NEBRASKA AUDITOR OF PUBLIC ACCOUNTS

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State Auditor

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February 12, 2014

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 (State) as of and for the year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America and standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and have issued our report thereon dated December 30, 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 (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) and Comment Number 2 (Agency Interference with Audit) to be significant deficiencies.

These comments 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 management with an opportunity to review the comments and recommendations contained herein. 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, 2013.

1. <u>Accrual Information</u>

The Department of Administrative Services State Accounting Division (State Accounting) generates the Comprehensive Annual Financial Report (CAFR) annually. In order for the State to receive the Government Finance Officers Association (GFOA) Certificate of Achievement for Excellence in Financial Reporting, the CAFR needed to be completed by December 31, 2013. State Accounting required all State agencies to determine and report payable and receivable amounts at the end of the fiscal year on an accrual response form due by August 6, 2013. A good internal control plan requires procedures to accurately report financial information to State Accounting in a timely manner.

Throughout the audit, several items were not accurately reported or submitted timely to State Accounting. Consequently, substantial audit adjustments were needed to ensure the financial statements were materially correct. First and foremost, the Agency did not submit its accrual response form to State Accounting until October 10, 2013, more than two months late. The Agency has had significant issues with its accrual calculations in the past and, as noted below, those issues were not resolved.

We noted the following concerning payables and receivables reported by the Agency to State Accounting:

Description	Accrual Type	Error	Amount
Intergovernmental	Payable	Understated	$ 13,643,401
Intergovernmental	Receivable	Understated	$ 7,386,588
Patient and County Billings	Receivable	Overstated	$ 4,364,168
NFOCUS	Receivable	Overstated	$ 1,282,253
Medicaid Drug Rebate	Receivable	Understated	$ 950,275
Women, Infants, & Children	Payable	Overstated	$ 761,364
Third Party Liability	Receivable	Overstated	$ 134,875
Medicaid Estate Recovery	Receivable	Overstated	$ 25,084
SCHIP-State/Federal Share	Payable	Over/Understated	$ 11,227

Additional information is as follows:

- The Agency determines amounts due to and from the Federal government and reports the payable and receivable to State Accounting for the CAFR. The payable and receivable were understated by $13,643,401 and $7,386,588, respectively. The understatements were caused by calculation errors in the spreadsheet, a misunderstanding of how to calculate the amounts, and information not properly updated from the prior year. The Agency provided three different versions of the calculation and took over one month to determine the proper figures after the Auditor of Public Accounts (APA) first questioned the support provided.

- The patient and county billings receivable was overstated by $4,364,168. The receivable was calculated for the Lincoln, Norfolk, and Hastings Regional Centers, the Beatrice State Developmental Center (BSDC), and the Developmental Disabilities program. The overstatement was caused by the following:

    - The Agency erroneously included State funding at BSDC totaling $3,116,465. The same error was reported during the prior audit.

    - Allowances for doubtful accounts were not considered, were not complete, or were not reasonably documented, and the Agency was unable to provide support for collection agency balances in a timely manner. The Agency did not provide support until December 16, 2013. A similar finding was noted during the prior audit.

    - Fourteen of 25 patient balances tested were not pursued by the Agency for collection or write off in a timely manner. For 13 of those 14 balances, either the entire balance or a portion thereof was not properly reported as a receivable, causing an overstatement of $221,943. A similar finding was noted during the prior audit.

- The NFOCUS receivable was overstated by $1,282,253. The receivable consisted 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 did not expect to collect on the balances. Lastly, the Agency did not have support for the Child Care allocation percentages between State and Federal funds. A similar finding was noted during the prior audit.

- The Medicaid drug rebate receivable was understated by $950,275. Medicaid drug rebates were established by law to require drug manufacturers to provide rebates for their drug products paid for by Medicaid. The following errors were noted:

  - The Agency did not properly update the spreadsheet used to calculate the receivable from the prior year, causing an overstatement of $1,781,910.

  - The physician-administered rebates for the 4th quarter in 2012 were not properly reported, overstating the receivable by $2,888,607.

  - The Agency did not include estimates for physician-administered rebates for the 1st and 2nd quarters in 2013 not yet billed, causing the receivable to be understated by $2,313,365. The same error was reported during the prior audit.

