Annual Audit Agenda

Summary of Information & Communications:
Annual Financial & Compliance Audit
As of and For the Year Ended June 30, 2013

Georgia Department of Community Health

Audited and Reported by a Joint Venture of
Certified Public Accounting Firms

Metcalf Davis
CPAs | ADVISORS

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 share information about the ***audit process and deliverables timeline***.

To address the overall ***independent auditors' report*** relative to fiscal year 2013.

To provide a ***summary overview of the financial statements and footnotes*** of fiscal year 2013.

To address certain ***required communications*** related to the fiscal year 2013 engagement.

To provide summarizations of ***findings and management letter comments*** related to the fiscal year 2013 engagement.

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AUDIT ORGANIZATION

Metcalf Davis / Mauldin & Jenkins:

- Large regional joint venture audit organization serving the Southeastern United States. Originated in Georgia and based out of Atlanta.

- Over 300 individuals employed.

- Seven (7) offices located in six (6) communities:

Georgia:
- Atlanta (2)
- Macon
- Albany

Alabama:
- Birmingham

Tennessee:
- Chattanooga

Florida:
- Bradenton

- Provider of approximately 375,000 hours of service to all clients on an annual basis.

- Serve more governmental entities in the Southeast USA than any other certified public accounting firm requiring over 65,000 hours of service on an annual basis.

- Auditors of approximately 200 total governmental entities, and also serve approximately 250 not-for-profit entities. The solid majority of these governmental and not-for-profit entities receive substantial federal funding.

- Auditors of a very large and substantial part of the State of Georgia (the "State") 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 and Accounts (the "DOAA").

- Auditors of entities with assets as much as $5 billion.

SPECIFIC ENGAGEMENT TEAM MEMBERS

Engagement Team Leaders on the Audit Engagement Include:

- **Miller Edwards**, Engagement Partner - 28 years experience serving governments with 14 years experience auditing the Department of Community Health (the "Department").

- **Greg Davis**, Quality Assurance Partner - 38 years experience serving governments with 14 years experience auditing the Department.

- **Matt Hill**, Manager (Compliance / Single Audit) - 15 years experience serving governments with 14 years experience auditing the Department.

- **Donarene Steele**, Manager (Financial Audit) - 22 years experience serving governments with 9 years experience auditing the Department.

- **Clayton Knox**, Manager (Financial Audit) - 12 years experience serving governments with 9 years experience auditing the Department.

- **Marci Thomas**, Quality Assurance Partner (Compliance and Financial Audits) - 27 years experience serving governments with four (4) years experience auditing the Department.

- **Joel Black**, Quality Assurance Partner - 20 years experience serving governments with three (3) years experience providing the quality assurance reviews of the audits of the Department.

- **Meredith Lipson**, Quality Assurance Partner (Compliance) - 24 years experience serving governments with 13 years experience providing the quality assurance reviews of the audits of the Department.

OVERVIEW OF AUDIT PROCESS & DELIVERABLES TIMELINE

The following information presents a small timeline of certain significant events in the conduct of the annual financial and compliance audit of the State of Georgia's Department of Community Health (the "Department"):

- **May 2013** — Single Audit (federal compliance audit) planning commenced on Medicaid and the Children's Health Insurance Plan ("CHIP") programs.
- **May 2013** — First audit status meeting, and initial audit plan was theorized and discussed with management. We began the annual audit process focusing on the compliance and planning elements of the audit. Bi-weekly audit status meetings were planned going forward.
- **June 2013** — Received draft of the preliminary Schedule of Expenditures of Federal Awards (the preliminary "SEFA").
- **June – August 2013** — Periodic meetings with management to discuss various status updates from management and the auditors points of view.
- **June – August 2013** — Substantial conduct and performance of the Single Audit.
- **September 2013** — Management provided adjusted general ledgers and draft financial statements for the enterprise and fiduciary funds. Weekly audit status meetings commenced.
- **September 2013** — Received from management a reissued actuarial report for the incurred-but-not-reported (IBNR") liability for the State Health Benefit Plan (enterprise and fiduciary funds).
- **October 2013** — Management provided adjusted general ledgers and draft financial statements for the governmental funds.
- **October 2013** — Management provided a final SEFA.
- **October 2013** — Management provided the financial statements notes.
- **October 2013** — Received from management a reissued actuarial report for the IBNR liability for the Medicaid program.

- **November 2013** Oral affirmations to the State Accounting Office relative to Department's ending balances was on November 8, 2013.

- **November 2013** Met with the Department's Audit Committee to discuss the status of the respective audits, and future key dates were addressed.

- **November 2013** We concluded our financial and compliance audits based on information and final finding responses provided by Department management. Accordingly, all of our reports (deliverables) are dated this date which was our last day of fieldwork as well as the completion of our extensive quality assurance and review process which was on November 18, 2013.

- **November 2013** Hand-delivery of the all the respective audit reports.

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") as of and for the year ended June 30, 2013, which collectively comprise the Department's basic financial statements as listed in the table of contents."

B. **Your Responsibility:** "These **financial statements are the responsibility of the Department'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. **Unmodified "Clean" Audit 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, as of June 30, 2013, 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

Effective July 1, 2011, under House Bill 214, the Department of Community Health (hereinafter referred to as the "Department") was reorganized and the public health programs were removed. This reorganization created a new, stand-alone state agency, the Georgia Department of Public Health. Therefore, for comparison purposes, the Department has consistency in operations for the past two (2) fiscal years. This Audit Agenda attempts to address significant highlights noted for the fiscal year 2013, and comparisons are sometimes shared with fiscal year 2012.

Statement of Net Position (Page 4) – This statement is similar to a balance sheet, and presents the governmental and business-type activities of the Department as of June 30, 2013. 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 ("SHBP").

Significant elements to consider as of June 30, 2013 include:

- Cash and cash equivalents amount to approximately $304 million as of June 30, 2013 as compared to $79 million as of June 30, 2012. Consequently, cash and cash equivalents increased by approximately $225 million during 2013. Prior to fiscal year 2013, and over a four (4) year period from June 30, 2008 to June 30, 2012, cash and cash equivalents decreased by approximately $612 million. Consequently, the turnaround in cash balances was quite significant to the Department for fiscal year 2013.

- Total receivables amount to approximately $1.585 billion as compared to $1.519 million as of the close of the prior fiscal year. This results in an increase in receivables during 2013 in the approximate amount of $66 million.

- Total assets amount to approximately $1.892 billion versus the prior year approximation of $1.600 billion. Therefore, total assets have increased by approximately $292 million.

- Liabilities include the usual items such as accounts payable, accrued liabilities and benefits payable. Total liabilities as of June 30, 2013 amounted to approximately $2.156 billion as compared to $2,270 billion as of June 30, 2012. This represents a decrease of approximately $114 million.

