Office of the Secretary of State

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March 5, 2013

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

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

Dear Ms. Kelley-Siel and Dr. Goldberg:

We have completed audit work of selected financial accounts at the Department of Human Services and the Oregon Health Authority (departments) for the year ended June 30, 2012.

This audit work was not a comprehensive audit of the departments. 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 departments as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered the departments' 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 departments' internal control. Accordingly, we do not express an opinion on the effectiveness of the departments' internal control.

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

SFMA Account	Description	DHS Audit Amount	OHA Audit Amount
GAAP Fund 0001 – General Fund			
Many	Expenditures	$ 836,449,962	$ 931,960,109
Many	Payroll	166,327,573	26,135,546
GAAP Fund 1108 – Health and Social Services Fund			
0065	Unreconciled Deposits		$ 8,264,256
0070	Cash on Deposit with Treasury		171,390,301
0129	Healthcare Provider Taxes	48,565,189	375,386,258
0300	Federal Revenue	1,691,303,067	2,271,313,272
0410	Insurance Premiums		90,002,037
0503	Accounts Receivable – Other Unbilled	11,340,720	147,595,591
0542	Accounts Receivable – Federal Unbilled	53,216,161	63,266,995
1105	Other Revenue		294,129,954
Many	Expenditures	1,611,378,845	3,203,464,551
Many	Payroll	273,760,775	126,818,181
GAAP Fund 1109 – Nutritional Support Fund			
0300	Federal Revenue	$ 1,195,502,044	$ 53,154,021
6800	Distribution to Individuals	1,200,368,493	66,723,561
GAAP Fund 4007 – State Hospitals Fund			
0852	Buildings and Building Improvements		$ 343,045,217
1301	Transfers In From Other Fund		232,209,512
Many	Payroll	31,995,687	159,249,715
GAAP Fund 4013 – Other Enterprise Fund			
Many	Payroll		$ 1,867,089
GAAP Fund 5001 – Central Services Fund			
0401	Administrative and Service Charges		$ 642,870,429
4975	Agency Program Related Services		603,302,518

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 deficiencies in internal control that we consider to be material weaknesses and another deficiency that we consider to be a significant deficiency.

Material Weaknesses

Misclassification of Healthcare Provider Tax

Oregon Health Authority (OHA) management is responsible for establishing and maintaining internal controls to ensure revenue is properly classified in the accounting system. During fiscal year 2012, the department used transfers to allocate Healthcare Provider Tax (HPT) into the appropriate sub accounts. Transfers were also used to reclassify certain types of HPT revenue from the Department of Human Services to OHA. Our review found that six transfers contained errors that incompletely or inaccurately moved the funds. Inadequate supervisory review and a lack of detective controls such as an account reconciliation or complete tracking log allowed the errors and resulted in understating Other Revenues by nearly $29 million and overstating HPT revenues by the same amount.

We recommend OHA management improve controls by considering the design and implementation of a reconciliation process to ensure transfer transactions are properly and completely recorded and ensuring adequate supervisory review of recorded transactions. Supervisory review could include a review of the SFMA to HPT tracking log to ensure all transfers are included and accurately reflected in SFMA.

Overstated Revenues and Expenditures Due to Shared Services

The Department of Human Services (DHS) and the Oregon Health Authority (OHA) are both reported in the Health and Social Services Fund of Oregon's Comprehensive Annual Financial Report. These departments share administrative divisions such as accounting and the Office of Information Services. Functionally, each division is established within one of the departments and provides a shared service to the other. Due to inappropriate accounting at year end, revenues and expenditures in the Health and Human Services Fund were overstated by more than $96 million.

For budgetary purposes, the amount billed is recorded as revenue for the billing agency and expenditures for the paying agency rather than as interfund transfers. This practice inappropriately records the expenditure twice (once when initially incurred and again through the billing process) and incorrectly recognizes revenue.

DHS and OHA management did not consider the impact on financial reporting when implementing the billing process. While certain practices might seem necessary for budgeting, management should have processes in place to ensure their financial information is in compliance with accounting principles.