  - The Agency began billing for managed care organization physician-administered rebates in August 2013; however, the Agency did not include this in the calculation, understating the receivable by $3,307,427.

- The Women, Infants, and Children (WIC) payable to individuals and the corresponding receivable from the Federal government were overstated by $761,364. The Agency reported a payable of $1,032,830; however, $761,364 was already on hand to pay claims and, therefore, would not be necessary from the Federal government. Therefore, the payable should have been reported at $271,466.

- The third party liability receivable was overstated by $134,875. 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:

  - 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, the Agency acknowledged continuing to attempt to collect them. The APA was unable to determine the total amount of these accounts, as a comprehensive listing was not available. For 1 of 10 account balances tested, the amount reported did not agree to the Medicaid system due to the balance over two years old being excluded, causing an understatement of $196,848. A similar finding was noted during the prior audit.

- For 2 of 10 balances tested, the accounts receivable balance was incorrect, resulting in an overstated receivable amount of $331,723.

- The Agency lacked adequate policies and procedures to pursue collections for payments made directly to a client instead of to Medicaid. The Agency did not create a submittal for the client, similar to procedures for insurance companies and attorneys, to ensure all possible avenues are pursued for collection of outstanding balances.

- The Medicaid estate recovery receivable was overstated by $25,084. The receivable is based upon claims filed against the estates of deceased persons who received Medicaid assistance. For 1 of 10 account balances tested, the claim was not properly recorded. The estate had sent a letter establishing the balance to be paid to the Agency; however, the Agency did not adjust the balance timely, causing an overstatement. A similar finding was noted during the prior audit.

- The State Children's Health Insurance Program (SCHIP) payable was incorrectly calculated, causing the State share to be overstated and the Federal share to be understated by $11,227.

In addition to accruals being incorrectly reported to State Accounting, the following information provided by the Agency for the CAFR was also improper:

- The Agency has trust fund activity that is reported as Agency funds for the State. For one of three trust funds tested, the additions and reductions were overstated by $3,721,499.

- The Agency did not provide accurate support to the APA for the State Ward Education payable. The payable reported by the Agency totaled $5,179,718, which agreed to the spreadsheet provided. However, when testing was performed, it was determined $4,060,489 was not accurately included in the accrual support. After the APA questioned the information, the Agency and State Accounting provided revised support. The inaccurate information provided caused delays of over 50 days to resolve the differences and review the revised support.

State Accounting did make correcting entries for all material amounts, as recommended by the APA.

Without adequate processes and procedures in place to ensure the accuracy of the CAFR, there is a greater risk material misstatements may occur and remain undetected. Furthermore, when information is not submitted to the APA on a timely basis, there is an increased risk the CAFR will not be completed by December 31, in accordance with the GFOA requirements.

> We recommend the Agency implement procedures to ensure information is complete, accurate, and submitted timely to the auditors. The Agency should also have procedures in place for a secondary review to verify the information is supported, reasonable, and accurate. We also recommend the Agency establish policies and procedures to ensure third-party liability collections are pursued against clients.

Agency Response: The Department will request its Internal Audit Section to review the current processes and procedures related to preparing the accrual information. The review will include the recommendations for enhanced procedures including secondary review procedures to reduce the likelihood of these errors occurring in the future. The Department will also work with the Department of Administrative Services Accounting Division to develop more compatible deadlines for completion of the accrual information.

2. <u>Agency Interference with Audit</u>

Neb. Rev. Stat. §§ 84-304(3) & (9) (Supp. 2013) direct the APA to conduct audits and examinations in accordance with the government auditing standards promulgated by the Comptroller General of the United States. The 2011 revision of those standards contain numerous directives regarding the necessity of maintaining and preserving auditor independence. For instance, Chapter 3.02 of the standards mandates:

> *In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be independent.*

Additionally, the American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards, which the Comptroller General's auditing standards incorporate by reference, emphasize the importance of making independent inquiries of individuals within an audited entity. Specifically, AICPA AU-C 240, paragraph .18, provides:

> *The auditor should make inquiries of management, and others within the entity as appropriate, to determine whether they have knowledge of any actual, suspected, or alleged fraud affecting the entity.*

Paragraph .A17 of that same section explains:

