NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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February 14, 2013

Kerry Winterer, Chief Executive Officer
Nebraska Department of Health and Human Services
301 Centennial Mall South, 3rd Floor
Lincoln, Nebraska 68509-5026

Dear Mr. Winterer:

We have audited the basic financial statements of the State of Nebraska (the State) as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, and have issued our report thereon dated January 16, 2013. In planning and performing our audit, we considered the State's internal control over financial reporting (internal control) as a basis for designing audit procedures for the purpose of expressing our opinions on the basic financial statements of the State, but not for the purpose of expressing an opinion on the effectiveness of the State's internal control. Accordingly, we do not express an opinion on the effectiveness of the State's internal control.

In connection with our audit described above, we noted certain internal control or compliance matters related to the activities of the Nebraska Department of Health and Human Services (the Agency) or other operational matters that are presented below for your consideration. These comments and recommendations, which have been discussed with the appropriate members of the Agency's management, are intended to improve internal control or result in other operating efficiencies.

Our consideration of internal control included a review of prior year comments and recommendations. To the extent the situations that prompted the recommendations in the prior year still exist, they have been incorporated in the comments presented for the current year. All other prior year comments and recommendations (if applicable) have been satisfactorily resolved.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified a certain deficiency in internal control that we consider to be a significant deficiency.

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 entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We did not identify any deficiencies in internal control that we consider to be material weaknesses.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider Comment Number 1 (Accrual Information) to be a significant deficiency.

This comment will also be reported in the State of Nebraska's Statewide Single Audit Report Schedule of Findings and Questioned Costs.

Draft copies of this letter were furnished to the Agency to provide them an opportunity to review the letter and to respond to the comments and recommendations included in this letter. All formal responses received have been incorporated into this letter. Responses have been objectively evaluated and recognized, as appropriate, in the letter. Responses that indicate corrective action has been taken were not verified at this time, but will be verified in the next audit.

The following are our comments and recommendations for the year ended June 30, 2012.

1. Accrual Information

As part of the Department of Administrative Services State Accounting's (State Accounting) preparation of the State Comprehensive Annual Financial Report (CAFR), State Accounting requires all State agencies to determine and report payable and receivable amounts at the end of the fiscal year on an accrual response form. A good internal control plan requires procedures to accurately report financial information to State Accounting.

We noted the following concerning payables and receivables reported by the Department of Health and Human Services (Agency) to State Accounting:

Description	Accrual type	Error	Amount
Medicaid Drug Rebate	Receivable	Understated	$ 5,948,143
Patient and County Billings	Receivable	Overstated	$ 5,050,690
Third Party Liability	Receivable	Overstated	$ 1,801,625
Medicaid Estate Recovery	Receivable	Overstated	$ 1,457,481
NFOCUS	Receivable	Overstated	$ 766,730
Women, Infants and Children Program	Receivable	Understated	$ 754,907
Women, Infants and Children Program	Payable	Understated	$ 961,811

Additional information is as follows:

- The Medicaid drug rebate receivable was understated by $5,948,143. Medicaid drug rebates were established by law to require drug manufacturers to provide rebates for their drug products paid for by Medicaid. The Agency did not include the physician administered rebate receivables for the 4th Quarter 2011 (billed in August 2012), 1st Quarter 2012 (billed in November 2012), and the 2nd Quarter 2012 (billed in February 2013).

- The patient and county billings receivable was overstated by $5,050,690. The receivable was calculated for the Lincoln, Norfolk, and Hastings Regional Centers, the Beatrice State Development Center (BSDC), and the Developmental Disabilities program. The overstatement was caused by the following:

  - The Agency erroneously included State funding at BSDC totaling $3,856,493.

  - Allowances for doubtful accounts were not considered, were not complete, or were not reasonably documented causing $1,174,095 in overstated receivables.

  - We tested 25 account balances and noted 10 of the 25 balances were not properly recorded or were not followed up timely, causing an overstatement of $20,102.

- The third party liability receivable was overstated by $1,801,625. The receivable is based upon claims filed with insurance companies, attorneys, etc. for payments made with Medicaid funds for individual claimants. The following was noted:

  - The Agency did not properly calculate the allowance for doubtful accounts causing an overstatement of $1,838,457.

