the DHS's ability to accurately report federal revenues earned which resulted in a material understatement of revenues and amounts receivable in the special revenue funds.

**Recommendation**

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

We also recommend that management review the process used to request the estimated quarterly federal award to ensure that the amount awarded is sufficient to reimburse the federal share of estimated expenditures on a timely basis. An increase in the initial award would reduce the amount of State general funds that would need to be advanced until the supplemental federal awards are received.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

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

**2008-02 Report All Federal Programs**

During our tests of the Schedule of Expenditures of Federal Awards (SEFA) for the fiscal year ended June 30, 2008, we noted that expenditures related to the Demonstration to Maintain Independence and Employment grant was not included in the SEFA for the fiscal year ended June 30, 2007. As a result, the 2007 SEFA was understated by \$301,984. The Med-QUEST Division had expended federal funds for this grant during the fiscal year ended June 30, 2007, but did not include those expenditures in its SEFA as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. This omission was not detected by review procedures performed on the SEFA by DHS management.

**Recommendation**

The DHS should establish procedures to ensure that all expenditures of federal awards are properly reported in the Schedule of Expenditures of Federal Awards. The personnel responsible for the preparation and review of the SEFA should have ready access to all financial reports filed for all programs which receive federal funding. In addition, a list of all federal awards expended should be circulated and reviewed by appropriate personnel in each division of DHS for completeness and accuracy as part of the review process.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

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

**2008-03 Properly Record All Capital Assets in the State Property Inventory Records**

All divisions of the DHS are responsible for reporting the acquisition and disposal of capital assets to the State Procurement Office on a quarterly basis to update the state property inventory records. The Department of Accounting and General Services (DAGS) uses the information from the state property inventory records to assist the DHS in compiling the department's capital assets and depreciation information for the fiscal year. We noted that during the fiscal year ended June 30, 2008, the DHS reported \$269,260 in capital asset additions (\$190,341, net of accumulated depreciation) that were purchased in prior fiscal years. In addition, we noted that \$857,635 of capital acquisitions were recorded as repairs and maintenance expenditures and not properly included in the state property inventory records in the current fiscal year.

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

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

**Recommendation**

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

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

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

**2008-04 Maintain Vacation and Sick Leave Records Properly**

The DHS prepared a summary leave schedule to compute its accrued compensated absence liability balance 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. The DHS uses a manual process to maintain and report the vacation and sick leave records which resulted in errors in the amount of hours and dollars reported to the State Comptroller. The following were the conditions noted during our review of 25 vacation and sick leave files:

- There were six instances where the vacation leave hours per the employee's Form DPS-7 did not agree to the "Vacation and Sick leave Accrual Listing" as of June 30, 2008. This resulted in a net understatement of accrued vacation totaling 5.25 hours or \$103.
- There were four instances where the vacation or sick leave hours per the employee's Form DPS-7 did not agree to the "Vacation and Sick leave Accrual Listing" as of June 30, 2008. This resulted in a net understatement of accumulated sick leave totaling 1.50 hours or \$17.
- There were four instances where the vacation hours per the employee's Form DPS-7 did not agree to the "Application of Leave of Absence" (Form G-1) filed for the period tested. This resulted in a net understatement of accrued vacation leave totaling 5.25 hours or \$66.
- There was one instance where the sick hours per the employee's Form DPS-7 did not agree to the "Application of Leave of Absence" (Form G-1) filed for the period tested. This resulted in an understatement of accumulated sick leave totaling 1.75 hours or \$45.

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

**Recommendation**

We recommend that the amounts of vacation and sick leave balance being reported are validated against personnel and payroll records to ensure accuracy and completeness before reporting the balance to the State Comptroller. The DHS should also increase the number of random quality control reviews of leave records to ensure that vacation and sick leave records are accurately maintained on a timely basis.



**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

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

**2008-05 Maintain Procurement Files Properly**

Divisions within the DHS are responsible for following the guidelines of the State Procurement Office, which serves as the central authority on procurement statutes and rules for all governmental bodies of the State.

Federal regulations (45 CFR 74.46) requires the DHS to maintain documentation supporting the history of the procurement process including the rationale for method of procurement, selection of contract type, contractor selection or rejection, and the basis of contract price. Section 103F-402 of the Hawaii Revised Statutes states that proposals are to be evaluated with criteria that are made known to the applicant during the initial request for proposals. The following were the conditions noted during our review of 25 procurement files:

- There were two instances where the DHS was unable to locate the documentation supporting the rationale of the contractor selected. The two contracts were awarded federal funds under CFDA 93.778 Medical Assistance Program.

Although the DHS has established policies and procedures within each division to comply with State procurement statutes, it appears that not all contracts were reviewed to ascertain the completeness of the files.

