OFFICE OF THE
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Auditing for a Better Oregon

February 9, 2006

Dr. Bruce Goldberg, Director
Department of Human Services
500 Summer St. NE, E15
Salem, OR 97301-1097

Dear Dr. Goldberg:

The statewide single audit that included selected financial accounts and federal awards at the Department of Human Services for the year ended June 30, 2005, has been completed.

This statewide single audit work is not a comprehensive audit of your agency. Instead, this audit permits us to give an opinion on the statewide financial statements contained in the State of Oregon's Comprehensive Annual Financial Report and to report on internal control and the state's compliance with laws and regulations. Regular audits of the Department of Human Services will continue on a periodic basis.

The following Department of Human Services accounts and transactions were audited to determine their fair presentation in accordance with generally accepted accounting principles in relation to the statewide financial statements.

SFMA Account	Description	Audit Amount
General Fund – GAAP Fund 0001		
6300	Distribution to Counties	$165,999,093
6800	Distribution to Individuals$568,336,431	
6950	Other Special Payments-Medical Services	$21,171,660
Special Revenue Fund – GAAP Fund 1108		
0070	Cash on Deposit with Treasurer	$(73,689,040)
0065	Unreconciled Deposit	$3,449,744
0125	Other Selective Taxes	$122,353,192
0300	Federal Revenue	$2,488,483,877
1105	Other Revenue	$166,291,773
1735	Loans Payable	$82,300,000
6300	Distribution to Counties	$230,153,487
6800	Distribution to Individuals	$2,296,339,337

We determined whether the Department of Human Services substantially complied with the federal requirements relevant to the following federal programs.

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INTERNET: http://www.sos.state.or.us/audits/audithp.htm

CFDA Number	Program Name	Audit Amount
10.551, 10.561	Food Stamps Cluster	$493,781,642
93.777, 93.778	Medicaid Cluster	$1,989,531,121
96.001, 96.006	Disability Insurance/SSI Cluster	$20,218,170

Based on our audit, we identified two reportable conditions relating to the above federal programs and five reportable conditions relating to our financial audit work needing corrective action. Our findings and recommendations are presented in the enclosed Audit Findings and Recommendations Summary accompanying this letter. We also identified three other conditions that we wanted to communicate to department management.

The reportable conditions, along with your responses, will be included in our Statewide Single Audit Report for the year ended June 30, 2005. Including your responses with responses from other state agencies satisfies the federal requirement that management prepare a Corrective Action Plan (CAP) covering all reported audit findings. Satisfying the federal requirement in this manner; however, can only be accomplished if the response to each reportable finding includes the information specified by the federal requirement, and only if the responses are received in time to be included in the audit report. The following information is required for each response.

1. Your agreement or disagreement with the finding. If you do not agree with an audit finding or believe corrective action is not required, include in your response an explanation and specific reasons for your position.

2. The corrective action planned.

3. The anticipated completion date.

4. The name of the contact person responsible for corrective action.

The other conditions are issues of lesser significance that do not require a Corrective Action Plan. We will follow up on the department's progress in addressing these issues during the next fiscal year audit. For the reportable conditions, please respond by February 17, 2006. Should you have any questions, please contact Julianne Kennedy or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

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Audit Manager

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NLY/KLO:bk
cc: Clyde Saiki, Deputy Director
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Lindsay Ball, Director, Department of Administrative Services
John Radford, Administrator, State Controller's Division, Department of Administrative Services
Jean Gabriel, SARS, State Controller's Division, Department of Administrative Services

Audit Findings and Recommendations Summary
Department of Human Services Statewide Audit
State Fiscal Year 2005

REPORTABLE CONDITIONS

Budget Law Violations

During the fiscal year ended June 30, 2005, the department's general fund expenditures exceeded its general fund appropriations by $86.6 million. Department management reported that budgetary estimates presented to the Legislature did not closely reflect demand for services and actual revenue fell short of projected amounts.

