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February 20, 2007

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, 2006, 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.

<u>SFMA Account</u>	<u>Description</u>	<u>Audit Amount</u>
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**General Fund – GAAP Fund 0001**

3111	Regular Employees	\$112,493,591
6200	Intraagency General Fund/Other Fund Transfer	\$199,161,865
6300	Distribution to Counties	\$172,343,255
6800	Distribution to Individuals	\$631,898,316

**Special Revenue Fund – GAAP Fund 1108**

0070	Cash on Deposit with Treasurer	\$(36,590,095)
0065	Unreconciled Deposit	\$19,702,787
0129	Healthcare Provider Taxes	\$131,370,628
0300	Federal Revenue	\$2,398,311,882
1105	Other Revenue	\$216,070,981
3111	Regular Employees	\$154,065,493
6200	Intraagency General Fund/Other Fund Transfer	\$(18,641,087)
6300	Distribution to Counties	\$237,616,751
6800	Distribution to Individuals	\$2,333,242,484

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

<b>CFDA Number</b>	<b>Program Name</b>	<b>Audit Amount</b>
93.777, 93.778	Medicaid Cluster	\$1,971,636,261
93.767	State Children's Insurance Program	\$33,398,203
93.659	Adoption Assistance	\$28,895,301
93.558	Temporary Assistance for Needy Families	\$130,219,566

Based on our audit, we identified eight reportable conditions relating to the above federal programs and four 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 six 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, 2006. 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:

- 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.
- The corrective action planned.
- The anticipated completion date.
- The name(s) of the contact person(s) 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 22, 2007.

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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

KLO:JK:brk

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Lindsay Ball, Director, Department of Administrative Services

**Audit Findings and Recommendations Summary**  
**Department of Human Services Statewide Audit**  
**State Fiscal Year 2006**

**REPORTABLE CONDITIONS**

**Inaccurate Revenue Accruals**

During the 2006 fiscal year, the department accounted for some non-federal expenditures in the federal appropriation fund of the state's accounting system. These transactions were not excluded when the department calculated its federal revenue accrual adjustment at fiscal year end. As a result, the department overstated federal revenue by approximately \$110 million at June 30, 2006.

In addition, although the department made progress toward accruing revenue in accordance with the modified accrual basis of accounting, it continued to recognize some revenues, such as drug rebates, on a cash basis. These revenues represented at least \$4.39 million that should have been recognized in fiscal year 2006.

Finally, the department appropriately estimated and accrued revenue for provider taxes but had not documented its methodology for calculating the estimate. Without an established methodology, revenue accruals may not be estimated in a consistent manner from year to year.

**We recommend** department management stop recording non-federal transactions as federal funds. We also recommend the department establish procedures to ensure all revenue is accrued properly at fiscal year end, and document the methodology for calculating the provider tax accrual.

**Lack of Documentation**

The Oregon Accounting Manual (OAM) requires all recorded transactions to be supported by copies of source documents and other supporting information sufficient to provide clear evidence of the authenticity of the transaction, the purpose or reason, and that revenue and expenditure transactions actually occurred.<sup>1</sup>

During testing of the Other Revenue, Distribution to Individuals, and Salaries and Wages accounts, we noted that transactions are not always supported by appropriate source documents, nor were sufficient details provided to determine the purpose or authenticity of the transaction. Specifically, we noted the following:

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<sup>1</sup> OAM 10.15.00.PO .107 and .108

- Of a sample of 47 Other Revenue transactions, we found that nine were unsupported. The department did not retain copies of the checks, detailed remittance advice information, cover letters that accompany the checks, or other documentation supporting the transaction. Although an individual began retaining documentation for the revenues in the last month or two of the year, a total of \$315,011 was unsupported, based on our testing.
- We tested 90 transactions in the Distribution to Individuals account. During our testing, we found that one payment for \$925 did not have any support, and another payment for \$120 did not have sufficient documentation to determine how the payment was calculated.
- State policy requires certain payroll forms to be retained in personnel files.<sup>2</sup> For example, Personnel Action Forms are to be retained for three years when there is a salary change. Of the 35 employee files we tested, we found that 25 did not contain Personnel Action Forms. Of the 25, 13 were for step increases and 12 were for cost-of-living increases. In addition, we found four files were missing time lock reports, and three were missing leave request reports.