**Recommendation**

We recommend that prior to contractor acceptance, the DHS implement a review process to ensure procurement files contain all documentation as required by State and federal procurement statutes.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

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

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings</b>	<b>Questioned Costs</b>
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<b>2008-06</b>	<b>Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims</b>	
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Federal agency: U.S. Department of Health and Human Services  
CFDA 93.778  
Medical Assistance Program

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

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

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

More specifically, we noted the following conditions:

- The Surveillance and Utilization Review Subsystem (SURS) reports are still not being used to identify potential fraud or abuse. During much of fiscal year 2008, SURS personnel were assigned

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
<b>2008-06</b>	<p><b>Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims (Continued)</b></p> <p>to perform prior authorization functions. In February 2008, the prior authorization function was contracted to ACS and three full-time SURS personnel were available by April 2008. However, based on discussion with SURS personnel there is a lack of meaningful, user-friendly SURS reports needed to identify potential fraud and abuse cases. As a result, there were no cases referred to the Medicaid Fraud Control Unit (MFCU) which operates under the State Attorney General's office based on the review of SURS reports. Any referrals from the SURS unit in fiscal year 2008, originated from public phone calls reporting potential fraud or abuse. The DHS continues to be in noncompliance with Title 42 CFR Part 456.23, which requires the DHS to have a post payment review process that allows state personnel to review recipient utilization and provider service profiles and exception criteria to identify and correct misutilization practices of recipients and providers.</p> <ul style="list-style-type: none"> <li>• The DHS continues to be in noncompliance with Title 42 CFR Part 455.13 which requires the DHS to have methods for identification, investigation, and referral of fraudulent activity. The Medicaid Investigations Unit (MIU) is responsible for these activities. In the past, this unit was comprised of one individual and in June 2008, this individual went on medical leave, has since left the DHS and to date the position remains vacant. The DHS currently has almost no formal activities to identify suspected fraud. Referrals of potential fraudulent activities to the MFCU only originate from complaints received via the MQD phone line. In an August 2006 report issued by the Centers for Medicare and Medicaid Services (CMS) the U.S. federal agency which administers the Medicaid program, the DHS was cited for a lack of communication and coordination of efforts with the MFCU. There appears to be no improvement in this condition. .</li> <li>• There is no formal ongoing post payment review of a sample of claims. It has been over five years since the last third party review was performed, which focused on pharmacy claims and the monitoring of ACS, its pharmacy benefits manager (PBM). That report issued by an independent healthcare auditing and consulting company reported potential overpayments of approximately \$462,000 and recommended the need to explore additional edits, analysis, and reporting in order to</li> </ul>	

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned Costs</b>
<b>2008-06</b>	<p><b>Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims (Continued)</b></p> <p>expand anti-fraud efforts. As part of our review of internal controls, we performed a test of drug and non-drug claims which did identify a provider billing/system error. The errors were identified as a provider billing error of non-emergency transportation services being billed twice which the system improperly overpaid. The error was identified by the MQD possibly in April 2008, however, the HPPMIS system was not corrected until January 2009 and a memo to providers informing them of the proper billing of non-emergency transportation was not sent until January 29, 2009. As the fiscal agent, ACS, is in the process of determining the number of claims affected by this error. Preliminarily, for fiscal year 2008 the overpayments are expected to be greater than \$1,000,000 and the MQD plans to research claims dating back to 2006.</p> <ul style="list-style-type: none"> <li>• The DHS has contracted a QIO to perform certain utilization control activities such as acute hospital reviews, pre-admission screening and resident reviews (PASRR) for nursing facilities and long-term level of care determinations. However, due to a lack of staffing follow-up activities such as ensuring recovery of overpayments and monitoring of QIO performance is not being performed. For example, the last recoupment of acute and ambulatory surgery service claims found to be at the incorrect level of care or not medically necessary dates back to the third quarter of fiscal year 2005. Since that time through June 2008, over 1,000 days of nursing facility services were found to be inappropriate and no recoveries have been made. We also noted there are PASRR cases dating back to July 2006 that have not yet been resolved.</li> <li>• During fiscal year 2008 the MQD experienced a great deal of personnel turnover. Specifically, the MQD lost and operated without the following positions at various times during the year; (1) the acting MQD administrator, (2) the acting Health Coverage Management Branch (HCMB) administrator, in charge of the managed care program, (3) the lone Medical Investigator, and (4) the Medical Standards Branch administrator who also served as the Medical Director at the time. The turnover in key positions diminished the efficiency, effectiveness and management of the program. Due to the lack of personnel, the MQD contracts third parties to perform many functions of the program. However, the MQD is ultimately responsible for the quality of the performance and compliance of these functions.</li> </ul>	

Department of Human Services  
State of Hawaii  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
Fiscal Year Ended June 30, 2008

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned Costs</b>
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<b>2008-06</b>	<b>Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims (Continued)</b>	
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In fiscal year 2008, total federal expenditures by DHS for this program was approximately \$694,000,000. In terms of dollars spent, Medicaid is the largest federal grant program in the United States and is considered a program of higher risk. Therefore, the DHS's inability to effectively implement and operate a system to control utilization and maintain program integrity results in noncompliance with federal guidelines and an increase in risk that fraudulent activity will go undetected and that unallowable costs will be charged to the federal grant.