  - Accounts with no activity for two years or more were not included in the receivable balance. These amounts had been removed from the Medicaid system; however, according to the Agency, they continued to attempt to collect the amounts. The Auditor of Public Accounts (APA) was unable to determine the total amount of these accounts as a comprehensive listing was not available. For 2 of 15 account balances tested, the amount did not agree to the Medicaid system due to the balances over two years old being excluded. The two accounts resulted in an understatement of $38,260.

  - For 1 of 15 account balances tested, the amount was not reduced for a payment made, causing an overstatement of $1,428.

- The Medicaid estate recovery receivable was overstated by $1,457,481. The receivable is based upon claims filed against the estates of deceased persons that received Medicaid assistance. We tested 15 account balances and noted 9 of the 15 balances were not properly recorded. The errors noted ranged from an understated balance of $5,341 to an overstated balance of $638,946. Furthermore, one account balance had not been followed up on since May 2011.

- The NFOCUS receivable was overstated by $766,730. The receivable consists of several Federal and State programs recorded in the NFOCUS system, including, but not limited to, Food Stamps, Aid to Dependent Children, and Child Care. The Agency did not determine an allowance for doubtful accounts for balances less than five years old. Accounts sent to the collection agency were not excluded even though the Agency does not expect to collect on these balances, causing an overstatement of $766,730.

- The Agency did not consider payables and receivables required to be reported for the Women, Infants, and Children (WIC) Program. Amounts payable to individuals, totaling $961,811, should have been reported to State Accounting. There was also a potential payable due to the Federal government, as amounts are drawn down in advance of services provided. The Agency was unable to determine the amount that would be due at June 30, 2012. There were also receivables totaling $754,907 for WIC rebates which were not reported.

State Accounting did make correcting entries for all material amounts as recommended by the APA. Similar findings have been noted in our previous audits.

Without proper controls to ensure amounts reported to State Accounting are accurate, there is an increased risk of financial statement misstatements not being detected and corrected in a timely manner. Also, lack of complete and accurate receivable information increases the risk all monies due the State may not be collected.

> We recommend the Agency implement procedures to ensure amounts reported are complete and accurate, including properly recording allowances for doubtful accounts.

Agency's Response: The Department will review the items noted and implement any additional procedures deemed necessary to address the current year's identified misstatements.

2. <u>Federal Receivable Write-Offs</u>

A good internal control plan requires procedures to ensure Federal reimbursement requests are performed timely and that all Federal funds due to the State are received. According to 31 USC § 1552(a), Federal funds can be requested up to five years after the grant's period of availability.

We noted the Agency wrote-off $1,821,941 in receivables due from the Federal government as of June 30, 2012. The Agency had not requested and drawn the funds within the five years allowed by 31 USC. The receivable balances written off were for 1996 to 2006 Federal grants. Because of the Agency's failure to request the Federal reimbursements in the period allowed, Federal dollars were lost. The following Federal funds were lost:

Grant Year	Grant Program	Amount Lost
1996	Child Support Enforcement	$ 46,230
1998	Adoption Assistance	76,096
1999	Adoption Assistance	417,194
2001	Child Support Enforcement	27,140
2002	Foster Care Title IV-E	210,713
2003	Foster Care Title IV-E	243,919
2004	Adoption Assistance	123,419
2006	Adoption Assistance	656,489
2006	State Survey and Certification of Health Care Providers	20,741
	Total Federal Funds Lost	$ 1,821,941

The Agency indicated the Federal government did not award the Child Support Enforcement amounts but the Agency believed they should have received this funding. The Agency never confirmed with the Federal government that they should have been awarded and reimbursed for this amount. The Agency also indicated the Foster Care amounts were not requested due to a clerical error in recording the authorized amounts in the accounting system. The Agency had no explanation as to why the other receivables noted were not requested.

When Federal reimbursements are not requested and drawn timely, the State loses Federal funding, which in turn requires State taxpayer dollars to fund the program expenditures.

> We recommend the Agency implement policies and procedures to ensure Federal reimbursements are performed timely in accordance with Federal regulations.

Agency's Response: The items you noted go back several years and include items that are not available in the Department's current accounting system. The Department had recorded these amounts as receivables for a number of years with the intent to research if the amounts reported were truly due to the Department.

The Department implemented policies and procedures during the current year to ensure Federal reimbursements are performed timely and in accordance with Federal regulations. While implementing these new procedures, the Department came to the understanding that amounts outstanding greater than five years were no longer collectible so the Department made the determination to write off these receivables as uncollectible.

