



STATE OF NORTH CAROLINA

**NORTH CAROLINA DEPARTMENT OF HEALTH
AND HUMAN SERVICES**

STATEWIDE FINANCIAL STATEMENT AUDIT PROCEDURES

FOR THE YEAR ENDED JUNE 30, 2009

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

**NORTH CAROLINA DEPARTMENT OF HEALTH
AND HUMAN SERVICES**

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AUDITOR'S TRANSMITTAL

The Honorable Beverly Eaves Perdue, Governor
Members of the North Carolina General Assembly
Lanier M. Cansler, Secretary
North Carolina Department of Health and Human Services

We have completed certain audit procedures at the North Carolina Department of Health and Human Services related to the State of North Carolina reporting entity as presented in the *Comprehensive Annual Financial Report (CAFR)* and *Single Audit Report* for the year ended June 30, 2009. Our audit was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

In the *CAFR*, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor presents the results of tests of internal control and compliance with laws, regulations, contracts and grants applicable to the State's financial statements. Our audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States.

Our audit objective was to render an opinion on the State of North Carolina's financial statements and not the Department's financial statements. However, the report included herein is in relation to our audit scope at the Department and not to the State of North Carolina as a whole.

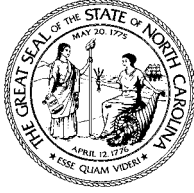
The audit findings referenced in the report are also evaluated to determine their impact on the State's internal control and the State's compliance with rules, regulations, contracts and grants. If determined necessary in accordance with *Government Auditing Standards*, these findings are reported in the State's *Single Audit Report*.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Secretary Lanier M. Cansler
and Management of North Carolina Department of Health and Human Services

As part of our audit of the State of North Carolina's financial statements, we have audited selected elements of the North Carolina Department of Health and Human Services' financial statements, as of and for the year ended June 30, 2009. Our report on the State of North Carolina's financial statements is included in the State's *Comprehensive Annual Financial Report*. Our financial statement audit scope at the North Carolina Department of Health and Human Services included the following:

- General Fund, excluding the Division of Mental Health, Developmental Disabilities and Substance Abuse Services

The audit results described below are in relation to our audit scope at the Department and not to the State of North Carolina as a whole.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the State's financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
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weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described in findings 1 and 2 in the Audit Findings and Responses section of this report to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

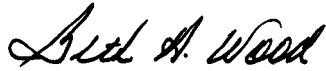
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the State's financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in finding 2 in the Audit Findings and Responses section of this report.

Management's responses to the findings identified in our audit are included in the Audit Findings and Responses section of this report. We did not audit the responses, and accordingly, we express no opinion on them.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
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This report is intended solely for the information and use of management, the Secretary, the Department's Audit Committee, others within the entity, and 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.



Beth A. Wood, CPA
State Auditor

October 30, 2009

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AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting

The following findings and recommendations were identified during the current audit and discuss conditions that represent deficiencies in internal control and/or noncompliance with laws, regulations, contracts or grants.

1. DEFICIENCIES IN FINANCIAL REPORTING

The Department incorrectly calculated the estimate of Medicaid claims payable, resulting in an understatement of the liability by \$22.7 million. There was a corresponding \$16.9 million understatement of the receivable from the federal government for its share of the liability.

The error occurred because the Department failed to appropriately update supporting documents used to calculate and record the Medicaid claims payable estimate. The Department is responsible for the fair presentation of its financial statements; therefore, it is essential that effective internal control over financial reporting be established to provide reasonable assurance regarding the reliability of financial reporting.

A similar finding has been reported for three consecutive years.

Recommendation: The Department should continue to enhance internal control over the year-end financial reporting process to ensure that financial statements are free of material misstatements.

Agency Response: The Department concurs with the finding. The error occurred when a programmer failed to update formulas to include the new year's information. Additional controls have been added to ensure amounts derived by the claims payment system are accurate. Specifically, a Budget Officer and a Business Officer will review and verify formulas are current prior to being added to the table used to calculate the accrual for Medicaid claims. The Chief Business Operations Officer will provide a final review of the calculation before the data is forwarded to the Office of the Controller for inclusion in the Department's Comprehensive Annual Financial Reports. The additional controls are intended to render the financial statements free of material misstatements related to Medicaid claims.

2. DISBURSING ACCOUNT NOT RECONCILED TIMELY

The Department did not complete monthly reconciliations for the Division of Social Services' disbursing account in a timely manner. As a result, there was an increased risk of an accounting error or misappropriation.

During our audit, we obtained the reconciliations of the disbursing account for the period May 2008 – June 2009. Our review identified:

- there was no evidence of timely review for any of the 14 reconciliations examined.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

- there were unreconciled differences for 13 of the 14 reconciliations, indicating that outstanding items were not identified, researched, and corrected in a timely manner.
- the bank reconciliation log had not been updated for any of the 14 reconciliations.

North Carolina Administrative Code (Section 20 NCAC 01C.0402) requires all agencies to reconcile the monthly disbursing account statements within 15 days of the statement date. In addition, departmental policies require the reconciliation of the Department's accounts with an explanation of any identified variances.

Recommendation: The Department should establish procedures to ensure that departmental disbursing accounts are properly reconciled each month. Adequate reconciliation procedures include promptly investigating and resolving outstanding items as well as establishing the appropriate level of management review and approval.

Agency Response: The Department agrees that departmental disbursing accounts should be properly reconciled each month. DHHS Controller's Office procedure number GA058 requires that the disbursing accounts be reconciled by the fifteenth day of each month and reviewed by management. Staff did not fully reconcile accounts and research unreconciled differences. This function will be handled by a new employee in the future. The Department will meet with staff to reinforce that all procedures should be followed, including identifying, researching, and correcting reconciling items.

The Department will also reinforce to management that they should always review and approve reconciliations in order to ensure that they are being done correctly and timely.

The Department will assign additional staff to the task of bringing the bank reconciliations current. Also, additional levels of management will review the reconciliations. Reconciling items will be identified, researched, and corrected in a timely manner. The bank reconciliation log will be updated and maintained on a current basis.

ORDERING INFORMATION

Audit reports issued by the Office of the State Auditor can be obtained from the web site at www.ncauditor.net. Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports may be obtained by contacting the:

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