Office of the Secretary of State

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February 13, 2012

Dr. Bruce Goldberg, Director
Oregon Health Authority
500 Summer Street NE
Salem, Oregon 97301

Erinn Kelley-Siel, Director
Department of Human Services
500 Summer Street NE
Salem, Oregon 97301

Dear Dr. Goldberg and Ms. Kelley-Siel:

We have completed audit work of selected financial accounts at the Department of Human Services (department) for the year ended June 30, 2011.

This audit work was not a comprehensive audit of the department. We performed this audit work as part of our annual statewide financial audit. The objective of the statewide audit was to express an opinion on whether the financial statements contained in the State of Oregon's Comprehensive Annual Financial Report were fairly presented, in all material respects, in conformity with generally accepted accounting principles.

In planning and performing our audit of the selected financial accounts at the department as of and for the year ended June 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered the department's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements of the State of Oregon, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control. Accordingly, we do not express an opinion on the effectiveness of the department's internal control.

We audited the following accounts at the department and determined their fair presentation in accordance with generally accepted accounting principles in relation to the statewide financial statements.

SFMA Account	Description	Audit Amount
GAAP Fund 0001 - General Fund		
Several	Expenditures – MMIS, Payroll, Other	$ 1,708,060,088
3111	Regular Employees	150,253,826

3210	Public Employees Retirement Contribution	13,242,102
3212	Pension Bond Assessment	8,837,946
3221	Social Security Taxes	11,616,983
3263	Medical, Dental, Life Insurance	48,096,465

GAAP Fund 1108 – Health and Social Services Fund

0065	Unreconciled Deposit	$ 15,929,807
0070	Cash on Deposit with Treasurer	48,603,851
0503	Accounts Receivable – Other Unbilled	116,613,576
0542	Accounts Receivable – Federal – Unbilled	111,999,175
0129	Healthcare Provider Taxes	233,826,292
0300	Federal Revenue	4,122,956,223
Many	Expenditures	4,911,508,914
3111	Regular Employees	211,824,889
3210	Public Employees Retirement Contribution	18,885,438
3212	Pension Bond Assessment	12,627,992
3221	Social Security Taxes	16,961,668
3263	Medical, Dental, Life Insurance	64,804,115

GAAP Fund 1109 – Nutritional Support Fund

0300	Federal Revenue	$ 1,169,191,625
6800	Distributions to Individuals	1,183,265,455

GAAP Fund 4007 – State Hospitals Fund

0852	Buildings and Buildings Improvement	$ 261,908,457
1301	Transfers In From Other Funds	347,991,946

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit the attention of those charged with governance.

Our consideration of internal control was for the limited purpose described above and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. As discussed below, we identified a deficiency in internal control that we consider to be a material weakness and other deficiencies that we consider to be significant deficiencies.

Material Weakness

Lack of Controls over Financial Reporting of Supplemental Nutritional Assistance Program Revenues and Expenditures

The Department of Human Services (department) employs a service provider to administer client benefits for its Supplemental Nutritional Assistance Program (formerly referred to as Food Stamps). At the beginning of each month client benefits are issued and as clients use benefits throughout the month, the service provider draws down federal revenues. At the end of each month, the department records the total amount of federal revenues drawn down by the service provider. Financial reporting standards require that Supplemental Nutritional Assistance Program expenditures be recognized when clients use the benefits, not when benefits are issued. The department initially records total expenditures at the beginning of each month for all client benefits issued. At year-end the department makes an adjustment to expenditures, based on federal revenues received, to ensure recorded expenditures equal benefits used.

The department failed to record $94,357,598 in federal revenues drawn down during January 2011. At year-end the department's adjustment to the related expenditures inappropriately reduced expenditures by the same amount. As a result, both revenues and expenditures were understated by $94,357,598 at June 30, 2011.

We recommend department management develop controls to ensure all Supplemental Nutritional Assistance Program federal revenues are recorded and year-end financial statement adjustments to expenditures are appropriate.

Significant Deficiencies

Lack of Assurance over Accuracy of Pharmacy Reimbursement Rates in MMIS

The Medicaid Management Information System (MMIS) processes Medicaid related payments for services and supplies provided to clients. One type of payment is to pharmacies that have provided drugs to Medicaid clients. The Department of Human Services (department) employs a service provider to calculate the reimbursement rates for drugs provided to clients. The reimbursement rates are uploaded into the MMIS, which processes the pharmacies' claims.

During the year, the department changed the service provider that calculated the reimbursement rates. The rates developed by the new service provider were uploaded into MMIS and became effective on January 1, 2011. The department did not review the accuracy of the upload to gain assurance that the initial reimbursement rates in MMIS are complete or accurate.

We recommend department management verify that the initial upload of the pharmacy rates in MMIS are complete and accurate.

Balance Transfers Misstate Fiscal Year 2011 Expenditures

The department routinely adjusts revenues and expenditures between funds. These adjustments (balance transfers) are inherent in the department's business processes and are due to budgetary refinancing, changes in eligibility, grant balancing and other events. Governmental accounting standards require expenditures to be recognized in the period in which the liability is incurred.

Changes in Federal guidelines regarding client eligibility of certain Medicaid reimbursable expenditures resulted in the department transferring expenditures incurred and recorded in past fiscal years from the General fund to the Health and Social Services fund during fiscal year 2011. This balance transfer caused expenditures to be understated by $2,146,677 in the General fund and overstated by the same amount in the Health and Social Services fund for fiscal year 2011. The department could have avoided the misstatements to fiscal year 2011, in part, by making the relevant adjustments to the fiscal year 2010 financial records, which were still open at the time of the transfer.

We recommend department management develop procedures to ensure that balance transfers pertaining to prior fiscal years are properly recorded and do not misstate current year fund balances.

Prior Year Findings

In a prior fiscal year, we reported a material weakness and a significant deficiency in a letter dated February 25, 2010. The material weakness is related to the department management's lack of assurance that controls exist and are effective over the Medicaid Management Information System. The significant deficiency is related to strengthening the department's knowledge, skills and abilities regarding preparing and approving transactions, including adjustments and year-end closing entries. These findings can also be found in the Statewide Single Audit Reports for the fiscal years ended June 30, 2009 and 2010; see Secretary of State audit report numbers 2010-19 and 2011-06, findings numbered 09-01 and 09-02. During fiscal year 2011, the department made progress toward correcting these findings. These findings will be reported in the Statewide Single Audit Report for the fiscal year ended June 30, 2011, with a status of partial corrective action.

The significant deficiencies and material weakness, along with your responses, will be included in our Statewide Single Audit Report for the fiscal year ended June 30, 2011. Including your responses satisfies the federal requirement that management prepare a Corrective Action Plan covering all reported audit findings. Satisfying the federal requirement in this manner, however, can only be accomplished if the response to each significant deficiency and material weakness 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 the 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(s) of the contact person(s) responsible for corrective action.

Please respond by February 24, 2012.

This communication is intended solely for the information and use of management, others within the organization, and is not intended to be and should not be used by anyone other than the specified parties.

We appreciate your staff's assistance and cooperation during this audit. Should you have any questions, please contact Sarah Anderson or me at (503) 986-2255.

Sincerely,
OREGON AUDITS DIVISION

Julianne Kennedy, CPA
Audit Manager

JK:SAA:nmj

cc: Jim Scherzinger, DHS Chief Operating Officer
Suzanne Hoffman, OHA Chief Operating Officer
Shawn Jacobsen, DHS Interim Controller
Dave Lyda, Chief Audit Executive
Michael J. Jordan, Director, Department of Administrative Services