

Annual Audit Agenda

June 30, 2009



Georgia Department of
Community Health

Audited and Reported by a Joint Venture of Firms



Certified Public Accountants

**MAULDIN
& JENKINS**
CERTIFIED PUBLIC ACCOUNTANTS, LLC

GEORGIA DEPARTMENT OF COMMUNITY HEALTH

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PURPOSE OF AGENDA

To share information about the *engagement team*.

To address the overall *independent auditors' report* relative to fiscal year 2009.

To provide a *summary overview of the financial statements & footnotes* of fiscal year 2009.

To address certain *required communications* related to the fiscal year 2009 engagement.

To provide summarizations of *findings and management letter comments* related to the fiscal year 2009 engagement.

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ENGAGEMENT TEAM

Metcalf Davis / Mauldin & Jenkins:

- Large regional joint venture audit organization serving the Southeastern United States.
- Offices located in Atlanta, Macon, Albany and Birmingham.
- Serve more governmental entities in Georgia than any other certified public accounting firm requiring over 60,000 hours of service on an annual basis. Provider of over 250,000 hours of service to all clients on an annual basis.
- Firms are the auditor of a very large and substantial part of the State of Georgia including approximately 25% of the State's general fund, and the solid majority of the State of Georgia's component units, including the audit of the State of Georgia's Department of Audits & Accounts.
- Most recent auditor of over 160 total governmental entities in Georgia.

Engagement team leaders on the audit engagement include:

- **Dave Decker**, Engagement Partner - 21 years experience in serving governments, and lead partner in managing the audit of the Department of Community Health for the past 10 years.
- **Miller Edwards**, Engagement Partner - 24 years experience serving governments with 10 years experience auditing the Department of Community Health.
- **Matt Hill**, Manager (Compliance / Single Audit) - 11 years experience serving governments with 10 years experience auditing the Department of Community Health.
- **Donarene Steele**, Manager (Financial Audit) - 18 years experience serving governments with 5 years experience auditing the Department of Community Health.
- **Clayton Knox**, Manager - 8 years experience serving governments with 5 years experience auditing the Department of Community Health.
- **Greg Davis**, Quality Assurance Partner - 34 years experience serving governments with 10 years experience auditing the Department of Community Health.
- **Rodney Brown**, Quality Assurance Partner – 36 years experience serving governments with 9 years experience auditing the Department of Community Health.
- **Meredith Lipson**, Quality Assurance Partner (Compliance) – 20 years experience serving governments with 9 years experience auditing the Department of Community Health.
- **Billy Minch**, Quality Assurance Partner (Compliance) – 20 years experience serving governments with 10 years experience auditing the Department of Community Health.

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INDEPENDENT AUDITORS' REPORT

Significant excerpts from the Independent Auditors' Report include the following:

- A. **Scope:** “We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the State of Georgia’s Department of Community Health (hereinafter referred to as the “Department of Community Health”) as of and for the year ended June 30, 2009, which collectively comprise the Department of Community Health’s basic financial statements as listed in the table of contents.”

- B. **Your Responsibility:** “These financial statements are the responsibility of the Department of Community Health’s management.”

- C. **Our Responsibility:** “Our responsibility is to express opinions on these financial statements based on our audit.”

- D. **Audit Standards:** “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.”

- E. **Clean Opinion:** “In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Department of Community Health, as of June 30, 2009, and the respective changes in financial position, and where applicable, cash flows, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.”

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OVERVIEW OF FINANCIAL STATEMENTS AND FOOTNOTES

Statement of Net Assets (Page 4) – This statement is similar to a balance sheet, and presents the governmental and business-type activities of the Department of Community Health (hereinafter referred to as the “Department”) as of June 30, 2009. The statement is prepared under the full-accrual method of accounting and includes components for capital assets and long-term debt. The governmental activities are primarily the Medicaid activities of the Department, and the business-type activities surround the State Health Benefit Plan.

