

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

Fiscal Year Ended June 30, 2011

**Submitted by
The Auditor
State of Hawaii**



March 20, 2012

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, 2011. Our audit was conducted 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, 2011, 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, 2011, 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 conducted 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, 2011.

ORGANIZATION OF THE REPORT

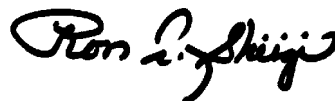
This report is presented in six parts as follows:

- Part I - The basic financial statements and related notes of the DHS as of and for the fiscal year ended June 30, 2011, 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 that could have a direct and material effect on 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 by 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.



Ron Shiigi
Principal

**DEPARTMENT OF HUMAN SERVICES
STATE OF HAWAII**

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**DEPARTMENT OF HUMAN SERVICES
STATE OF HAWAII**

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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, 2011, 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, 2011, 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, 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, 2011, 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 5, 2012, on our consideration of the DHS's internal control over financial reporting and on 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 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 conducted for the purpose of forming an opinion on the financial statements that collectively comprise the DHS's basic financial statements. The 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 financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

N&K CPAs, Inc.

Honolulu, Hawaii
March 5, 2012

**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS
Fiscal Year Ended June 30, 2011**

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, 2011. 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, 2011**

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.

**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2011**

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, 2011 and 2010.

Condensed Statement of Net Assets

	2011	2010
Current assets	\$ 180,695,089	\$ 261,064,784
Capital assets, net	<u>27,230,404</u>	<u>29,224,660</u>
Total assets	\$ <u>207,925,493</u>	\$ <u>290,289,444</u>
Current liabilities	\$ 161,904,040	\$ 334,504,001
Non-current liabilities	<u>9,564,578</u>	<u>9,476,174</u>
Total liabilities	<u>171,468,618</u>	<u>343,980,175</u>
Net assets		
Invested in capital assets	27,230,404	29,224,660
Restricted	1,956,910	1,687,062
Unrestricted (deficit)	<u>7,269,561</u>	<u>(84,602,453)</u>
Total net assets (deficit in)	<u>36,456,875</u>	<u>(53,690,731)</u>
Total liabilities and net assets	\$ <u>207,925,493</u>	\$ <u>290,289,444</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, 2011, the combined net assets of the DHS increased by approximately \$90 million.

The unrestricted net assets of the DHS was approximately \$7.3 million as of June 30, 2011. This deficit in unrestricted net assets as of June 30, 2010 was principally the result of liabilities for program services that were incurred as of June 30, 2010, for which state allotments were not yet available. The largest liability as of June 30, 2011, is the estimated amount of medical assistance service provided as of June 30, 2011, for which the related claims and capitation fees will be processed and paid subsequently. Of the estimated \$83.3 million of medical assistance payable, the state share of these costs is approximately \$25 million. The estimated federal share of these costs 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 approximately \$14.2 million as of June 30, 2011, 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, 2011.

**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2011**

The DHS reported a total of approximately \$27.2 million in net assets invested in capital assets as of June 30, 2011. 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, 2011.

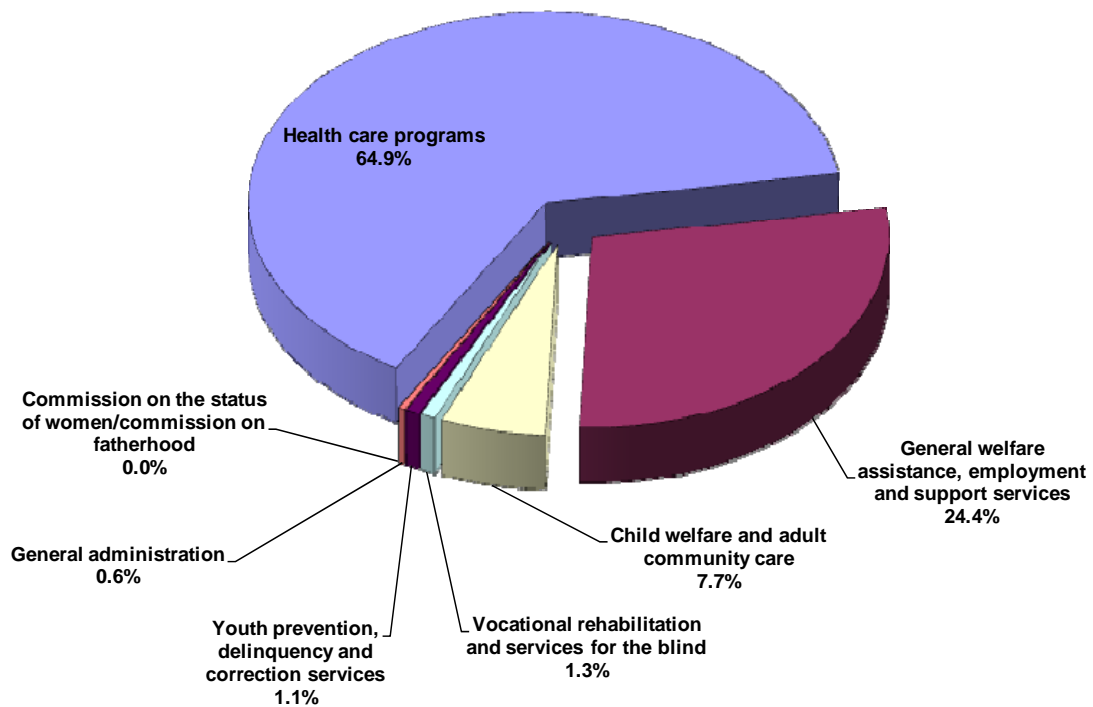
The changes in the net assets of the DHS from governmental activities are summarized below. The DHS directs its resources towards assisting people to meet their basic needs for food, shelter, medical care and other essentials for daily living. As such, the DHS does not conduct business-type activities 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>2011</u>	<u>2010</u>	<u>Percent Change</u>
Revenues			
Program revenues	\$ 1,770,603,483	\$ 1,604,087,065	10.38 %
General revenues	<u>859,083,682</u>	<u>704,823,685</u>	21.89 %
Total revenues	<u>2,629,687,165</u>	<u>2,308,910,750</u>	13.89 %
Expenses			
Health care programs	1,663,787,860	1,486,074,562	11.96 %
General welfare assistance, employment and support services	729,345,892	633,215,414	15.18 %
Child welfare and adult community care services	147,853,916	152,454,381	(3.02) %
Youth prevention, delinquency and correction services	20,157,892	22,486,801	(10.36) %
Vocational rehabilitation and services for the blind	21,478,800	20,442,453	5.07 %
General administration	9,012,414	9,723,431	(7.31) %
Commission on the status of women/ commission on fatherhood	<u>89,897</u>	<u>93,114</u>	(3.45) %
Total expenses	<u>2,591,726,671</u>	<u>2,324,490,156</u>	11.50 %
Change in net assets, before transfers	\$ <u>37,960,494</u>	\$ <u>(15,579,406)</u>	

**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2011**

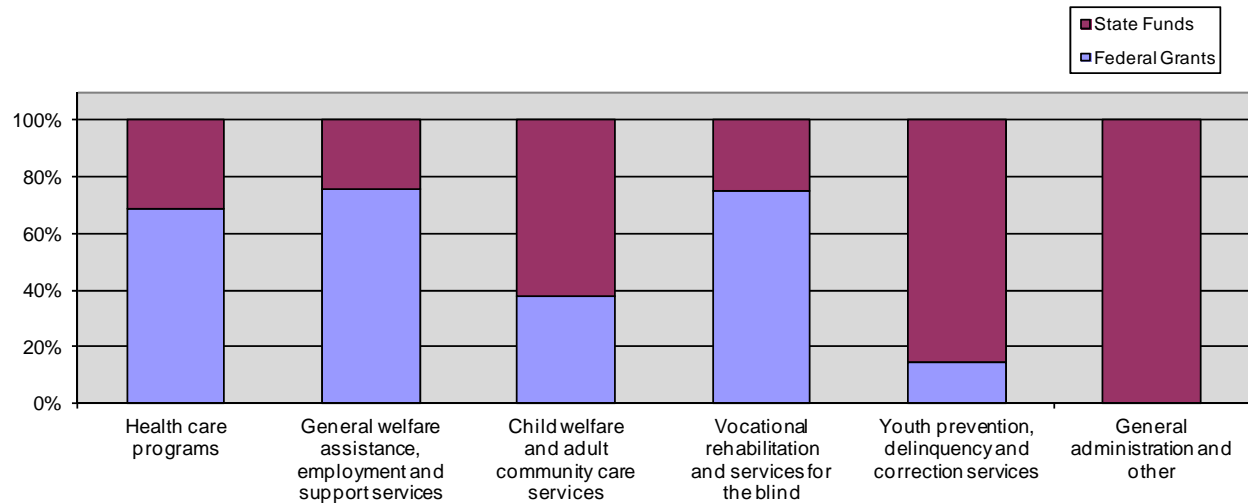
The total cost of all programs and services was approximately \$2.6 billion, a 11.4% increase from the prior fiscal year. Health care and general welfare assistance programs comprised 64.9% and 24.4%, respectively, of the total costs. The following chart presents each major activity as a percent of the total cost of all DHS activities:



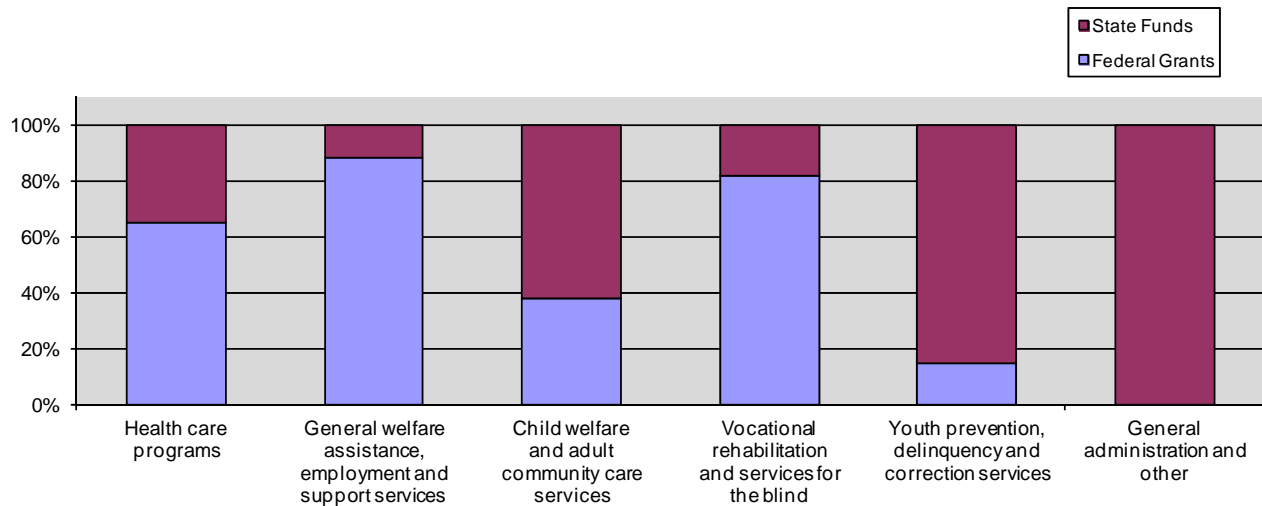
**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2011**

Program revenues consist primarily of operating grants from the federal government. Revenues from these federal grants paid for 68.3% 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, 2011 and 2010:

Fiscal Year 2011



Fiscal Year 2010



**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2011**

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 an accrual basis increased by \$266 million over the prior fiscal year. This increase is primarily related to health care program costs and general welfare assistance, employment and support services costs administered by the DHS which have increased by approximately \$177 million or 11.96% and \$95.7 million or 15.11%, respectively. The increase in the health care program costs are due to the increase in the QUEST enrollment, the rate increase for QExA and the completion of the fee for services payments from the previous fiscal year. Capitation payments increased by \$202.8 million to approximately \$1.25 billion in capitation payments for fiscal year 2011. The increase in the caseload for the general welfare assistance, employment and support service programs in addition to the \$56.1 million increase in Supplemental Nutrition Assistance Program payments in fiscal year 2011, accounting for the majority of the increase in the general welfare assistance, employment and support services costs.