\$ Unknown

**Recommendation**

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

- Complete the development of meaningful SURS reports and regularly analyze the reports as required by Title 42 CFR Part 456.23. The analysis of these reports should help identify exceptions or abnormal patterns of treatment or service and allow for the correction of misutilization practices of recipients and providers. It also serves as an important tool to identify and investigate potential fraudulent behavior.
- Given the high percentage of claims submitted via electronic media, the DHS should reinstitute the electronic media claims (EMC) audits performed by third parties. EMC audits increase controls over the accuracy of claims and provides an opportunity to increase provider education that reduces risks of unintentional errors in future claims. It may also serve as a valuable referral source of potential fraud to the MIU.
- Perform regular reviews on a sample of drug and non-drug claims paid to detect processing errors and identify ways to improve the claims processing system and procedures.
- Take timely corrective action on problems or noncompliance identified by its QIO such as recovery of overpayments and implementation of recommendations issued.

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
<b>2008-06</b>	<b>Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims (Continued)</b> <ul style="list-style-type: none"><li>• Allocate the necessary resources needed to actively identify and investigate suspected fraud as required by Title 42 CFR Part 455.13.</li></ul>	

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned Costs</b>
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**2008-07 Complete Eligibility Applications and Annual Eligibility Re-  
verifications in a Timely Manner**

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

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

The DHS is still behind in its processing of Medicaid applications and annual eligibility re-verifications. As of June 30, 2008, the number of applications outstanding longer than 45 days was 1,954 compared to 2,565 applications as of June 30, 2007. Although the number of applications outstanding longer than 45 days decreased by approximately 24%, the number of outstanding applications still represents a backlog of about 14 days. In September 2008, the Eligibility Branch started a statewide Application Backlog Project to address overdue applications in excess of 45 days. The number of overdue annual re-verifications was reduced to 919 as of June 30, 2008, which is a reduction of approximately 93% from the overdue re-verifications as of June 30, 2007. This is a direct result of an Eligibility Review cleanup project conducted by the Eligibility Branch during fiscal year 2008.

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**Recommendation**

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

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned Costs</b>
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**2008-08 Monitor the Medicaid Drug Rebate Program**

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

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

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

While the day-to-day operations of the drug rebate program have been subcontracted to ACS, the DHS is still ultimately accountable for the drug rebate program. Much reliance is placed on ACS to operate the drug rebate program, but there is little monitoring of subcontractor activities. This lack of the DHS oversight of ACS could result in future noncompliance with CMS guidelines such as issues which occurred under the previous fiscal agent that the DHS is still trying to resolve. The DHS continues to try and collect outstanding drug rebates and related interest dating as far back as 1991. The balance remaining on the rebate receivable ledger totaled approximately \$13.5 million. It is estimated that over \$6 million of the outstanding balances were collected by ACS but these payments have not been applied to the receivable ledger. The DHS is currently working on the reconciliation of these payments to reflect a more accurate receivable balance. The DHS will not be able to collect or write-off the receivable balance in accordance with CMS guidelines until the ledger is properly reconciled.

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**Recommendation**

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



**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
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**2008-09 Maintain All Required Documentation in Medicaid Files**

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

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

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

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**Recommendation**

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

Department of Human Services  
State of Hawaii  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)**  
Fiscal Year Ended June 30, 2008

<b>Ref. No.</b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b>Questioned Costs</b>
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**2008-10 Maintain All Required Medicaid Provider Documentation**

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

In order to receive Medicaid payments, providers are required to be licensed in accordance with federal, state, and local laws and regulations to participate in the Medicaid program. A completed and signed Provider Information Form (Form 1139) constitutes the full written agreement. Title 42 CFR Part 455, Subpart B also requires providers to make certain required disclosures to the State which are included in the Provider Information Form.

During our tests of provider eligibility for the Medicaid program, we noted nine of the twenty-five providers tested were missing the Form 1139 and/or required disclosures, resulting in noncompliance with federal grant guidelines. According to MQD Administration, the task of updating provider agreements is still ongoing. The MQD cannot ensure that proper documentation is maintained for all Medicaid providers. As a result, payments may have been made to ineligible providers.

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**Recommendation**

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

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

<u>Ref. No.</u>	<b>Compliance and Internal Control Findings (Continued)</b>	<u>Questioned Costs</u>
<b>2008-11</b>	<p><b>Maintain All Required Documentation in Child Care Case Files</b></p> <p>Federal agency: U.S. Department of Health and Human Services CFDA 93.575 and 93.596 Child Care Development Block Grant Child Care Mandatory and Matching Funds of the Child Care and Development Fund</p> <p>For the fiscal year 2008, total federal expenditures for the Child Care Cluster by the DHS was approximately \$27,800,000. During our testing of eligibility, we noted that supporting documentation to support eligibility determinations was not always maintained as follows:</p> <ul style="list-style-type: none"> <li>• Seven instances in which the required documentation was not maintained in the participant case file. Missing documentation included birth certificate, child care provider confirmation form, child care provider receipts, or verification of income resulting in payments totaling \$24,678 without adequate support.</li> <li>• Three instances in which the DHS was either unable to locate a case file or unable to provide case file information to support fiscal year 2008 child care payments resulting in payments totaling \$12,725 without adequate support.</li> </ul> <p>Title 45 CFR Part 98.65(e) requires that appropriate documentation be maintained to allow the verification that child care federal funds are expended in accordance with the statutory and regulatory requirements.</p>	<p><b>\$ <u>37,403</u></b></p>
	<p><b>Recommendation</b></p> <p>The DHS should ensure that required documents are maintained in each case file to support the allowability and eligibility of the child care payments claimed for federal reimbursement. The DHS should perform secondary reviews on a sample basis in order to assess case manager performance.</p>	