Significant elements to consider as of June 30, 2009 include:

- Cash and cash equivalents which amount to approximately \$288 million. As compared to the prior fiscal year, cash has been reduced by approximately \$390 million. Most of the cash reduction was in the State Health Benefit Plan.
- Receivables amount to approximately \$840 million, but this too is less than the prior year when such amounts were reported to be approximately \$1.13 billion.
- The statement reports no investments in these activities, yet in 2008 the State Health Benefit Plan reported investments of approximately \$127 million.
- Total assets amount to approximately \$1.13 billion versus the prior year approximation of \$1.89 billion. Therefore, total assets have been reduced by approximately \$760 million in the form of cash, investments and receivables.
- Liabilities include the usual items such as accounts payable and benefits payable. The more significant obligations include accounts payable and other accruals approximating \$154 million, and benefits payable approximating \$908 million. The benefits payable consists primarily of actuarially calculated amounts for the respective incurred-but-not-reported liabilities for the payment of claims.
- Total current liabilities approximated \$1.13 billion. As of June 30, 2008, current liabilities amounted to approximately \$1.27 billion. Current liabilities decreased by approximately \$140 million while assets decreased by approximately \$760 million. This caused net assets (a/k/a equity in the private sector) to decrease by approximately \$616 million bringing net assets to a deficit of \$2.5 million.

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Statement of Activities (Page 5) – This statement is intended to report the operations of the Department based on its primary functions and programs. It is reported on the full-accrual basis of accounting and is certainly a unique presentation as required by governmental financial reporting standards.

Significant elements to consider for the year ended June 30, 2009 include:

- Total expenses (first column) amounted to approximately \$10.86 billion.
- Program revenues (second and third columns) are those revenues received and earned that directly offset the functional expenses. Program revenues (charges for services and operating grants) amounted to approximately \$7.79 billion.
- The governmental activities primarily surround the Medicaid Program and Children's Health Insurance Program (CHIP) programs. Expenses increased over the prior year by approximately \$360 million going from \$8.29 billion to approximately \$8.65 billion. The offsetting program revenues also increased over the prior year by approximately \$900 million going from \$5.13 billion to approximately \$6.03 billion. Included in these program revenues is approximately \$500 million of federal funds provided by the American Recovery & Reinvestment Act (commonly referred to as ARRA).
- The business-type activities represent activities of the State Health Benefit Plan. Expenses increased over the prior year by approximately \$220 million going from \$1.99 billion to approximately \$2.21 billion. However, as substantially dictated by the State budgeting process, the offsetting program revenues decreased from that of the prior by approximately \$480 million going from \$2.24 billion to approximately \$1.76 billion.
- As designed and budgeted, the net effect of the above bullets reflects a net cost of \$3.07 billion (far right column & midway down) for which certain general revenues are needed to support the programs. At this point in the prior year's statement of activities, a net cost was also reported in the approximate amount of \$2.91 billion. Therefore, the net costs of providing the primary functions and programs of the Department increased by approximately \$160 million (or 6%) over the prior year.
- General revenues primarily include the State appropriations, other revenue collections, and intergovernmental transfers. There was a substantial reduction of State appropriations. In the prior year, appropriations amounted to approximately \$2.37 billion, and this year they approximated \$1.90 billion. This represents a reduction of State funding in the amount of approximately \$470 million. Other general revenues decreased by approximately 9% from that of the previous year.

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- The change in net assets (a/k/a net income or loss) amounted to approximately a \$617 million loss for the year ended June 30, 2009, and approximately \$473 million of that net loss was attributable to the State Health Benefit Plan.

General Fund Financial Statements (Pages 6 – 8) – Such statements include a balance sheet and a statement of revenues, expenditures and changes in fund balance. These statements follow accounting standards, and use the modified accrual method of accounting. Reconciliations from the modified accrual to full-accrual bases of accounting are reported at the bottom of page 6 and also on page 8.

Proprietary Fund Financial Statements (Pages 9 – 12) – Such statements include a statement of net assets and a statement of revenues, expenses and changes in net assets. These statements follow accounting standards, and use the full-accrual method of accounting. A statement of cash flows is included, and it reflects the sources and uses of cash and cash equivalents.

Fiduciary Fund Financial Statements (Pages 12 – 13) – Such statements include a statement of net assets and a statement of changes in fiduciary net assets relative to post employment health benefits. These statements follow accounting standards, and use the full-accrual method of accounting.

Footnotes (Pages 14 – 33) – The more significant footnotes are discussed below:

Note 1 – Summary of Significant Accounting Policies. This footnote discusses the overall Department, and the nature of its operations. This footnote also shares with the reader of the financial statements the significant accounting policies and principles utilized in the preparation of the financial statements.

Note 2 – Deposits and Investments. This footnote discloses common deposit and investment risks related to credit risk, concentration of credit risk, and interest rate risk. The footnote also addresses collateralization of bank deposits.

Note 3 – Accounts Receivable. Information regarding receivables and allowances for bad debts are discussed in this footnote.

Note 9 – Risk Management. This footnote provides details on how the Department manages risks for which it is exposed.