At June 30, 2011, the total governmental fund balance of the DHS consisted of assigned and committed fund balance of approximately \$1.9 million and \$21.4 million, respectively. The committed fund balance of the general fund totaling \$21.4million is principally comprised of liabilities and encumbrances for program services that were incurred as of June 30, 2011. The assigned fund balance of the special revenue funds totaling \$1.9 million is principally the result of amounts that are restricted to use by law or grantor.

The following table presents total revenues and expenditures of the governmental funds of the DHS for the fiscal years ended June 30, 2011 and 2010:

	<u>2011</u>	<u>2010</u>	<u>Percent Change</u>
REVENUES			
State allotted appropriations	\$ 840,138,066	\$ 683,915,952	22.84 %
Intergovernmental revenues	1,770,603,483	1,604,087,065	10.38 %
Non-imposed employee fringe benefits	<u>18,945,616</u>	<u>20,907,733</u>	(9.38) %
Total	\$ <u>2,629,687,165</u>	\$ <u>2,308,910,750</u>	13.89 %

Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2011

	2011	2010	Percent Change
EXPENDITURES			
Health care programs	\$ 1,663,664,384	\$ 1,485,999,324	11.96 %
General welfare assistance, employment and support services	728,822,404	633,139,685	15.11 %
Child welfare and adult community care services	148,014,650	153,031,687	(3.28) %
Youth prevention, delinquency and correction services	19,279,544	21,832,172	(11.69) %
Vocational rehabilitation and services for the blind	21,470,208	20,635,195	4.05 %
General administration	9,102,924	9,653,812	(5.71) %
Commission on the status of women/ commission on fatherhood	<u>89,897</u>	<u>93,114</u>	(3.45) %
Total	\$ <u>2,590,444,011</u>	\$ <u>2,324,384,989</u>	11.45 %

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:

	Original Budget	Final Budget	Actual on Budgetary Basis	Variance Favorable (Unfavorable)
Health care programs	\$ 600,507,095	\$ 663,381,731	\$ 620,682,637	\$ 42,699,094
General welfare assistance, employment and support services	97,276,283	156,765,379	147,946,072	8,819,307
Child welfare and adult community care services	89,335,918	90,244,896	86,265,441	3,979,455
Youth prevention, delinquency and correction services	16,932,174	16,132,174	14,884,455	1,247,719
General administration	6,243,202	6,983,202	6,980,919	2,283
Vocational rehabilitation and services for the blind	3,511,631	3,511,631	3,510,914	717
Commission on the status of women/ commission on fatherhood	<u>156,478</u>	<u>156,478</u>	<u>89,866</u>	<u>66,612</u>
	\$ <u>813,962,781</u>	\$ <u>937,175,491</u>	\$ <u>880,360,304</u>	\$ <u>56,815,187</u>

**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2011**

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

The change in the Health Care Program's process of reimbursement to the State Department of Health - Developmentally Disabled Division resulted in a lower utilization of the budgeted appropriation. The majority of the savings for the General Welfare Assistance, Employment and Support Services programs were due to the lower than anticipated caseload for the Aged, Blind and Disabled clients, vacancy savings and the reallocation of a portion of the funds for the homeless program to the next fiscal year. Vacancy savings and a decrease in caseload accounted for the majority of the savings for the Child Welfare and Adult Community Care Services program. A lower youth population at the Hawaii Youth Correctional Facility and vacancy savings for the Youth Prevention, Delinquency and Correction Services' program accounted for the majority of their savings. Thus the amounts expended in comparison to the amount budgeted appears favorable.

CAPITAL ASSETS

As of June 30, 2011 and 2010, the cost basis of capital assets, net of accumulated depreciation, used by the DHS are presented in the table below. Approximately \$186,000 of capital assets were added in the fiscal year ended June 30, 2011. Annual depreciation totaling approximately \$2.2 million decreased the net cost basis during the fiscal year ended June 30, 2011.

Capital Assets, Net of Depreciation

	<u>2011</u>	<u>2010</u>
State office buildings and improvements	\$ 14,664,725	\$ 15,466,248
Buildings and improvements for the Office of Youth Services	<u>11,218,300</u>	<u>11,922,651</u>
Total buildings and improvements	25,883,025	27,388,899
Furniture, equipment and vehicles	1,347,373	1,835,755
Nondepreciable land	<u>6</u>	<u>6</u>
Total	\$ <u>27,230,404</u>	\$ <u>29,224,660</u>

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.

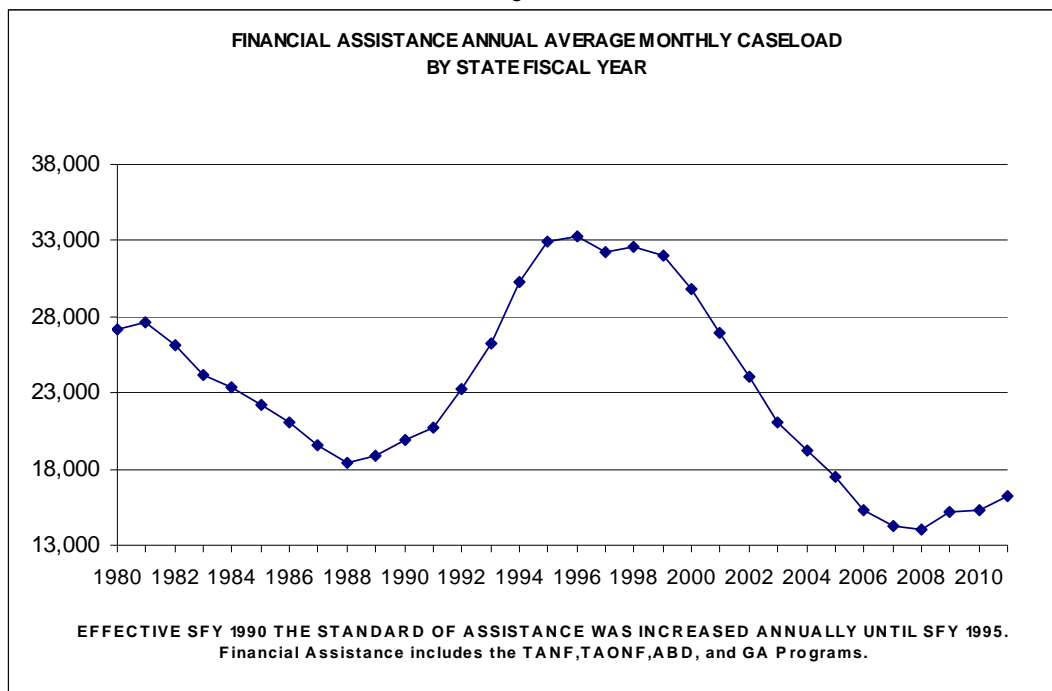
**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2011**

ECONOMIC FACTORS

The average monthly financial assistance caseload increased from State fiscal year 2010 to 2011, from 15,313 to 16,211 respectively, an increase of 898 cases for the period ending June 2011 (see figure 1). More recent data for the number of individuals receiving financial assistance shows an upward trend. In September 2010, a total of 33,799 individuals in Hawaii were receiving financial assistance as compared to 34,826 in September 2011, an increase of 1,027 or 3.0% (see figure 2). However, there continues to be uncertainty regarding the amount of federal and state monies available for financial assistance programs. Federal funds targeted for state financial assistance programs are no longer available due to the expiration of federal stimulus programs. At the state-level, additional changes to program eligibility and benefit payment policies may be required which will have a direct impact on the number of individuals that can receive financial assistance in the future.

The number of individuals in Hawaii receiving Supplemental Nutrition Assistance Program (SNAP), formerly known as Food Stamp Program, benefits continued on a steep upward trend from 88,171 in April 2007, to 168,151 in September 2011. During this period, SNAP participation increased by 79,980 or 90.7%. In the past twelve months from September 2010 to the same month in 2011, the number of individuals receiving SNAP benefits increased by 20,901 or 14.2%. The rise in SNAP participation can be attributed to challenging economic conditions in Hawaii and high unemployment rates. Additionally, the federal government provided additional funding for state SNAP programs in the American Recovery and Reinvestment Act of 2009 (ARRA). More recently, changes in SNAP eligibility requirements has contributed to more individuals qualifying for SNAP benefits.

Figure 1.



**Department of Human Services
State of Hawaii
MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)
Fiscal Year Ended June 30, 2011**

Figure 2.