**Department of Human Services  
State of Hawaii  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)  
Fiscal Year Ended June 30, 2008**

<b><u>Ref. No.</u></b>	<b>Compliance and Internal Control Findings (Continued)</b>	<b><u>Questioned Costs</u></b>
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**2008-12 Improve the Accuracy of Child Care Reimbursements**

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

For the fiscal year 2008, total federal expenditures for the Child Care Cluster (CFDA 93.575 and 93.596) program were approximately \$27,800,000. During our testing of allowability and eligibility for the Child Care payments, we noted two benefit payment errors. The errors were a result of case worker error or oversight such as incorrect calculation of activity hours and type of care, and incorrect reimbursement calculation based on the maximum provider reimbursement rate. The errors noted resulted in overpayments totaling \$2,492.

\$ 2,492

**Recommendation**

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

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

**Department of Human Services  
State of Hawaii  
STATUS REPORT  
Fiscal Year Ended June 30, 2008**

This section contains the current status of the prior auditors' recommendations. The recommendations are referenced to the pages of the previous audit report for the fiscal year ended June 30, 2007, dated March 25, 2008.

**SECTION II - FINANCIAL STATEMENT FINDINGS**

<u>Recommendations</u>	<u>Status</u>
<p><b>2007-01    Improve Reconciliation Process of Federal Funds Received (page 60)</b></p> <p>The DHS should perform reconciliations between federal expenditures recorded on the DHS' accounting records and the financial reports filed with each respective monitoring agency. In addition, a secondary review of the information used to prepare the Schedule of Expenditures of Federal Awards should be performed to ensure that all federal expenditures are accounted for and that the balances are correct.</p>	<p>Not accomplished. See Reference No. 2008-02.</p>
<p><b>2007-02    Reconcile Accounts to Supporting Documentation (page 61)</b></p> <p>The DHS should perform reconciliations between the DHS financial records for the Electronic Benefit Transfers (EBT), the bank account where EBT monies are deposited and JP Morgan Chase Treasury Services (JP Morgan) account records. Any differences should be investigated and properly adjusted for in the respective accounting records.</p>	<p>Accomplished.</p>
<p><b>2007-03    Properly Record All Capital Assets in the State Property Inventory Records (pages 62)</b></p> <p>The DHS should implement monitoring procedures to ensure that all appropriate personnel properly and accurately report all fixed asset acquisitions and dispositions to the State Procurement Office on a quarterly basis. The DHS should implement a process to review, in a timely manner, the transactions that are posted to the department property inventory records to ensure that the transactions were properly posted to the state property inventory records.</p>	<p>Not accomplished. See Reference No. 2008-03.</p>

**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2008**

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

<u>Recommendations</u>	<u>Status</u>
<p><b>2007-04 Maintain Vacation and Sick Leave Records Properly (pages 59-60)</b></p> <p>The DHS should increase the number of quality control reviews of leave records and perform them periodically throughout the year to ensure that vacation and sick leave and compensatory time records are accurately maintained and reviewed on a timely basis. In addition, the summary leave schedule should be reviewed and tested before reporting to the State Controller.</p>	<p>Not accomplished. See Reference No. 2008-04.</p>

**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2008**

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

<u>Recommendations</u>	<u>CFDA Number</u>	<u>Status</u>
<p><b>2007-05 Improve Utilization Controls over Medicaid Claims (pages 64 - 66)</b></p> <p>To ensure compliance with federal regulations, the DHS should increase its back-end control activities over the Medicaid program. The DHS should consider the following:</p> <ul style="list-style-type: none"> <li>• Complete the development of meaningful SURS reports and regularly analyze the reports as required by Title 42 CFR Part 456.23.</li> <li>• Prepare a request for proposal to continue the EMC audits, given the high percentage of claims submitted via electronic media.</li> <li>• Perform regular post payment reviews on a sample of drug and non-drug claims to detect processing errors and identify ways to improve the claims processing system and procedures.</li> <li>• Implement proper corrective action on problems or noncompliance identified by its QIO such as recovery of overpayments and implementation of recommendations issued.</li> <li>• Allocate the necessary resources needed to actively identify and investigate suspected fraud.</li> </ul>	<b>93.778</b>	Not accomplished. See Reference No. 2008-06.
<p><b>2007-06 Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner (page 67)</b></p> <p>The DHS should assess the staffing needs at the MQD Eligibility Branch and make every effort to eliminate the backlog of applications pending eligibility determinations and perform annual re-verifications timely as required by federal regulations and to reduce the risk that ineligible recipients are receiving Medicaid benefits.</p>	<b>93.558</b>	Not accomplished. See Reference No. 2008-07.