We recommend DHS and OHA management implement procedures for reviewing and evaluating program changes to identify any necessary revisions in financial reporting to ensure compliance with GAAP. We also recommend management consider the need to revise the billing process or prepare year-end adjustments to ensure transactions involving shared services are reported in conformity with generally accepted accounting principles.

Insufficient Understanding of a New Program (PEBB)

The Public Employees Benefit Board (PEBB) merged with the Oregon Health Authority (OHA) in fiscal year 2012 and OHA management assumed responsibility for PEBB's year-end reporting and ensuring all programs are properly accounted for in accordance with generally accepted accounting principles (GAAP). OHA uses Shared Services staff for financial reporting.

Shared Services staff did not have a sufficient understanding of PEBB's financial processes or of accounting for fund activities and accruals. Management involvement and supervisory review were insufficient controls to prevent or detect the errors.

Specifically, we noted the following:

1. In 2012 PEBB began collecting healthcare surcharges. These surcharges were reported in the Health and Social Services special revenue fund, but should have been reported in the internal service fund with the rest of the PEBB activities. Shared Services was encouraged to reclassify the surcharges to the proper fund before the accounting records closed for the year. Shared Services did not make any financial statement adjustments or communicate with the auditors their plan for resolving the issue. Auditors contacted the Department of Administrative Services, Statewide Accounting and Reporting Services (SARS) to advise them of the situation and SARS took immediate action to correct the issue before the year-end closed.
2. Fund balance transfers were made using revenue account coding; inappropriately increasing revenue.
3. Year-end revenue and expenditure accruals were omitted or were posted in error resulting in an overstatement of revenues and understatement of expenditures.

We recommend OHA management ensure staff obtain a better understanding of the PEBB program and timing of program related revenues and expenditures to ensure accurate and complete year-end reporting in compliance with GAAP. We also recommend management implement procedures for reviewing and evaluating program changes and ongoing business practices to identify any necessary revisions in financial reporting to ensure compliance with GAAP.

Significant Deficiency

Receivables Not Reclassified as Expenditures (OR-Kids)

Department management is responsible for ensuring financial reporting is in accordance with generally accepted accounting principles (GAAP). During the year, the Department of Human Services (DHS) put into service a new information technology system, OR-Kids. Due to implementation difficulties, some payments were manually processed outside of OR-Kids. Vendor claims that could not be processed through OR-Kids were paid manually and recorded in the accounting records as an accounts receivable for that vendor. Recording these payments as a receivable rather than an expenditure helped to ensure that once the claim was accurately processed through OR-Kids the vendor would not be paid twice; the receivable offset the submitted claims until no receivable balance existed. Though an effective control against duplicate payments, a year-end closing adjustment was needed to accurately record the payments made to vendors as expenditures and remove the related accounts receivable balances.

The Shared Services financial reporting staff did not adjust the accounting records at year-end to correct the accounts receivable and expenditure accounts for this manual process; thus, resulting in \$5.3 million overstatement of accounts receivable and a related understatement in expenditures in the financial statements.

We recommend DHS management establish a process to better ensure all year-end adjustments are properly posted to the accounting records in order to facilitate accurate financial statement reporting.

Prior Year Finding

In a letter dated February 13, 2012, we reported a significant deficiency related to balance transfers made by the Department of Human Services, that are intended to adjust prior year transactions, but unintentionally misstate current year fund balances. This finding can also be found in the Statewide Single Audit Report for the fiscal year ended June 30, 2011, see Secretary of State audit report number 2012-08, finding number 11-03. During fiscal year 2012, the department partially corrected the finding by providing training on recognizing the correct period for balance transfers. This finding will be reported in the Statewide Single Audit Report for the fiscal year ended June 30, 2012, with a status of partial corrective action taken.

The significant deficiency and material weaknesses, along with your responses, will be included in our Statewide Single Audit Report for the fiscal year ended June 30, 2012. 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 March 8, 2013.

This communication is intended solely for the information and use of management and others within the organizations 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:AID:nmj

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