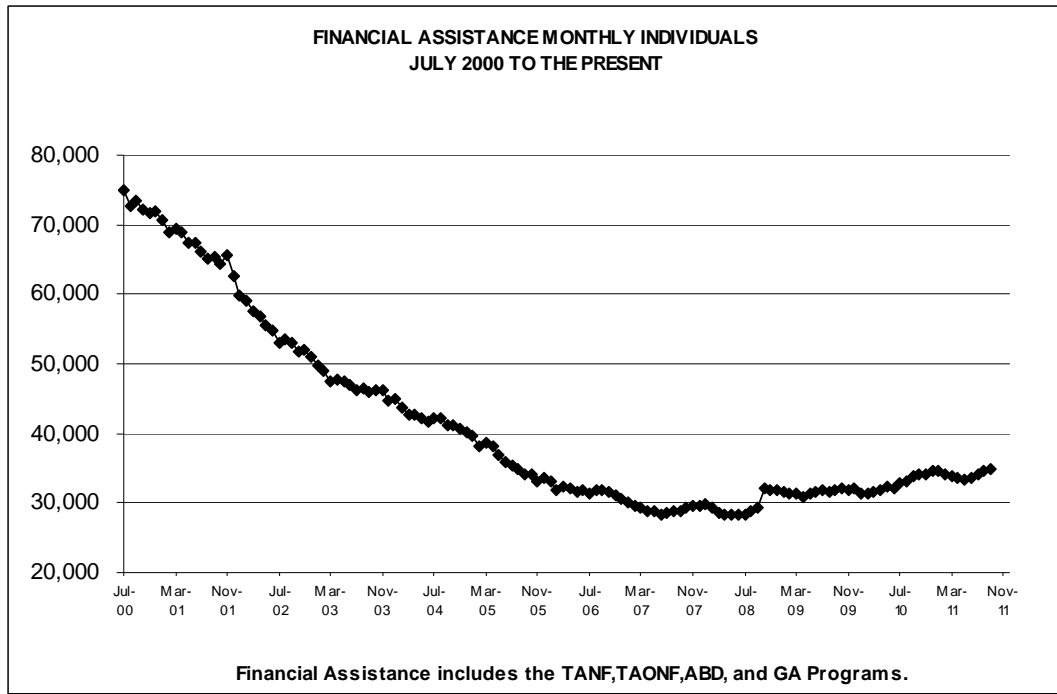
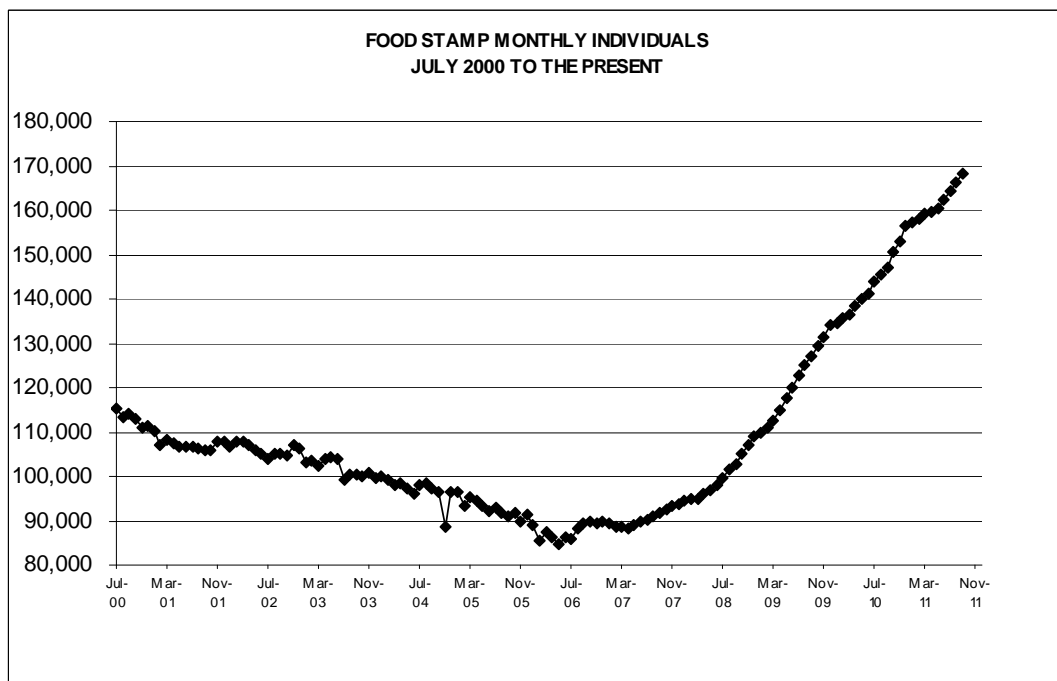


Figure 3.



**Department of Human Services
State of Hawaii
STATEMENT OF NET ASSETS
June 30, 2011**

	<u>Governmental Activities</u>
ASSETS	
Cash and cash equivalents	\$ 117,693,162
Receivables	5,365,729
Due from other governments	<u>57,636,198</u>
Total current assets	180,695,089
Capital assets, net of accumulated depreciation	<u>27,230,404</u>
Total assets	\$ <u><u>207,925,493</u></u>
LIABILITIES	
Vouchers payable	\$ 18,202,309
Accrued wages and employee benefits payable	6,325,237
Due to State general fund	49,526,494
Accrued medical assistance payable	83,250,000
Accrued compensated absences	<u>4,600,000</u>
Total current liabilities	161,904,040
Accrued compensated absences, less current portion	<u>9,564,578</u>
Total liabilities	<u>171,468,618</u>
NET ASSETS	
Invested in capital assets, net of related debt, as restated	27,230,404
Restricted	1,956,910
Unrestricted	<u>7,269,561</u>
Total net assets	<u>36,456,875</u>
Total liabilities and net assets	\$ <u><u>207,925,493</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, 2011**

Functions/Programs	Expenses	Program Revenues		Net (Expenses) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	
Governmental activities:				
Health care programs	\$ 1,663,787,860	\$ --	\$ 1,145,691,955	\$ (518,095,905)
General welfare assistance, employment and support services	729,345,892	--	549,682,417	(179,663,475)
Child welfare and adult community care services	147,853,916	--	56,194,065	(91,659,851)
Youth prevention, delinquency and correction services	20,157,892	--	2,785,635	(17,372,257)
Vocational rehabilitation and services for the blind	21,478,800	--	16,249,411	(5,229,389)
General administration	9,012,414	--	--	(9,012,414)
Commission on the status of women / commission on fatherhood	89,897	--	--	(89,897)
Total governmental activities	\$ <u>2,591,726,671</u>	\$ <u>--</u>	\$ <u>1,770,603,483</u>	\$ <u>(821,123,188)</u>
General revenues:				
State allotments, net of lapsed appropriations				840,138,066
Nonimposed employee fringe benefits				<u>18,945,616</u>
Total general revenues				<u>859,083,682</u>
Transfers				<u>52,187,112</u>
Change in net assets				90,147,606
Deficit in net assets at June 30, 2010, as restated				<u>(53,690,731)</u>
Net assets at June 30, 2011				\$ <u>36,456,875</u>

See accompanying notes to the basic financial statements.

**Department of Human Services
State of Hawaii
BALANCE SHEET
GOVERNMENTAL FUNDS
June 30, 2011**

	<u>General</u>	<u>Med-QUEST Special Revenue Fund</u>	<u>Human Services Special Revenue Fund</u>	<u>Total</u>
ASSETS				
Cash and cash equivalents	\$ 59,174,178	\$ 11,726,978	\$ 46,792,006	\$ 117,693,162
Receivables	4,236,979	104,750	1,024,000	5,365,729
Due from other funds	47,799,102	--	--	47,799,102
Due from other governments	<u>--</u>	<u>83,816,606</u>	<u>--</u>	<u>83,816,606</u>
Total assets	\$ <u>111,210,259</u>	\$ <u>95,648,334</u>	\$ <u>47,816,006</u>	\$ <u>254,674,599</u>
LIABILITIES AND FUND BALANCES				
LIABILITIES				
Vouchers payable	\$ 11,371,023	\$ 1,174,804	\$ 5,656,482	\$ 18,202,309
Accrued wages and employee benefits payable	3,908,604	620,503	1,796,130	6,325,237
Due to other funds	--	35,573,027	12,226,075	47,799,102
Due to other governments	--	--	26,180,408	26,180,408
Due to State general fund	49,526,494	--	--	49,526,494
Accrued medical assistance payable	<u>24,970,000</u>	<u>58,280,000</u>	<u>--</u>	<u>83,250,000</u>
Total liabilities	<u>89,776,121</u>	<u>95,648,334</u>	<u>45,859,095</u>	<u>231,283,550</u>
FUND BALANCES				
Restricted	--	--	464,871	464,871
Committed	--	--	1,492,040	1,492,040
Assigned	21,434,138	--	--	21,434,138
Unassigned	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>
Total fund balances (deficit)	<u>21,434,138</u>	<u>--</u>	<u>1,956,911</u>	<u>23,391,049</u>
Total liabilities and fund balances	\$ <u>111,210,259</u>	\$ <u>95,648,334</u>	\$ <u>47,816,006</u>	\$ <u>254,674,599</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, 2011**

Total fund balances - governmental funds **\$ 23,391,049**

**Amounts reported for governmental activities in the
statement of net assets are different because:**

Capital assets used in governmental activities are not
financial resources and, therefore, are not reported
in the governmental funds.

Capital Assets

Governmental capital assets	\$ 85,385,451	
Less accumulated depreciation	<u>(58,155,047)</u>	27,230,404

Accrued compensated absences are not due in the
current period and therefore are not reported
in the governmental funds.

(14,164,578)

Net assets of governmental activities **\$ 36,456,875**

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, 2011**

	General	Med-QUEST Special Revenue Fund	Human Services Special Revenue Fund	Total
REVENUES				
State-allotted appropriations	\$ 840,138,066	\$ --	\$ --	\$ 840,138,066
Intergovernmental	--	1,145,691,955	624,911,528	1,770,603,483
Nonimposed employee fringe benefits	18,945,616	--	--	18,945,616
	<u>859,083,682</u>	<u>1,145,691,955</u>	<u>624,911,528</u>	<u>2,629,687,165</u>
EXPENDITURES				
Health care programs	517,849,588	1,145,814,796	--	1,663,664,384
General welfare assistance, employment and support services	179,139,464	--	549,682,940	728,822,404
Child welfare and adult community care services	91,977,559	--	56,037,091	148,014,650
Vocational rehabilitation and services for the blind	5,340,683	--	16,129,525	21,470,208
Youth prevention, delinquency and correction services	16,493,909	--	2,785,635	19,279,544
General administration	9,102,924	--	--	9,102,924
Commission on the status of women/ commission on fatherhood	89,897	--	--	89,897
	<u>819,994,024</u>	<u>1,145,814,796</u>	<u>624,635,191</u>	<u>2,590,444,011</u>
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	39,089,658	(122,841)	276,337	39,243,154
OTHER FINANCING SOURCES				
Transfers in (out)	52,070,759	122,841	(6,488)	52,187,112
NET CHANGE IN FUND BALANCES	91,160,417	--	269,849	91,430,266
FUND BALANCES (DEFICIT) AT JULY 1, 2010	<u>(69,726,279)</u>	<u>--</u>	<u>1,687,062</u>	<u>(68,039,217)</u>
FUND BALANCES AT JUNE 30, 2011	\$ <u>21,434,138</u>	\$ <u>--</u>	\$ <u>1,956,911</u>	\$ <u>23,391,049</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, 2011**

Net change in fund balances - total governmental funds **\$ 91,430,266**

Amounts reported for governmental activities in the statement of activities are different because:

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.

Expenditures for capital assets	\$ 185,895	
Less current year depreciation and other changes	<u>(2,180,151)</u>	(1,994,256)

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.