**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2008**

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

<u>Recommendations</u>	<u>CFDA Number</u>	<u>Status</u>
<p><b>2007-07 Maintain All Required Documentation in Child Care Case Files (page 68)</b></p> <p>The DHS should ensure that required documents are maintained in each case file to support the allowability and eligibility of the child care payments claimed for federal reimbursement. The DHS should perform secondary reviews on a sample basis to ensure that all required documents are properly completed and maintained in the case files.</p>	<p><b>93.575 93.596</b></p>	<p>Not accomplished. See Reference No. 2008-011.</p>
<p><b>2007-08 Monitor the Medicaid Drug Rebate Program (page 69)</b></p> <p>The DHS should establish formal procedures to monitor its subcontractor to ensure the drug rebate program operates in compliance with CMS guidelines and help identify issues timely and prevent difficult time consuming problems such as collecting old outstanding balances.</p>	<p><b>93.778</b></p>	<p>Not accomplished. See Reference No. 2008-08.</p>
<p><b>2007-09 Maintain All Required Documentation in Medicaid Files (page 70)</b></p> <p>The DHS should ensure that all required documents are maintained in each case file to support the allowability and eligibility of the Medicaid assistance payments being claimed for federal reimbursement. The DHS should perform case file reviews in order to assess case manager performance.</p>	<p><b>93.778</b></p>	<p>Not accomplished. See Reference No. 2008-09.</p>
<p><b>2007-10 Maintain All Required Medicaid Provider Documentation (page 71)</b></p> <p>The DHS should ensure all provider agreements are properly completed and maintained.</p>	<p><b>93.778</b></p>	<p>Not accomplished. See Reference No. 2008-10.</p>

**Department of Human Services  
State of Hawaii  
STATUS REPORT (Continued)  
Fiscal Year Ended June 30, 2008**

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

<u>Recommendations</u>	<u>CFDA Number</u>	<u>Status</u>
<p><b>2007-11 Improve Controls over Voiding of Outstanding Checks (page 72)</b></p> <p>The DHS should ensure that outstanding checks beyond 180 days of issuance are voided and credited to the Medicaid program properly. The DHS should implement controls to monitor ACS's monthly bank reconciliations to ensure that checks outstanding beyond 180 days of issuance are properly credited to the Medicaid program.</p>	<p><b>93.778</b></p>	<p>Substantially accomplished. During the fiscal year, the DHS voided and credited outstanding checks timely. However, at fiscal year end there were three checks totaling \$21 that were outstanding beyond 180 days.</p>
<p><b>2007-12 Maintain All Required Documentation in Temporary Assistance for Needy Families (TANF) Files (page 73)</b></p> <p>The DHS should ensure that all required documents are maintained in each case file to support the allowability and eligibility of the TANF payments being claimed for federal reimbursement. A secondary review would help ensure that all required documents are properly completed.</p>	<p><b>93.558</b></p>	<p>Accomplished.</p>
<p><b>2007-13 Improve the Accuracy of Child Care Reimbursements (page 74)</b></p> <p>The DHS should ensure that reimbursements to child care program participants are calculated properly. The DHS should perform post payment reviews of a sample of child care payments to ensure accuracy and assess case worker performance.</p>	<p><b>93.575 93.596</b></p>	<p>Not accomplished. See Reference No. 2008- 12.</p>
<p><b>2007-14 Maintain All Required Documentation in Adoption Assistance Files (page 75)</b></p> <p>The DHS should ensure that all required documents are maintained in each case file to support the allowability and eligibility of the Adoption Assistance payments being claimed for federal reimbursement.</p>	<p><b>93.659</b></p>	<p>Accomplished.</p>

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

LINDA LINGLE  
GOVERNOR



LILLIAN B. KOLLER, ESQ.  
DIRECTOR

HENRY OLIVA  
DEPUTY DIRECTOR

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


March 25, 2009

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

Dear Mr. Shilgi:

Attached are the Department of Human Services' responses and corrective action plans related to your fiscal year 2008 audit report findings and recommendations. We appreciate the opportunity to comment on the audit report.

Sincerely,

  
fw Lillian B. Koller  
Director

Attachment

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**Ref. no. 2008-01      Revise Federal Award Reimbursement Process**

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

We also recommend that management review the process used to request the estimated quarterly federal award to ensure that the amount awarded is sufficient to reimburse the federal share of estimated expenditures on a timely basis. An increase in the initial award would reduce the amount of State general funds that would need to be advanced until the supplemental federal awards are received.