Note 11 – Georgia Retiree Health Benefit Fund (GRHBF). Substantial information is disclosed in this footnote about the Department's administration of the defined benefit post employment healthcare plan.

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Footnotes (Continued)

Note 12 – Retirement Systems. Disclosure is provided about the Department's participation in the various retirement plans administered by the State.

Note 14 – Subsequent Events. This footnote shares with readers the fact that there has been a reorganization of the Department to include all the public and long-term care regulation programs formerly provided through the Department of Human Resources. This note also shares the fact that the GRHBF has been split into two plans – one for State retirees and one for School retirees.

Required Supplementary Information (Pages 34 – 38) – Governmental Accounting Standards Board (GASB) pronouncements require certain supplemental information with the basic financial statements. A summary of this information is provided below:

Schedules of Funding Progress and Employer Contributions (Page 34). As required by GASB, information is disclosed regarding the State's other post employment benefit plan.

Budget Comparison Schedules, Reconciliations, and Notes (Pages 35 – 38). As required by GASB, this information attempts to share information regarding budget to actual amounts on a budget basis and then reconciled to generally accepted accounting principles.

Supplementary Information (Pages 39 – 41) – Additional budgetary information which the Department desired to include in the annual report is provided in this section.

OVERVIEW OF COMPLIANCE REPORTS

As part of the annual audit process, we have performed a substantial compliance audit and Single Audit of the programs which are federally funded. We have issued two reports which are required by *Government Auditing Standards* and they are in a separate package from the financial statements. As part of those reports, we have issued findings, conditions and management points which we have also included a summation of within this Audit Agenda.

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REQUIRED COMMUNICATIONS

The Auditor's Responsibility under Auditing Standards Generally Accepted in the United States of America and Government Auditing Standards

As previously stated in our agreement with the Department and as stated above, we would like everyone to understand our responsibility in connection with your audit.

Our audit of the financial statements of the Department for the year ended June 30, 2009, was conducted 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 financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department of Community Health's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the 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 opinions.

In accordance with *Government Auditing Standards*, we have also performed tests of controls and compliance with laws and regulations that contributed to the evidence supporting our opinion on the financial statements. However, they do not provide a basis for opining on the Department's internal control or compliance with laws and regulations.

Accounting Policies

Management has the ultimate responsibility for the appropriateness of the accounting policies used by the Department. There were no significant new accounting policies or standards implemented this year. There are new accounting standards which will be required to be implemented in the coming years. These are discussed later in this document.

In considering the qualitative aspects of the Department's accounting policies, we did not identify any significant or unusual transactions or significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. The Department's policies relative to the timing of recording of transactions are consistent with generally accepted accounting principles (GAAP) and typical government organizations.

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Management Judgments and Accounting Estimates

Accounting estimates are an integral part of the preparation of financial statements and are based upon management's current judgment. The process used by management encompasses their knowledge and experience about past and current events and certain assumptions about future events. Management has informed us they used all the relevant facts available to them at the time to make the best judgments about accounting estimates and we considered this information in the scope of our engagement. We considered this information along with the qualitative aspects of management's calculations in evaluating the Department's significant accounting estimates. Estimates significant to the financial statements include such items as the estimate for the valuation of benefit claims incurred but not reported, federal accounts receivable, over/under payment of claims, and allowance for doubtful accounts receivable.

Financial Statement Disclosures

The footnote disclosures to the financial statements are also an integral part of the financial statements. The process used by management to accumulate the information included in the disclosures was the same process used in accumulating the financial statements and the accounting policies described above are included in those disclosures. The overall neutrality, consistency, and clarity of the disclosures was considered as part our audit and in forming our opinion on the financial statements.

Significant Difficulties Encountered in Performing the Audit

Difficulties encountered in performing the audits are to include any serious difficulties that we encountered in dealing with management related to the performance of the audits. *Statements of Auditing Standards* issued by the American Institute of Certified Public Accountants (AICPA) defines "difficulties encountered" to include, but not limited to: unreasonable delays by management in providing needed information; unreasonable timetables set by management; and unavailability or lack of cooperation of client personnel in responding to appropriate audit inquiries.

We believe we received full cooperation of Department personnel, and believe we were given direct and unrestricted access to the Department's officials and the respective books and records. We experienced no significant difficulties (as defined in the above paragraph) in the performance of the fiscal year 2009 audit.

Audit Adjustments

As part of the Department's post-closing exercises, the Department made a significant amount of general ledger and financial statement adjustments. In accordance with GAAP, audit adjustments were necessary to properly reflect the Department's financial statements as of and for the fiscal year ended June 30, 2009.