> *Inquiries of management and others within the entity are generally most effective when they involve an in-person discussion.*

Paragraph .A18 addresses in detail the importance of interviewing individuals other than management – both pointing out the danger of relying solely upon management responses to audit inquiries and stressing the need to have alternative sources for audit information:

> *The auditor's inquiries of management may provide useful information concerning the risks of material misstatements in the financial statements resulting from employee fraud. However, such inquiries are unlikely to provide useful information regarding the risks of material misstatement in the financial statements resulting from management fraud. Making inquiries of others within the entity, in addition to management, may provide individuals with an opportunity to convey information to the auditor that may not otherwise be communicated. It may be useful in providing the auditor with a perspective that is different from that of individuals in the financial reporting process. The responses to these other inquiries might serve to corroborate responses received from management or, alternatively, might provide information regarding the possibility of management override of controls. The auditor may also obtain information about how effectively management has communicated standards of ethical behavior throughout the organization.*

Paragraph .A19 offers specific examples of the types of individuals who should be subject to personal audit interviews:

Examples of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include the following:

Operating personnel not directly involved in the financial reporting process

Employees with different levels of authority

Employees involved in initiating, processing, or recording complex or unusual transactions and those who supervise or monitor such employees

In-house legal counsel

Chief ethics officer or equivalent person

The person or persons charged with dealing with allegations of fraud

Finally, paragraph .A20 warns that auditors may need to seek independent verification of any responses provided by management:

Management is often in the best position to perpetrate fraud. Accordingly, when evaluating management's responses to inquiries with professional skepticism, the auditor may judge it necessary to corroborate responses to inquiries with other information.

Despite the obvious significance given in the government auditing standards to both auditor independence and the utility of direct auditor access to employees outside of management, the Agency took deliberate steps to impede both during the course of the present audit.

While carrying out their audit fieldwork, the auditors became aware of a June 28, 2013, memo that Matthew G. Clough, the Chief Operating Officer for the Agency, had issued to the agency's employees. (See Exhibit A) That communiqué set out a series of guidelines that, if followed, would effectively prevent the APA from receiving confidential, or even unfiltered, information from Agency employees – including from potential whistleblowers.

Among the memo's requirements were the following:

When an auditor makes contact with any DHHS employee regarding an audit, the DHHS Internal Auditor must be notified as soon as possible.

Inquiries from auditors should be directed towards and responded to by DHHS employees at the Manager or Administrator level or above. Managers may delegate certain responses at the Manager's discretion to staff but the Manager must be consulted prior to the response being provided AND the Manager must be copied on the response.

If you [a DHHS employee] receive an inquiry from an auditor and did not have prior contact from the DHHS Internal Auditor regarding the purpose of the inquiry (or if the dhhs.singleaudit@nebraska.gov was not copied on the inquiry), you should contact the DHHS Internal Auditor PRIOR to responding to the auditor.

Upon learning of the memo's existence, the APA contacted Mr. Clough, objecting to the obvious attempt to restrict direct auditor communications with Agency employees. In doing so, the APA emphasized the resulting harmful impact of the new agency guidelines upon the ability of the auditors both to maintain their independence and to obtain potentially crucial audit evidence – unaltered or uncensored by management – directly from those workers with the most relevant information.

The APA's concerns are clearly supported by the government auditing standards referenced under § 84-304. Nevertheless, the APA attempted to cooperate with the Agency by offering suggestions for revising the guidelines so as to retain management's control of employee activity without infringing upon auditor independence and the ability to carry out confidential or unsupervised interviews. Despite professing a willingness to work with the APA in modifying the guidelines the Agency made no changes.

By denying the APA direct and unrestricted access to, as well as confidential correspondence with, various personnel, Agency management interfered with the audit. As long as the Agency insists upon monitoring, and possibly even revising, employee responses to audit inquires, the APA will be prevented from exercising full audit authority pursuant to relevant government auditing standards.

> We recommend that Agency management withdraw immediately the memo at issue, revoking any impediments to unrestricted and unmonitored auditor access to Agency employees.