**Corrective Action Taken or Planned:**      A reconciliation process has been established since July 2008 for quarter ending September 2008 in which the MQD accountant reconciles all cash drawn during the quarter with the federal financial report. This Schedule of Drawdown reconciliation accounts for all cash drawn, reclassed funds, and actual federal shares of earned funds with the initial grant and supplemental quarter awards. It is reviewed quarterly by the Finance Officer.

The MQD has been working to establish two higher level Accountant V and Accountant IV positions to provide necessary resources to the Accounting Section of the Finance Office. Presently, the Accounting Section includes only one Accountant III, therefore requiring consultant services for financial reporting. The addition of these two positions that have received Governor's approval for filling will greatly assist the Finance Office in providing proper accounting, reconciliation and reporting services required to properly manage the over \$1.3 billion dollars of the Med-QUEST programs.

Finally, the estimated quarterly federal awards are estimated to meet anticipated costs for the quarter. However, due to higher than anticipated utilization of services, estimates are sometimes significantly less than actual. The MQD strives to provide budget estimates as close as possible to expected actual costs to reduce the amount of advance of state general funds.

**Start Date:**      July 2008

**End Date:**      Ongoing

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

**Ref. no. 2008-02      Report All Federal Programs**

**Auditor's Recommendation:**      The DHS should establish procedures to ensure that all expenditures of federal awards are properly reported in the Schedule of Expenditures of Federal Awards. The personnel responsible for the preparation and review of the SEFA should have ready access to all financial reports filed for all programs which receive federal funding. In addition, a list of all federal awards expended should be circulated and reviewed by appropriate personnel in each division of DHS for completeness and accuracy as part of the review process.

**Corrective Action Taken or Planned:**      The MQD will ensure that a copy of all federal awards be sent to the DHS Fiscal Management Office (FMO) so they are aware of all awards in the MQD.

**Start Date:**      Ongoing

**End Date:**      Ongoing

**Responding Person:**      Ann H. Kinningham, MQD Finance Officer,  
Phone: (808) 682-7956

**Ref. no. 2008-03      Property Record All Capital Assets in the State Property Inventory Records**

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

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

The Department is also required to reconcile on a quarterly basis, the DAGS-Inventory Management Branch Report titled the Reconciliation of FAMIS Expenditures for State Property. This

report serves to verify 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 enhance the financial reporting function of the FAIS. Monitoring procedures, including the periodic review of program expenditures, have been implemented on a department-wide basis.

In November 2005, a DHS memorandum (FMO Circular IM 06-05) was issued to clarify the inventory reporting responsibilities and promote the timely reporting of fixed asset acquisitions. The memorandum specified the responsible office for reporting purposes, especially in cases where physical custody is uncertain (e.g. software).

The Department uses the detailed procedures established in the DAGS Inventory System Manual and the Hawaii Administrative Rules (HAR) to provide instructions and guidelines. In addition, the Department issues internal circulars and memoranda that serve to update any procedural or HAR changes, and to provide clarification or information that is necessary for proper inventory reporting. The Inventory System Manual, the HAR, the FMO Circulars and memoranda all serve to provide guidelines and procedures. On this basis, all departmental personnel with inventory responsibilities are made knowledgeable of the proper inventory procedures and reporting requirements.

The Department has also provided inventory training in partnership with DAGS Inventory Management Branch and plans to conduct refresher training sessions. The State Procurement Office plans to conduct a series of inventory training sessions for the 2009 calendar year. Department offices are also advised to consult with FMO/Property and Procurement Staff whenever questions or the need for information arise, providing effective "on-the-job" training.

**Start Date:** Ongoing

**End Date:** Ongoing

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

**Ref. no. 2008-04** **Maintain Vacation and Sick Leave Records Property**

**Auditor's Recommendation:** We recommend that the amounts of vacation and sick leave balance being reported are validated against personnel and payroll records to ensure accuracy and completeness before reporting the balance to the State Comptroller. The DHS should also increase the number of random quality control reviews of

leave records to ensure that vacation and sick leave records are accurately maintained on a timely basis.

**Corrective Action  
Taken or Planned:**

To improve the accuracy of the summary leave schedule, the Fiscal Management Office Pre-Audit Staff will be increasing its random review to approximately 15% of the 2,000-plus employee records. Established procedures require that the employee responsible for maintaining the leave records to compile and review the information needed for the summary leave schedule. The appropriate supervisor is also required to review and sign the worksheet to validate its completeness and accuracy.

DHS will continue to insure procedures regarding the approval process of leave request are in compliance with appropriate collective bargaining unit agreements and policies and procedures.

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 of leave records.

**Start Date:** Ongoing

**End Date:** Ongoing

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

**Ref. no. 2008-05 Maintain Procurement Files Properly**

**Auditor's  
Recommendation:** We recommend that prior to contractor acceptance, the DHS implement a review process to ensure procurement files contain all documentation as required by State and federal procurement statutes.

