STATE OF ILLINOIS
OFFICE OF THE
AUDITOR GENERAL
Frank J. Mautino, Auditor General

SUMMARY REPORT DIGEST

DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES

Financial Audit
For the Year Ended June 30, 2017

Release Date: March 20, 2018

FINDINGS THIS AUDIT: 13

	New	Repeat	Total
Category 1:	10	2	12
Category 2:	0	1	1
Category 3:	0	0	0
TOTAL	10	3	13

FINDINGS LAST AUDIT: 4

AGING SCHEDULE OF REPEATED FINDINGS

Repeated Since	Category 1	Category 2	Category 3
2016	3		
2015	11	8	

SYNOPSIS

- **(17-01)** The Department failed to implement adequate fiscal-related monitoring controls over Managed Care Organization (MCO) contracts. In addition, the Department failed to exercise or enforce fiscal-related monitoring controls as provided for in the various MCO contracts.

- **(17-02)** The Department did not calculate the annual Medical Loss Ratios (MLRs) of the State's Medicaid Managed Care Organizations (MCOs) for mandatory enrollment for Coverage Years (CY) 2013, 2014, and 2015. As a result, the Department did not seek and collect an estimated $65 million in potential refunds due back from the MCOs to the State.

- **(17-03)** The Department did not ensure its annual financial reports were prepared in conformity with U.S. generally accepted accounting principles (GAAP).

- **(17-06)** The Department and the Department of Human Services did not maintain adequate controls to ensure applications for human service programs were reviewed and approved or denied within the mandated 45-day timeframe.

- **(17-07)** The Department and the Department of Human Services did not conduct timely redeterminations of eligibility for Medicaid recipients.

Category 1: Findings that are **material weaknesses** in internal control and/or a **qualification** on compliance with State laws and regulations (material noncompliance).

Category 2: Findings that are **significant deficiencies** in internal control and **noncompliance** with State laws and regulations.

Category 3: Findings that have **no internal control issues but are in noncompliance** with State laws and regulations.

{Financial date is summarized on next page.}

DEPARTMENT OF HEALTHCARE AND FAMILY SERVICES
FINANCIAL AUDIT
For the Year Ended June 30, 2017

FINANCIAL INFORMATION - Governmental Funds (in thousands)	**FY 2017**	**FY 2016**
REVENUES		
Program revenue: charges for service	$ 43,710	$ 43,672
Program revenue: operating grants	11,980,782	11,608,392
General revenue: taxes, interest and other	1,981,742	1,862,378
Total revenue	14,006,234	13,514,442
EXPENDITURES		
Health and social services	17,729,115	16,776,985
Debt service - principle	11	32
Debt service - interest	1	16
Capital outlays	31,857	24,810
Total expenditures	17,760,984	16,801,843
OTHER SOURCES (USES)		
Appropriations from State resources	7,414,514	7,342,109
Transfers in	50,092	10,324
Transfers out	(83,000)	(40,000)
Receipts collected & transmitted to the State Treasury	(2,752,138)	(2,840,472)
Lapsed appropriation	(2,312,612)	(1,204,491)
Other	(35,000)	(35,000)
Total other sources (uses)	2,281,856	3,232,470
Increase in fund balance	(1,472,894)	(54,931)
Fund balance, July 1, as restated	5,152	62,739
Fund balance, June 30	$ (1,467,742)	$ 7,808

SELECTED ACCOUNT BALANCES - June 30, Governmental Funds (in thousands)	**FY 2017**	**FY 2016**
ASSETS		
Cash and cash equivalents & investments	$ 3,408,095	$ 2,391,566
Due from other governments - federal & local	4,034,894	1,372,258
Loans, taxes and other receivables, net	640,397	502,275
Due from other Department and State funds	29,328	10,787
Total assets	$ 8,112,714	$ 4,276,886
LIABILITIES		
Accounts payable and other liabilities	$ 5,570,715	$ 2,473,936
Unearned revenue	11,521	75
Obligations under securities lending of State Treasurer	74,182	100,922
Due to other funds - State, federal, local & Department	1,244,102	798,960
Total Liabilities	6,900,520	3,373,893
DEFERRED INFLOWS OF RESOURCES - Unavailable Revenue	2,679,936	895,185
FUND BALANCE	(1,467,742)	7,808
TOTAL LIABILITIES AND FUND BALANCE	$ 8,112,714	$ 4,276,886