Agency Response: The Department does not agree with the APA's conclusion and recommendation. In an attestation report issued on September 7, 2011, the APA cited a "lack of cooperation by DHHS" due to "numerous examples of DHHS's failure to respond either timely or completely, or both, to requests for information." The APA recommended that "DHHS implement procedures to ensure all information requested by the APA is provided in a timely manner." In response to the APA recommendation, the Department issued policies and procedures in June 2012 to improve the Department's responses to audit requests. The Department also hired an Internal Auditor to serve as the point of contact for all federal or state audits. These same procedures are being used for all audits and no federal auditors have stated that these procedures impede their audit; rather several have stated that the procedures enhance the audit process and make it more efficient. Unilaterally the APA has chosen to conduct its audit process outside these procedures. The Department would also point out that these same procedures were in place for the previous year's CAFR audit, and the APA did not cite any concerns.

Throughout the APA's summary, the APA makes strong implications that Department management has interfered with the APA receiving confidential, or even unfiltered, information from Department employees. The APA's implications stop just short of allegations of fraud. The Department strongly objects to the APA's implications.

APA Response: The effort to prevent the APA from obtaining unofficial communications from Agency staff constitutes an interference with the audit process – one which has required the APA to conduct the audit process "unilaterally," as the Agency alleges, outside of the unacceptable procedures. The APA has provided certain relevant auditing standards with which the Agency's memo, requiring all APA communications to go through the Internal Auditor, is impossible to reconcile. Thus, while not reporting findings of alleged fraud, the Agency's actions remain clearly improper nonetheless. It is critically important that the APA be able to communicate directly with the persons handling transactions to verify the processes are in place.

The APA first became aware of the Department's memo in August 2013. While a similar memo was cited as existing in prior years, Agency management never brought the procedures to the APA's attention, which would explain why that document was not an issue in the previous year's CAFR audit.

As for the supposed failure of federal auditors to object to the Agency's interference, the APA considers wholly irrelevant any such occurrence. The APA is subject to periodic Quality Control Reviews to ensure both adherence to applicable auditing standards and the proper performance of official duties. The same federal auditors whom the Agency claims to be indifferent to audit interference have participated in the Quality Control Reviews of this office, examining closely our audit reports and working papers in the process. The most recent such review was completed on August 16, 2013, and, like all of its predecessors, commended our work. The review reports can be found on the APA's website.

In addition, the notion that the memo in question was created as a corrective response to a prior audit finding is implausible. In the 2011 attestation report comment referenced by the Agency, the APA objected to numerous unreasonable delays in responding to auditor requests for documentation. That repeated lack of responsiveness did not result from a mere lack of coordination on the part of the Agency. Rather, the APA believes the frequency of the delays to have been indicative of an overall pattern of intentional noncooperation with the audit work. Instead of providing any sort of relief, the current memo and the unacceptable procedures that it implements have further exacerbated the APA's difficulty in obtaining needed audit documentation.

3. <u>Improper Recording of Federal Reimbursements</u>

According to Chapter 9, "Revenue Recognition in Governmental Funds, Intergovernmental Revenues," of Governmental Accounting, Auditing, and Financial Reporting (GAAFR), published by the Government Finance Officers Association:

> *Intergovernmental revenues can be broadly divided between entitlements and share revenues (typically formula grants) and expenditure-driven grants (reimbursement-type grants).*

A good internal control plan requires policies and procedures to ensure revenues are properly recorded for financial statement presentation.

The Agency's Division of Veterans' Homes received per diem reimbursements totaling $18,883,705 from the Federal government during the fiscal year ended June 30, 2013. The per diem reimbursements were calculated based upon the number of veterans the Agency provided care for or the cost of the care, whichever was less. The Agency recorded the reimbursements into its Federal funds as sales and charges instead of intergovernmental revenues. These revenue classifications were separately reported in the financial statements for the CAFR. Therefore, State Accounting made the appropriate adjustment, as suggested by the APA, for the miscoding to ensure the financial statements were materially correct.

Although unable to provide an adequate explanation for why the per diem reimbursements were recorded as sales and charges, the Agency insisted the coding was correct and disagreed with the adjustment.

> We recommend the Agency ensure Federal reimbursements are properly recorded as intergovernmental revenues for the proper presentation of the financial statements.

