STATE OF NORTH CAROLINA

SOUTHEASTERN CENTER FOR MENTAL HEALTH/DEVELOPMENTAL DISABILITIES/SUBSTANCE ABUSE SERVICES

FISCAL CONTROL AUDIT

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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AUDITOR'S TRANSMITTAL

February 4, 2009

The Honorable Beverly E. Perdue, Governor
The General Assembly of North Carolina
Area Board of Directors, Southeastern Center for Mental Health/Developmental Disabilities/Substance Abuse Services
Foster Norman, Area Director

This report presents the results of our fiscal control audit at the Southeastern Center for Mental Health/Developmental Disabilities/Substance Abuse Services. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the performance audit standards contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The objective of a fiscal control audit is to identify improvements needed in internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources.

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Responses section of this report.

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OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS

OBJECTIVES, SCOPE, AND METHODOLOGY

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes*, we have conducted a fiscal control audit at the Southeastern Center for Mental Health/Developmental Disabilities/Substance Abuse Services (Center). The audit was performed at the request of Senator Julia Boseman, representative of New Hanover County. The senator's request indicated that mental health and substance abuse services in the counties of Brunswick, New Hanover, and Pender were in crisis due to the abrupt and significant decrease in funding for mental health providers from the Center.

The objective of a fiscal control audit is to identify improvements needed in internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources. Our audit does not provide a basis for rendering an opinion on internal control, and consequently, we have not issued such an opinion.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

To accomplish our audit objectives, we gained an understanding of internal control over matters described below and evaluated the design of the internal control. We then performed further audit procedures consisting of tests of control effectiveness and/or substantive procedures that may reveal significant deficiencies in internal control. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records, and examining documentation supporting recorded transactions and balances.

As a basis for evaluating internal control, we applied the internal control guidance contained in *Internal Control Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). As discussed in the framework, internal control consists of five interrelated components, which are (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our audit scope covered the period January 1, 2008 through October 15, 2008, and included selected internal controls in the following organizational units:

Area Board

The area board is the governing body for the Center, exercising the powers and duties conferred by the General Assembly. The structure of the area board is established by *North Carolina General Statute* 122C-118.1.

Executive Administration

This organizational unit is responsible for the overall management functions of the Center. The unit comprises the area director and managers/directors for the other operational units of the Center. The Center's area board passed an annual operating budget for the 2008 fiscal year of approximately $33.6 million, of which $14.7 million was funded by State appropriations, $3.2 million was funded by Federal sources, and $15.7 million was funded from local sources. Local funding consisted of planned receipts of $3.1 million from the Center's county partners (New Hanover, Brunswick, and Pender) and the balance from reimbursed services, including Medicaid.

Business Administration

This organizational unit is responsible for the general accounting functions of the Center. The unit accounts for and issues financial reports covering all Center operations.

Integrated Payment and Reporting System (IPRS)

State and federal dollars are provided to local management entities each year to support locally provided mental health, developmental disability, and substance abuse services. The majority of these funds are provided through unit cost reimbursement (UCR) systems. The Division of Mental Health, Developmental Disabilities, and Substance Abuse Services implemented the Integrated Payment and Reporting System (IPRS) to track, pay and report on all claims submitted by providers for services rendered. The IPRS system is designed to process the claim from the appropriate funding source.

During our audit, we considered internal control related to the following control objectives:

The Center's management of financial resources – The Center serves as the local management entity that provides management and oversight of mental health, developmental disabilities, and substance abuse services through a provider network for residents of Brunswick, New Hanover, and Pender counties. The Center is responsible for both the authorization and utilization management functions for state-funded services to ensure the most effective and efficient uses of limited resources. For the year ended June 30, 2008, the Center over-obligated its budgeted amount for IPRS-reimbursed services by approximately $2 million. As of October 2008, the Center had expended approximately 51% of its 2009 fiscal year budgeted allocation for IPRS-reimbursed services. We examined internal control designed to ensure that the Center properly manages its financial resources.

The Center's compliance with financial and operational reporting requirements to its area board and its partner county organizations – The Center's Executive and Business Administration units are responsible for preparing financial and operational data reports for its oversight parties. The area board is responsible for the overall operations of the Center and should be provided with accurate and relevant information necessary to make informed, timely management decisions. *North Carolina General Statute* 122C-117 establishes minimum reporting requirements that each local area management entity must provide to its partner county organizations. We examined internal control designed to ensure that the Center complied with financial reporting requirements to its oversight governing entities.

The Center's compliance with Board structure requirements, including term-limit requirements – North Carolina General Statute 122C-118.1 establishes the requirements for local area board structure including term-limit requirements. We examined internal control designed to ensure that the Center has complied with State regulations as they pertain to the Center's area board.