**Corrective Action  
Taken or Planned:**

1. The process for MQD proposal review and acceptance is being reviewed and adapted.
2. Changes to the process for proposal review include:
  - a. At the start of the procurement process, an electronic file for that procurement will be created by the Finance Office on a secure drive.
  - b. Electronic files for each aspect of the procurement will be stored in the electronic file: RFI, RFP, Proposal submission, documentation that supports contractor selection or rejection, and a copy of the executed contract. Only staff members that need the procurement



information will have access to the file.

- c. Upon completion of proposal review, the score sheets will be scanned and filed electronically. The original score sheets will then be hand delivered to Contract Officer in the Med-QUEST Division's Finance Office.
- d. The contract will not be executed without the score sheets to support contract award.
- e. A hard copy file of all documents will be maintained in the MQD Finance Office.

**Start Date:** Ongoing

**End Date:** Ongoing

**Responding Persons:** Patricia M. Bazin, MQD Health Care Services Branch Administrator  
Phone: (808) 692-8083, and  
Ann H. Kinningham, MQD Finance Officer  
Phone: (808) 692-7956

**Ref. no. 2008-06** **Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims**

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

- Complete the development of meaningful SURS reports and regularly analyze the reports as required by Title 42 CFR Part 456.23. The analysis of these reports should help identify exceptions or abnormal patterns of treatment or service and allow for the correction of misutilization practices of recipients and providers. It also serves as an important tool to identify and investigate potential fraudulent behavior.
- Given the high percentage of claims submitted via electronic media, the DHS should reinstitute the electronic media claims (EMC) audits performed by third parties. EMC audits increase controls over the accuracy of claims and provides an opportunity to increase provider education that reduces risks of unintentional errors in future claims. It may also serve as a valuable referral source of potential fraud to the MIU.

- Perform regular reviews on a sample of drug and non-drug claims paid to detect processing errors and identify ways to improve the claims processing system and procedures.
- Take timely corrective action on problems or noncompliance identified by its QIO such as recovery of overpayments and implementation of recommendations issued.
- Allocate the necessary resources needed to actively identify and investigate suspected fraud as required by Title 42 CFR Part 455.13.

**Corrective Action  
Taken or Planned:**

HPMMIS management reports have been produced for review and use by MQD staff. In the recently reorganized Finance Office, Financial Integrity Staff Unit, three nurse positions have been assigned to regularly analyze the SURS reports to identify exceptions, abnormal patterns and mistakes for corrective actions. Modifications to the SURS reports are being made as needed with dialogue ongoing between the Financial Integrity Staff nurses and the Systems Office. The Systems Office Health Care Business Analysts also provide the nurses on occasion with on-demand provider specific reports for targeted utilization reviews. A new Data Warehouse component is being developed for HPMMIS which is envisioned to provide users the capability to create SURS and other on-demand reports. Initial staff orientation has been provided on an overview level last calendar year.

With the February 2008 implementation of the new QUEST Expanded Access (QExA) managed care program, the former aged, blind and disabled fee-for-service population is now served by two health plans. This change will greatly diminish the fee-for-service claims being processed for payment by the MQD, although the SURS nurses continue to review for fraud and abuse incidents in the fee-for-service claims to date. The focus of the SURS will likewise, move into the managed care arena, in which, nationally, integrity units are starting to explore these new roles and responsibilities. In addition, the SURS nurses are highly involved with the CMS Medicaid Integrity Group activities, including attending national CMS sponsored conferences and training, participating in monthly teleconferences with other states, and assisting with PERM project requirements.

THE DHS will consider the continued use of EMC audits to enhance provider education opportunities as well as provide a referral source of potential fraud to the MIU, in light of the change of the fee-for-service program into managed care.

DHS will review its capacity to perform regular post payment reviews on samplings of drug and non-drug claims to detect processing errors and identify ways for claims processing system and procedural improvements. These reviews are also impacted by the new managed care environment.

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

The MQD has one Investigator IV position in its Financial Integrity Unit. The incumbent was on long-term sick leave for most of the 2008 calendar year and has retired as of February 27, 2009. The MQD will be seeking Governor's approval to fill this permanent position to enable the unit to have an active investigator on the job. The MQD will work to quickly identify and investigate suspected fraud as required by federal regulations and continues to work closely with the Attorney General's Medicaid Fraud Control Unit (AG's MFCU) on all complaints. The Integrity Unit has initiated the re-establishment of regular meetings with the AG's MFCU to improve communication and promote a strong working relationship with their colleagues.

**Start Date:** Ongoing

**End Date:** Ongoing

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

**Ref. no. 2008-07** **Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner**

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

**Corrective Action Taken or Planned:** The DHS is working with existing staff to address the backlogs of work at each unit with approved overtime for pay or compensatory time off. Efforts continue to fill all vacant positions as quickly as possible despite the current hiring freeze. Eligibility Branch will be submitting another list of vacant positions for approval to recruit and fill. Eligibility Branch completed an overdue application backlog project in September 2008 through December 31, 2008. Eligibility Branch completed an overdue Eligibility Renewal project in May 2008 through June 2008.