Agency Response: The Department does not agree with the APA's conclusion and recommendation. The Department believes that these federal dollars were compensation for room and board services provided by the Department to veterans and thus recording these receipts as sales and charges is appropriate. Furthermore, the Department believes that the intergovernmental revenue account suggested by the APA is for recording grant receipts received by the Federal Government. These receipts are not considered grants and thus the Department believes that recording these receipts as intergovernmental revenue would not be appropriate. Finally, the Department believes it has provided an adequate explanation to the APA for why the per diem reimbursements were recorded as sales and charges.

APA Response: The Federal dollars received by the Agency are considered Federal grants and the expenditures from the program are recorded as Federal aid on the Schedule of Expenditures of Federal Awards (SEFA). According to accounting guidance, the revenues should be recognized as intergovernmental revenues. Therefore, the APA recommended an adjustment to the financial statements and State Accounting agreed.

4. Inadequate Support for Use of Federal Funds

OMB Circular A-87, Attachment A, § C(1)(j), requires costs to be adequately documented in order to be allowable under Federal awards.

Furthermore, OMB Circular A-87, Attachment A, § C(3)(c), states:

> *Any cost allocable to a particular Federal award or cost objective under the principles provided for in this Circular may not be charged to other Federal awards to overcome fund deficiencies, to avoid restrictions imposed by law or terms of the Federal awards, or for other reasons.*

A good internal control plan requires proper accounting records and reconciliations to be performed timely to ensure Federal monies are spent in accordance with Federal awards.

The Agency performed an accounting entry during the fiscal year that lacked support for the proper use of Federal funds. The entry recorded $1,150,600 of Federal monies to what the Agency called "miscellaneous Federal grants and projects," for postage and communication expenses. Per discussions with the Agency, there remained an unknown balance in a Federal fund with no attached Federal grant. The balance was converted to the current State Accounting system in 2003 from the old Nebraska Accounting System (NAS).

The Agency did not attempt to determine what Federal award(s) the fund balance was for until fiscal year 2013, more than 10 years later. Since adequate documentation was not on file, it was unknown what the funds consisted of and whether the expenditures for postage and communication were allowable per the original grant(s) requirements. Use of Federal funds for unallowable expenditures could require repayment to the Federal government.

> We recommend the Agency ensure all fund balances contained in the accounting system are adequately monitored and supported for allowable use.

Agency Response: The Department does not agree with the comments made by the APA. The Department has made attempts over the past ten years to determine the source of these Federal funds. The Department has concluded these funds were deposited in a Federal cash fund more than ten years ago and in all likelihood were brought into the Department during the merger of 1996. We believe these funds are most likely reimbursements or monies earned by the Department in previous years from Federal sources and therefore belong to the Department. The accounting system used by the Departments involved in that merger is no longer available.

APA Response: The Agency was unable to provide any documentation to support the Federal funds were researched prior to the journal entry or that the funds belonged to the Agency.

5. Quality Assurance Assessment Tax

Neb. Rev. Stat. § 68-1917 (Cum. Supp. 2012) states, in relevant part:

> *[E]ach nursing facility or skilled nursing facility licensed under the Health Care Facility Licensure Act shall pay a quality assurance assessment based on total resident days, including bed-hold days, less medicare days, for the purpose of improving the quality of nursing facility or skilled nursing facility care in this state. The assessment shall be three dollars and fifty cents for each resident day for the preceding calendar quarter.*

To ensure the correct tax amount is remitted to the Agency, a good internal control plan requires procedures to be in place for ascertaining the reasonableness of the number of resident days reported.

The Agency did not have adequate policies and procedures in place to verify that the quality assurance assessment tax was paid in accordance with State statute.

Nursing facilities submitted quarterly reports of Medicaid patient days, which were used to determine the quality assurance assessment tax. The Agency reviewed those quarterly reports and compared the days reported to each facility's annual cost report, which showed total patient days for Medicaid and Medicare recipients. Typically, the cost report would be greater for patient days due to the Medicare recipients who are not included in the quarterly reports for the tax assessment.

Aside from identifying the variances between the quarterly and annual cost reports, the Agency performed no additional research to ensure the reasonableness of the number of Medicaid days reported. For one facility, the APA noted a 30,632 day difference between the quarterly reports and the cost report, which the Agency chose not to investigate. Per discussions with the Agency, a review of the facilities' census reports could offer a sufficient indication of whether the days reported and used in the calculation of the tax assessment were reasonable. However, the census reports were not reviewed during the fiscal year.