711,596

Change in net assets of governmental activities **\$ 90,147,606**

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, 2011**

	<u>Original</u>	<u>Final</u>	<u>Actual on Budgetary Basis</u>	<u>Variance Favorable (Unfavorable)</u>
REVENUES				
State allotments	\$ <u>813,962,781</u>	\$ <u>937,175,491</u>	\$ <u>840,138,066</u>	\$ <u>(97,037,425)</u>
EXPENDITURES				
Health care programs	600,507,095	663,381,731	620,682,637	42,699,094
Child welfare and adult community care services	89,335,918	90,244,896	86,265,441	3,979,455
General welfare assistance, employment and support services	97,276,283	156,765,379	147,946,072	8,819,307
Youth prevention, delinquency and correction services	16,932,174	16,132,174	14,884,455	1,247,719
General administration	6,243,202	6,983,202	6,980,919	2,283
Vocational rehabilitation and services for the blind	3,511,631	3,511,631	3,510,914	717
Commission on the status of women / commission on fatherhood	<u>156,478</u>	<u>156,478</u>	<u>89,866</u>	<u>66,612</u>
	<u>813,962,781</u>	<u>937,175,491</u>	<u>880,360,304</u>	<u>56,815,187</u>
Excess of revenues over (under) expenditures	<u>--</u>	<u>--</u>	<u>(40,222,238)</u>	<u>(40,222,238)</u>
OTHER FINANCING SOURCES				
Transfers in	<u>--</u>	<u>--</u>	<u>52,070,759</u>	<u>52,070,759</u>
	<u>--</u>	<u>--</u>	<u>52,070,759</u>	<u>52,070,759</u>
EXCESS OF REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES	\$ <u>--</u>	\$ <u>--</u>	\$ <u>11,848,521</u>	\$ <u>11,848,521</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, 2011**

	Original	Final	Actual on Budgetary Basis		Variance Favorable (Unfavorable)
			Med-QUEST Special Revenue Fund	Human Services Special Revenue Fund	
REVENUES					
Intergovernmental revenues					
Med-QUEST	\$ 1,123,051,289	\$ 1,123,051,289	\$ 1,204,106,811	\$ --	\$ 81,055,522
Human services	<u>302,956,446</u>	<u>302,956,446</u>	<u>--</u>	<u>291,819,933</u>	<u>(11,136,513)</u>
	<u>1,426,007,735</u>	<u>1,426,007,735</u>	<u>1,204,106,811</u>	<u>291,819,933</u>	<u>69,919,009</u>
EXPENDITURES					
Health care programs	1,123,051,289	1,123,051,289	1,166,877,424	--	(43,826,135)
General welfare assistance, employment and support services	196,941,272	196,941,272	--	138,736,809	58,204,463
Child welfare and adult community care services	67,239,240	67,239,240	--	54,873,393	12,365,847
Vocational rehabilitation and services for the blind	31,829,504	31,829,504	--	15,703,349	16,126,155
Youth prevention, delinquency and correction services	5,208,955	5,208,955	--	3,109,624	2,099,331
General administration	<u>1,737,475</u>	<u>1,737,475</u>	<u>--</u>	<u>1,691,518</u>	<u>45,957</u>
	<u>1,426,007,735</u>	<u>1,426,007,735</u>	<u>1,166,877,424</u>	<u>214,114,693</u>	<u>45,015,618</u>
Excess of revenues over (under) expenditures	<u>--</u>	<u>--</u>	<u>37,229,387</u>	<u>77,705,240</u>	<u>114,934,627</u>
OTHER FINANCING SOURCES (USES)					
Transfers in	--	--	--	4,118,261	(4,118,261)
Transfers out	<u>--</u>	<u>--</u>	<u>(4,118,261)</u>	<u>--</u>	<u>4,118,261</u>
	<u>--</u>	<u>--</u>	<u>(4,118,261)</u>	<u>4,118,261</u>	<u>--</u>
EXCESS OF REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 33,111,126</u>	<u>\$ 81,823,501</u>	<u>\$ 114,934,627</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, 2011**

	<u>Agency Funds</u>	<u>Private Purpose Trust Funds</u>
ASSETS		
Cash	\$ <u>1,578,814</u>	\$ <u>67,914</u>
Total assets	\$ <u><u>1,578,814</u></u>	\$ <u><u>67,914</u></u>
LIABILITIES		
Due to individuals	\$ 950,825	\$ --
Due to others	<u>627,989</u>	<u>--</u>
Total liabilities	\$ <u><u>1,578,814</u></u>	<u>--</u>
NET ASSETS - HELD IN TRUST		\$ <u><u>67,914</u></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, 2011**

	<u>Private Purpose Trust Funds</u>
ADDITIONS	
Donations	\$ <u>40,500</u>
Total additions	<u>40,500</u>
DEDUCTIONS	
Other	<u>17,991</u>
Total deductions	<u>17,991</u>
CHANGE IN NET ASSETS	22,509
NET ASSETS AT JULY 1, 2010	<u>45,405</u>
NET ASSETS AT JUNE 30, 2011	\$ <u><u>67,914</u></u>

See accompanying notes to the basic financial statements.

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

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 Supplemental Nutrition Assistance Program (SNAP) - formerly known as the Food Stamp Program, helps to ensure that no one goes hungry. The First-To-Work, 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. In 2011, the state homeless programs previously administered by the Hawaii Public Housing Authority, was transferred to the Division. 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, 2011

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. Youths' 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, 2011

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, 2011

NOTE A - FINANCIAL REPORTING ENTITY (Continued)

Commission on Fatherhood: The Commission promotes healthy relationships between parents and children, 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 excluded from 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.

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

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's 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 and report the proceeds of specific revenue sources that are legally restricted or committed to expenditure for specific purposes other than debt service or capital projects. 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.

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

NOTE B - SIGNIFICANT ACCOUNTING POLICIES (Continued)

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.

On July 1, 2010, the DHS adopted GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. This statement establishes criteria for classifying governmental fund balances into specifically defined classifications. Classifications are hierarchical and are based primarily on the extent to which the DHS is bound to honor constraints on the specific purposes for which amounts in the funds may be spent. Application of the statement requires the DHS to classify and report amounts in the appropriate fund balance classifications. The State's accounting and finance policies are used to interpret the nature and/or requirements of the funds and their corresponding assignment of restricted, committed, assigned, or unassigned. The DHS permits funds to be expended in the following order: Restricted, committed, assigned then unassigned.

The DHS reports the following classifications:

Restricted Fund Balance - Restricted fund balances are restricted to specific purposes which are usually imposed by external parties such as grantors, contributors, or laws or regulations of other governments.

Committed Fund Balance - Committed fund balances are amounts that can only be used for specific purposes pursuant to formal action of the State Legislature. Examples are program revenues credited to special and revolving funds. Committed amounts cannot be used for any other purpose unless the State Legislature removes those constraints by taking the same type of formal action.

Assigned Fund Balance - Assigned fund balances are amounts that are constrained by the State's intent to be used for specific purposes, but are neither restricted or committed. The State Legislature authorizes the amounts to specific purposes through the budgetary process. Assigned amounts within general fund include non-liquidated encumbrances at year end that are carried forward to the next fiscal year.

Unassigned Fund Balance - Unassigned fund balance is the residual classification for the General Fund. This classification represents General Fund balance that has not been assigned to other funds, and that has not been restricted or assigned to specific purposes within the General Fund.

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

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 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.

Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011

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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NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011

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) ***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.
- (9) ***Operating Grants and Contributions*** - Federal grants and assistance awards are recorded as intergovernmental receivables and revenues when all eligibility requirements have been satisfied.
- (10) ***Intrafund and Interfund Transactions*** - Significant transfers of financial resources between activities included within the same fund are offset within that fund.
- (11) ***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.
- (12) ***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.

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 those estimates as compiled by the Council on Revenues and the Director of Finance. Budgeted expenditures are derived primarily from the Appropriations Act of 2010 (Act 180, SLH 2010), and from other authorizations contained in the State Constitution, Hawaii Revised Statutes, and other specific appropriation acts in various Session Laws of Hawaii (SLH).

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

NOTE C - BUDGETING AND BUDGETARY CONTROL (Continued)

All expenditures of these appropriated funds are made pursuant to the appropriations in the fiscal 2009 - 2011 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, 2011, 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 cash basis of accounting except for the encumbrance of purchase orders and contract obligations (basis difference), which is a departure from GAAP.

The following schedule reconciles the budgetary amounts to the amounts presented in accordance with GAAP for the fiscal year ended June 30, 2011.

	<u>General</u>	<u>Med-QUEST</u>	<u>Human Services</u>
Excess of revenues over (under) expenditures and other sources (uses) - actual on a budgetary basis	\$ 11,848,521	\$ 33,111,126	\$ 81,823,501
Reserved for encumbrances at fiscal year-end	39,491,804	46,755,013	17,540,749
Expenditures for liquidation of prior fiscal year encumbrances	(11,004,964)	(98,033,389)	(77,505,915)
Net changes in unreserved liabilities	3,019,469	5,945,351	734,341
Net change in accrued medical assistance payable	54,917,000	105,727,000	--
Accruals related to federal reimbursements for program expenditures	(6,361,296)	(35,086,240)	45,771,123
Net change in other receivables	(750,117)	(4,005)	(46,500)
Difference for revenues recognized for GAAP purposes	<u>--</u>	<u>(58,414,856)</u>	<u>(68,047,450)</u>
Net change in fund balances - GAAP basis	\$ <u>91,160,417</u>	\$ <u>--</u>	\$ <u>269,849</u>

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

NOTE D - CASH AND CASH EQUIVALENTS

The State's Director of Finance is responsible for the safekeeping of all monies paid into the State Treasury. The 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 specific requirements of the State. Investment earnings are allocated to the Primary government based on its equity interest in the pooled monies. 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, auction rate securities 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, money market funds and student loan resource securities maintaining a Triple-A rating.

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. The State also 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.

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

NOTE D - CASH AND CASH EQUIVALENTS (Continued)

Cash in Bank

The DHS maintains cash in banks which are held separately from cash in the State Treasury. As of June 30, 2011, the carrying amount of total bank deposits was approximately \$448,000 and the corresponding bank balances which are represented were approximately \$618,000.

NOTE E - RECEIVABLES

Receivables of the DHS, net of an allowance for doubtful accounts, consisted of the following at June 30, 2011:

	<u>General</u>	<u>Med-QUEST</u>	<u>Human Services</u>
Welfare benefit overpayments	\$ 23,733,863	\$ 2,149,500	\$ 22,450,699
Medicaid providers receivable	2,445,266	--	--
QUEST premiums receivable	55,924	60,076	--
Social Security interim assistance loans	368,000	--	--
CSEA receivable	338,463	--	--
	<u>26,941,516</u>	<u>2,209,576</u>	<u>22,450,699</u>
Less allowance for doubtful accounts:			
Welfare benefit overpayments	22,655,363	2,052,000	21,426,699
QUEST premiums receivable	49,174	52,826	--
	<u>22,704,537</u>	<u>2,104,826</u>	<u>21,426,699</u>
Receivables, net	\$ <u>4,236,979</u>	\$ <u>104,750</u>	\$ <u>1,024,000</u>

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

NOTE F - CAPITAL ASSETS

For the fiscal year ended June 30, 2011, capital assets activity for the DHS was as follows:

	Balance		Net			Balance
	July 1, 2010	Additions	Disposals	Transfers	Other	June 30, 2011
Depreciable Assets						
Building and improvements	\$ 47,903,096	\$ --	\$ --	\$ --	\$ 65,228	\$ 47,968,324
Furniture and equipment	36,071,729	148,499	(391,148)	(166,059)	51,971	35,714,992
Motor vehicles	1,704,177	37,396	(31,444)	--	(8,000)	1,702,129
Non-Depreciable Assets						
Land	<u>6</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>6</u>
Total at historical cost	<u>85,679,008</u>	<u>185,895</u>	<u>(422,592)</u>	<u>(166,059)</u>	<u>109,199</u>	<u>85,385,451</u>
Less Accumulated Depreciation:						
Building and improvements	20,514,196	1,571,102	--	--	--	22,085,298
Furniture and equipment	34,382,825	570,822	(346,977)	(157,184)	12,572	34,462,058
Motor vehicles	<u>1,557,327</u>	<u>89,807</u>	<u>(31,443)</u>	<u>--</u>	<u>(8,000)</u>	<u>1,607,691</u>
Total accumulated depreciation	<u>56,454,348</u>	<u>2,231,731</u>	<u>(378,420)</u>	<u>(157,184)</u>	<u>4,572</u>	<u>58,155,047</u>
Capital Assets, Net	\$ <u>29,224,660</u>	\$ <u>(2,045,836)</u>	\$ <u>(44,172)</u>	\$ <u>(8,875)</u>	\$ <u>104,627</u>	\$ <u>27,230,404</u>

Depreciation expense for the fiscal year ended June 30, 2011 was charged to functions/programs of the DHS as follows:

	Governmental Activities
Health care programs	\$ 208,937
General welfare assistance, employment and support services	738,190
Child welfare and adult community care services	315,424
Vocational rehabilitation and services for the blind	59,533
Youth prevention, delinquency and correction services	783,182
General administration	<u>126,465</u>
	\$ <u>2,231,731</u>

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

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, 2011, was as follows:

	<u>Amount</u>
Balance at July 1, 2010	\$ 14,876,174
Additions	6,347,568
Reductions	<u>(7,059,164)</u>
Balance at June 30, 2011	14,164,578
Less current portion	<u>(4,600,000)</u>
	\$ <u>9,564,578</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, 2011, were as follows:

	<u>Balance July 1, 2010</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2011</u>
ASSETS				
Cash	\$ <u>1,548,764</u>	\$ <u>134,320,142</u>	\$ <u>134,290,092</u>	\$ <u>1,578,814</u>
LIABILITIES				
Due to individuals and others	\$ <u>1,548,764</u>	\$ <u>134,320,142</u>	\$ <u>134,290,092</u>	\$ <u>1,578,814</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 \$18,946,000 for the fiscal year ended June 30, 2011, 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.

**Department of Human Services
State of Hawaii
NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

NOTE J - INTERFUND RECEIVABLE AND PAYABLE

The general fund had a net receivable due from the special revenue funds totaling \$47,799,102 as of June 30, 2011, for federal reimbursements of program expenditures. The Med-QUEST and Human Services special revenue funds had a payable to the general fund totaling \$35,573,027 and \$12,226,075, respectively, as of June 30, 2011, for federal reimbursements of program expenditures.

NOTE K - 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, 2011:

<u>Fiscal Year Ending June 30,</u>	<u>Amount</u>
2012	1,658,000
2013	1,369,000
2014	1,195,000
2015	970,000
2016	733,000
2017 - 2021	2,249,000
2022 - 2023	<u>513,000</u>
	\$ <u>8,687,000</u>

The DHS's federal share of rent expenditures for operating leases for the fiscal year ended June 30, 2011, amounted to approximately \$1,899,000, and is included in the accompanying financial statements.

NOTE L - 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. All contributions, benefits, and eligibility requirements are established by HRS Chapter 88 and can be amended by legislative action. The ERS issues an annual comprehensive financial report that is available to the public. The report may be obtained by writing to the ERS at City Financial Tower, 201 Merchant Street, Suite 1400, Honolulu, Hawaii 96813.

**Department of Human Services
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June 30, 2011**

NOTE L - 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 noncontributory 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. The benefit plan options are similar to the current contributory plan. Almost 58,000 current members, all members of the noncontributory plan and certain members of the contributory plan, were eligible to join the new hybrid plan. Most of the new employees hired from July 1, 2006, were required to join the hybrid plan.

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.

The DHS's general fund share of the expense for pension benefits for the fiscal years ended June 30, 2011, 2010, and 2009 was paid from the State General Fund and totaled approximately \$7,220,000, \$8,570,000, and \$10,110,000, respectively. The DHS's federal share of pension benefits expense for the fiscal years ended June 30, 2011, 2010, and 2009 was approximately \$2,563,000, \$3,303,000, and \$3,957,000, respectively. The employer contribution rate for the fiscal years ended June 30, 2011, 2010, and 2009 was 14.69%, 14.58%, and 14.80%, respectively.

**Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

NOTE L - RETIREMENT BENEFITS (Continued)

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 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, 2011, was approximately \$4,625,000.

For employees hired before July 1, 1996, the State pays the entire monthly contribution for employees retiring with 10 or more years of credited service, and 50% of the monthly contribution for employees retiring with fewer than 10 years of credited service. A retiree can elect family plan to cover dependents.

For employees hired after June 30, 1996 but before July 1, 2001, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Retirees in this category can elect a family plan to cover dependents.

For employees hired on or after July 1, 2001, and who retire with fewer than 10 years of service, the State makes no contributions. For those retiring with at least 10 years but fewer than 15 years of service, the State pays 50% of the base monthly contribution. For those retiring with at least 15 years but fewer than 25 years of service, the State pays 75% of the base monthly contribution. For those employees retiring with at least 25 years of service, the State pays 100% of the base monthly contribution. Only single plan coverage is provided for retirees in this category. Retirees can elect family coverage but must pay the difference.

The State is required to contribute the annual required contribution (ARC) of the employer, an amount that is actuarially determined. 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.

Measurement of the actuarial valuation and the ARC are made for the State as a whole and are not separately computed for the individual state departments and agencies such as the DHS. 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.

**Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
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NOTE L - RETIREMENT BENEFITS (Continued)

The EUTF issues an annual financial report that is available to the public. That report may be obtained by writing to the State of Hawaii Employer-Union Health Benefits Trust Fund at 201 Merchant Street, Suite 1520, Honolulu, Hawaii 96813.

NOTE M - 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 \$225 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.

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 \$15 million.

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

**Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

NOTE M - RISK MANAGEMENT (Continued)

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, 2011, 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, 2011, was approximately \$265,000.

NOTE N - 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, 2011, accumulated sick leave was approximately \$42 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.

NOTE O - RELATED PARTY TRANSACTIONS

The DHS had various amounts due to the State totaling \$49,526,494 as of June 30, 2011, which included federal reimbursements for program expenditures totaling \$47,799,102, receivables totaling \$1,446,500, and cash held outside of the State Treasury totaling \$280,892.

**Department of Human Services
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NOTES TO THE BASIC FINANCIAL STATEMENTS
June 30, 2011**

NOTE P - FUND BALANCE CONSTRAINTS

The constraints on fund balance as listed in aggregate in the *Statement of Revenues, Expenses, and Changes in Fund Balance* are detailed according to balance classification and fund.

	General	Med-QUEST Special Revenue Fund	Human Services Special Revenue Fund	Total
RESTRICTED:				
Child Welfare and Adult Community Care	\$ --	\$ --	\$ 464,871	\$ 464,871
Total - Restricted	<u>--</u>	<u>--</u>	<u>464,871</u>	<u>464,871</u>
COMMITTED:				
Commission on the Status of Women / Commission on Fatherhood	--	--	5,494	5,494
Child Welfare and Adult Community Care	--	--	729,807	729,807
Vocational Rehabilitation	<u>--</u>	<u>--</u>	<u>756,739</u>	<u>756,739</u>
Total - Committed	<u>--</u>	<u>--</u>	<u>1,492,040</u>	<u>1,492,040</u>
ASSIGNED:				
Human Services	<u>21,434,138</u>	<u>--</u>	<u>--</u>	<u>21,434,138</u>
Total - Assigned	<u>21,434,138</u>	<u>--</u>	<u>--</u>	<u>21,434,138</u>
Total Fund Balances	\$ <u>21,434,138</u>	\$ <u>--</u>	\$ <u>1,956,911</u>	\$ <u>23,391,049</u>

NOTE Q - PRIOR PERIOD ADJUSTMENT

The DHS has restated its June 30, 2010 department-wide net assets to correct for an error in the DHS's net investment in capital assets. As a result of the correction, the DHS made the following adjustment to its previously reported June 30, 2010 department-wide net assets.

	<u>Amount</u>
Net assets as of June 30, 2010, as previously reported	
Invested in capital assets, net of related debt	\$ 36,923,389
Adjustment attributed to the overstatement of capital assets	<u>(7,698,729)</u>
Net assets as of June 30, 2010, as restated	
Invested in capital assets, net of related debt	\$ <u>29,224,660</u>

SUPPLEMENTARY INFORMATION

Department of Human Services
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Fiscal Year Ended June 30, 2011

<u>Federal Grantor/Pass-through Grantor and Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-through Entity Identifying Number</u>	<u>Federal Expenditures¹</u>	<u>Amount Provided to Subrecipient</u>
U.S. Department of Health and Human Services				
Promoting Safe and Stable Families	93.556		\$ 1,185,683	\$ --
Temporary Assistance for Needy Families ²	93.558		85,930,604	20,352,360
ARRA - Emergency Contingency Fund For Temporary Assistance For Needy Families (TANF) State Program	93.714		19,576,859	--
Low-Income Home Energy Assistance	93.568		6,350,277	209,400
Child Care and Development Block Grant ²	93.575		12,808,927	6,304,507
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		11,190,544	--
Chafee Education and Training Vouchers Program (ETV)	93.599		208,408	--
Head Start	93.600		124,713	--
Adoption Incentive Payments	93.603		391,775	--
Family Connections Grant	93.605		415,553	--
Children's Justice Grants to States	93.643		91,494	--
Stephanie Tubbs Jones Child Welfare Services Program	93.645		1,403,639	--
Foster Care - Title IV-E	93.658		20,051,485	--
ARRA - Foster Care - Title IV-E	93.658		415,171	--
Adoption Assistance	93.659		13,821,097	--
ARRA - Adoption Assistance	93.659		2,093,042	--
Social Services Block Grant ²	93.667		13,924,548	2,133,714
Child Abuse and Neglect State Grants	93.669		225,398	--
Family Violence Prevention and Services/Grants for Battered Women's Shelters - Grants to States and Indian Tribes	93.671		1,125,603	--
Chafee Foster Care Independence Program	93.674		876,479	--
State Survey and Certification of Health Care Providers	93.777		231,479	--
Medical Assistance Program	93.778		909,300,148	--
ARRA - Medical Assistance Program	93.778		223,797,679	--
Children's Health Insurance Program	93.767		33,999,469	--
Medicaid Transformation Grants	93.793		1,365,385	--
Demonstration to Maintain Independence and Employment	93.769		633,227	--
Pass-through State Department of Labor and Industrial Relations Refugee and Entrant Assistance - State Administered Programs	93.566		3,827	--
Total U.S. Department of Health and Human Services			\$ 1,361,542,513	\$ 28,999,981

Department of Human Services
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2011