- Current liabilities includes items such as cash overdrafts, accounts payable and other accruals which collectively amounted to approximately $771 million as compared to $904 million as of the close of the prior fiscal year. This results in a decrease in payables during 2013 in the approximate amount of $133 million.

- Benefits payable approximated $1.131 billion as of June 30, 2013 as compared to $1.175 billion as of June 30, 2012. The benefits payable consists primarily of actuarially calculated amounts for the respective incurred-but-not-reported (IBNR") liabilities for the payment of claims.

- Unearned revenue primarily consists of amounts paid but not earned until the month of July representing a prepayment of premiums. Other deferred revenues are included.

- Due to other funds amounted to approximately $42 million and such amounts were primarily owed to the fiduciary funds by the enterprise fund.

- In the end, a quick look at the Department's balance sheet is as follows and represents a very positive shift in the balance sheet in the right direction:

	6-30-13	**6-30-12**	**Net Change**
▪ Current Assets	$1,889 billion	$1,586 billion	$303 million increase
▪ Current Liabilities	$2,154 billion	$2,250 billion	$96 million decrease
▪ Net Current Liabilities	$265 million	$664 million	**$399 million improvement**

	6-30-13	**6-30-12**	**Net Change**
▪ Total Assets	$1,892 billion	$1,599 billion	$293 million increase
▪ Total Liabilities	$2,156 billion	$2,270 billion	$114 million decrease
▪ Net Liability Position	$264 million	$671 million	**$407 million improvement**

The goal of any operation is to reflect a Net Asset Position. The Department continues to report a Net Liability Position, however, fiscal year 2013 resulted in a significant improvement.

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, 2013 include:

- The governmental activities primarily surround the Medicaid Program and Children's Health Insurance Program (CHIP") programs, but other smaller Federal subsidized programs are also captured and reported. The business-type activities represent activities of the SHBP.

- **Expenses**. Total expenses (first column) amounted to approximately $12.267 billion as compared to $12.382 billion in the prior year. This represents a decrease of approximately $115 million or 1%. A further breakdown and comparison is as follows:

	FY 2013	FY 2012	Change
Education	$ 42,500,000	$ 41,000,000	3.7%
Health & Welfare - Public	9,609,000,000	9,599,000,000	.1%
Contribution to State	421,500,000	379,000,000	11.2%
Health & Welfare – State Health Benefit Plan	2,194,000,000	2,363,000,000	(7.2%)
Total Expenses	**$12,267,000,000**	**$12,382,000,000**	**.9%**

- **Revenues**. Program revenues are directly related to the respective expenses and act as direct offsets to the respective costs. Federally funded revenues are included. Total program revenues amounted to $8.890 billion and $8.794 billion for fiscal years 2013 and 2012, respectively. The end result of program revenues against expenses represents the net costs which the State of Georgia must fund from a variety of General Revenues.

  The net costs of all programs amounted to $3.377 billion and $3.588 billion for fiscal years 2013 and 2012, respectively.

- General revenues primarily include the State Appropriations, other revenue collections, and intergovernmental transfers, and such amounts totaled approximately $3.784 billion for the fiscal year ended 2013.

- **Change in Net Position**. In the end, the change in Net Position represents the current fiscal year revenues over expenses in the approximate amount of $407 million.

Governmental 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 basis of accounting are reported at the bottom of page 6 and also on page 8.

Proprietary Fund Financial Statements (Pages 9 – 11) – Such statements include a statement of net position 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 position and a statement of changes in fiduciary net position 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 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 including actuarial estimates for claims that have been incurred but not reported ("IBNR").

Note 11 – Other Post-employment Benefits (OPEB). Substantial information is disclosed in this footnote about the Department's administration of the defined benefit post-employment healthcare plan.

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

Required Supplementary Information (Pages 34 – 41) – 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 and 35). As required by GASB, information is disclosed regarding the State's other post-employment benefit plan.

Budget Comparison Schedules, Reconciliations, and Notes (Pages 36 – 41). As required by GASB, this information attempts to share information regarding budget to actual amounts on a budget basis and then is reconciled to GAAP.

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OVERVIEW OF COMPLIANCE REPORTS

- **Federal Funds.** As part of the annual audit process, we have performed a substantial compliance audit and Single Audit of the programs which are federally funded. For the year ended June 30, 2013, total expenditures of federal awards amounted to approximately $6.421 billion. Similar to fiscal year 2012, federally funded expenditures approximated 52% of total Department expenditures in fiscal year 2013.

  For fiscal year 2013, ARRA funded expenditures amounted to approximately $99 million as compared to $71 million in fiscal year 2012 and $586 million in fiscal year 2011.

- **Reports.** We have issued two (2) reports which are required by *Government Auditing Standards* and they are in a separate package from the financial statements. We reported four (4) findings classified as significant deficiencies relative to the Department's lack of internal controls and noncompliance with certain Federal programs' rules and regulations. For comparison, the 2012 audit noted seven (7) findings (including a material weakness).

  The Single Audit compliance testing covered three (3) major programs as follows:

1)	$6.082 billion -	Medicaid Cluster
2)	$306 million -	Children's Healthcare Insurance Program
3)	$20 million -	Money Follows the Person
	$6.408 billion -	**Total Federal Expenditures Tested Under the Provisions of the Single Audit Act of 1984 (= 99.8% of Expenditures)**

- **Management Letter.** We have also issued a management letter with further recommendations for improvement in the areas of internal control, compliance and general operations. We reported ten (10) additional recommendations to the Department in the management letter. For comparison, the 2012 audit reported fifteen (15) recommendations.

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, 2013, 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'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.

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. However, we did experience delays by management in providing certain information considered to be significant to the audit process. This information related to the incurred-but-not-reported (IBNR") estimate and the matters affecting the budget of the Department. No other significant difficulties (as defined in the above paragraph) were noted in the performance of the fiscal year 2013 audit.

Audit Adjustments

As part of the Department's post-closing exercises, the Department made 135 Hyperion adjusting journal entries to the respective general ledgers and financial statements. For comparison purposes, we noted 184 such adjustments as part of the closing of fiscal year 2012.

Included in the 135 adjusting journal entries were a series of audit adjustments which were necessary to properly state the Department's financial statements as of and for the fiscal year ended June 30, 2013.

Such adjustments surrounded amounts computed and recorded relative to:

a) Reclassifications for financial statement purposes;
b) Incurred-but-not-reported liabilities; and,
c) Accrued expenses associated with claims and judgments.

See various management letter comments that address several of the above audit adjustments.

Uncorrected Misstatements

No passed adjusting journal entries were noted which should be reported.

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.