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The following is a summary of the June 30, 2009 audit adjustments proposed and recorded in the **General Fund**:

Budgetary Entries

	Debits	Credits
Federal Receivables	\$ 18,330,438.00	
Accounts Receivable	6,521,100.00	
Benefits Expense	24,851,538.00	
Accounts Payable		\$ 24,851,538.00
Federal Government Grants		18,330,438.00
Other Intergovernmental Revenues		6,521,100.00

To accrue additional liabilities related to Upper Payment Limit identified during audit procedures.

Cash	500,000.00	
State Appropriation Receivable		500,000.00

To adjust State receivable to actual identified during audit procedures.

Encumbrances Payable	21,447,512.23	
Federal Government Grants	13,112,658.68	
Contracts Expense		21,447,512.23
Federal Receivables		13,112,658.68

To release encumbrances and adjust federal revenue for released encumbrances identified during audit procedures.

To record federal revenue adjustments for deleted encumbrances.

Federal Receivables	6,031,881.22	
Contracts Expense	6,031,881.22	
Interfund Payable		6,031,881.22
Federal Receivables		6,031,881.22

To accrue payables to Department of Human Resources identified during audit procedures.

Reserve for Encumbrances	21,447,512.23	
Fund Balance	1,241,327.39	
Fund Balance		4,681,525.55
Unreserved, Undesignated Fund Balance (Surplus)		18,007,314.07

To adjust reserves as identified during audit procedures.

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Budgetary Entries (Continued)

	Debits	Credits
Contracts Expense	\$ 21,447,512.23	
Federal Government Grants		\$ 13,112,658.68
Unreserved, Undesignated Fund Balance (Surplus)		8,334,853.55

To reclass reversal of prior period encumbrance.

GAAP Entries

	Debits	Credits
Federal Receivables	\$ 7,129,977.97	
Accounts Receivable	1,093,777.40	
Contracts Expense	4,425,867.25	
Benefits Expense	5,326,424.52	
Accounts Payable		\$ 9,752,291.77
Federal Government Grants		7,129,977.97
Other Intergovernmental Revenues		1,093,777.40

To accrue additional receivables and payables as identified during audit procedures.

Federal Receivables	24,914,737.43	
Benefits Expense	38,633,490.00	
Accounts Payable		38,633,490.00
Federal Government Grants		24,914,737.43

To accrue Disproportionate Share Hospital payments as identified during audit procedures.

Contracts Expense	21,447,512.23	
Federal Receivables	13,112,658.68	
Accounts Payable		21,447,512.23
Federal Government Grants		13,112,658.68

To reverse encumbrance releases and adjust federal revenue for related encumbrance reversals as identified during audit procedures.

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GAAP Entries (Continued)

	<u>Debits</u>	<u>Credits</u>
Federal Government Grants	\$ 13,112,658.68	
Unreserved, Undesignated Fund Balance (Surplus)	8,334,853.55	
Contracts Expense		\$ 21,447,512.23
<i>To reclass reversal of prior period encumbrance.</i>		
Cash Held by Others	3,496,386.86	
Deferred Revenue		3,496,386.86
<i>To accrue for PSI PeachCare funds as identified during audit procedures.</i>		

Uncorrected Misstatements

We had no passed adjustments.

Disagreements with Management

We encountered no disagreements with management over the application of significant accounting principles, the basis for management's judgments on significant matters, or significant disclosures to be included in the financial statements.

Representation from Management

We requested written representations from management relating to the accuracy of information included in the financial statements and the completeness and accuracy of various information requested by us, during the audit. Management provided those written representations without a problem.

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Management's Consultation with Other Accountants

We know of no outside consultation by the Department or us in connection with our engagement, except as follows:

- ❑ The Department utilized the services of the Georgia Department of Audits & Accounts for internal auditing functions throughout the year,
- ❑ The Department utilized actuarial services of outside consultants for assistance in calculating the Medicaid and Employee Health Benefits claims incurred but not reported,
- ❑ The Department utilized the attestation services of other certified public accounting firms for purposes of providing attestation reports relative to the over/under payment of claims associated with payment accuracy of the Medicaid Management Information System (MMIS),
- ❑ We, likewise, utilized the services of an outside consultant for purposes of evaluating the Medicaid and Employee Health Benefits claims payable and the over/under payment of claims amounts as of June 30, 2009,
- ❑ The Department utilized the services of other certified public accounting firms for purposes of obtaining Statement on Auditing Standards (SAS) No. 70, "*Reports on Internal Controls in a Services Organization*" and reports for various aspects of the Department's operations. We reviewed those reports, and considered their effects on the financial audit,
- ❑ We, likewise, retained an independent CPA consultant, as provided in our contract, for ongoing assistance in planning and reviewing our audits as we deemed prudent.