DIRECTOR
During Audit Period: Ms. Felicia Norwood
Current Secretary: Ms. Felicia Norwood

FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

INADEQUATE CONTROLS OVER FISCALLY MONITORING MANAGED CARE ORGANIZATIONS

Failure to Fiscally Monitor MCOs

The Department of Healthcare and Family Services (Department) failed to implement adequate fiscal-related monitoring controls over Managed Care Organization (MCO) contracts. In addition, the Department failed to exercise or enforce fiscal-related monitoring controls as provided for in the various MCO contracts. Since 2013, the Department has paid the 12 MCOs approximately $22.5 billion.

While testing the contracts the Department entered into with the 12 MCOs, we noted the Department **did not**:

Did Not Review or Audit Encounter Data

- **Have a review process** in place to ensure MCO capitation payments were accurate. As a result, we noted instances totaling $619,455 for which the Department had a net underpayment to the MCOs for services paid during fiscal year 2017.
- **Have a review process** in place to ensure the correct percentage of the MCO incentive payments, manually calculated, were withheld in accordance with the MCO contracts. As a result, we noted instances totaling $10,991,086 for which the Department overpaid the MCOs during fiscal year 2017 by failing to withhold at the rate established by the contract.
- **Review or audit** self-reported encounter data (valid claims of services rendered by medical providers) submitted to the Department by the MCOs as required by the MCO contracts and the federally-approved State Plan.

Did not calculate or finalize MLRs

- **Receive** all healthcare program encounter data.
- **Review or audit** the MCOs denial of claims data.
- **Review** MCO actual administrative costs or other non-benefit costs.
- **Calculate and finalize** the MCOs' annual Medical Loss Ratio calculations for mandatory enrollment for Coverage Years 2013, 2014, and 2015. This provision of the MCO contracts is included to determine whether the MCOs met established benefit levels for the coverage year and provides a mechanism for the State to recoup payments that fail to meet the target.

Did not conduct internal audits

- **Conduct internal audits** over the Managed Care Program for mandatory enrollment since 2013. (Finding 1, pages 46-48)

We recommended the Department take immediate action to exercise and enforce monitoring and accountability provisions established in the contracts with the MCOs. We also recommended the Department establish and implement additional internal controls, internal audits, and on-site

reviews to fiscally monitor the MCOs to ensure the State's Medicaid program is carried out in an effective, efficient, and economical manner.

Department accepted the recommendation

The Department accepted the recommendation.

DEPARTMENT DID NOT SEEK POTENTIAL REFUNDS FROM MANAGED CARE ORGANIZATIONS

Department did not seek or collect an estimated $65 million in potential refunds from MCOs

The Department did not calculate the annual Medical Loss Ratios (MLRs) of the State's Medicaid Managed Care Organizations (MCOs) for mandatory enrollment for Coverage Years (CY) 2013, 2014, and 2015. As a result, the Department did not seek and collect an estimated $65 million in potential refunds due back from the MCOs to the State.

The MLR is defined within the MCO contracts as total plan benefit expense divided by total capitation revenue. Each of the MCO contracts contains a provision requiring the Department to calculate the MLR within 90 days following the six month claims run-out period following the CY. The MCOs then have 60 days to review the Department's calculation. If the MCO did not meet the Targeted MLR set forth in the applicable contract, the MCO is required to refund to the State an amount equal to the difference between the calculated MLR and the Targeted MLR (expressed as a percentage) multiplied by the CY revenue. According to the MCO contracts, the State requires health plans to have a Targeted MLR of 85 percent for the Family Health Population (FHP), Affordable Care Act (ACA), Medicare-Medicaid Alignment Initiative (MMAI), and Managed Long-Term Services and Supports (MLTSS) plans. The Integrated Care Program (ICP) plan has a Targeted MLR of 88 percent.