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures ¹	Amount Provided to Subrecipient
U.S. Department of Agriculture				
Supplemental Nutrition Assistance Program ³	10.551		\$ 401,140,993	\$ --
State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	10.561		13,046,486	1,799,359
National School Lunch Program	10.555		33,163	--
School Breakfast Program	10.553		21,847	--
Total U.S. Department of Agriculture			<u>414,242,489</u>	<u>1,799,359</u>
U.S. Department of Justice				
Juvenile Justice and Delinquency Prevention - Allocation to States	16.540		316,670	221,372
Title V - Delinquency Prevention Program	16.548		27,123	20,000
Juvenile Accountability Block Grant	16.523		232,630	184,684
Crime Victim Assistance	16.575		149,804	--
Total U.S. Department of Justice			<u>726,227</u>	<u>426,056</u>
U.S. Department of Labor				
Pass-through State Department of Labor and Industrial Relations Senior Community Service Employment Program	17.235	PY10-OACSEP-CC-DHS	260,560	--
Total U.S. Department of Labor			<u>260,560</u>	<u>--</u>
U.S. Department of Education				
Rehabilitation Services - Vocational Rehabilitation Grants to States	84.126		5,860,855	1,031,697
Independent Living - State Grants	84.169		215,936	646,266
Rehabilitation Services - Independent Living Services for Older Individuals Who are Blind	84.177		166,930	--
Supported Employment Services for Individuals with the most Significant Disabilities	84.187		336,343	174,400
Assistive Technology	84.224		435,332	400,907
Rehabilitation Training - State Vocational Rehabilitation Unit In-Service Training	84.265		18,128	--
Rehabilitation Long-Term Training	84.129		43,330	--
ARRA - Rehabilitation Services - Vocational Rehabilitation Grants to States, Recovery Act	84.390		\$ 353,750	\$ --

**Department of Human Services
State of Hawaii
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS (Continued)
Fiscal Year Ended June 30, 2011**

Federal Grantor/Pass-through Grantor and Program Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures ¹	Amount Provided to Subrecipient
ARRA - Independent Living State Grants, Recovery Act	84.398		\$ 187,631	\$ 55,284
Safe and Drug-Free Schools and Communities - State Grants	84.186		235,702	227,936
Total U.S. Department of Education			<u>7,853,937</u>	<u>2,536,490</u>
Corporation for National and Community Service				
Foster Grandparent Program	94.011		474,137	--
Senior Companion Program	94.016		416,759	--
Retired and Senior Volunteer Program	94.002		42,526	--
Total Corporation for National and Community Service			<u>933,422</u>	<u>--</u>
Social Security Administration				
Social Security - Disability Insurance	96.001		7,360,036	--
Total Social Security Administration			<u>7,360,036</u>	<u>--</u>
U.S. Department of the Interior				
Pass-through the State Governor's office				
Economic, Social, Political Developments				
of the Territories	15.875	Hawaii-CI-2011-1	11,228,742	--
Total U.S. Department of the Interior			<u>11,228,742</u>	<u>--</u>
U.S. Department of Housing and Urban Development				
Emergency Shelter Grants Program	14.231		58,749	--
Housing Opportunities for Persons with AIDS	14.241		56,751	--
Homeless Prevention and Rapid Re-Housing Program	14.257		112,956	--
Shelter Plus Care	14.238		584,554	--
Supportive Housing Program	14.235		478,967	--
Total U.S. Department of Housing and Urban Development			<u>1,291,977</u>	<u>--</u>
TOTAL FEDERAL EXPENDITURES			<u>\$ 1,805,439,903</u>	<u>\$ 33,761,886</u>

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

² Grant awards totaling \$22,417,500 were transferred from CFDA 93.558 Temporary Assistance for Needy Families to CFDA 93.667 Social Services Block Grant (\$7,417,500) and to CFDA 93.575 Child Care Development Block Grant (\$15,000,000).

³ 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, 2011, which collectively comprise the DHS's basic financial statements and have issued our report thereon dated March 5, 2012. 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.

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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the DHS's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a certain deficiency in internal control over financial reporting, which is described in the accompanying schedule of findings and questioned costs as item 2011-01 that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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 5, 2012

PART III

AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH
REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON
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 Department of Human Services of the State of Hawaii (DHS) compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the DHS's major federal programs for the fiscal year ended June 30, 2011. 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 2011-02 to 2011-07 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.
93.575, 93.596 and 93.713	Child Care Cluster	Activities Allowed and Eligibility	2011-02 - 2011-03
93.778	Medical Assistance Program	Activities Allowed, Allowable Costs, Eligibility, and Special Tests and Provisions	2011-04 - 2011-07

Compliance with such 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 compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the fiscal year ended June 30, 2011. The results of our auditing procedures also disclosed an instance of noncompliance with those requirements, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item 2011-08.

Internal Control Over Compliance

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 to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, 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 was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses in internal control over compliance and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 2011-02 to 2011-07 to be material weaknesses.

A significant deficiency in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2011-08 to be a significant deficiency.

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 5, 2012

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, 2011**

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 deficiency(ies) identified? ☒ 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 deficiency(ies) identified? ☒ 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
93.575	Child Care and Development Block Grant
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund
93.714	ARRA - Emergency Contingency Fund for Temporary Assistance for Needy Families State Program
93.767	Children's Health Insurance Program
93.777	State Survey and Certification of Health Care Providers and Suppliers
93.778	Medical Assistance Program
96.001	Social Security - Disability Insurance (DI)

Dollar threshold used to distinguish between Type A and Type B programs: \$5,416,320

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, 2011**

SECTION II - FINANCIAL STATEMENT FINDINGS

**Ref.
No. Internal Control Findings**

2011-01 Submit Accurate Financial Status Reports

Criteria: The preparation of the DHS's financial statements requires an adjustment for the federal share of federally subsidized programs. This adjustment requires the preparation of a reconciliation of federal reported expenditures to the expenditures recorded in the DHS's financial records.

Condition: We noted one (1) instance where a transfer of expenditures totaling \$10,850,000 between the Child Care and Development Block Grant and Temporary Assistance for Needy Families program was reported by both programs for the quarter ended June 30, 2010, and subsequently adjusted for in the September 2010 quarter. Due to the timing of the report filing, an amended report for the June quarter was not prepared.

Cause: The DHS did not properly adjust for the expenditures reported by the two programs when preparing the financial statements.

Effect: Expenditures were not accurately reported in the financial statements for the period ended June 30, 2010 which were subsequently adjusted in the reporting period ended June 30, 2011.

Recommendation

The DHS should ensure that a thorough review of financial data compilations and computations are performed in the preparation of the financial statements. All adjustments to reported expenditures should be properly identified and adjusted for.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2011**

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Ref. No.	Compliance and Internal Control Findings	Questioned Costs
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2011-02 Maintain All Required Documentation in Child Care Case Files

Federal agency: U.S. Department of Health and Human Services
CFDA No.: 93.575 and 93.596
Program: Child Care and Development Block Grant;
Child Care Mandatory and Matching Funds of
the Child Care and Development Fund

Criteria: 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.

Condition: We noted seven (7) instances in which documentation to support eligibility determinations were not always maintained or supporting documentation for the calculation of child care payments was either missing or incorrect resulting in overpayments totaling \$57,684.

Cause: Program workers did not maintain or complete all required documentation supporting eligibility determinations and/or child care benefit payments to child care providers.

Effect: Benefit payments made to seven participants could not be properly supported or were incorrectly calculated resulting in overpayments.

\$ 57,684

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.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2011**

Ref. No.	Compliance and Internal Control Findings (Continued)	Questioned Costs
---------------------	---	-----------------------------

2011-03 Improve the Accuracy of Child Care Reimbursements

Federal agency: U.S. Department of Health and Human Services
CFDA No.: 93.575 and 93.596
Program: Child Care and Development Block Grant;
Child Care Mandatory and Matching Funds of
the Child Care and Development Fund;

Criteria: Title 45 CFR Part 98.67 requires that the DHS shall expend and account for Child Care and Development funds in accordance with their own laws and procedures for expending and accounting for their own funds. According to the Amendment to Chapter 17-798.2 Hawaii Administrative Rules, child care payments shall include the monthly cost of child care per child, which shall be made in accordance with the established fee scale and rate table as stipulated in the amendment.

Condition: We noted seven (7) instances in which benefit payments were overpaid to participants and two (2) instances in which benefit payments were underpaid to participants.

Cause: Program workers' clerical error or oversight which resulted in incorrect co-pay percentage being applied, incorrect reimbursement calculation based on the level of child care need, and clerical transposing error.

Effect: Benefit payments made to nine participants were incorrectly calculated resulting in net overpayments totaling \$2,535.

\$ 2,535

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.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2011**

Ref. No.	Compliance and Internal Control Findings (Continued)	<u>Questioned Costs</u>
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2011-04 Complete Eligibility Applications and Annual Eligibility Re-Verifications in a Timely Manner

Federal agency: U.S. Department of Health and Human Services
CFDA No.: 93.778
Program: Medical Assistance Program

Criteria: Title 42 CFR Part 435.911 requires the determination of eligibility of individuals who apply for Medicaid benefits within 45 days from the date of application. In addition, Title 42 CFR Part 435.916 requires annual re-verifications of participant eligibility.

Condition: We noted that the DHS is still behind in its processing of Medicaid applications and annual eligibility re-verifications. The number of applications outstanding longer than 45 days increased to 4,475 as of June 30, 2011, which is an increase of approximately 290% from the overdue applications as of June 30, 2010. The number of overdue annual re-verifications increased to 6,308 as of June 30, 2011, which is an increase of approximately 142% as compared to the overdue re-verifications as of June 30, 2010.

In addition, the most recent Payment Error Rate Measurement (PERM) audit performed by CMS for the federal fiscal year 2008, found 113 cases with an eligibility error while 104 of them were classified as undetermined cases due to insufficient documentation. Contributing to the number of errors was the passive renewal process. In response to the large number of past due eligibility re-verifications, the DHS adopted a passive renewal process for all Medicaid cases with children. Under passive renewal, if recipients do not respond to annual re-verification requests they automatically remain eligible because no response is interpreted as no change.

Cause: The DHS does not have the necessary staffing requirements to process eligibility applications and annual re-verifications on a timely basis. During the fiscal year 2011, the MQD Eligibility Branch had experienced staff shortages of approximately 42% due to hiring freezes and reduction in force.

Effect: The backlog of applications pending eligibility determinations and overdue annual re-verifications may result in the risk that ineligible recipients may be receiving Medicaid benefits.

\$ -

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2011**

Ref. <u>No.</u>	Compliance and Internal Control Findings (Continued)	<u>Questioned Costs</u>
2011-04	Complete Eligibility Applications and Annual Eligibility Re-Verifications in a Timely Manner (Continued)	

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. In addition, the DHS should maintain documentation to support participant eligibility and implement a corrective action plan to properly resolve the errors caused by the passive renewal process.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2011**

Ref. No.	Compliance and Internal Control Findings (Continued)	Questioned Costs
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2011-05 Perform ADP System Risk Analysis and System Security Review

Federal agency: U.S. Department of Health and Human Services
CFDA No.: 93.778
Program: Medical Assistance Program

Criteria: Title 45 CFR Part 95.621 requires the conducting of a review of the Automatic Data Processing (ADP) system on a biennial basis. At a minimum, the review shall include an evaluation of physical and data security operating procedures and personnel practices.