Significant Issues Discussed with Management

There were no significant issues discussed with management related to business conditions, plans, or strategies that may have affected the risk of material misstatement of the financial statements. We are not aware of any consultations management had with us or other accountants about accounting or auditing matters. No major issues were discussed with management prior to our retention to perform the aforementioned audit.

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Other Information in Documents Containing Audited Financial Statements

If you intend to publish or otherwise reproduce the Department's June 30, 2009 financial statements and make reference to either of our firms, we must be provided with printers' proofs or masters for our review and approval before printing. You must also provide us with a copy of the final reproduced material for our approval before it is distributed. We are not aware of any other documents that contain the basic financial statements. If such documents were to be published, we would have a responsibility to determine that such financial information was not materially inconsistent with the statements of the Department.

Independence

We are independent of the Department, and all related organizations, in accordance with auditing standards promulgated by the American Institute of Certified Public Accountants and Government Auditing Standards, issued by the Comptroller General of the United States.

Audit Firm Retention

We know of no issues which would prevent us from performing next year's audits.

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ACCOUNTING RECOMMENDATIONS AND RELATED MATTERS

Recommendations for Improvement

During our audit of the financial statements as of and for the year ended June 30, 2009, we noted areas within the accounting and internal control systems that we believe can be improved. We noted certain items as significant deficiencies in our supplemental reports on internal controls and compliance. Additionally, we noted certain items management should consider as part of its decision making process. Our recommendations (also commonly referred to as management points) are presented in the following paragraphs. Further, during our audit of the financial statements as of and for the year ended June 30, 2009, we noted other matters which we wish to communicate to you in an effort to keep the Department abreast of accounting matters that could present challenges in financial reporting in future periods. We believe consideration of these recommendations will help provide proper control over financial activities, and add effectiveness and efficiency to overall operations.

Significant Deficiencies

As noted in our supplemental reports on internal controls and compliance, we reported the following significant deficiencies:

1. Upper Payment Limit Calculation (This is considered to be a material weakness)

Title 42 of the Code of Federal Regulations, sections 447.272 for inpatient services and 447.321 for outpatient services and nursing homes, states that the Department is eligible to calculate Upper Payment Limit (UPL) for providers that are State Government, Non-State Government and Privately owned and operated facilities. UPL refers to a reasonable estimate of the amount that would be paid for the services furnished by the group of facilities under Medicare payment principles.

During the performance of our annual audit procedures, we obtained UPL calculations that were performed twice during fiscal year 2009, one for first and second quarter and the other for third and fourth quarter. Through examination of the UPL calculations we noted that all second, third and fourth quarter calculations for nursing homes had been performed incorrectly, which led to underpayments of UPL, and an understatement of the respective assets and liabilities associated with this calculation.

Management should develop procedures to review UPL calculations to ensure the calculations of the Department's obligations and offsetting receivables are properly performed and recorded. Part of this should encompass a review of supporting documentation to ensure the data within the calculation is reasonable and accurate.

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2. Reserve for Encumbrances, Accounts Payable and Other Accruals (This is a modification and partial repeat of finding FS 08-01 and this is considered to be a material weakness)

The Department's management is responsible for accurately reporting reservations of fund balance which would include a reserve for any encumbrances at year end. A reserve for encumbrance exists when a commitment resulting from a contract, purchase order, salary agreement, travel claim or other such commitment remains unsatisfied and the delivery of goods or services and the related expenditure will occur after year end. Encumbered funds may be released when no further transactions will be forthcoming or are pending related to an encumbrance.

Further, the Department's management is responsible for ensuring costs associated with payment obligations are recorded promptly when incurred and measurable, and reported accurately in the schedule of expenditures of federal awards as well as the financial statements. An account payable exists when the Department has benefited from the delivery of goods or services and the related obligation remains unsatisfied. Additionally, management is responsible for consistently applying adequate review and approval controls over all disbursements made by the Department as well as compliance with all terms of contractual agreements where the Department is a party to the agreement.

Finally, an accounts receivable is typically calculated and recorded when the Department determines benefits have been paid or are payable. The Department's management is responsible for recognizing and recording revenues and accounts receivable associated with these benefits.