3. <u>Untimely Response to Audit Requests for Information</u>

Neb. Rev. Stat. § 84-305 (Reissue 2008) provides, in relevant part:

> *"The Auditor of Public Accounts shall have access to all records of any public entity, in whatever form or mode the records may be, unless the auditor's access to the records is specifically prohibited or limited by federal or state law."*

Good business practice, which necessarily entails compliance with statutory directives, such as that referenced above, requires timely responses to both requests for audit documentation and access to financial systems by the APA.

Applicable professional financial auditing standards also mandate cooperation with a financial audit. Most specifically, U.S. Auditing Standards, AU § 316.04 provides, in relevant part:

> *"Management, along with those charged with governance, should set the proper tone; create and maintain a culture of honesty and high ethical standards; and establish appropriate controls to prevent, deter, and detect fraud."*

Furthermore, the Appendix Examples of Fraud Risk Factors (A.2) to AU § 316 warns auditors against the following:

> *"Formal or informal restrictions on the auditor that inappropriately limit access to people or information…"*

> *"Domineering management behavior in dealing with the auditor, especially involving attempts to influence the scope of the auditor's work…."*

During testing of the CAFR and the Statewide Single Audit, the Agency did not respond timely to audit requests by the APA.

<u>OnBase System Access</u>

The APA requested supporting documentation for payments selected for testing from the Agency's accounting division on June 4, 2012. On June 7, an accountant with the Agency indicated that the OnBase System (OnBase) was implemented during the fiscal year. OnBase was used to store payment related documentation and the approval process for payments entered into EnterpriseOne, the State's accounting system.

The Agency accountant asked who from the APA needed access to OnBase to review the documents selected for testing. The APA requested access for designated audit staff that same day. On June 8, 2012, the Agency replied that no one from the APA would be granted access to OnBase. This began an extensive series of communications in which the APA made repeated requests for access to OnBase, and the Agency denied those requests. On October 19, 2012, the APA granted access to OnBase as requested – some 134 days after the original request for access. The Agency is now working cooperatively with the APA as we continue our information technology audit work on OnBase.

Date	APA Request/ Agency Response
6/4/2012	The APA requested documentation for items selected for testing.
6/7/2012	Agency indicated it was using a new document storage system, OnBase, and could provide access to the APA.
6/7/2012	The APA requested access for APA staff working on the CAFR and Single Audit.
6/8/2012	Agency indicated access would not be provided; instead, documents would be provided electronically.
6/8/2012	The APA requested 'inquiry only" access to OnBase for all APA staff.
6/19/2012	Agency denied access to OnBase and indicated it would provide documents as noted on 6/8/2012.

Date	APA Request/ Agency Response
7/2/2012	Agency provided the APA with an OnBase demonstration so the APA could understand the capabilities of the system.
7/17/2012	The APA requested that the Agency reconsider and provide the APA with "inquiry only" access.
7/20/2012	Agency CEO stated the APA would be provided with "inquiry only" access to OnBase. The APA was to arrange the access with the Agency COO.
7/24/2012	The APA provided a listing of APA staff to the Agency COO for "inquiry only" access to OnBase.
7/24/2012	Agency COO indicated the "inquiry only" access was requested and would let the APA know when it was set up.
8/14/2012	The APA followed up with the Agency COO to determine the status of the "inquiry only" access.
8/14/2012	Agency COO indicated the Agency was still working on the access request.
8/21/2012	Agency COO updated the APA that the Agency was still working on the access request.
9/5/2012	The APA questioned why the access was taking so long.
9/6/2012	The APA requested a meeting with the Agency CEO to discuss access.
9/6/2012	Agency COO indicated the Agency was trying to address the request and that the Agency Internal Auditor would walk the APA through the work that had been done. The APA and Agency set a meeting for 9/21/2012.
9/10/2012	As the 9/6/2012 request for a meeting went unanswered, the APA again requested a meeting with the Agency CEO to discuss access.
9/11/2012	The APA met with the Agency CEO and COO to discuss access.
9/13/2012	The APA again requested "inquiry only" access to OnBase.
9/21/2012	APA staff met with Agency for OnBase training. Agency indicated it had passwords for APA staff but needed confidentiality agreements signed.
10/5/2012	The APA sent a letter to the Agency CEO indicating an examination of agency records contained within OnBase would be conducted beginning October 16, 2012.
10/5/2012	Agency indicated the APA's access would be provided by October 19, 2012.
10/19/2012	APA received OnBase IDs and passwords for two staff persons.