Condition: We noted that the last ADP system risk analysis and system security review was conducted in April 2008. The DHS has scheduled their next review to be performed in the calendar year 2012.

Cause: The DHS does not have the necessary resources to perform risk analysis and system reviews on a biennial basis. In addition, the DHS was awaiting the receipt of an assessment from a recent federal audit prior to performing such analysis and review, which was recently received in September 2011.

Effect: The system serves as a critical control over participant eligibility and the processing of payments. Therefore, the lack of biennial system reviews increases the risk that non-compliance with regard to utilization, fraud and accuracy of claims could go undetected.

\$ --

Recommendation

The DHS should allocate the necessary resources needed to perform the ADP risk analysis and system security review on a biennial basis.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2011**

Ref. No.	Compliance and Internal Control Findings (Continued)	Questioned Costs
---------------------	---	-----------------------------

2011-06 Monitor the Medicaid Drug Rebate Program

Federal agency: U.S. Department of Health and Human Services
CFDA No.: 93.778
Program: Medical Assistance Program

Criteria: The Medicaid Drug Rebate Program, as set forth in Section 1927 of the Social Security Act requires the DHS to maintain drug utilization data that identifies the number of units of each covered outpatient drug for which the DHS reimbursed providers. The number of units is applied to the unit rebate amount to determine the actual rebate amount due from each manufacturer. In addition, the DHS should report drug rebate accounts receivable data on Form CMS-64.9R.

Condition: The DHS contracts Affiliated Computer Services, Inc. (ACS) to perform the daily operations of the drug rebate program including billing, collection, accounting and dispute resolution. While the day-to-day operations of the drug rebate program have been subcontracted to ACS, DHS is still ultimately accountable for the drug rebate program. We noted that much reliance is placed on ACS to operate the drug rebate program, as there is no monitoring of subcontractor activities.

Cause: Due to the complexity involved in the drug rebate calculations, the DHS does not have the necessary resources and staffing requirements to perform monitoring procedures of subcontractor activities.

Effect: The lack of sub-monitoring activities may result in the risk that the drug rebates are not being calculated correctly and accurately reported. In the past, the DHS reported inaccurate amounts on the Form CMS-64.9R, resulting in additional payments and related interest due, dating as far back as 1991. The DHS had determined that the remaining outstanding balances should be written-off as these amounts were erroneously posted or had already been collected. The balance remaining on the rebate receivable ledger totaled approximately \$2.8 million. The DHS is currently working with the Attorney General's Office on legal write-offs of uncollectible receivable balances.

\$ --

Recommendation

The DHS should establish formal procedures to monitor its subcontractor activities of the drug rebate program. In addition, the DHS should resolve outstanding issues on a timely basis.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2011**

Ref. No.	Compliance and Internal Control Findings (Continued)	<u>Questioned Costs</u>
2011-07	<p>Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims</p> <p>Federal agency: U.S. Department of Health and Human Services CFDA No.: 93.778 Program: Medical Assistance Program</p> <p>Criteria: Title 42 CFR Part 456 Subpart A requires a statewide program of control of the utilization of all Medicaid services. In addition, Title 42 CFR Part 456.23 requires 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. Lastly, Title 42 CFR Part 455.13 requires the Medicaid agency to have methods for identification, investigation, and referral of fraudulent activity.</p> <p>Condition: 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).</p> <p>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.</p> <p>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.</p>	

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2011**

<u>Ref. No.</u>	Compliance and Internal Control Findings (Continued)	<u>Questioned Costs</u>
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2011-07 Improve Controls over Utilization, Fraud, and Accuracy of Medicaid Claims (Continued)

More specifically, we noted the following conditions:

- The Surveillance and Utilization Review Subsystem (SURS) reports were not being used to effectively identify potential fraud or abuse. In June 2010, the MQD developed the Data Storage Warehouse (DSW) to assist in producing more user friendly and meaningful data and reports for back-end control activities, such as SURS and Peer Review Organization (PRO) functions. Claims data from the HPMMIS is periodically loaded to the DSW at scheduled times. To date, the loaded data in the DSW has not been verified and reconciled to the HPMMIS.
- The DHS has contracted a PRO 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. In order for the PRO to perform such reviews, claims samples must meet specific claims sampling criteria which are determined by the MQD through the use of the DSW. To date, the MQD has not been able to generate any claims samples for managed care claims dating back to the 3rd Quarter 2009 and has not been able to verify that the claims samples generated for fee for service claims are meeting all specific sampling criteria.
- The SURS functions include the generation of utilization reports by MQD using DSW. 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. To date, formal training of the DSW has not been provided to SURS personnel. The MQD is currently in the process of generating both standardized and customized reports through the use of new anti-fraud technology, EDIWatch, which is expected to be launched in 2012.
- There is still no formal ongoing post payment review of a sample of claims. It has been over eight years since the last review and the monitoring of ACS, its pharmacy benefits manager (PBM). That report issued by an independent healthcare auditing and consulting company recommended the need to explore additional edits, analysis, and reporting in order to expand anti-fraud efforts.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2011**

Ref. No.	Compliance and Internal Control Findings (Continued)	Questioned Costs
2011-07	<p>Improve Controls over Utilization, Fraud, and Accuracy of Medicaid Claims (Continued)</p> <ul style="list-style-type: none"> The Medicaid Investigations Unit (MIU) is an important component of identifying and investigating fraudulent activity. In the past, this unit was comprised of one individual and in June 2008, this individual retired from the DHS. The position was later filled by another individual during the months of January to June 2011. To date, the position remains vacant. However, the DHS is currently in the process of looking to fill the position. <p>Cause: The DHS does not have the necessary resources and staffing requirements to perform back-end control activities.</p> <p>Effect: The lack of back-end control activities may result in the risk of failure to identify and correct misutilization practices and potential fraud. More specifically, we noted the following effects:</p> <ul style="list-style-type: none"> Erroneous and ineffective data and reports may be inadvertently used for PRO and SURS functions. In addition, the inability to generate claims samples according to specific sampling criteria has delayed the process of reviewing managed care claims for PRO functions. The lack of regular post payment claim reviews create an uncertainty on whether or not the claims were correctly processed and paid. During our testing of drug and non-drug claims we identified two different payment errors. One payment error was due to the HPPMIS system improperly paying as the primary insurer for Medicare crossover claims of durable medical equipment (DME). These claims should have been denied by the system after the full implementation of Quest Expanded Access effective October 1, 2009. MQD has determined that the error affected 3,576 claims totaling an overpayment of \$83,990. MQD has implemented a system fix to deny Medicare DME claims and is in the process of readjudicating the claims and requesting payment refunds from the respective providers. The second error was due to the claim being processed using the incorrect SMAC (State maximum allowable cost) rate in computing the eligible charge for the claim. Upon further investigation, it was discovered that the claim used an expired SMAC rate that was not end-dated in the system. The system continued to use the old SMAC rate as the basis for pricing claims after a new rate was loaded, resulting in an underpayment of the claim tested. MQD has implemented the system fix and estimated that the error affected approximately 35,000 claims totaling an underpayment of approximately \$25,000. 	

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2011**

Ref. No.	Compliance and Internal Control Findings (Continued)	Questioned Costs
2011-07	Improve Controls over Utilization, Fraud, and Accuracy of Medicaid Claims (Continued)	
	<ul style="list-style-type: none"> Due to the lack of a staff investigator there has been no follow-up on any fraud referrals which may result in ongoing fraud and abuse activity. In addition, any referrals from SURS is now being communicated directly from SURS personnel to the Medicaid Fraud Control Unit. 	\$ <u> </u>

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 need to be made a higher priority. The DHS should also consider the following:

- Verify that the data in the DSW is accurate and complete and that proper reviews and reconciliations are performed to ensure consistency with the data in the HPMMIS.
- Allocate the necessary resources to assist in the generation of useful and meaningful data and reports for PRO and SURS functions.
- 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.
- Allocate the necessary resources to permanently hire an investigator to identify and investigate suspected fraud.

**Department of Human Services
State of Hawaii
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (Continued)
Fiscal Year Ended June 30, 2011**

Ref. No.	Compliance and Internal Control Findings (Continued)	Questioned Costs
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2011-08 Prepare Time Reports Accurately

Federal agency: U.S. Social Security Administration
CFDA No.: 96.001
Program: Social Security - Disability Insurance (DI)

Criteria: The Social Security Administration's (SSA) Program Operations Manual System policy instructions, DI 39506.231, require that the hours worked by staffing category and employment status, such as full-time, part-time, or temporary employees, be accurately reported on the Time Reports of Personnel Service for Disability Determination Services (Form SSA-4514).

Condition: We noted that the hours reported on the quarterly Form SSA-4514 did not reconcile to the supporting documents. More specifically, we noted the following errors:

- Total on-duty, holiday and leave, and overtime hours reported on the Form SSA-4514 did not agree to the quarterly personnel report and overtime and sick leave worksheets.
- Leave and overtime hours per the overtime and sick leave worksheets did not agree to the time sheets for three (3) employees.
- Total hours by staffing category reported on the Form SSA-4514 did not agree to overtime and sick leave worksheets as one (1) trainee examiner was erroneously reported as an examiner.

Cause: The DHS performed manual inputs of hours worked from the supporting documents to the Form SSA-4514 without proper reconciliations and reviews.

Effect: Hours worked by staffing category and employment status were not accurately reported on the quarterly Form SSA-4514.

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Recommendation

The DHS should establish a review and approval process to ensure the accurate preparation of the Form SSA-4514 prior to submission to the SSA.

PART V
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

**Department of Human Services
State of Hawaii
STATUS REPORT
Fiscal Year Ended June 30, 2011**

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, 2010, dated March 18, 2011.

SECTION II - FINANCIAL STATEMENT FINDINGS

Recommendations	Status
<p>2010-01 Properly Record All Capital Assets in the State Property Inventory Records (page 64)</p> <p>To ensure that the state property inventory records are complete and accurate, 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 acquisitions and dispositions are properly posted to the state property inventory records and included in the capital asset listings used for financial reporting.</p>	Accomplished.

**Department of Human Services
State of Hawaii
STATUS REPORT (Continued)
Fiscal Year Ended June 30, 2011**

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

<u>Recommendations</u>		<u>CFDA Number</u>	<u>Status</u>
2010-02	Improve Controls over Utilization, Fraud and Accuracy of Medicaid Claims (pages 65-68) 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: <ul style="list-style-type: none">• Allocate the necessary resources needed to perform the SURS function and to actively identify and investigate suspected fraud as required by Title 42 CFR Part 456.23 and Title 42 CFR Part 455.13.• Complete the development of meaningful SURS reports using the Data Storage Warehouse and regularly analyze the reports. 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.• 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.• Take timely corrective action on problems or noncompliance identified by its QIO such as recovery of overpayments and implementation of recommendations issued.	93.778	Not accomplished. See Reference No. 2011-07.