During fiscal year 2013, the Agency collected $13,480,621 for the tax assessment.

Without procedures to ensure the number of patient Medicaid days is correct, there is an increased risk the quality assurance assessment tax received by the Agency will not be paid in the amount required by State statute.

> We recommend the Agency implement policies and procedures to ensure the number of resident days is correct and, therefore, the tax assessment is paid in accordance with State statute.

Agency Response: The Department does not agree with comments made by the APA. The APA noted a 30,632 day difference between the quarterly reports and the cost report and stated that the Department chose not to investigate. The Department would point out that the quarterly report is for the entire facility where as the cost report is just for those beds in the facility that are certified as Medicaid only so reconciling those amounts would not be appropriate. The Department will investigate the feasibility of reviewing the facilities' census reports to determine if the days reported and used in the calculation of the tax assessment is reasonable.

6. Lack of Adequate Collateral for Trust Fund Deposits

Neb. Rev. Stat. § 77-2395(1) (Reissue 2009) states, in relevant part:

> *[T]he custodial official shall not have on deposit in such depository any public money or public funds in excess of the amount insured or guaranteed by the Federal Deposit Insurance Corporation, unless and until the depository has furnished to the custodial official securities, the market value of which are in an amount not less than one hundred two percent of the amount on deposit which is in excess of the amount so insured or guaranteed.*

A good internal control plan requires policies and procedures for the review of depository fund balances in excess of the Federal Deposit Insurance Corporation's (FDIC) $250,000 limit to confirm they are properly collateralized.

Prior to January 1, 2013, the non-interest bearing accounts were covered in full under the Transaction Account Guarantee Program (TAGP). However, that program ended on December 31, 2012, at which time the Agency was required to obtain collateral for amounts greater than the FDIC coverage. During the audit, we requested documentation that the Agency's trust fund depository accounts had adequate collateral for balances in excess of the FDIC limit.

For one of three accounts tested, we determined no collateral was obtained for the balance above the FDIC limit. As of June 30, 2013, the balance of that account was $341,081, which was $91,081 above the FDIC coverage. We also reviewed each monthly balance of that same account from January 1, 2013, through June 30, 2013, and noted the balances above $250,000 ranged from $306,707 to $642,790, or unsecured balances of $56,707 to $392,790.

When bank balances are not adequately collateralized, the Agency increases the risk of loss of funds and is not in compliance with State statute.

> We recommend the Agency establish policies and procedures for the regular monitoring of bank balances to ensure adequate pledged collateral is established to protect the Agency's funds in accordance with State statute.

Agency Response: The Department will develop and implement procedures to ensure that adequate pledged collateral is established for trust fund depository accounts with balances in excess of the FDIC limits.

7. <u>Improper Federal Medicaid Assistance Percentages</u>

Title 42 CFR § 433.10(a) addresses "payments to States, on the basis of a Federal medical assistance percentage [FMAP], for part of their expenditures for services under an approved State plan." The FMAP is designed so the Federal government pays a larger portion of Medicaid costs in States with lower per capita incomes relative to the national average.

In the prior Single Audit, it was noted the Agency did not properly adjust the FMAP percentage in its Medicaid system at the beginning of the Federal fiscal year 2012. Instead, the 2011 rate was used, causing a Federal overcharge of $1,209,492. When performing a correcting entry during the current fiscal year to remedy that error, the Agency erroneously included transactions that had been recorded at the proper rate, which resulted in a Federal undercharge of $208,228. Furthermore, during our review of the correcting entry, we noted one line item was incorrectly recorded, producing an overcharge of $39.

According to the Agency, the FMAP rate is not updated in the system until a few weeks after the new grant award is received. This resulted in a timing issue for payments recorded to the old FMAP rate. The Agency did not have procedures for reviewing the transactions during this period and making correcting entries.

Without adequate policies and procedures for the timely update of system rates or the review and correction of errors relating thereto, there is an increased risk payments will not be properly recorded to the Federal grant, causing over or under charges.

> We recommend the Agency ensure the FMAP rate is updated timely in the system or perform procedures to ensure transactions applied with the improper rate are properly corrected.