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 and Accounts (DOAA") for internal auditing functions throughout the year as well as the performance of an attestation engagement relative to the Department's Budget Comparison Reports;
- The Department utilized actuarial services of outside consultants for assistance in calculating the Medicaid (governmental activities) and Employee Health Benefits (business-type activities) claims IBNR;
- 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, 2013;
- 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;
- The Department utilized the services of other certified public accounting firms for purposes of obtaining Statement on Standards for Attestation Engagements (SSAE) No. 16, *"Reports on Internal Controls at a Service Organization"* and reports for various aspects of the Department's operations. We reviewed those reports, and considered their effects on the financial audit; and

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.

Other Information in Documents Containing Audited Financial Statements

If you intend to publish or otherwise reproduce the Department's June 30, 2013 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 AICPA 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.

ACCOUNTING RECOMMENDATIONS AND RELATED MATTERS

Recommendations for Improvement

During our audit of the financial statements as of and for the year ended June 30, 2013, 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, 2013, 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

1. Verification and Documentation of Medicaid Eligibility (Substantial Repeat of Prior Year Finding)

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 (CMS"). The Department is responsible for determining that all recipients meet prescribed eligibility requirements and ensuring those requirements are appropriately documented.

The Department has contracted with the Division of Family and Children Services (DFCS") to provide enrollment and monitoring services for Medicaid members. During fieldwork we noted six (6) recipients' files in a sample of sixty (60) Medicaid recipients whose eligibility was not properly documented. Those six (6) files included the following documentation deficiencies:

a) Three (3) cases files contained limited information or could not be located;

b) Two (2) case files did not contain a signed application;

c) One (1) case file did not contain evidence that eligibility was recertified in a timely manner.

Without adherence to the Department's policies and procedures in place to determine and document Medicaid eligibility, members in the Medicaid program may no longer be eligible to receive benefits if documentation of their eligibility status is incomplete or inadequate.

An indeterminate number of participants are inadequately documented as to eligibility for Medicaid. The monetary effect is that federal funds used to fund the Medicaid program may be used to provide benefits for members who are not eligible for the program.

The Department does not have an adequate monitoring process in place over DFCS to ensure that all CMS guidelines in regards to the documentation of a member's eligibility are properly followed.

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

2. Verification and Documentation of Medicaid Eligibility (Substantial Repeat of Prior Year Finding)

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

The Department of Community Health has contracted with the Georgia Department of Human Services' Division of Aging Services (DAS") and the Georgia Department of Behavioral Health and Developmental Disabilities (DBHDD") to provide enrollment and monitoring services for Money Follows the Person participants. During fieldwork we noted twenty-eight (28) participant files in a sample of sixty (60) Money Follows the Person participants whose eligibility was not properly documented in accordance with departmental procedures. Those twenty-eight (28) files included the following documentation deficiencies:

a) Sixteen (16) participant files did not contain a MFP Screening form;

b) Eighteen (18) participant files did not contain form DMA 6/*Level of Care*;

c) Three (3) participant files did not contain a Discharge Day Checklist;

d) Seven (7) participant files did not contain form DMA 59/*Authorization for Nursing Facility Reimbursement*;

e) Nine (9) participant files did not contain a MAO/Communicator.

Without adherence to the Department of Community Health's policies and procedures in place to determine and document Money Follows the Person eligibility, participants in the Money Follows the Person program may not be eligible to receive benefits.

An indeterminate number of participants are inadequately documented in accordance with departmental policy and procedures to demonstrate eligibility for the Money Follows the Person program. The monetary effect is that federal funds used to fund the Money Follows the Person program may be used to provide benefits for participants who are not eligible for the program.

The Department of Community Health initiated a monitoring process to review eligibility determinations made by the Georgia Department of Human Services' Division of Aging Services (DAS") and the Georgia Department of Behavioral Health and Developmental Disabilities (DBHDD") in April 2013, but the Department did not have an adequate monitoring process in place for the entire fiscal year. In addition, the Department of Community Health did not obtain from DAS and DBHDD all of the appropriate eligibility and enrollment documentation for MFP participants in accordance with departmental policy and procedures.

The Department of Community Health should continue the implemented eligibility determination review process to ensure that DAS and DBHDD are appropriately determining participant MFP eligibility in accordance with federal and departmental guidelines. In addition, the Department should improve the procedures for monitoring the participant file documentation received from DAS and DBHDD to ensure that all appropriate documents are received.

3. Matching of Allowable Expenditures for CHIP (Substantial Repeat of Prior Year Finding)

The Department of Community Health is responsible for administering 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 of Community Health 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 enhanced Federal Medical Assistance Percentage (Enhanced FMAP). The Enhanced FMAP for federal fiscal year (FFY) 2013 is 75.89 percent and the Enhanced FMAP for FFY 2012 is 76.31 percent. During fieldwork, we noted two (2) instances in a sample of fifty-one (51) CHIP administrative expenditures in which incorrect federal matching rates were used. Those two instances were as follows:

a) One (1) expenditure was incorrectly matched at the FFY 2012 Enhanced FMAP (76.31%) based on the date of the expenditure;

b) One (1) expenditure was incorrectly matched at a rate other than the Enhanced FMAP for CHIP expenditures.

The Department of Community Health has an extensive chart of accounts to separately denote expenditure funding sources and other details. If the funding and other account information is documented incorrectly and is not corrected during the review and approval process, the expenditure could be recorded incorrectly.

The Department of Community Health did not match CHIP expenditures at the correct federally determined rate. The Department of Community Health did not adequately monitor the matching rate applied to CHIP administrative expenditures.

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

4. Surveys to Monitor Facility Compliance with Provider Health and Safety Standards

The Department of Community Health 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 (CMS"). The Department of Community Health's Healthcare Facility Regulation Division functions as the State Survey Agency (SSA") for the State of Georgia to perform surveys (i.e. inspections) on behalf of CMS to determine whether providers meet the conditions of participation. The Social Security Act mandates the establishment of minimum health and safety standards that must be met by providers and suppliers participating in the Medicare and Medicaid programs.

The Department of Community Health is responsible for ensuring that providers meet prescribed health and safety standards for hospital, nursing facilities and Intermediate Care Facilities for individuals with Mental Retardation (ICF/MR). In accordance with 42 CFR 488.308, the survey agency must conduct a standard survey of each skilled nursing facility and nursing facility, not later than 15 months after the last day of the previous standard survey and the statewide average interval between standard surveys must be 12 months or less.

During our review, we noted four (4) nursing facilities out of a sample of twenty-five (25) facilities for which more than 15 months had elapsed since the last standard inspection.

The Department of Community Health has an obligation to ensure that providers meet prescribed health and safety standards and performs this responsibility in part through conducting surveys in accordance with CMS guidelines.

The Department of Community Health's Healthcare Facility Regulation Division did not perform the surveys within the required timeframe. Due to staff turnover and training issues, the Department of Community Health's Healthcare Facility Regulation Division did not complete surveys in accordance with CMS guidelines.