As an example, assume an MCO was paid $100 million in revenue by the Department for its ICP plan during CY 2013. Since the ICP contracts have a Targeted MLR of 88 percent, the Department would expect the MCO to have spent, at least, $88 million on benefit expenses (i.e. not administrative costs or profit) during CY 2013. After the conclusion of the six month claims run-out period for CY 2013, the Department receives data from the MCO indicating that its actual benefit expense for CY 2013 was only $80 million. In this example, the MCO would refund the Department $8 million.

As estimated by the Department's actuary as of the end of fieldwork, if the Department had calculated the CY 2013, CY 2014, and CY 2015 MLRs within the required contractual timeframe, the Department should have received at least $65 million in refunds from the MCOs by June 30, 2017.

Did not calculate and pay monies due back to the Federal government

Finally, the Department receives reimbursement from the Federal government to offset the cost of Medicaid assistance at the applicable federal financial participation (FFP) rate. By not calculating the MLRs and receiving the estimated $65 million in refunds, the Department has also not calculated and paid the applicable FFP rate back to the Federal government; thus, resulting in a potential liability. (Finding 2, pages 49-50)

We recommended the Department take action to ensure all MLRs are timely calculated and any amounts due back to the State are aggressively pursued.

Department accepted the recommendation

The Department accepted the recommendation and stated the Department has taken steps to calculate the outstanding Medical Loss Ratios and recoup any refunds due.

FINANCIAL STATEMENT PREPARATION

Department did not perform a sufficient review of all accounts and amounts recorded within its financial statements

The Department did not ensure its annual financial reports were prepared in conformity with U.S. generally accepted accounting principles (GAAP). We noted the Department did not perform a sufficient review of all accounts and amounts recorded within its financial statements, GAAP Package reports prepared for the Office of the State Comptroller to prepare the State's Comprehensive Annual Financial Report, and various additional supporting schedules. The following are some of the errors in the Department's financial statements, GAAP packages prepared for the Illinois Office of the Comptroller, and additional supporting schedules and analysis we noted:

Beginning Net Position restated by $29.2 million as a result of not calculating or estimating MCO MLRs

- The Department did not calculate the annual Medical Loss Ratios (MLRs) for the State's Medicaid Managed Care Organizations (MCOs) with mandatory enrollment since 2013. Consequently, the Department had not ensured reasonable estimations of this activity, including amounts due to the federal government from its participation in the Medicaid program, had been prepared for its financial reports. To correct the error for prior years, the Department restated its beginning net position by $29.2 million, including an increase in its accounts receivables related to the MCOs by $67.2 million and an increase in liabilities due to the federal government by $38 million. To correct the current year's errors, the Department recorded a reduction of its expenses and an increase in its accounts receivables related to the MCOs by $22.3 million and increased its liabilities due to the federal government by $13 million.

- The Department did not calculate and record its liability to the MCOs for certain incentive payments.

Incentive Payments estimated payable at June 30, 2017 not recorded for $37 million

In accordance with the Department's contracts with the MCOs, the Department withholds a percentage from each MCO's monthly capitation payment and holds these amounts within an incentive pool. At the end of the coverage period, the MCO is entitled to receive the withheld payments if the MCO met certain performance measures. The Department did not record an estimated liability for accounts payable to the MCOs where the Department and the MCO had not yet finalized the performance process at either June 30, 2017 or 2016. To correct this error for the prior year, the Department restated its beginning net position by ($14.3) million. To correct the current year's errors, the Department recorded an increase in its accounts payable and expenses by $37 million.

$47.3 million in Drug Manufacturer Rebates credits not accounted for

- The Department lacked adequate controls over its accounts receivable related to drug manufacturer rebates. Specifically, one of the errors noted related to the Department not applying credit balances of $46.5 million as of June 30, 2016, and $47.3 million as of June 30, 2017, to the manufacturers' accounts or taken this situation into consideration during the Department's financial reporting process.