Agency Response: The Department will develop procedures for changing FMAP rates in MMIS. These procedures will include a process for reviewing and adjusting transactions during the period between the effective date of the FMAP change and the date the change is made in MMIS.

* * * * *

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 communication is intended solely for the information and use of management, the Governor and State Legislature, and others within the Agency and is not intended to be, and should not be, used by anyone other than these specified parties. However, this communication is a matter of public record, and its distribution is not limited.

SIGNED ORIGINAL ON FILE

Pat Reding, CPA, CFE
Assistant Deputy Auditor

EXHIBIT A

Department of Health & Human Services

DHHS

NEBRASKA

Matthew G. Clough
Chief Operating Officer

State of Nebraska
Dave Heineman, Governor

June 28, 2013

To: All DHHS Staff

From: Matthew G. Clough, Chief Operating Officer

Subject: Federal and State Audit Policies

With the end of the State Fiscal Year upon us (June 30, 2013), the State Auditor's Office will be conducting the Annual State-wide Single Audit. For several areas of DHHS, the Auditor's Office has begun preliminary audit procedures. The State-wide Single Audit is required to be issued by March 31, 2014 and auditors will be working with us up until that date. In addition, we have several different Federal Agencies conducting audits, reviews, and site visits related to Federal grants and programs. With all of this going on, it is important to remind each of you of the Department's policies and procedures regarding **ALL** Federal and State audit activity. Timely and acurate communication and responses to all audit inquiries and questions is imperitive. The Department's Internal Auditor (Kevin Nelson, CPA) is responsible for coordinating all Federal and State audits and can assist you with any audit related questions. Please keep in mind that while I am using the generic term of "audit", for purposes of this policy an "audit" can encompass any audit, review, attestation, site visit, etc. in which a Federal or State official is reviewing one or more of our programs with the purpose of issuing a report that may contain findings requiring a corrective action plan. Also, bear in mind that "auditor" would relate to either a Federal or State official.

1. When an auditor makes contact with any DHHS employee regarding an audit, the DHHS Internal Auditor must be notified as soon as possible.
2. An engagement letter stating the purpose and estimated beginning of the audit is required to be provided to the Department PRIOR to the beginning of fieldwork. A copy of the engagement letter must be provided to the DHHS Internal Auditor.
3. The DHHS Internal Auditor must be invited to the entrance and exit conferences at the beginning and end of fieldwork.
4. Inquiries from auditors should be directed towards and responded to by DHHS employees at the Manager or Administrator level or above. Managers may delegate certain responses at the Managers discretion to staff but the Manager must be consulted prior to the response being provided AND the Manager must be copied on the response.
5. If you receive an inquiry from an auditor and did not have prior contact from the DHHS Internal Auditor regarding the purpose of the inquiry (or if the dhhs.singleaudit@nebraska.gov was not copied on the inquiry), you should contact the DHHS Internal Auditor PRIOR to responding to the auditor.
6. In order for us to work with greater unison as a team, written communication with auditors is preferred.
7. If you have any questions regarding what the auditor is asking or if you have concerns with how to respond to the request, the DHHS Internal Auditor should be contacted prior to communicating with the auditor.

8. All e-mails to auditors must be copied to dhhs.singleaudit@nebraska.gov. The DHHS Internal Auditor monitors the e-mails coming into this account.
9. Supporting documentation should be provided electronically to auditors whenever possible. If electronic documentation is not possible or reasonable, you may provide the auditors copies of original documentation or the auditors may review original documentation at one of our offices. Maintaining control of the original documents insures that our files stay orderly and complete. Under no circumstances, should original documentation leave the premises of DHHS. Premises of DHHS does NOT include the Auditor's Office on the 5th floor of the Nebraska State Office Building.
10. Before providing access to DHHS software or applications (i.e. EnterpriseOne, OnBase, Workday, NFOCUS) prior approval of the DHHS Internal Auditor is required.
11. If there is an audit finding you should consult with the DHHS Internal Auditor regarding the finding and any corrective action plan.
12. A copy of auditors final report should be provided to the DHHS Internal Auditor as well as any response to the report or any corrective action plans.

If you have any questions regarding audit activity within the Department, please contact:
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kevin.r.nelson@nebraska.gov;