The Department of Community Health should improve their process for performing and completing surveys to ensure that surveys are completed in accordance with CMS guidelines in a timely manner, including increasing staff size and providing adequate training.

Management Points

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

5. Journal Entry Review and Approval

During our audit of the Department's fiscal year 2013 journal entries, we noted the general ledger application used by management allowed an employee to repost a journal entry from a prior year with no review or approval by mistake. Management was unaware this entry was posted until our testing procedures identified the entry.

The general ledger application used by the Department is a software package maintained by the State Accounting Office (SAO) which is another state agency. We recommend the Department consult with the SAO to determine the cause and consider modifying to the software package, if needed, to prevent and detect the posting of any entries without the Department's knowledge, review and approval.

6. Federal Receivable Amounts (Partial Repeat of Prior Year Management Point)

During our audit of the Department's federal receivables and related revenue, we noted management was able to provide a reconciliation supporting the total dollar amount of the reported federal receivable. However, the Department's federal receivable is comprised of amounts which represent expected reimbursements from the federal government for expenditures which may be reimbursed at different rates. For example, fiscal year 2013 Medicaid benefit expenditures were reimbursed at a rate of 65.33 percent while fiscal year 2013 administrative expenditures could be reimbursed between 50 percent and 100 percent depending upon the nature of the expense. Management's reconciliation of the Medicaid benefit portion of the federal receivable reflected a positive variance of approximately

$17,400,000 or an amount less than could be supported by the reconciliation prepared by management.

Management's reconciliation of the Medicaid administrative portion of the federal receivable reflected a negative variance of approximately $17,100,000 or an amount greater than could be supported by the reconciliation prepared by management.

Therefore, based on the reconciliation prepared by management, it is possible the reported federal receivable could be overstated or understated due to the difference in the reimbursement rates for Medicaid benefits and Medicaid administrative expenses. We recommend the Department regularly reconcile federal receivables in order to determine any discrepancies between classes of expenditures, and any variances should be resolved in a timely manner.

**7. Provider Eligibility and Enrollment
(Repeat of Prior Year Management Point)**

During our testing of provider eligibility for Medicaid, we noted that due to indexing issues after the Medicaid Management Information System (MMIS) conversion, there are ongoing problems accessing original provider enrollment documents such as the statement of participation and power of attorney. Management ultimately provided substitute or replacement documents which were used to substantiate eligibility. However, we recommend the Department initiate a system to properly scan and maintain all original files related to provider eligibility.

**8. Financial Statement Review
(Repeat of Prior Year Management Point)**

The Department's management is responsible for establishing and maintaining internal control which will, among other things, initiate, record, process, and report transactions consistent with management's assertions embodied in the financial statements. Thus, the fair presentation of financial statements in conformity with generally accepted accounting principles is an implicit and integral part of management's responsibility. Internal control over financial reporting should include the comparison of expected amounts to reported amounts. We noted two (2) bank accounts totaling $1,854,247 which were incorrectly reported by the Department. Of the two (2) accounts, one was no longer an account of the Department and the other had been closed prior to year end. Neither should have been reflected in the Department's unaudited trial balance. Management subsequently removed the $1,854,247 from the Department's reported balances prior to issuance of the financial statements.

We noted management has developed, within the Department's report writing application, an analysis of balances. The analysis is used to compare the amounts reported at the financial statement level in the prior year to amounts reported in the current year. We further understand management has developed a financial statement review checklist which will be used to verify certain reported balances. We encourage management to continue their efforts to improve the financial statement review process and recommend management's additional steps in the preparation and review process include comparing expected amounts to the supporting detail.

9. Reconciling Bank Statements Regularly
(Repeat of Prior Year Management Point)

During the audit, we noted a bank account of the Composite State Board of Medical Examiners, an attached agency of the Department, had not been properly reconciled to the general ledger. The bank account is a zero-balance account in which all deposits represent online credit card payments that are swept daily to other State of Georgia or Department bank accounts. However, the Department reported an unreconciled balance of $219,103 in the general ledger account at June 30, 2010, 2011, 2012 and 2013. Account reconciliations provided by management did indicate a reduction in the number of reconciling items between April 2013 and June 2013. As of June 30, 2013, we noted seven (7) reconciling items compared to sixty-three (63) reconciling items at April 30, 2013.

Timely and accurate reconciliations between the monthly financial institution statements and the general ledger are important in order for errors or fraud to be detected and corrected in a timely manner as well as ensuring the Department's balances are properly reported. We recommend priority be placed on completing an accurate reconciliation of this account and adjusting the general ledger as necessary in a timely manner. Such reconciliations should be performed and reviewed monthly.

10. Violations of Purchase Card Policy (Repeat of Prior Year Management Point)

During our audit of the Department's fiscal year 2013 financial statement, we observed the following:

- The laws of the State of Georgia states that business purchases paid with state funds are exempt from Sales Tax. According to the Purchasing Card policy, the Department's approving officials and purchasing card ("P-card") holders are responsible to ensure merchants do not charge Sales and Use Tax. If tax is charged, the P-cardholder should contact the appropriate merchant to obtain a credit for any sales tax paid. Further, the P-cardholder is required to document attempts to obtain credit for any State of Georgia (State) Sales and Use Tax charged in error. During our test work, we noted five (5) transactions in which sales tax was improperly charged. However, the Department was unable to provide supporting documentation of the amounts which were disputed with vendors and if the sales tax charge was credited back to the P-card.

- Four (4) of the five (5) P-card transactions listed above were for group meals. According to the Statewide Travel Regulations, "purchase of such meals should be approved by a higher level approving authority prior to the date of the event, and the group meals must be documented by a copy of the formal written agenda and a list of attendees." However, the formal written agenda and the list of attendees were not scanned into Team Georgia Marketplace (TGM) – the application used to store such supporting documentation – as the Department's policy requires. While the documentation was subsequently provided, it was not done so in a timely manner. This practice is in violation of the current P-card Policy, which requires all supporting documentation be scanned into TGM prior to approval."

- During our testing of P-card transactions, we noted a purchase of $2,603 which is in violation of the Department's current P-card Policy which limits the amount of a single transaction to no more than $2,500. From discussions with management, we understand the Department has made certain exceptions to the single transaction limit without updating the written policy.

- We understand management scans the documentation within the TGM module for improper P-card transactions on a monthly basis. However, this review is not formally documented.

- According to the Department's policy, P-card transactions are to be closed within five (5) days after the closing date of each monthly statement. As P-card transactions are closed, the amounts are applied to the appropriate general ledger accounts and the encumbrance reduced. If transactions are not closed in a timely manner, these amounts are not allocated to the general ledger. As a result, encumbrances and reductions in budgeted amounts are not reflected in the appropriate accounts. This could lead to problems such as error, misstatements or budget overruns at the end of the fiscal year. We, as well as the Department of Administrative Services (DOAS) in a DOAS recent report, noted P-card transactions are not always closed in a timely manner.