Transfers totaling $402.2 million not reported

- During testing of statutory transfers from the Public Aid Recoveries Trust Fund (Fund 0421) to the Drug Rebate Fund (Fund 0728) at June 30, 2017, we noted some transfers were omitted from the Department's GAAP Packages. This error resulted in an understatement in Fund 0421's due to other funds and transfers out and an understatement of Fund 0728's due from other funds and transfers in by $402.2 million. (Finding 3, pages 51-55)

We recommended the Department take action to ensure all of its transactions are properly recorded and presented in its financial statements and GAAP Packages in accordance with GAAP. Further, the Department should ensure the accuracy and completeness of its financial and non-financial information used during the financial reporting process by reviewing the source for, and manual and electronic process of, its underlying transactions.

Department accepted the recommendation

The Department accepted the recommendation and stated the Department plans to implement changes to address the issues contained within the overall finding. This will include a review of the Department's GAAP preparation procedures and consultation with its contracted CPA firm to limit opportunities for oversight or human error.

BACKLOG OF APPLICATIONS FOR HUMAN SERVICE PROGRAMS

Applications were not reviewed and approved or denied within mandated 45-day timeframe

The Department of Healthcare and Family Services and the Department of Human Services (Departments) did not maintain adequate controls to ensure applications for human service programs were reviewed and approved or denied within the mandated 45-day timeframe.

The Departments' Integrated Eligibility System (IES) takes in applications from individuals in order to determine eligibility and subsequent payments for the State's human service programs.

Backlog of 74,649 applications as of June 30, 2017

As of June 30, 2017, the Departments had incurred a backlog of 74,649 applications that were more than 45 days old, with the oldest application dating back to November 19, 2014. As of January 12, 2018, The Departments had worked 1,714 applications for medical services resulting in payments totaling $209,894 and 676 applications for SNAP (Supplemental Nutrition Assistance Program) and TANF (Temporary Assistance for Needy Families) services resulting in payments totaling $47,568 incurred during FY2017. (Finding 6, page 61)

We recommended the Department of Healthcare and Family Services work with the Department of Human Services to implement controls to comply with the requirement that applications are reviewed and approved or denied within 45 days.

Departments accepted the recommendation

The Departments accepted the recommendation and stated the Departments continue to strive to be in compliance with its mandated application disposition timelines.

UNTIMELY REDETERMINATION OF ELIGIBILITY

Timely redeterminations of eligibility not conducted

The Department of Healthcare and Family Services and the Department of Human Services (Departments) did not conduct timely redeterminations of eligibility for Medicaid recipients.

8,187 individuals' eligibility redeterminations not performed annually

In order to determine if redeterminations were performed timely, we tested all individuals who received a capitation payment on their behalf to a managed care organization during the audit period and reviewed their redetermination dates. The testing results indicated 8,187 individuals' eligibility redeterminations were not performed within the required 12 month period.

The Departments made payments on behalf of these individuals, totaling $71,300,077, for medical services during FY2017. (Finding 7, page 62)

We recommended the Department of Healthcare and Family Services work with the Department of Human Services to establish the appropriate controls to monitor eligibility redeterminations, and assign the resources necessary so that redeterminations of eligibility are performed annually as required by the Code of Federal Regulations.

Departments accepted the recommendation

The Departments accepted the recommendation and stated the redetermination process will be enhanced with the implementation of the newly updated processing system in IES Phase II, which went live on October 24, 2017.

OTHER FINDINGS

The remaining findings pertain to inaccurate rates used to pay MCOs, incorrect claim payments made to medical providers and MCOs, inaccurate determinations of eligibility for human services programs, lack of controls over changes to the Integrated Eligibility System, lack of security controls over the IES computing environment, service provider controls, inadequate controls over drug rate changes, and inadequate project management over the Pharmacy Benefits Management System. We will review the Department's progress towards the implementation of our recommendations in our next financial audit.

AUDITOR'S OPINION

The auditors stated the financial statements of the Department of Healthcare and Family Services as of and for the year ended June 30, 2017 are fairly stated in all material respects.

This financial audit was performed by Sikich LLP.

SIGNED ORIGINAL ON FILE

JANE S. CLARK
Division Director

This report is transmitted in accordance with Section 3-14 of the Illinois State Auditing Act.

SIGNED ORIGINAL ON FILE

FRANK J. MAUTINO
Auditor General

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