RESULTS

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under generally accepted government auditing standards. These items are described in the Audit Findings and Responses section of this report.

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1. CENTER DID NOT PROPERLY MANAGE ITS FINANCIAL RESOURCES

The Center did not manage its budget to ensure that the cost of services offered did not exceed available resources. As a result, the Center has encountered financial difficulties that required the North Carolina Department of Health and Human Services (Department), Division of Mental Health, Developmental Disabilities, and Substance Abuse Services (Division) to intervene in managing its operations.

In February 2008, the Center determined that it had expended 86% of its budgeted IPRS funding for mental health services for the fiscal year ended June 30, 2008 and was in jeopardy of running out of funds. It notified the Division of the problem.

The Division responded by sending in a team of monitors to review the circumstances of the Center's financial distress. Based on the assessment, the Division implemented an initial intervention plan for the balance of the 2008 fiscal year, placed a team of consultants within the Center to continue to assist the Center in its operations, and assumed approval authority over the financial operations of the Center. The Division has developed a final corrective action plan for the Center that was adopted by the Center's area board at its November 2008 meeting. The Center continues to operate under Division oversight as of the conclusion of our audit fieldwork.

During the shortfall encountered for the fiscal year ended June 30, 2008, the Center approached its regional county partners for additional funding but those requests were denied. The Center was able to meet its fiscal year financial obligations by spending some of its fund balance reserves and through additional funding provided by the State.

We identified three causes of the financial management problems:

- Management operates under a philosophy of offering requested services and finding funding for the services after-the-fact.
- Internal control was not in place to prevent over-obligating funds.
- The area board did not exercise appropriate financial oversight of the Center.

Management Philosophy

It was evident during our audit that the executive administration was focused on providing mental health services and growing the Center's ability to provide those services. While this should be a primary goal for the Center, management cannot ignore its responsibility to provide services within the amount of funding it can reasonably expect to receive.

Even in the current year, the executive administration continues to authorize services without identifying its impact on funding and cost of services. At the October 2, 2008 area board meeting, board members expressed concern about the Center missing its targeted IPRS budget. In response, the former area director stated that this was only one way of looking at the issue and his thoughts were that the Center should continue providing the ongoing levels of service and request additional funding from its government sources to cover the shortfall.

The Center has not periodically evaluated the types of services being authorized and how those services are being delivered. Client service plans that had been established years ago have not been updated to reflect the current needs of the client. A prioritization of needs could possibly lead to the provision of less expensive care.

Budgetary Control

The Center has not implemented effective internal control procedures to prevent over-expenditure of its budget. Such internal control procedures may include:

- Encumbrance accounting. Obligations should be tracked so that the unobligated budget amount is readily available. The Center's accounting system has the capability to provide for encumbrance accounting, and there are several other techniques available to the Center to track its unobligated budget.

- Use of cost ceilings in contracts with service providers so that there is a known maximum cost for each contract. These cost ceilings were used previously, but the Center removed the provision from its fiscal year 2008 contracts.

- Enforcing the "prompt pay" requirement in contracts with providers. For state-funded services, a provider is generally allowed 60 days from the date of providing the service to submit the claim for reimbursement. The prompt pay requirement provides local management entities assistance in managing its authorizations as well as its cash management needs. From discussions with state-level personnel, it appears that although this clause is a part of the Center's contracts with each provider, it was not being enforced by the Center.

- Procedures to ensure that revenues are maximized and expenses are minimized. Authorized services need to be scrutinized to ensure the maximization of Medicaid funding. In addition, the Center should periodically review its provider network to ensure cost effectiveness and efficiencies in the provision of services across the service delivery area.

Under the *Management of State Service Funds* section of its contract with the Department, the Center is required to establish "processes and procedures that ensure that funds are available to reimburse providers for legitimately authorized, provided, and billed services. This includes estimating the percentage of authorized services that will be delivered so that only those funds that will be spent are encumbered."

Board Oversight

The Center's area board did not exercise sufficient oversight of management. Our discussions with board members indicated that several members considered the board's role to be advisory, meaning that the board could express opinions but management was not required to follow the board's directives. The Center's area board is established by *North Carolina General Statute* 122C-119, which grants the board governing authority over the Center's statutory responsibilities.

In response to our inquiries, board members indicated that they have constantly asked the Center's representatives to the board to follow-up on open items or unanswered questions; however, the appropriate level of follow-up was rarely provided. Frustration was also expressed about the format of information presented to the board. In many cases, raw data were presented to the board for decision-making rather than a summarized analysis of information that would allow for an informed decision.