- We further noted the review conducted by DOAS of the Department's P-Card transactions made between December 28, 2011, and December 27, 2012 revealed instances of non compliance which included failure to use statewide contracts without obtaining a waiver, inadequate documentation supporting purchases and the lack of timely reconciliation in TGM.

We recommend the Department clearly communicate to all P-card users the importance of ensuring merchants do not charge Sales and Use Tax. We additionally recommend the approver perform a detail review of the monthly transactions to make certain Sales and Use Tax was not charged, as well as maintain an audit trail which documents the attempts to obtain credit for the tax charged in error.

Current practice should always be consistent with the written policy. It is, however, important that written policies should support the Department in an effective and efficient manner. Therefore, we recommend the Department's P-card policy, as with any policy, be periodically reviewed and if appropriate updated.

Additionally, we recommend the monthly review performed by management which consists of scanning documents within the TGM module be detailed enough to identify unusual and improper transactions including sales tax charges and amounts in excess of the single transaction limit. We further recommend the review be formally documented and provide an adequate audit trail for management's consideration as needed throughout the year.

Finally, we recommend additional training for the appropriate employees to ensure the importance of complying with the Department's P-card policies including those related to approvals, timely closing of transactions, the use of waivers when Statewide contracts are not used, adequate documentation of all transaction and other relevant P-card policies is communicated.

11. Internal Oversight Function
(Partial Repeat of Prior Year Management Point)

We acknowledge the Department's hiring of an additional auditor within the Internal Audits Division of the Office of Inspector General in response to our prior year recommendation that internal oversight by the Department be strengthened. We further acknowledge his work related to reviewing the status of prior year findings and management points.

However, we believe the additional oversight should be used to further enhance the Department's system of internal quality control. In an entity the size and complexity of the Department, even an excellent system of internal controls will only provide reasonable assurance that financial reporting errors, irregularities, fraud and operating inefficiencies will be identified, addressed and resolved.

We recommend that one of the responsibilities of this position, with management's should input, include a formal, documented assessment of the Department's risks particularly in the area of financial reporting. The identified risks should be prioritized according to degree of risk. In response to those identified risks an audit plan should be developed and implemented to provide adequate testing and reporting directed at mitigating such risks. The risk assessment should be performed periodically (at least annually) and the audit plan updated accordingly.

12. SHBP and Trust Fund Operations
(Substantial Repeat of Prior Year Management Point)

As part of our audit, we perform various analytical reviews of amounts reflected in the Department's annual financial statements. As part of the analysis, we noted the Department continues to report a negative net position in the State Health Benefit Plan (SHBP). At June 30, 2013, the Department's SHBP reflected a negative net position of $129.8 million, which is an improvement of $142.7 million from the $272.5 negative net position reported at the end of fiscal year 2012. Although there have been various increases noted in the contribution rates of participants and employers, the total contributions plus the State appropriations have not been sufficient to cover the deficit as well as the growing costs of providing healthcare to the participants. Thus, basically the SHBP operates on a pay-as-you-go basis.

Further, we noted the total liabilities in the State OPEB fund and the School OPEB fund are each equal to the total assets reported by the funds. Thus, neither the State OPEB fund nor the School OPEB fund report any amounts held in trust for other post-employment benefits. We further noted, the total assets reported by the two funds are comprised of only receivables and amounts due from other funds. The amount due from other funds in both the State OPEB fund and the School OPEB fund which totals $41.5 million is due from the SHBP and represents more than two thirds of the total assets reported in each of the two trust funds. As noted above the SHBP reported a negative net position of $129.8 million at June 30, 2013.

We understand management recognizes these funding shortfalls and the reduction of available assets needed to satisfy current and future claims and have communicated their concerns to appropriate State of Georgia officials. This ongoing concern was made most recently in a letter dated June 28, 2013 addressed to the State CFO and director of the State's Office of Planning and Budget. We continue to recommend that the Department should proactively communicate such concerns to appropriate State of Georgia officials.

13. Service Auditor's Reports
(Partial Repeat of Prior Year Management Point)

User organizations that obtain a Service Auditor's Report from their service organizations receive valuable information regarding the service organization's controls and the effectiveness of those controls. In order to benefit fully from the use of Service Auditor's Reports, it is important to understand the SOC reporting framework and how it impacts what SOC report is most valuable to the Department's management. The following bullets highlight the fundamental difference between the SOC reports.

- The SOC 1 reports on the controls of the service organization which are relevant to the user organization's financial statement assertions.

- The SOC 2 reports on the effectiveness of the controls of the service organization related to compliance or operations, including the following criteria: security, availability, processing integrity, confidentiality, and/or privacy (also known as trust services principles and criteria). The security, availability, and processing integrity criteria are related to the controls system, and the confidentiality and privacy criteria are related to the information processed by the system.

- The SOC 3 report is very similar to the SOC 2 report. The two key differentiators are: 1) a SOC 3 report does not require a detailed description of the controls of the service organization related to compliance or operations or detailed testing procedures (though it does cover the trust services principles and criteria); and 2) the distribution of the report is not restricted. The SOC 3 report simply reports on whether the service organization achieved one or more of the trust services principles and criteria.

SOC 1 and SOC 2 reports can both be further subdivided into Type 1 and Type 2 reports. A Type 1 report is an assessment of the service organization's system and the suitability of the design of controls at a specific point in time. A Type 2 report is not only an assessment of the service organization's system and the suitability of the design of controls; it is an assessment of the operating effectiveness of controls over a period of time. SOC 3 reports have no such subdivision.

We noted significant improvement by management in obtaining and reviewing service auditor reports. However, management was unable to provide a SOC 1 Type 2 report for Wells Fargo, an entity where the operating effectiveness of controls at the service organization is relevant to the Department's financial statement assertions. Additionally, management was unable to provide any SOC report for Georgia Technology Authority, a service organization relevant to the Department's controls. Moving forward, we recommend management review the services provided by each service organization, determine the applicable SOC report needed and ensure the requirement to provide the appropriate level of SOC report as well as the appropriate subdivided report - Type 1 or Type 2- is included in the written agreement with the service organization.

14. Vendor Performance Monitoring and Performance Management

The Department has adopted policies and procedures which govern the manner in which management conducts activities associated with vendor performance monitoring and its management of and interaction with contract vendors. Contract monitoring and reporting activities are the responsibility of each business owner assigned a contract. The Vendor Management System utilizes a Vendor Report Card to assess and document the progress a vendor is making in accordance with the terms of the agreement. The frequency of the Report Cards is based upon the contract execution date and/or a profile and a risk assessment analysis. Report Card frequencies vary from one (1) per year to four (4) per year.