According to the Nebraska Attorney General, an agency's compliance with a statutory directive requiring access to records for audit purposes must occur within "a time frame that is reasonable under the circumstances." As the above chronology reveals, the Agency's refusal to comply with the APA's repeated requests for access to OnBase was unreasonable under any circumstances. Thus, the Agency clearly failed to comply with § 84-305.

Accounts Receivable and Accounts Payable Testing

The annual State CAFR is supposed to be completed by December 31 of the reporting year in order for the State to receive the Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association (GFOA). In order to ensure completion by December 31, the Department of Administrative Services State Accounting Division (State Accounting) requested all agencies to submit their accounts receivable and accounts payables (accruals) by August 6, 2012.

Unexplainably, despite being well aware of State Accounting's request, the Agency did not submit its accruals until October 12, 2012, more than two months late. During subsequent testing of accruals, moreover, the Agency delayed compliance with the APA's requests for information for up to 46 days. The APA had to follow up repeatedly on all outstanding requests in order to obtain the documentation necessary to complete testing.

Given that the Agency calculates all of its accruals prior to submission to State Accounting, the information requested by the APA should have been readily available. It is unknown why the Agency continually delayed, for over six weeks, complying with the APA's request for information.

As a direct result of the Agency's two-month delay in submitting its accruals to State Accounting, as well as the ongoing delays by the Agency to provide the APA with support in a timely manner, the APA was unable to complete the testing of the Agency's accruals until December 13, 2012.

When the Agency does not submit needed information timely to State Accounting or to the auditors, there is an increased risk the CAFR will not be completed by December 31.

> We recommend the Agency ensure all financial system access is provided to the APA in compliance with § 84-305. We also recommend the Agency work to ensure supporting documentation is provided promptly upon request by the auditors.

Agency's Response: The Department does not agree with the APA's statements and conclusions. The Department would like to point out the following facts related to this complaint:

- *The APA requested supporting documentation on June 4, 2012. The Department provided the requested documentation in early July. The APA's complaint is not based on <u>whether</u> the Department provided the requested supporting documentation but rather on <u>how</u> the Department provides the APA the requested supporting documentation.*

- *The APA was able to complete the testing of Department's accruals by December 13, 2012 which is 18 days prior to the deadline for the State to receive the Certificate of Achievement for Excellence in Financial Reporting from the Government Financing Officers Association.*

- *Neb. Rev. Stat. § 84-304 (3) states the APA is only authorized to conduct audits and examinations in accordance with Government Auditing Standards. The Department believes that the APA's request for access to every type of transaction in the OnBase system including employee performance evaluations, background checks, charitable donations, educational transcripts and other non-financial information is not consistent with those auditing standards.*

- *Government Auditing Standards contains no guidance related to timeliness of providing information to an auditor. Whatever may be the APA's concern about timeliness of the response; it is not consistent with the standards applicable to the audit and did not inhibit the APA in completing the audit.*

APA Response: DHHS errs in asserting that no guidelines exist "related to timeliness of providing information to an auditor." The APA is required to assess delays and denial of access when performing audits in accordance with AU § 316.68,

> ***"The auditors assessment of the risks of material misstatement due to fraud should be ongoing throughout the audit. Conditions may be identified during fieldwork that change or support a judgment regarding the assessment of the risks, such as the following:***
>
> - ***Unusual delays by the entity in providing requested information,***
> - ***Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques."***

The Nebraska Attorney General has also weighed in on the matter. Op. Att'y Gen. No. 07004 (Feb. 9, 2007) states that an agency's compliance with a statutory directive requiring access to records for audit purposes must occur within "a time frame that is reasonable under the circumstances." The intentional delay of almost five months by DHHS in granting the APA direct access to requested audit documentation is unreasonable under any circumstances.

* * * * *

Our audit procedures are designed primarily on a test basis and, therefore, may not bring to light all weaknesses in policies or procedures that may exist. Our objective is, however, to use our knowledge of the Agency and its interaction with other State agencies and administrative departments gained during our work to make comments and suggestions that we hope will be useful to the Agency.

This report is intended solely for the information and use of the Agency, the Governor and State Legislature, others within the Agency, Federal awarding agencies, pass-through entities, and management of the State of Nebraska and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

SIGNED ORIGINAL ON FILE

Pat Reding, CPA, CFE
Assistant Deputy Auditor