**We recommend** department management ensure adequate supporting documentation is maintained for all recorded transactions.

### **Weakness in Cash Controls**

The Oregon Accounting Manual states that departments should regularly perform reconciliations of cash recorded in department records to amounts reported on treasury statements.<sup>3</sup> Those reconciliations should be performed by persons not otherwise responsible for handling or recording cash, and should be independently reviewed by management.

During the year the department worked toward improving controls over reconciliations. Although improvements were noted, we found that 11 percent of the reconciliations we audited were not performed timely and 22 percent were not reviewed within a reasonable time period. The department took as long as 11 months to perform some reconciliations. Out of the 13 suspense accounts from which we selected reconciliations, one account had not been reconciled during the fiscal year. One reconciling item was inappropriately included during the reconciliation process, resulting in an audit adjustment of \$21.7 million.

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<sup>2</sup> DAS HRSD 10.011.01

<sup>3</sup> OAM 10.20.00.PR .103-104

In addition, ending balances from all suspense accounts should be accounted for in the state's accounting system at June 30, fiscal year end. The department did not include balances for all suspense accounts in the accounting system at June 30. The treasury balance for the accounts as of June 30 was \$1,724,482.

**We recommend** department management continue taking steps to ensure all cash account reconciliations are performed regularly and timely. We recommend management perform timely reviews of the reconciliations and ensure reconciling items are appropriate. Further, we recommend department management ensure that all suspense account balances are included in the cash balance at June 30.

### **Lack of Knowledge, Skills and Abilities**

Management's responsibility for controls includes ensuring key staff have the requisite knowledge and skills to perform their duties. Department management should ensure that accounting personnel responsible for recording transactions, making adjustments, and performing year-end closing entries possess the requisite accounting knowledge, skills, and abilities to perform their duties in accordance with Generally Accepted Accounting Principles (GAAP) and Governmental Accounting and Financial Reporting Standards.

During the course of our audit, we encountered several instances in which decisions were made and actions taken that inferred a lack of knowledge, skills or abilities with regard to Generally Accepted Accounting Principles (GAAP) and Governmental Accounting and Financial Reporting Standards. For example:

- The department did not include some suspense cash account balances in the accounting system at June 30, as required by accounting standards.
- When adjusting expenditures to the proper period during year end adjustments, the department adjusted cash without regard to accounting standards.
- The department included non-federal activity when determining federal revenue accruals. In addition, the department did not present revenue balances in accordance with governmental reporting standards, by adjusting for accruals for all revenue accounts at year end.
- The department made adjustments to correct fiscal year 2003 general ledger accounts. Instead of recording a prior period adjustment, the department adjusted revenue and expenditure accounts in fiscal year 2006.
- The department made various entries during fiscal year 2006 related to activity from fiscal year 2005. The entries should have had no effect on expenditures or transfers for fiscal year 2006. During the audit, we asked the department to research as we believed the entries misstated fiscal year 2006 expenditures

and transfers. The department researched the issue and determined that there was no misstatement. We then researched and provided the department with our results and a proposed audit adjustment for \$46 million to correct 2006 expenditures and transfers.

- The department recorded capital assets related to an enterprise fund in the general fund.

**We recommend** department management ensure personnel have the requisite knowledge, skills, and abilities to accurately perform their assigned duties.

### **Medicaid Cluster** **Allowable Costs**

The department was in dispute with the Centers for Medicare and Medicaid Services over Medicaid Upper Payment Limit (UPL) claims for fiscal years 2002 and 2003. The Office of Inspector General (OIG) issued its final report in February 2005, which included a response from the department. The department's response contained an estimate of the expected UPL for 2004 and 2005.