In order to adequately document and evaluate the performance of a vendor, it is important that these assessments be completed in a timely manner. From a sample test of three (3) vendors, we noted two (2) vendors where by the quarterly assessments were not always performed in a timely manner. Both were considered high risk contractors which required a quarterly report card during the fiscal year 2013. For one vendor, all four quarterly Report Cards for the year were completed on August 23, 2013. For the second, vendor, the third and fourth quarter Report Cards were completed in a timely manner. However, the first quarter report card was not completed until December 23, 2012 and the second quarter was not completed until June 4, 2013.

Recognizing the need for the Department to ensure contract compliance on the part of the Department's vendors, we recommend all assessments be performed and documented in a timely manner, but not more than fifteen (15) days after the performance period.

Other Matters

During our audit of the financial statements as of and for the year ended June 30, 2013, 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.

15. New Financial Reporting Standards

As has been the case for the past decade, the Governmental Accounting Standards Board (GASB) has issued several other new pronouncements which were effective for the 2013 fiscal year, or will be effective in future years. The following is a brief summary of the new standards:

a) **Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*** was effective for the 2013 fiscal year. This statement addresses arrangements where a transferor conveys to an operator the right, and related obligation, to provide public services through the use and operation of a capital asset in exchange for significant consideration. The Department should: apply certain due diligence to addressing the potential for restatements relative to the pronouncements; review various agreements previously entered into by the Department; and, determine the potential effects from adopting the requirements of this pronouncement. The provisions of this pronouncement generally are required to be applied retroactively for all periods presented. The Department was not affected by the implementation of this statement.

b) **Statement No. 61, *The Financial Reporting Entity: Omnibus (An Amendment to GASB No.'s 14 and 34)*** was effective for the 2013 fiscal year. This standard addresses the concept and definition of a component unit. This new statement raises the bar for an entity to be included in another primary government's financial statements. Additionally, the criteria determining whether a component unit should be blended or discretely presented has changed significantly, most notably that if it is expected that the primary government will repay substantially all of the component unit's debt, then the component unit should be blended. This statement also addresses the recognition of joint venture arrangements with other governmental units. The Department should apply certain due diligence to addressing the potential effects from adopting the requirements of this pronouncement. The Department was not affected by the implementation of this statement.

c) **Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*** was effective for the 2013 fiscal year. The provisions of this pronouncement generally are required to be applied retroactively for all periods presented. FASB has adopted a new codification and its original pronouncements are considered to be non-authoritative. This standard identifies those provisions in FASB Statements & Interpretations, APB Opinions, ARB's, and AICPA Accounting Interpretations issued before November 30, 1989 that are applicable to state and local governmental entities and incorporated into the GASB's literature. GASB Statement No. 20 is superseded by this statement. Matters of significance to the Department specifically addressed include:

- Capitalization of interest costs
- Statement of net asset's classifications
- Special and extraordinary items
- Comparative financial statements
- Related party activities, transactions and relationships
- Prior period adjustments and restatements
- Accounting changes and error corrections
- Contingencies
- Extinguishment of debt
- Troubled debt restructuring
- Inventory
- Leases (capital, operating, etc.)
- Sales of real estate
- Real estate projects
- Research and development arrangements
- Insurance enterprises
- Regulated operations

The Department was not affected by the implementation of this statement.

d) **Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*** was effective for the 2013 fiscal year. This statement is intended to improve financial reporting by providing citizens and other users of state and local government financial reports with information about how past transactions will continue to impact a government's financial statements in the future. This statement provides a new statement of net position format to report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position (which is the net residual amount of the other elements or "equity"). This statement of net position replaces what was previously presented as the statement of net assets and does not change the title of the governmental fund balance sheet or fund balance. This statement requires that deferred outflows of resources and deferred inflows of resources be reported separately from assets and liabilities.

A deferred outflow of resources is a consumption of net assets that is applicable to a future reporting period. An example of a deferred outflow of resources is a government's hedging interest rate swap agreement in which the fair value becomes negative. If the hedge is determined to be effectively offsetting the changes in fair value of the debt, the decrease in the fair value of the derivative instrument would be reported as a liability with a corresponding deferred outflow of resources to reflect the fact that this decrease is not expected to be recognized in investment income in future periods.

A deferred inflow of resources is an acquisition of net assets that is applicable to a future reporting period. An example of a deferred inflow of resources is a service concession arrangement that involves a public toll road. If the government receives an up-front payment from an operator, the revenue associated with that payment will be recognized in future years because the arrangement that generated the up-front payment relates to those periods.

Statement No. 63 also amends certain provisions of Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments, and related pronouncements to reflect the residual measure in the statement of financial position as net position, rather than net assets and to include deferred amounts in the major fund calculation with assets or liabilities, as applicable.

The Department was not significantly affected by the implementation of this statement.

e) **Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions (An Amendment of GASB Statement No. 53)*** was effective for the fiscal year 2013. However, as of the close of June 30, 2013, this standard was not applicable to the Department due to the lack of hedging activities.

This statement is intended to improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. This statement clarifies that when certain conditions are met, the use of hedge accounting should not be terminated. Hedge accounting entails reporting fair value changes of a hedging derivative as either deferred outflows of resources or deferred inflows of resources, rather than recognizing those changes in investment income. When a hedging derivative is terminated, Statement 53 requires that hedge accounting cease and all accumulated deferred amounts be reported in investment income.

As Statement 53 was being implemented, questions had arisen regarding situations in which a government has entered into a hedging interest rate swap or a hedging commodity swap and the swap counterparty (or the swap counterparty's credit support provider) commits or experiences an act of default or a termination event under the swap agreement through no fault of the government. When a swap counterparty (or a swap counterparty's credit support provider) is replaced through an assignment or an insubstance assignment, the GASB concluded that the government's financial position remains unchanged.

f) **Statement No. 65, *Items Previously Reported as Assets and Liabilities*** will be effective for fiscal years beginning after December 15, 2013 resulting in the Department's fiscal year ending June 30, 2014. Although implementation is a year later, this standard goes along with the previously discussed Statement 63. GASB Concepts Statement No. 4, *Elements of Financial Statements*, and Statement 63 specify that recognition of deferred outflows and deferred inflows should be limited to those instances specifically identified in authoritative GASB pronouncements. Consequently, guidance was needed to determine which balances being reported as assets and liabilities should actually be reported as deferred outflows of resources or deferred inflows of resources, according to the definitions in Concepts Statement 4. Based on those definitions, Statement 65 reclassifies certain items currently being reported as assets and liabilities as deferred outflows of resources and deferred inflows of resources. In addition, this Statement recognizes certain items currently being reported as assets and liabilities as outflows of resources (expense) and inflows of resources (revenue). Examples of these changes are as follows:

*** Reclassifying certain assets to be deferred outflows of resources:**

- Grants paid in advance of meeting time requirements;
- Deferred amounts from refunding of debt (debits);
- Costs to acquire rights to future revenues; and,
- Deferred losses from sale-leasebacks.