To exceed general fund appropriations, the department circumvented budgetary controls designed to ensure compliance with appropriation levels by creating a temporary grant in the system of record for the express purpose of moving general fund expenditures to other funds and federal funds. The intended result of this action was to increase general fund spending authority in order to keep up with the demand for services.

By taking this action, the department directly violated the purpose of appropriations and expenditure limitations, which represent the legal level of control against which budgetary compliance is measured. The department's actions directly violated Article IX, Section 4 of the Oregon Constitution and Oregon Revised Statute 291.238, which states that no person shall incur, or order or vote to incur, any obligation against the state in excess of, or make or order or vote to make any expenditure not authorized by, an allotment. Violation of this statute is punishable by a fine. As of June 30, 2005, the department had moved $40.6 million of expenditures back to the General fund; the remaining $46 million was moved back as a result of actions taken by the October 2005 Emergency Board.

Agencies are required to record expenditure limitations and appropriations in the Oregon Budget Information Tracking System (ORBITS). Limitation and appropriation amounts are subject to review and audit by the Statewide Audit and Budget Reporting (SABR) section. The SABR section enters limitations and appropriations into the Relational Statewide Accounting and Reporting System (R*STARS). The R*STARS controls expenditures against budgets as established in approved appropriation bills. Agencies are responsible for ensuring that budget amounts recorded in ORBITS and R*STARS are accurate. Statewide Accounting and Reporting Services (SARS) extracts appropriation information from R*STARS for budgetary financial reporting. When management circumvented the budgetary controls within R*STARS, they disrupted the monitoring and reporting processes that are dependent upon the accuracy of the information recorded in R*STARS.

The department further violated the Constitutional and statutory budget laws when they increased general fund spending authority for the appropriation year 2003-2005, by borrowing against appropriations set aside for the 2005-2007 biennium. The department reported that as of November 4, 2005, the amount borrowed from 2005-2007 general fund appropriations was $98,103.

Although the department intended to repay the amounts borrowed, without the use of sound budgeting and accounting practices, their actions could result in inaccurate budgetary reports regarding program costs and inconsistent reporting from biennium to biennium.

We recommend that department management use sound budgeting and accounting practices when managing cash flow emergencies and comply with rather than circumvent budgetary controls.

Internal Control Weaknesses –Control Environment

Internal control is a process effected by management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

Internal control consists of the following five interrelated components:

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communication Systems Support
- Monitoring

The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Basic to the control environment are organizational structure, assignment of authority and responsibility, and human resources policy. More difficult to quantify are ethics, commitment to competence, and management operating style.

Management of the State is responsible for establishing and maintaining internal control. While opportunities exist for the department to improve all internal control components, the department should focus on improving its control environment.

We noted that department management, which includes individuals responsible for supervising and managing department operations, did not always create an environment that supports or enforces adherence to all state and federal laws and funding requirements.

Specifically, during fiscal year 2005:

- Department management directed staff to circumvent budgetary controls by creating a grant specifically for the purpose of reducing expenditures in the General fund so the department would not be restricted to budget limitations set by the Oregon Legislature.

- Department management directed staff to spend appropriations legally set aside for the 2005-2007 biennium in order to continue making 2003-2005 payments.

- Department management directed staff to disregard normal draw procedures and draw federal funds for obligations that were not yet paid, in violation of the federal requirement that funds be drawn on a reimbursement basis.

- Department management missed due dates established in Oregon Law for the transfer of funds to the Department of Administrative Services.

- Department management presented information to auditors in a formal letter of response to specific inquiries. Due to insufficient and inconsistent information provided, we were unable to verify management's assertions.

- Department management does not always ensure that personnel responsible for recording transactions, making adjustments, and preparing reconciliations possess adequate accounting knowledge, skills, and abilities required to perform their duties in accordance with Generally Accepted Accounting Principles (GAAP) and Governmental Accounting and Financial Reporting Standards.