Once the dispute was resolved, the department processed its claim for the last UPL payment for the years 2004 and 2005. The department distributed to nursing facilities \$48,598,015, of which \$29,703,106 was federal funds. The department's support for this claim was the estimate it had previously provided to the OIG, not calculations of actual UPL payment as required by federal regulations. As a result, the department was unable to provide documentation to support that it had actually incurred the expenditures.

**We recommend** department management ensure adequate supporting documentation is maintained to support amounts claimed.

### **State Children's Insurance Program (SCHIP)** **Allowable Activities**

As part of testing allowable activities, we judgmentally selected 12 transactions that had been directly entered into the department's accounting system instead of through interface and cost allocation processes. The transactions included vaccine expenses, fee-for-service cost settlements, managed care wraparound payments and a variety of other miscellaneous charges. Our sample represented almost 42 percent of the dollar population for these transactions.

For transactions related to vaccine expenses, we noted errors in the spreadsheet used to support the accounting transactions. These errors resulted in questioned costs of \$147. We also reviewed an accounting transaction to correct the federal matching rate for transactions between October 1, 2005, and January 10, 2006.

The department's support for this entry was a printout of a query of the state's accounting datamart. The department did not document the limits of the query, and neither we nor the department were able to duplicate the results of the query. As a result, the department was unable to support \$884 charged to the SCHIP federal program. In addition, a travel claim for \$183 was charged to this federal program but was not related to SCHIP.

The Oregon Accounting Manual states that all transactions should be properly calculated. When queries are used as support for accounting transactions, they should be fully documented and the logic supporting the query should be explained.<sup>4</sup>

**We recommend** department management ensure that transactions are properly calculated, documented, and an allowable activity.

### **Temporary Assistance for Needy Families Earmarking**

Federal requirements state that agencies must submit a complete and accurate financial report, which accurately reflects information in the financial records. For the Temporary Assistance for Needy Families (TANF) program, agencies are allowed to spend up to, but not more than, 15 percent of program expenditures on administrative costs.<sup>5</sup>

While preparing the quarterly federal financial reports, the department monitors and makes adjustments to TANF expenditures to ensure federal and state expenditures do not exceed the 15 percent administrative cost requirement. At the end of the third federal quarter, however, the department had already exceeded the limit with 16.9 percent in administrative costs. At the end of the fourth federal quarter, the department's financial records indicated that actual administrative costs were at 18.6 percent. The department reported that it met the 15 percent earmarking limitation for the federal fiscal year ended September 30, 2006 based upon an adjustment that was not made in the financial records until January 11, 2007. Therefore, when the department filed its September 30, 2006 federal report, recorded actual administrative costs were \$4,452,022 more than the amount on the federal report.

**We recommend** department management closely monitor, throughout the year, administrative costs to ensure compliance with earmarking requirements. In addition, we recommend adjustments necessary to support the report are made in

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<sup>4</sup> OAM 10.15.00.PO

<sup>5</sup> 45 CFR 263.13; 265.7

the financial records at the time the report is submitted to the federal government in order to fully comply with reporting requirements.

**Temporary Assistance for Needy Families**  
**Allowable Costs – Questioned Costs \$1,322,652**

Federal requirements state that the department may use TANF funds for expenditures that are not in violation of the Office of Management and Budget (OMB) Circular A-87.<sup>6</sup> The OMB Circular A-87 states that allowable costs must meet the following general criteria: (1) be necessary and reasonable for proper and efficient performance and administration of Federal awards, and (2) be adequately documented.<sup>7</sup>

During our testing of 20 balance transfers that moved expenditures into and out of the TANF program, we found one that was not supported as an allowable TANF cost totaling \$1,322,652. The transaction moved costs allocated to a non-federal grant in the general fund to the TANF program as federal expenditures. The department was unable to provide sufficient documentation to show that these costs should be allocated to the TANF program.

**We recommend** department management ensure that funding transactions are allowable for federal programs and documented in accordance with OMB Circular A-87.