**Department of Human Services
State of Hawaii
STATUS REPORT (Continued)
Fiscal Year Ended June 30, 2011**

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

<u>Recommendations</u>		<u>CFDA Number</u>	<u>Status</u>
2010-03	Reconcile Federal Award Drawdowns (pages 69-70)	93.778	
	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 reconciliations. 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.		Accomplished.
2010-04	Complete Eligibility Applications and Annual Eligibility Re-verifications in a Timely Manner (pages 71-72)	93.778	
	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. In addition, the DHS should consider eliminating the passive renewal process or at a minimum maintain documentation to support participant eligibility.		Not accomplished. See Reference No. 2011-04.
2010-05	Perform ADP System Risk Analysis and System Security Review (pages 73)	93.778	
	To ensure compliance with federal regulations, the DHS should allocate the necessary resources needed to perform the ADP risk analysis and system security review on a biennial basis.		Not accomplished. See Reference No. 2011-05.

**Department of Human Services
State of Hawaii
STATUS REPORT (Continued)
Fiscal Year Ended June 30, 2011**

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

	<u>Recommendations</u>	<u>CFDA Number</u>	<u>Status</u>
2010-06	Monitor the Medicaid Drug Rebate Program (pages 74)	93.778	Not accomplished. See Reference No. 2011-06.
	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 resolve outstanding issues on a timely basis.		
2010-07	Maintain All Required Documentation in Child Care Case Files (pages 75)	93.575, 93.596, and 93.713	Not accomplished. See Reference No. 2011-02.
	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.		
2010-08	Improve the Accuracy of Child Care Reimbursements (pages 76)	93.575, 93.596, and 93.713	Not accomplished. See Reference No. 2011-03.
	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.		
2010-09	Submit Financial Status Report Timely (pages 77)	93.568, 93.778, and 93.767	Accomplished.
	The DHS should establish procedures to ensure that the OMB Standard Form 269A, Form CMS-64 and CMS-21 are submitted in a timely manner. The personnel responsible for the preparation and review of the forms should utilize a checklist of reporting due dates as a reminder.		

PART VI
CORRECTIVE ACTION PLAN

NEIL ABERCROMBIE
GOVERNOR



PATRICIA McMANAMAN
DIRECTOR

BARBARA A. YAMASHITA
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF HUMAN SERVICES
P. O. Box 339
Honolulu, Hawaii 96809-0339

March 14, 2012

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

Dear Mr. Shiigi:

Attached are the Department of Human Services' responses and corrective action plans related to your fiscal year 2011 audit report findings and recommendations. We appreciate the opportunity to comment on the audit report.

Sincerely,

A handwritten signature in black ink, appearing to read "Patricia McManaman".

Patricia McManaman
Director

Attachment

Ref. No. 2011-01**Submit Accurate Financial Status Reports****Auditor's
Recommendation:**

The DHS should ensure that a thorough review of financial data compilations and computations are performed in the preparation of the financial statements. All adjustments to reported expenditures should be properly identified and adjusted for.

**Corrective Action
Taken or Planned:**

Effective immediately, an additional review of the financial data compilations and computations will be performed to ensure that adjustments are properly identified and accounted for in the preparation of the financial statements.

End Date:

Ongoing

Responding Person:

Derek Oshiro, Fiscal Management Office, Chief Accountant
Phone: (808) 586-5630

Ref. No. 2011-02**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 Department has taken action to ensure that the required documents are maintained in each case file. The two types of documents missing from the case files have usually been child care receipts and current child care certificate and provider confirmation forms (DHS-918).

Although it was not a finding during this audit, the Department addressed the issue of the missing child care receipts by making a concerted effort to re-train the staff on the need for the receipts. Also, the Department modified the 6-month eligibility form in November 2011 by adding a page that highlights an area for the child care receipt to be attached.

To address the missing child care certificate and provider confirmation forms (DHS-918), the Department implemented an electronic system modification on January 30, 2012 that requires a current DHS-918 to be on file in order to authorize a child care subsidy. This modification will alert workers when there is an expired certificate (DHS-918) and will not allow a payment to be issued until the worker obtains a new certificate.

The Child Care Program Office (CCPO) met with the Employment and Training Program Office (ETPO) and the contracted service provider for the child care subsidy program to introduce the common review instrument that will be utilized by

all parties to standardize the review of child care payments. The contractor has established a sampling methodology and frequency for case reviews and has 2 quality assurance staff who are assigned to do case reviews on a monthly basis.

Additionally, the office supervisors are required to conduct a monthly case review of a random sample of cases for each worker, and a monthly review of 100% of a trainee's cases until they feel confident that the trainee is knowledgeable about the policy and procedures for the program. The contractor will submit their findings on a monthly basis to the Child Care Program Office and the Child Care Program staff will conduct a re-review of a sample of all cases reviewed.

For the First-To-Work program that issues child care subsidies to families receiving financial assistance, staff from the Employment & Training Program Office will incorporate the child care subsidy portion into their established case review process. Of the cases that they will sample for their First-To-Work reviews, they will utilize the common review instrument to determine whether the child care subsidy issued was properly authorized. Training has been provided to the reviewers to ensure consistency in how they are conducting the reviews.

End Date: Ongoing

Responding Person: Julie Morita, Benefit, Employment & Support Services Division (BESSD) Child Care Program Office Administrator
Phone: (808) 586-7187

Ref. No. 2011-03 **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 Department has modified the electronic system to automatically calculate income eligibility, co-payment rates, activity hour, and provider rates. We will examine the details of the types of errors that still contribute to incorrect payment calculations to determine whether there are any other system modifications that could be recommended and implemented to further automate the process to reduce these calculation errors. In the meantime, the Child Care Program Office will continue to work with the training office to emphasize the need for correct payment issuances and continue with the plan (as stated in the corrective action section of Ref. No. 2011-02 regarding case reviews) to conduct sample case reviews to ensure accuracy of payments issued.

End Date: Ongoing

Responding Person: Julie Morita, BESSD Child Care Program Office Administrator
Phone: (808) 586-7187

Ref. No. 2011-04 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. In addition, the DHS should maintain documentation to support participant eligibility and implement a corrective action plan to properly resolve the errors caused by the passive renewal process.

Corrective Actions Taken or Planned: The Branch lost nearly 35 positions through the reduction in force despite a near 35% increase in enrollment over the past three years. The volume is simply in excess of resource capacity. However, the Governor has submitted a message to the State Legislature requesting 15 new permanent Eligibility Worker positions.

The Branch has received approval to recruit and fill vacant positions statewide, and filling these positions is a Division priority. To the extent possible, temporary 89-day appointments are being utilized. Many new staff have been added.

After the close of the audit period, staff made substantial progress in eliminating the backlog through new hires, special projects and overtime. In addition, staff has been instructed to give presumptive eligibility for overdue applications.

The Branch is also restructuring its operations by creating function based units, and an assessment by a consultant for business process reengineering is planned.

The DHS attempted to stop passive renewal, understanding its negative impact on program integrity; however CMS considered it a maintenance of effort violation and disapproved.

End Date: Ongoing

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

Ref. No. 2011-05 Perform ADP System Risk Analysis and System Security Review

Auditor's Recommendation: The DHS should allocate the necessary resources needed to perform the ADP risk analysis and system security review on a biennial basis.

Corrective Action Taken or Planned: The DHS-MQD is working with a contractor to perform an ADP risk analysis and system security review. The review is scheduled for the summer of 2012.

End Date: June 30, 2012

Responding Person: Randy Chau, MQD Systems Office Administrator
Phone: (808) 692-7951

Ref. No. 2011-06 Monitor the Medicaid Drug Rebate Program

Auditor's Recommendation: The DHS should establish formal procedures to monitor its subcontractor activities of the drug rebate program. In addition, the DHS should resolve outstanding issues on a timely basis.

Corrective Action Taken or Planned: Over the last few years, MQD has lost its full time pharmacist who assisted in the monitoring of the drug rebate program. Many of the rebate issues are related to unit discrepancies which can only be resolved by the pharmacist. MQD will be requesting that a position and funding be approved to hire a full time pharmacist.

Also, the Finance Office is in the process of procuring a vendor to assist in the development of a procedure manual for the financial reporting process which will include the monitoring of reports for the drug rebate program submitted by the contractor.

We should also note that the current drug rebate program is based on fee for service payments. Beginning July 1, 2012, most of the drug payments will be under the managed care plans, so the monitoring of the rebates will be focused on the contracted health plans.

End Date: September 30, 2012

Responding Person: Brian Pang, MQD Finance Officer
Phone: (808) 692-7956

Ref. No. 2011-07 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 need to be made a higher

priority. The DHS should also consider the following:

- Verify that the data in the DSW is accurate and complete and that proper reviews and reconciliations are performed to ensure consistency with the data in the HPMMIS.
- Allocate the necessary resources to assist in the generation of useful and meaningful data and reports for PRO and SURS functions.
- 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.
- Allocate the necessary resources to permanently hire an investigator to identify and investigate suspected fraud.

**Corrective Actions
Taken or Planned:**

- The MQD continues to verify data in the DSW to ensure that the data is consistent with HPMMIS. In addition, the SURS Subsystem has been procured and the MQD Financial Integrity Staff (FIS) is in the process of working with EDI Watch to bring this subsystem up and running. This SURS subsystem will allow the MQD FIS to do post-payment reviews in a more meaningful manner.
- The SURS Subsystem will allow the generation of useful and meaningful data reports. These reports will allow for the monitoring and investigation of payments for both managed care and fee for service payments. MQD Finance Office (FO) is also in the process of reorganizing the branch. There has been ongoing discussion on the hiring of a data analyst position, giving priority to Finance Office and Financial Integrity Staff. This position would coordinate and work with EDI Watch staff to ensure reports produced are accurate and complete. In addition, this position will be tasked with designing adhoc reports from the Data Storage Warehouse as required by the investigator, SURS staff and FO staff.
- With implementation of the SURS Subsystem, the MQD will be able to perform regular post payment reviews for both drug and non-drug claims. Implementation of the SURS Subsystem is expected by September 30, 2012.
- MQD has hired a full time investigator. The investigator is scheduled to begin employment on March 27, 2012.

End Date: September 30, 2012

Responding Person: Randy Chau, MQD Systems Office Administrator
Phone: (808) 692-7951

Gary Ojiri, MQD Third Party Liability Program Specialist
Phone: (808) 692-7978
Suzanne Noland, MQD Registered Nurse
Phone: (808) 692-8055
Shelley Siegman, MQD Registered Nurse
Phone: (808) 692-8095

Ref. No. 2011-08

Prepare Time Reports Accurately

**Auditor's
Recommendation:**

The DHS should establish a review and approval process to ensure the accurate preparation of the Form SSA-4514 prior to submission to the SSA.

**Corrective Action
Taken or Planned:**

The Disability Determination Branch (DDB) has taken action to address the finding and auditor's recommendation.

DDB is now using an Excel worksheet, which eliminates manual calculations, to compile employees' hours.

After the Branch Secretary prepares the Form SSA-4514, a professional staff person will verify the reported hours by reconciling them to the supporting documents.

The DDB Administrator will review the form prior to submission to the SSA.

End Date:

March 31, 2012

Responding Person:

Vikki Nakamura, Vocational Rehabilitation & Services for the Blind Division, Disability Determination Branch Administrator
Phone: (808) 973-2244 x224