We have communicated with the department's executive management and internal audit staff regarding the issues related to the control environment. We are encouraged by the sincere interest they have displayed toward effecting change.

We recommend the department's executive management continue to take the necessary steps to implement and enforce proper internal controls and project the appropriate tone toward controls in the department. We also recommend the department involve all levels of management to achieve the necessary improvements.

Incomplete, Inaccurate Cash Reconciliations

The Oregon Accounting Manual states that departments should regularly perform reconciliations of cash recorded in agency records to amounts reported on Treasury statements.[1] Those reconciliations should be performed by persons not otherwise responsible for handling or recording cash and should be independently reviewed by management. A written record of the reconciliations, including a listing of outstanding checks and in-transit deposits, should be prepared by the reconciliation accountant and retained with the statements.

We reviewed 15 out of 25 active cash accounts held at Oregon State Treasury for the Department of Human Services. We found that management had neither assigned responsibility for all accounts to be reconciled nor had they ensured all assigned accounts were reconciled during the year. We found that eight account reconciliations were not performed timely and management did not review 10 account reconciliations. Several reconciliations were not performed properly and some did not include adequate supporting documentation.

Similar to the prior year's cash reconciliation finding, department management did not adequately emphasize the importance of performing reconciliations for all cash accounts. Management did not ensure the reconciliations were performed properly and that independent review was provided on a timely basis. In addition, management inactivated one account so the balance would not be viewable, thus, preventing the reconciliation staff from identifying the account as active and performing monthly reconciliations of the account.

Reconciling bank statements to amounts recorded in agency accounting records is an essential internal control. Timely and effective reconciliations can help identify errors or other problems that may have occurred, and provide additional assurance that reported cash balances are valid. With incomplete cash reconciliations, management is less able to manage the department's cash flow, which increases the potential for overdrawing accounts, incurring additional bank fees, or requiring creative accounting to pay

[1] OAM 10.20.00.PR .103-.105

the department's current expenses. In addition, management is less able to timely detect and correct potential problems within the cash accounts.

We recommend department management ensure all cash account reconciliations are assigned and performed regularly. Management should conduct a timely review of reconciliations to ensure they are performed accurately and contain adequate supporting documentation.

Weak Controls Over Cash Receipting

The Oregon Accounting Manual states that the recording of accounts receivable should be segregated so that accuracy and completeness can be verified through independent checks.[2] The fundamental rules for attaining control over cash receipts include depositing cash receipts daily, separating cash handling from record keeping, and not allowing one person to handle a cash transaction from beginning to end.

In the last three months of fiscal year 2005, the department responded to the prior year's cash finding by requiring two people be present when opening mail that contains checks. The department, however, had not segregated duties between cash handling and record keeping. Personnel who are responsible for opening the mail and preparing a deposit slip were also recording the receipt of cash into the system. In addition, we found that five percent of the receipts tested were not deposited within one business day as required.

Management did not emphasize the importance of safeguarding cash by establishing proper controls within the receipting process. As a result, risk of fraud or misuse of cash was not sufficiently reduced.

We recommend the department management follow the policies and procedures outlined in the Oregon Accounting Manual for receipting cash.

Lack of Proper Revenue Accruals

Revenue must be recognized in governmental funds using the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenue must be both measurable and available to finance current period expenditures. To meet the "available" criteria, it must be legally usable to finance current period expenditures and be collected in the current period or within 90 days after the fiscal year end. Revenue can be considered "measurable" if: (1) the precise amount is known because the transaction is completed, or (2) the amount can be determined and/or reasonably estimated from other available information.

When testing revenue recorded as "Other Revenue" and "Other Selective Taxes," we found that the department did not always apply the proper accounting principles for recording revenue. Other Revenue of $15 million was recorded in fiscal year 2005 that should have been recorded in fiscal year 2004, and $4 million was recorded in fiscal year 2006 that should have been recorded in fiscal year 2005. The net effect to fiscal year 2005 is that the Other Revenue account was overstated by $11 million. Similarly, Other Selective Taxes of $7.8 million was recorded in fiscal year 2005 that should have been recorded in fiscal year 2004, and $29.7 million was recorded in fiscal year 2006 that should have been recorded in fiscal year 2005. The net effect to fiscal year 2005 is that the Other Selective Taxes account was understated by $21.9 million.