**Temporary Assistance for Needy Families**  
**Eligibility – Questioned Costs \$14**

To be eligible for Temporary Assistance for Needy Families (TANF) Child Welfare Emergency Assistance, all applicants must have an emergent need as determined by the State. The department's Integrated Information System (IIS) is used to make TANF Child Welfare Emergency Assistance payments; it also interfaces with the department's accounting system, which is used to determine the Federal government's reimbursement for eligible children.

Of the 10 cases we reviewed, one case was miscoded in IIS as TANF eligible when the child did not meet all of the eligibility requirements. The department received federal reimbursement for this transaction in the amount of \$14. When projected to the population, the questioned costs exceeded \$10,000.

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<sup>6</sup> 45 CFR 263.11

<sup>7</sup> OMB Circular A-87 Attachment A – General Principles for determining allowable costs

**We recommend** department management correct the identified error in the system. We further recommend that management take steps to ensure eligibility is correctly coded in the system so that federal funds are not charged for ineligible clients.

**Adoption Assistance**  
**Eligibility – Questioned Costs \$212,692**

Eligibility for federal adoption assistance (Title IV-E) is originally determined when a child enters substitute care. Coding entered into the department's Integrated Information System (IIS) directs the expenditure to the appropriate funding source for payment. The department's Adoption Recruitment Management System (ARMS) records information such as the child's biological record.

A performance audit conducted by the Audits Division identified 24 adoptions finalized between July 1, 2003, and June 30, 2005, that were incorrectly coded in IIS system as Title IV-E eligible, but were ineligible according to the case files maintained by the department. The performance audit team informed department management of the errors in January 2006. During our current fiscal year audit, we reviewed the 24 cases and confirmed that they were improperly coded and should not be funded with federal funds.

The total amount billed to the federal government for the 24 cases from the first payment through June 30, 2006 was \$212,692. As of December 31, 2006, the department had not corrected the coding errors and was still billing the federal government for the ineligible cases.

**We recommend** department management correct the above 24 cases and work with the federal government to resolve the financial ramifications of the errors. In addition, we recommend the department review coding entries in IIS to verify the correct code is entered and ensure the department is not inappropriately billing the Federal government for ineligible clients.

**Adoption Assistance**  
**Eligibility – Questioned Costs \$14,355**

In order to receive federal adoption assistance (Title IV-E), children must meet the eligibility requirements of the Social Security Act.<sup>8</sup> In part, eligibility is based upon the family's monthly earned income for the month the child entered substitute care.

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<sup>8</sup> Section 473 (2)(a)

Out of a sample of 40 Title IV-E transactions, we found one case that was inappropriately determined eligible. Eligibility was based on half of the family's monthly income and was not reassessed when the complete income information was added to the client's file. At the time the determination was made, there was evidence in the department's Client Maintenance System that the amount reported by the family was not complete and that actual income exceeded the eligibility "need standard" threshold.

The department has received federal reimbursement for this case since February 2003. The total questioned costs from then through December 2006 is \$14,355.

**We recommend** department management correct this case in the system so that the appropriate funding source is used for assistance payments and return any disallowed costs to the federal government. We further recommend the department use all available information when determining eligibility and follow the eligibility guidelines established by the federal government.

**Adoption Assistance**  
**Eligibility – Questioned Costs \$2,765**

Eligibility for federal adoption assistance is based on a variety of factors that are present at the time the child enters substitute care. These factors are documented with an eligibility determination worksheet and appropriate support. Examples of support that should be included are: documentary evidence of judicial language on court orders, countable family or child income and benefits, family or child resources, and determination of any special needs that should be considered in caring for the child. According to the department's retention schedule, these documents and records should be maintained for 25 years after the case is closed.

We reviewed 40 Title IV-E Adoption Assistance transactions and related case files. Nine case files lacked sufficient documentation for determining eligibility and one lacked sufficient documentation to determine if the monthly subsidy payment was appropriately based on the child's special needs. We are questioning costs in the amount of \$2,765 for the transactions. When projected to the population, the questioned costs exceed \$10,000.

**We recommend** department management retain all supporting documentation used for making eligibility determinations and for determining the monthly subsidy payment amount, in accordance with its retention schedule.