During our auditing procedures, we noted management originally encumbered a dollar amount related to a specific purchase order which resulted from a contractual agreement with another agency of the State of Georgia. As the Department applied payments to this purchase order, it became apparent the encumbrance was insufficient to fully fund the related projects set forth in the contract. As a result, the Department utilized an alternative control whereby a journal voucher was created for the estimated remaining liability related to the delivery of goods and services provided under the contract agreement. The Department applied approximately \$16 million to the journal voucher and ultimately released approximately \$4 million of the remaining encumbered from the original purchase order. However due to the nature of the agreement and the use of the journal voucher, management was unable to determine in a timely manner using adequate monitoring controls if the costs associated with the contract were in excess of the contract's 'not-to-exceed' amount.

Our procedures also noted two encumbered purchase orders within the reserve for encumbrances for which no further transactions would be forthcoming or pending at June 30, 2009. Management of the responsible division had not notified the Department's Financial Services division the amounts should be released.

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Management of the Department provided a detail listing of liabilities supporting the accounts payable and other accruals reported by the Department at June 30, 2009. As a result of our audit procedures, we identified several significant obligations which were not included within the detail and thus excluded from the reported balances of the Department at year end. Additionally, we noted certain payments to hospital authorities which were supported by documents provided by another department of the State of Georgia which lacked evidence of adequate controls relating to the review and approval by employees of the Department.

Management also provided a reconciliation of intergovernmental revenues and receivables from the federal government as of and for the year ended June 30, 2009. Due to the nature of the previously discussed adjustments to the detail listing of liabilities supporting the accounts payable and other accruals, significant adjustments were required to be recorded to properly recognize intergovernmental revenues and receivables from the federal government at year end.

We understand management's reluctance to release encumbrances when the potential exists that a future invoice may yet be presented for payment or is pending. However, we recommend management of the various divisions within the Department recognize their responsibility to monitor more closely the remaining encumbered funds related to their contract responsibilities and to provide the Financial Services division accurate and more timely information related to the need to continue the encumbrance.

We further recommend the Department's Office of Inspector General review actual payments for all contracts with 'not-to-exceed' amounts as well as the relevant controls which ensure compliance with such contractual terms.

In an effort to ensure the Department's reported obligations and related receivables are not materially misstated, we recommend management implement and maintain a system which carefully reviews material disbursements subsequent to year end with the intended purpose of identifying liabilities which should be reflected in the Department's accounts payable and other accruals at fiscal year end.

We further recommend the Department consistently apply its controls over disbursements even for requests received from other State of Georgia agencies.

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3. Verification and Documentation of Eligibility (This is a modification and partial repeat of finding SA 08-01 and this is considered to be a material weakness)

The Department is responsible for administering the State of Georgia's Medicaid program. The Medicaid program is overseen by the U.S. Department of Health and Human Services through the Centers for Medicare and Medicaid Services (CMS). The Department is also responsible for determining that all recipients meet prescribed eligibility requirements and those requirements are appropriately documented.

The Department has contracted with the Department of Human Resources' Division of Family and Children Services (DFCS) to provide enrollment and monitoring services for Medicaid members. During fieldwork we noted nine instances in a sample of 60 of Medicaid recipients whose eligibility was not properly documented. Those nine instances were as follows:

1. One case file was not able to be located.
2. Additional volumes of two case files were not able to be located.
3. Five case files did not contain evidence that eligibility was recertified in accordance with the policies and procedures in place.
4. One case file did not contain acceptable verification of income.

The Department should improve their verification and documentation monitoring policy for Medicaid members and create more stringent controls over the eligibility process.

4. Journal Entries

The Department is responsible for maintaining adequate and effective internal controls over the journal entry process to prevent or detect material misstatements and ensure accurate reporting of financial data.

During our testing of the journal entry process, we noted two instances, in a sample of 22 financial statement preparation entries, which did not have documented approval or adequate supporting documentation. In addition, we noted the individual who assists in the preparation of the financial statements was able to create and post financial statement entries with no documented review or approval by another individual.

We recommend the Department require documented review and approval by a knowledgeable member of management for all journal entries and that all entries include supporting documentation that substantiates the basis for the entry.

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5. Matching of Allowable Expenditures

The Department is responsible for administering the CHIP. CHIP is overseen by the U.S. Department of Health and Human Services through the Centers for Medicare and Medicaid Services (CMS). The Department is responsible for matching federal program expenditures at the federally determined rate.