[2] OAM 10.20.00.PR .102, .121, and .123

The department did not have adequate controls established to provide for the proper recognition of revenue. Further, not all persons responsible for recording revenue may have the necessary knowledge of revenue recognition accounting standards to ensure revenue is recorded to the proper period.

As a result, the department was not always accurately reporting state revenues and federal programs that require matching with state funds may not be in compliance.

We recommend department management establish controls to ensure revenue is recorded in the proper period. In addition, we recommend the department ensure personnel receive the appropriate training and guidance to accurately perform the duties assigned to them.

Medicaid Cluster
Non Compliance with Cash Management

Expenditures for Medicaid must be paid for by the State before reimbursement is requested from the Federal government. The State of Oregon has entered into a formal agreement with the U.S. Treasury outlining requirements for drawing down Federal funds. The Cash Management Improvement Act (CMIA) agreement says, “The State shall request funds such that they are deposited in a State account not more than three days prior to the day the State makes a disbursement.”

Department management directed staff to draw down all remaining funds for Medicaid grant number 100000 on June 23, 2005. The amount available and drawn on that date was $26.9 million. This draw was conducted to provide funding for remaining Pro-Share leveraging following resolution of the department’s disagreement with the Federal Centers for Medicare and Medicaid Services (CMS) over the department’s calculation of the leveraged amount. The department held on to these funds for nearly seven weeks and did not disburse the funds to providers until August 10, 2005, resulting in non-compliance with the Federal-State Cash Management Improvement Act (CMIA).

Management stated that they wanted the funds drawn prior to June 30 and directed staff to disregard the federal cash management requirements and draw funds down prior to incurring expenditures. After the funds were drawn, management stated that they experienced difficulties in distributing the funds.

We recommend that department management follow the CMIA agreement and minimize the time between the drawing down of Federal funds and the disbursement of such funds for Federal program purposes.

Food Stamps Cluster
Eligibility

The department’s Family Services Manual, which is based on federal requirements, is the policy manual caseworkers are instructed to follow when determining eligibility for food stamp benefits. The Family Services Manual requires caseworker to verify certain eligibility and benefit calculation factors reported by the claimant on the food stamp application. Among other information, the caseworker must verify the applicant's income. When the filing group does not provide acceptable verification, the application should be denied.

The manual also explains that some people who live together must be considered to be in the same filing group. The filing group is considered as a whole when determining eligibility for benefits. Children under the age of 18 are specifically identified under this requirement.

Out of a sample of 40 food stamp cases, we found that 2 cases were approved for benefits without the proper verifications.

- In one instance, the client's income was not verified, but benefit payments were made for a four-month period. After this period, the caseworker attempted to verify the income in order to continue the payments. After not receiving the requested documents, the case was appropriately closed. We question costs in the amount of $578 for benefits paid out over the course of the four months.

- In the second instance, a fifteen-year-old was living in a non-family household and was financially dependent upon the adult caretaker. The teenager was granted benefits without regard to the rest of the filing group. We question costs in the amount of $908 for the seven months of benefits the claimant received.

We recommend the department emphasize the importance of adherence to the department's policies regarding eligibility determination.

OTHER CONDITIONS

Medicaid Cluster
Inaccurate Reporting

The Federal CMS-64 Quarterly Statement of Expenditures for the Medical Assistance Program presents expenditures, recoveries and other items that reduce expenditures for each quarter. Per federal guidelines, the amounts reported on the CMS-64 and its attachments must be actual expenditures for which all supporting documentation, in readily reviewable form, has been compiled and is available immediately at the time the claim is filed.[3]

The department uses the Federal Medical Assistance Percentage (FMAP) to estimate total expenditures on the CMS 64 report, rather than using the actual total expenditures acquired from reports out of the system. The department has been unable to provide evidence that this method of deriving actual expenditures is federally approved.