Critical responsibilities of any board are to oversee the management of financial resources and to monitor programs and services. Both rely on the provision of accurate financial and programmatic data from management. Our audit indicated that the Center's area board was not receiving accurate financial data; however, this was not known by board members until the state monitoring team began its review of the Center's operations. In reviewing the Center's financial data, the state monitoring team identified numerous reporting errors in the monthly financial statements. Also, financial reports were rarely available to board members on a timely basis, particularly the Center's operations/finance committee. Adequate control systems are needed to ensure that accurate, complete financial and operational reports are provided to the board in a timely manner.

North Carolina General Statute 122C-118.1(a) requires that the area board "shall include two individuals with financial expertise." *North Carolina General Statute* 122C-119(d) requires that an area board establish a finance committee that has at least two members with fiscal control and budgeting expertise. The Center's internal tracking of its area board members identifies three current members as having the required expertise; however, throughout our interviews of the Center's board members, the lack of financial expertise was a consistent theme that members identified as needing to be addressed. This weakness was also expressed by those members who were identified as members with financial expertise.

Center's Explanation of Financial Difficulties

Members of management and the board often cited two alternative causes for the financial difficulties:

- An unexpected reduction in funding.
- The installation of a new computer system for the Center's business operations.

In the May 1, 2008 area board minutes, the deputy director of business services noted that the Center had made a formal request to the Division "to reinstate the $2.3 million that was taken from us in the 2007-2008 budget." However, the Division established the Center's 2007-2008 budget for state-funded services at the beginning of the fiscal year based on the previous year's actual expenditures. The Center was well aware of the amount of funding available but did not adjust its expenditures accordingly.

The Center installed a new financial accounting software system at the beginning of the 2008 fiscal year. Throughout our audit process, interviewees at all levels indicated that the "new accounting software" was the root cause of most of the Center's financial difficulties. However, the same software is currently in use at multiple local management entities within the State and none are reporting the difficulties that are being identified at the Center. Furthermore, accounting software is only a means or process to get financial data. The actual interpretation of that data and the verification of its accuracy is the responsibility of the Business Administration unit and management.

Recommendation: The Center should recognize its responsibility to provide services within the limitations of its expected funding levels and should not depend on unidentified future funding to cover services provided currently. Internal control should be implemented to monitor the status of the budget, including providing accurate and timely financial reports to the area board. The area board must assert its authority in overseeing the strategic direction and financial management of the Center. The state monitoring team has provided some guidance through its correction action plan that has been adopted by the area board. However, the area board must ensure that those corrective actions are appropriately implemented. Consideration should be given to obtaining appropriate training for Center staff in the areas of budgeting and financial reporting, as well as updated training on the use of its accounting software package.

Center's Response: The agency understands that the cost of services must be provided within the allocated service budget. The agency shall provide the Area Board and others with a monthly income statement based on the cash basis of accounting and a balance sheet. The agency shall track authorization of services and at least monthly will compare the value of authorizations to the budget allocation. Additionally, the service budget shall be reviewed monthly to determine whether any adjustments are required in service allocations. The agency has implemented a service benefit plan that guides staff in the volume of service to authorize initial requests and subsequent requests. These authorization trends shall also be reviewed at least monthly and adjustments will be made as needed. The Area Director and Area Board shall develop the Corrective Action Plan and shall assure implementation. The Area Director shall evaluate the training needs of staff and secure external training as needed.

2. NONCOMPLIANCE WITH REPORTING REQUIREMENTS

The Center did not comply with the reporting requirements to the regional counties included in its local management entity. *North Carolina General Statute* 122C-117 establishes the powers and duties of the area authority and provides that the Center shall:

- Submit to the boards of county commissioners and the county managers the approved budget and provide quarterly reports on the financial status of the program.
- Submit to each participating board of county commissioners the Center's business plan.
- Submit to the boards of county commissioners, on a quarterly basis, service delivery reports that assess the quality and availability of the public services within the service delivery area. Specific service delivery information to be provided is included in the statute.
- Submit to the boards of county commissioners, at least annually, a progress report that provides an assessment of the progress in implementing local service plans, goals, and outcomes.

In addition to the above requirements, *North Carolina General Statute* 122C-117(c) specifies that the Center's area director and finance officer shall provide the Center's quarterly report to the county managers within 30 days of the end of each quarter of the fiscal year. At least twice a year, the reports shall be presented in person to the boards of county commissioners and read into the minutes of the meeting at which it is presented.

We inquired of the county managers for Brunswick and Pender Counties and the assistant county manager of New Hanover County to determine whether the Center had been submitting the required reports to the counties. All stated that the Center had previously only provided a copy of its annual audit report. They indicated that they had not received copies of the approved budget or any of the financial or operational reports required by state law. The first financial reports that any of the counties could recall receiving were received for the months of July and August 2008. The Center's delivery of these reports can be traced to the terms of the intervention plan put in place by the North Carolina Department of Health and Human Services, Division of Mental Health, Developmental Disabilities, and Substance Abuse Services.