*** Reclassifying certain liabilities to be deferred inflows of resources:**

- Grants received in advance of meeting time requirements;
- Taxes received in advance;
- Deferred amounts from refunding of debt (credits);
- Proceeds from sales of future revenues;
- Deferred gains from sale-leasebacks; and,
- "Unavailable" revenue in governmental funds.

*** Recognizing certain assets as outflows (expenses):**

- Debt issuance Costs (other than bond insurance);
- Initial costs incurred by lessor in an operating lease;
- Loan origination costs (by entities in the lending business); and,
- Costs to acquire loans.

*** Recognizing certain assets as inflows (revenues):**

- Loan origination fees, excluding points (by entities in the lending business);
- Commitment fees (after exercise or expiration); and,
- Fees received for sales of loans.

A further breakdown of the change in the balance sheet presentation to the new statement of net position is as follows:

Assets:		
Current:		
Cash	$	xxx
Accounts Receivable		xxx
Inventory		xxx
Prepaids		xxx
	$	xxx
Non-current:		
Fixed Assets	$	xxx
Accumulated Depreciation		xxx
	$	xxx
Total Assets	$	xxx
Deferred Outflows:		
Grants Paid in Advance of Timing Requirements	$	xxx
Total Deferred Outflows	$	xxx

Liabilities:		
Current:		
Accounts Payable	$	xxx
Accrued Expenses		xxx
Bonds Payable		xxx
Notes Payable		xxx
	$	xxx
Non-current:		
Bonds Payable	$	xxx
Notes Payable		xxx
	$	xxx
Total Liabilities	$	xxx
Deferred Inflows:		
Grants Received in Advance of Timing Requirements	$	xxx
Taxes Received in Advance		xxx
Total Deferred Outflows	$	xxx
Net Position:		
Net Investment in Capital Assets	$	xxx
Restricted		xxx
Unrestricted		xxx
Net Position	$	xxx

g) **Statement No. 66, *Technical Corrections – 2012*** will be effective for fiscal years beginning after December 15, 2012 resulting in the Department's fiscal year ending June 30, 2014. This pronouncement amends Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues,* by removing the provision that limits fund-based reporting of a state and local government's risk financing activities to the general fund and the internal service fund type. As a result, governments would base their decisions about governmental fund type usage for risk financing activities on the definitions in Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions.*

This Statement also amends Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA*

Pronouncements, by modifying the specific guidance on accounting for: (1) operating lease payments that vary from a straight-line basis; (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans; and, (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes would eliminate any uncertainty regarding the application of Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases,* and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues,* respectively.

h) **Statement No. 67, *Financial Reporting for Pension Plans*** will be effective for fiscal years beginning after June 15, 2013 resulting in the Department's fiscal year ending June 30, 2014. This pronouncement replaces the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans* and Statement 50 as they relate to pension plans that are administered through trusts or similar arrangements meeting certain criteria.

Statement No. 67 builds upon the existing framework for financial reports of defined benefit pension plans, which includes a statement of fiduciary net position (the amount held in a trust for paying retirement benefits) and a statement of changes in fiduciary net position. Statement No. 67 enhances note disclosures and RSI for both defined benefit and defined contribution pension plans. Statement No. 67 also requires the presentation of new information about annual money-weighted rates of return in the notes to the financial statements and in 10-year RSI schedules.

The changes noted above by Statement No. 67 are significant to pension plans, and we strongly encourage Department officials to review the actual pronouncement and consider the potential effects on the financial reporting of the Department.

i) **Statement No. 68, *Accounting and Reporting for Pensions*** will be effective for fiscal years beginning after June 15, 2014 resulting in the Department's fiscal year ending June 30, 2015. This pronouncement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and Statement No. 50, *Pension Disclosures,* as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria, including agent and cost-sharing multiple employer plans.

Statement No. 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. The Statement also enhances accountability and transparency through revised and new note disclosures and required supplementary information (RSI).

Defined Benefit Pension Plans. Statement No. 68 requires governments that participate in defined benefit pension plans to report in their statement of net position a net pension liability. The net pension liability is the difference between the total pension liability (the present value of projected benefit payments to employees based on their past service) and the assets (mostly investments reported at fair value) set aside in a trust and restricted to paying benefits to current employees, retirees, and their beneficiaries.

Statement No. 68 calls for <u>immediate recognition of more pension expense</u> than is currently required. This includes immediate recognition of annual service cost and interest on the pension liability and immediate recognition of the effect on the net pension liability of changes in benefit terms. Other components of pension expense will be recognized over a closed period that is determined by the average remaining service period of the plan members (both current and former employees, including retirees). These other components include the effects on the net pension liability of: (1) changes in economic and demographic assumptions used to project benefits; and, (2) differences between those assumptions and actual experience. Lastly, the effects on the net pension liability of differences between expected and actual investment returns will be recognized in pension expense over a closed five-year period.

Of great interest to the Department, Statement No. 68 requires <u>cost-sharing employers, such as the Department, to record a liability and expense equal to their proportionate share of the collective net pension liability and expense for the cost-sharing plan</u>. This means that the Department will be required to record its share of the total liabilities the any and all cost-sharing plans it participates.

The Statement also will improve the comparability and consistency of how governments calculate the pension liabilities and expense. These changes include:

- **Projections of Benefit Payments.** Projections of benefit payments to employees will be based on the then-existing benefit terms and incorporate projected salary changes and projected service credits (if they are factors in the pension formula), as well as projected automatic post-employment benefit changes (those written into the benefit terms), including automatic cost-of-living-adjustments (COLAs). For the first time, projections also will include ad hoc post-employment benefit changes (those not written into the benefit terms), including ad hoc COLAs, if they are considered to be substantively automatic.

- **Discount Rate.** The rate used to discount projected benefit payments to their present value will be based on a single rate that reflects (a) the long-term expected rate of return on plan investments as long as the plan net position is projected under specific conditions to be sufficient to pay pensions of current employees and retirees and the pension plan assets are expected to be invested using a strategy to achieve that return; and (b) a yield or index rate on tax-exempt 20-year, AA-or-higher rated municipal bonds to the extent that the conditions for use of the long-term expected rate of return are not met.

- **Attribution Method.** Governments will use a single actuarial cost allocation method – "entry age," with each period's service cost determined as a level percentage of pay.