In addition, the department reported a reduction of expenditures in the amount of $66 million on its June 30, 2005 CMS 64 report, partially to comply with a Centers for Medicare and Medicaid Services (CMS) resolution of a legal investigation. However, due to cash flow problems, management was unable to record this adjustment to the system of record until November 4, 2005.

We recommend the department ensure the CMS 64 report is prepared in compliance with federal reporting requirements and that all information reported is supported by the accounting system at the time of submission.

Temporary Assistance For Needy Families
Inaccurate Reporting

As part of the Temporary Assistance for Needy Families (TANF) grant, the United States Office of Management and Budget A-133 Compliance Supplement states that every fiscal year a state must maintain an amount of qualified state expenditures for eligible families.[4] This is termed 'basic MOE' (Maintenance of Effort).

The department transferred general fund expenditures from the Oregon Children's Plan to the Substance Abuse Prevention and Treatment (SAPT) grant and then to the TANF grant in order to meet the required amount of TANF MOE for the 2005 federal fiscal year. However, without verifying that these expenditures were made on the behalf of needy families who meet TANF eligibility requirements, the expenditures may not be allowable under the TANF program requirements.

Expenditures of state funds in TANF or separate state programs may count if they are made for certain types of benefits or services, including non-medical treatment services for alcohol and drug abuse provided that the State has not commingled its MOE funds with Federal TANF funds to pay for the services. However, the use of these funds must be consistent with the goals of the program, which are to:

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[3] OMB A-133 Compliance Supplement, Part 4, Medical Assistance Program, March 2004 pg 4
[4] OMB A-133 Compliance Supplement, Part 4, Temporary Assistance for Needy Families, March 2004, pages 10-11

(a) Provide assistance to needy families so that children may be cared for in their own homes or in the homes of relatives;
(b) End the dependence of needy parents on government benefits by promoting job preparation, work, and marriage;
(c) Prevent and reduce the incidence of out-of-wedlock pregnancies and establish annual numerical goals for preventing and reducing the incidence of these pregnancies; and
(d) Encourage the formation and maintenance of two-parent families.

We recommend the department thoroughly investigate the source and use of funds and whether they are allowable under the TANF MOE requirements before using the funds to meet the MOE requirements.

Non Compliance with State Law

The 2003 legislature passed several laws requiring the transfer of other funds to the State General Fund. Three of these requirements are as follows: (1) On or before March 15, 2004, $6.25 million shall be transferred from the Long Term Care Facility Quality Assurance Fund to the General Fund; (2) On or before March 15, 2005, $6.25 million shall be transferred from the Long Term Care Facility Quality Assurance Fund to the General Fund; and (3) Not later than January 1, 2005, for each state agency, the amount identified under subsection (1)(d) of this section shall be transferred to the General Fund to be available for general governmental expenses. The amount of "Other Funds" identified by the Department of Human Services was $241,869.

The department did not make the required transfers to the Department of Administrative Services by the dates stated in the Oregon Laws.[5] Transfer (1) was made nine months after its due date. The department stated that they "did not receive federal approval to implement the operative components of House Bill 2747 until late May 2004," which contributed to missing the March 15, 2004 due date. Further, department management stated that even though all funds were received from June to September, they encountered problems with tracking the new tax and did not transfer the required amount until December 29, 2004. Transfer (2) was made almost three months after its due date, on June 01, 2005. The department discussed its cash flow concerns with the Department of Administrative Services and received an extension to this date. Transfer (3) was made six months after its due date, on June 29, 2005.

The department's difficulties with implementing the new tax resulted in non-compliance with state law and denied use of the funds to the Department of Administrative Services for three to nine months.

We recommend the department comply with state laws.

[5] Oregon Law Chapter 709, Section 83; Chapter 734, Section 8