## **OTHER CONDITIONS**

### **Salaries and Wages Controls**

Policies and procedures outlined in the Oregon Accounting Manual and by the department address proper handling of time reporting documentation. According to the Oregon Accounting Manual, a supervisor is responsible for review and approval of all employee time records and should ensure that time records are reviewed timely.

We reviewed 35 payroll transactions to ensure supporting documentation and supervisor approvals existed. We found the following errors:

- Three leave requests did not have a supervisor's signature.
- Three leave requests and three timesheets were not approved prior to the release of pay.

**We recommend** department management ensure appropriate supervisory approvals are obtained.

### **Distribution to Individuals – Internal Controls**

The department is responsible for establishing and maintaining internal controls over the reliability of financial reporting. Transaction processing controls should be designed with several objectives in mind, which include: (a) recorded transactions are valid and supported by appropriate documentation, and (b) transaction dollar amounts are properly calculated and accurately recorded.

During our testing of the distribution to individuals account, we found that two of the 20 transactions tested contained errors.

- In June 2006, a payment was issued from the Integrated Information System (IIS) to a provider who was authorized to receive payments only through December 2005.
- A payment was issued from IIS to a provider of foster care services at an expired rate.
- The effect of these two errors totaled \$39.

**We recommend** department management follow up on these exceptions and make appropriate corrections. We further recommend management analyze why the errors occurred.

### **MMIS Application Controls**

The department is responsible for providing internal controls over transactions processed through its computer systems. These controls should include computer application controls to ensure only complete, accurate, and valid data are entered into a computer system; processing performs correct functions; and data are properly maintained.

The department utilizes the Medicaid Management Information System (MMIS) to process payments to claimants. This system is a legacy mainframe application with known control weaknesses that sometimes allows issuance of inappropriate or inaccurate payments. To address these issues, department management contracted with an outside firm to perform analytical procedures to detect payment errors that may have occurred through the system. This compensating control was not effective for our audit period, however, because the contract firm had not yet reviewed payments issued during the period we audited.

We concluded that the lack of effective automated application controls for MMIS, coupled with ineffective compensating controls, increased the risk that erroneous payments could occur and go uncorrected.

**We recommend** department management ensure that timely and effective post-payment reviews are conducted to compensate for MMIS application control weaknesses.

### **Medicaid Cluster Late Submission of Reports**

Within 30 days after the end of each quarter, the department is required to submit the CMS-64 reports to the Centers for Medicare and Medicaid Services. The reports provide a summary of Medicaid expenditures and other items for each quarter.

In a prior year, we reported a finding for the late submission of these reports. During fiscal year 2006, the department focused efforts on making the preparation of the report more efficient and accurate. During our review of the fiscal year 2006 reports, we found that the department had greatly improved upon the timeliness of their submissions, but that the initial submission of the reports to the federal government was still as much as two weeks past the federal due date.

**We recommend** department management ensure CMS 64 reports are submitted in compliance with federal reporting deadlines.

**Medicaid Cluster**  
**Missing Client Application**

The Code of Federal Regulations requires the department to follow specific requirements to ensure that individuals meet the financial and categorical requirements for Medicaid.<sup>9</sup> These requirements include obtaining a written application signed under penalty of perjury and include in each applicant's case record the basis for the department's decision on the application. The department was unable to provide one client application out of 60 Medicaid transactions tested.

**We recommend** department management ensure that client applications for eligibility determinations are retained to allow for independent verification in accordance with federal requirements.

**Subrecipient Monitoring**

The department was assigned 23 subrecipient single audit reports to review in accordance with the Oregon Accounting Manual (OAM) and OMB Circular A-133. We selected 10 of 23 subrecipient reviews and found six were not completed within 90 days as required by the OAM, and two were not completed within six months as required by OMB Circular A-133. According to the department, staff turnover slowed the monitoring process. Without timely review, discrepancies may not be investigated and resolved.

**We recommend** department management ensure all subrecipient audit reports are reviewed in a timely manner.

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<sup>9</sup> 42CFR435.907