Note Disclosures and Required Supplementary Information. Statement No. 68 also requires employers to present more extensive note disclosures and RSI, including disclosing descriptive information about the types of benefits provided, how contributions to the pension plan are determined, and assumptions and methods used to calculate the pension liability. Single and agent employers will disclose additional information, such as the composition of the employees covered by the benefit terms and the sources of changes in the components of the net pension liability for the current year. A single or agent employer will also will present RSI schedules covering the past 10 years regarding:

- Sources of changes in the components of the net pension liability

- Ratios that assist in assessing the magnitude of the net pension liability

- Comparisons of actual employer contributions to the pension plan with actuarially determined contribution requirements, if an employer has actuarially determined contributions.

Cost-sharing employers also will present the RSI schedule of net pension liability, information about contractually required contributions, and related ratios.

Defined Contribution Pensions. The existing standards for governments that provide defined contribution pensions are largely carried forward in this new statement. These governments will recognize pension expenses equal to the amount of contributions or credits to employees' accounts, absent forfeited amounts. A pension liability will be recognized for the difference between amounts recognized as expense and actual contributions made to a defined contribution pension plan.

Special Funding Situations. Certain governments are legally responsible for making contributions directly to a pension plan that is used to provide pensions to the employees of another government. For example, a state is legally required to contribute to a pension plan that covers local school districts' teachers. In specific circumstances called special funding situations, the Statement requires governments that are non-employer contributing entities to recognize in their own financial statements their proportionate share of the other governmental employers' net pension liability and pension expense.

The changes noted above by Statement No. 68 are significant to governments who sponsor retirement plans, and we strongly encourage Department officials to review the actual pronouncement and consider the potential effects on the financial reporting of the Department.

j) **Statement No. 69, *Government Combinations and Disposals of Government Operations*** will be effective for periods / fiscal years for years beginning after December 15, 2013 resulting in the Department's fiscal year ending June 30, 2015. This pronouncement primarily applies to governments involved in some form of mergers, acquisitions, transfers of operations or disposal of operations. Unless the Department enters into any agreements whereby such actions are anticipated, this pronouncement should not affect the Department.

k) **Statement No. 70, *Accounting and Financial Reporting for Non-exchange Financial Guarantees*** will be effective for fiscal years beginning after June 15, 2013 resulting in the Department's fiscal year ending June 30, 2014. Department officials should review the provisions of this new pronouncement and determine if the Department is a party to any form of non-exchange guarantees. If the Department has ever entered into any currently active guarantee agreements, the Department may be required to record certain accounting entries and, or disclose relevant details surrounding the guarantees.

16. AICPA Group Audit Standards

With the release of Statement on Auditing Standards (SASs) Nos. 122-126, the Auditing Standards Board (ASB) has substantially completed its project to redraft all of the auditing sections into the *Codification of Statements on Auditing Standards* (contained in AICPA Professional Standards). The issuance of the clarified standards reflects the ASB's established clarity drafting conventions designed to make the standards easier to read, understand, and apply. Among other improvements, generally accepted auditing standards (GAAS) now specify more clearly the objectives of the auditor and the requirements with which the auditor has to comply when conducting an audit in accordance with GAAS. These standards are applicable for both the private, public, and governmental sectors.

In the particular case of the Department, the need for the primary government (in this case, the State of Georgia) and its auditor (Department of Audits and Accounts a/k/a DOAA) to obtain and maintain correspondence with the Department auditor (Metcalf-Davis/Mauldin & Jenkins a/k/a MD/MJ) has been formally heightened. However, the State Accounting Office (SAO) and the DOAA have historically had a certain amount of involvement in the annual audit process thereby mitigating the potential effect of this new audit standard.

Even though the DOAA will continue to reference and rely on the MD/MJ's audit report of the Department, going forward and beginning with the State of Georgia issuing the fiscal year 2013 Comprehensive Annual Financial Report (CAFR), the SAO and the DOAA will be required to perform additional, but limited, procedures to include the audit results of the Department into the financial report of the State of Georgia. Such procedures may extend to the management of the Department and MD/MJ for which we collectively will have to consider subsequent events and other matters that may have occurred since the release of the audit report of the Department just prior to the release of the State of Georgia's annual audit report. A great deal of this exercise will be dictated by the SAO and the DOAA.

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 issues resolved quite timely should management elect to employ the corrective measures.

FREE QUARTERLY CONTINUING EDUCATION AND NEWSLETTERS FOR GOVERNMENTAL CLIENTS

Free Continuing Education. We provide free quarterly continuing education for all of our governmental clients. Each quarter we pick a couple of significant topics tailored to be of interest to governmental entities. In an effort to accommodate our entire governmental client base, we offer the sessions several times per quarter at a variety of client provided locations resulting in greater networking among our governmental clients. We normally see approximately 100 people per quarter. We obtain the input and services of experienced outside speakers along with providing the instruction utilizing our in-house professionals. We hope Department staff and officials have been able to participate in this opportunity, and that it has been beneficial to you. Examples of subjects addressed in the past few quarters include:

1. American Recovery & Reinvestment Act (ARRA) information and issues;
2. GASB updates (several sessions);
3. Internal Controls Over Revenue and Cash Receipting;
4. Collateralization of Deposits and Investments;
5. SPLOST Accounting, Reporting and Compliance;
6. Internal Controls Over Accounts Payable, Payroll and Cash Disbursements;
7. Capital Asset Accounting Processes and Controls;
8. Grant Accounting Processes and Controls;
9. American Recovery & Reinvestment Act (ARRA) Updates;
10. Policies and Procedures Manuals;
11. Segregation of Duties;
12. GASB No. 51 – Intangible Assets;
13. Single Audits for Auditees;
14. GASB No. 54 – Governmental Fund Balance (subject addressed twice);
15. Best Budgeting Practices, Policies and Processes;
16. Internal Revenue Service (IRS) Compliance Issues, Primarily Payroll Matters;
17. CAFR Preparation (several times including a two (2) day hands-on course).
18. GASB No. 60, Service Concession Arrangements (webcast)
19. GASB No.'s 63 & 65, Deferred Inflows and Outflows (webcast)
20. GASB No. 61, the Financial Reporting Entity (webcast)

Governmental Newsletters. We produce newsletters tailored to meet the needs of governments. The newsletters have addressed a variety of subjects and are intended to be timely in their subject matter. The newsletters are authored by Mauldin & Jenkins partners and managers, and are not purchased from an outside agency. The newsletters are produced and delivered periodically, and are intended to keep you informed of current developments in the government finance environment.

Communication. In an effort to better communicate our free continuing education plans and newsletters, please email Lauren Payne at LPayne@mjcpa.com (send corresponding copy to medwards@mjcpa.com), and provide to her individual names, mailing addresses, email addresses and phone numbers of anyone you wish to participate and be included in our database.

CLOSING

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. 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 information is intended solely for the use of the Department's management, and others within the Department's organization 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. Thank you.