Inquiries of the former area director and the New Hanover County Commissioners' board representative indicated that they were unaware of the reporting requirements. In addition, management did not implement adequate control systems to ensure compliance with statutory requirements to provide financial and operational reports to the appropriate oversight bodies.

Recommendation: Management should establish proper policies and procedures to ensure compliance with the reporting requirements established by state laws.

Center's Response: The agency shall provide each county manager with the Area Board approved budget ordinance, the monthly income statement and balance sheet, and the Division required Fiscal Monitoring Report. The agency shall quarterly submit a copy of the Fiscal Monitoring Report to each county manager along with an agency performance report. The agency shall assure that each county has a copy of the agency's local business plan. Annually, the agency shall also provide each county with a copy of the agency's progress in meeting the local business plan.

3. DEFICIENCIES NOTED WITH AREA BOARD REQUIREMENTS

We noted deficiencies with the organization and operations of the Center's area board per statutory requirements. In addition, the Center's area board did not comply with all statutory requirements governing its meetings.

Board Expertise

As noted in Finding 1, the Center's area board does not comply with *North Carolina General Statute* 122C-118.1(a) that requires the area board to have two individuals with financial expertise. This deficiency also impacts the Center's operations/finance committee. As per *North Carolina General Statute* 122C-119(d), the Center's operations/finance committee is responsible for reviewing the financial strength of the Center and should include two members that have fiscal control and budgeting expertise. The lack of financial expertise for the area board also filters down to the committee level.

Board Terms

A critical element in the structure of the area board involves the appointment of board members and the establishment of the terms of service. *North Carolina General Statute* 122C-118.1(d) establishes area board term limits as such:

- A member who is a county commissioner serves on the board in an ex officio capacity and serves concurrent with their terms as a county commissioner.
- Terms of other members shall be for three years. Members shall not be appointed for more than two consecutive terms. (During the initial formation of the area board, members were appointed for staggered one year, two year, and three year terms for succession purposes.)

However, revisions made by the General Assembly per Session Law 2006-142 appear to have negated the intended impact on term limits for area board membership. A provision was inserted into *North Carolina General Statute* 122C-118.1(d) that allowed all members serving on an area board as of July 1, 2006, the opportunity to remain on the board for one additional term.

Our review of the Center's area board membership identified that many of the members have served for numerous terms. In reviewing board related documentation, we were able to identify where at least six current board members have been involved with the Center's area board since 1994. In addition, many of the current members have been sitting members of the Center's area board since its creation as part of the mental health reform legislation enacted in 2001. The long-term involvement of the Center's area board members would have been a violation of previous versions of the statute and contradicts the intention of the statute.

Board Minutes

North Carolina General Statute 143-318.10(b) defines a public body to include a board or committee, composed of two or more members, that "is authorized to exercise a legislative, policy-making, quasi-judicial, administrative, or advisory function." Section (e) of the statute requires that "every public body shall keep full and accurate minutes of all official meetings, including any closed sessions held pursuant to G.S. 143-318.11."

We examined the Center's board minutes for the period August 4, 2005 through November 6, 2008 and identified the following concerns:

- The minutes provided limited information on the discussion of an agenda item prior to the motion for and approval of a decision, thus providing little record of how important decisions were made. Our discussions with board members indicated that in many cases, members asked for additional information to be provided or for follow-up actions to be taken by the Center staff. We found no instances of such actions being documented in the board minutes.

- We noted that the board entered into 11 closed sessions during the period of our review. In accordance with *North Carolina General Statute* 143-318.11(c), a public body may hold a closed session only after a properly identified motion to close a meeting. In each instance reviewed, the board moved to hold a closed session by a generic reference to the statute, but the minutes did not contain the specific closed session exemption as required by statute.

- The board did not maintain minutes for its closed sessions for five of the 11 closed sessions included in our review. The board did not begin to record closed session minutes until February 2008. In addition, the minutes that were maintained for the closed sessions were very brief and did not provide sufficient detail for the actions that occurred during the closed sessions. Three of the 11 closed sessions appeared to be for discussions that did not qualify under the exemptions listed in *North Carolina General Statute* 143-318.11(a). For one of the closed sessions reviewed, we were unable to ascertain the purpose of or discussions held during the closed session.

- Minutes were not maintained for the operations/finance committee or many of the other defined committees of the board.

It appears that many of the problems noted above occurred because board members were not familiar the specific statutory requirements for the operations of an area board.

Recommendation: The Center's area board members should thoroughly review statutory requirements governing its meetings and take measures to ensure compliance with the requirements.

Center's Response: The agency shall assure that the Area Board is in compliance with statutes regarding composition, terms, and meeting minutes. The agency shall assure there are minutes of all Area Board committee meetings.

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