The State matching rate for its CHIP expenditures is determined in accordance with the federal matching rate for such expenditures, referred to as the enhanced Federal Medical Assistance Percentage (Enhanced FMAP). The Enhanced FMAP rate for federal fiscal year (FFY) 2009 is 75.14 percent and the Enhanced FMAP rate for FFY 2008 is 74.17 percent. During fieldwork we noted five instances in a sample of 40 CHIP administrative expenditures in which an incorrect federal matching rate was applied. Those five instances were as follows:

1. One expenditure was incorrectly matched at the prior year enhanced FMAP rate based on the date of the expenditure.
2. Four expenditures were incorrectly matched at a rate other than the enhanced FMAP for CHIP expenditures.

The Department should improve their monitoring policy for the payment of CHIP administrative expenditures to ensure that expenditures are coded appropriately and matched at the proper rate.

Management Points

We have discussed various matters with management pertaining to operations and controls including, but not limited to:

6. State Health Benefit Plan (the "Plan") Operations

As part of our audit, we performed various analytical reviews of amounts reflected in the Department's annual financial statements. As part of this review, we noted a reduction in net assets (i.e., losses) of \$439 million in the current year, causing a reduction from \$472 million as of June 30, 2008, to \$33 million as of June 30, 2009.

We understand, due to the State budget crisis, employer contributions from State and school system agencies were practically eliminated in March 2009 to assist those employers in compensating for the overall decrease in State revenues. The reduction of employer contributions was funded from net assets of the Plan.

We further understand the Department has taken steps to evaluate costs associated with the Plan in addition to communicating these concerns to the appropriate State of Georgia

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officials. It is expected a continuation of this practice will create difficulties in continuing to fund the claims on a pay-as-you go basis.

That being said, we recommend the Department continue evaluating Plan costs and cash flow in an effort to provide support and communication to appropriate State of Georgia officials to avoid unsustainable increases in the burden of charity care. Should charity care increase to a level providers can not sustain, a decrease in the quality of life may occur among State employees, retirees and others covered by the Plan.

7. State Health Benefit Plan Dependent Documentation

This is a modification and partial repeat of comment number nine from June 30, 2008. During our review of the State Health Benefit Plan claims paid during the year ended June 30, 2009, we noticed one of 30 claims tested did not have support for dependent eligibility. We understand the documentation supporting dependent eligibility received prior to September 2008 is stored off site and is often difficult to locate. Nonetheless, all documentation supporting eligibility should be accessible in a timely manner.

We further understand the Department began to utilize a scanning system in September 2008 and all dependent verification documents currently received by the State Health Benefit Plan are scanned.

We recommend the Department continue utilizing scanning, where possible, to enable efficiency in locating documents, especially documents supporting eligibility. We further recommend the Department continue with its efforts to scan documents supporting dependent eligibility which were received prior to September 2008 for all currently eligible participants in the Plan.

8. Drug Utilization Rebates

The Department, as a State Medicaid agency, is entitled to drug rebates offered by drug manufacturers just as any other entity receives drug rebates. The Centers for Medicare and Medicaid Services ("CMS") requires, through prescribed steps in the Medicaid Cluster compliance supplement, that a State Medicaid agency provide drug manufacturers with quarterly drug rebate data within 60 days of the end of the quarter. The Department has contracted with First Health to perform this process. Through our examination we noted invoices for drug rebates were not mailed within the allotted time for two quarters during fiscal year 2009.

We recommend the Department develop a system to monitor the progress with regard to the timely mailing and reporting of quarterly drug rebate data.

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9. Testing of Service Providers' Relevant Internal Controls

This is a modification and partial repeat of comment number four from June 30, 2008. The Department of Community Health relies frequently on outside entities to provide services which are critical to the Department of Community Health's objectives. As a matter of policy, the Department of Community Health requires assurance from independent sources that relevant internal controls at its service providers are in place and functioning effectively.

The State Accounting Office provides services which are critical to the Department's objectives to provide timely, accurate and reliable financial information. We understand, in August 2009 a report was issued by the Georgia Department of Audits and Accounts based on procedures performed to determine whether adequate internal controls exist to address the operational, managerial, and technical controls of the financial systems administered by the State Accounting Office and supported by the Georgia Technology Authority. The report revealed significant deficiencies in the protection of sensitive information and critical computer systems. We further understand, the majority of the deficiencies have been at least partially addressed or will be addressed.

During 2009, the Department's infrastructure services and managed network services were outsourced to external service providers. However, the Department's management was unable to provide the procedures as to how it would seek assurance that the significant service providers' internal controls relevant to the Department's financial reporting process are in place and functioning effectively.