Branch and Oahu Section Administration continue to work with unit supervisors to address the needed improvement with

supervisory management, monitoring of timeliness requirements and employee work performance expectations. The goal is to decrease the approved overtime for pay or compensatory time off as management, timeliness and employee work performance improves.

**Start Date:** Ongoing

**End Date:** Ongoing

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

**Ref. no. 2008-08**      **Monitor the Medicaid Drug Rebate Program**

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

**Corrective Action Taken or Planned:** The MQD is working to reconcile the old HMSA Fiscal Agent period of outstanding accounts receivables. Our current Fiscal Agent and Pharmacy Benefits Manager, ACS Healthcare, has shipped to us copies of invoices, receipts and checks received for drug rebate payments of old HMSA invoices. A total of 28 boxes of records were received in our office in January 2009. Our Account Clerk is painstakingly going through all of the documents in each box to identify and reconcile these payments to the accounts receivable ledgers. To date, more than half of the boxes have been completed with over \$600,000 of drug rebate payments identified for posting. Due to the large volume of documents that one clerk is working through, it may take longer than anticipated to complete this task, beyond the March 31, 2009 date identified earlier as an anticipated completion date. We have also had several meetings with our Attorney General's Office to assist us with legal write offs of any rebate receivables that may remain once all of the 28 boxes of documents are reviewed and reconciled with our outstanding accounts receivable ledger.

**Start Date:** Ongoing

**End Date:** June 2009

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

**Ref. no. 2008-09      Maintain All Required Documentation In Medicaid Files**

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

**Corrective Action Taken or Planned:**      The importance of properly completing and filing required departmental forms continues to be emphasized to Eligibility Branch Supervisors and Eligibility Workers.

Supervisory case reviews will include evaluation of proper documentation and case record maintenance.

**Start Date:**      Ongoing

**End Date:**      Ongoing

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

**Ref. no. 2008-10      Maintain All Required Medicaid Provider Documentation**

**Auditor's Recommendation:**      The DHS should ensure all provider agreements are properly completed and maintained.

**Corrective Action Taken or Planned:**      The Health Care Services Branch has revised and updated the process for processing provider agreements. The revised process is as follows:

- a. When provider applications are submitted to the MQD, the application is recorded in a database that tracks provider applications. In addition, the provider application is started in the HPMMIS system.
- b. The application is then forwarded to an employee who reviews the application and assures completeness. After the application is reviewed, the majority of the application is entered into HPMMIS.
- c. Prior to enacting the application, the Data Technician reviews the whole process prior to signing and authorizing the enactment of the application. After the application is signed, the provider is enacted into the HPMMIS system.
- d. The application is then recorded and sent to ACS for scanning and permanent filing.

Each month, 5% of all provider applications will be reviewed to

assure the process is effective.

This process will assure that all necessary steps are taken prior to allowing a provider to participate in the Medicaid program. In addition, this process assures that information is filed so that it can be retrieved as needed.

**Start Date:** Ongoing

**End Date:** Ongoing

**Responding Person:** Patricia M. Bazin, MQD Health Care Services Branch  
Administrator  
Phone: (808) 692-8083

**Ref. no. 2008-11** **Maintain all Required Documentation in Child Care Case Files**

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

**Corrective Action Taken or Planned:** The DHS agrees with the recommendations and will be implementing monthly sample reviews of payment case records to verify eligibility compliance.

Additionally, prior to the end of the current Federal Fiscal Year, DHS will need to implement a detailed secondary review plan of payment cases as required by the Improper Payment Information Act of 2002. This review plan, with approval by the Administration for Children and Families (ACF) prior to implementation, will be a review of payment records for the current federal fiscal year.

The DHS has recently established an office, the Child Care Program Office (CCPO) within the Benefit, Employment and Support Services Division (BESSD), that will specifically focus on Child Care and will be the office responsible for implementation of the secondary reviews. The DHS is confident there will be greater management and oversight of the Child Care Payment program through this reorganization effort.

**Start Date:** April 2009

**End Date:** Ongoing

**Responding Person:** Julie Morita, BESSD CCP Administrator  
Phone (808) 586-7072

**Ref. no. 2008-12**      **Improve the Accuracy of Child Care Reimbursements**

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

**Corrective Action Taken or Planned:**      The DHS agrees with the recommendations and will be implementing monthly sample reviews of payment case records to verify eligibility compliance.

Additionally, prior to the end of the current Federal Fiscal Year, DHS will need to implement a detailed secondary review plan of payment cases as required by the Improper Payment Information Act of 2002. This review plan, with approval by the Administration for Children and Families (ACF) prior to implementation, will be a review of payment records for the current federal fiscal year.

The DHS has recently established an office, the Child Care Program Office (CCFO) within the Benefit, Employment and Support Services Division (BESSD), that will specifically focus on Child Care and will be the office responsible for implementation of the secondary reviews. The DHS is confident there will be greater management and oversight of the Child Care Payment program through this reorganization effort.

**Start Date:**      April 2009

**End Date:**      Ongoing

**Responding Person:** Julie Morita, BESSD CCP Administrator  
Phone (808) 586-7072