We strongly recommend management require assurance that relevant internal controls are in place and functioning at all service providers which are significant to the Department's financial reporting process. We further recommend management have a process in place to evaluate the consequences to the Department when control deficiencies at such service providers are reported.

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Other Matters

During our audit of the financial statements as of and for the year ended June 30, 2009, we noted other matters which we wish to communicate to you in an effort to keep the Department abreast of accounting matters that could present challenges in financial reporting in future periods.

10. New GASB Standards - As has been the case for the past 10 years, GASB has issued several other new pronouncements which will be effective in future years. The following is a brief summary of the new standards:

- a. Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which establishes accounting for assets such as easements, water rights, trademarks, and internally generated computer software. This is effective for the Department with fiscal year ending June 30, 2010.
- b. Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is intended to improve how governments report information about derivative instruments in their financial statements. Specifically, it requires governments to measure most derivative instruments at fair value in their financial statements. It also addresses hedge accounting requirements to determine whether a derivative instrument results in an effective hedge. This is effective for the Department with fiscal year ending June 30, 2010.
- c. Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which is intended to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. This is effective for the Department with fiscal year ending June 30, 2011.

Currently, we have fund balance terms such as reserved, unreserved and designated. Going forward under this new pronouncement we will have terms such as:

1. Nonspendable
2. Restricted
3. Committed
4. Assigned
5. Unassigned

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Nonspendable fund balance would include amounts associated with inventory, prepaids, long-term receivables, property held for sale and the corpus of a permanent fund. In essence, *nonspendable* is the fund balance term to indicate that the respective resources are not available to be spent in any way due to their very nature and, or their lack of availability.

Restricted carries the same definition as set forth by GASB No. 34 relative to net assets. This would include any fund balance that is restricted in its use by: a) external parties; b) constitutional provisions; or, c) enabling legislation. An example would be the fund balance mandated by bond resolutions and covenants to be carried and reported in a Debt Service Fund.

Committed fund balance represents amounts for which the governing board of the respective reporting government imposes constraints on how funds may or may not be used. In such a case, the only way a constraint can be removed or changed is by action of the respective governing board. Actions to constrain resources should occur prior to the end of a fiscal year, though the exact amount may be determined subsequently.

Assigned fund balance represents amounts intended to be used for specific purposes with the intent being expressed by the reporting government's governing board or a high level body or individual authorized by the governing board. With the exception of the General Fund, amounts in all other governmental funds that are not *nonspendable*, *restricted* or *committed* will be considered to be *assigned*. Also, at the fiscal year end any appropriation of existing fund balance to eliminate a projected budgetary deficit in the next year's budget is considered to be an assignment of fund balance.

Unassigned fund balance is anything that does not meet the above definitions and represents fund balance that is available for any purpose. The only fund that will ever report *unassigned* fund balance is the General Fund except in cases of other governmental funds reporting deficit fund balance (or negative fund balance).

As you can see, financial reporting for governmental units continues to evolve and change with each and every GASB pronouncement. Along with the above financial statements elements this new pronouncements will require additional information and changes to the respective notes to the financial statements and the management discussion and analysis (MD&A).

The biggest implication to consider today is how your fund balance will be reflected under these new reporting standards and what will interested parties think and understand these amounts to mean and represent. For instance, will your unreserved fund balance of today equate with unassigned fund balance of tomorrow?

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- d. Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, which is intended to incorporate the hierarchy of generally accepted accounting principles (GAAP) for state and local governments into the Governmental Accounting Standards Board's (GASB) authoritative literature. This was effective for the Department upon issuance in March 2009.

- e. Statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Statements*, which is intended to incorporate into the Governmental Accounting Standards Board's (GASB) authoritative literature certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statements on Auditing Standards. This Statement addresses three issues not included in the authoritative literature that establishes accounting principles related party transactions, going concern considerations, and subsequent events. This Statement does not establish new accounting standards but rather incorporates the existing guidance (to the extent appropriate in a governmental environment) into the GASB standards. This was effective for the Department upon issuance in March 2009.

Summations of Thoughts Noted Above

We believe the implementation of these suggestions will enhance both the control environment and the financial reporting process, making both more effective. We also believe these recommendations can be easily implemented, and all problems resolved quite timely should management elect to employ the corrective measures.

CLOSING

If you have any questions regarding any comments, suggestions or recommendations set forth in this memorandum, we will be pleased to discuss it with you at your convenience.

This report is intended solely for the information and use of the Board, the audit committee, management of the Department, 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.

We appreciate the opportunity to serve the Department of Community Health and look forward to serving the Department in the future. If we could be of further assistance, please feel free to call upon us.