



STATE OF ILLINOIS
**OFFICE OF THE
 AUDITOR GENERAL**

William G. Holland, Auditor General

SUMMARY REPORT DIGEST

DEPARTMENT OF HUMAN SERVICES

**Financial Audit
 For the Year Ended June 30, 2014**

Release Date: February 11, 2015

FINDINGS THIS AUDIT: 7	New	Repeat	Total	AGING SCHEDULE OF REPEATED FINDINGS			
				Repeated Since	Category 1	Category 2	Category 3
Category 1:	2	2	4	2009	14-3		
Category 2:	1	2	3	2007	14-4	14-7	
Category 3:	<u>0</u>	<u>0</u>	<u>0</u>	2005		14-6	
TOTAL	3	4	7				

FINDINGS LAST AUDIT (Government Auditing Standards Findings only): 4

INTRODUCTION

This report presents our Department-wide financial statement audit for the year ended June 30, 2014. At June 30, 2014, the Department operated 6 Developmental Centers, 7 Mental Health Centers, 1 combined Mental Health and Developmental Center and 3 Rehabilitation Services Facilities. The findings are presented in the report beginning at page 55.

SYNOPSIS

- **(14-1)** The Department had inadequate controls over the reporting of year-end balances related to its various federal grant programs which resulted in material audit adjustments to the financial statements.
- **(14-2)** The Department's allowance for doubtful accounts was materially misstated because all available information was not used to determine the amount.
- **(14-3)** The Department's year-end financial reporting to the Illinois Office of the Comptroller contained inaccuracies and errors which resulted in changes being made to originally submitted information.
- **(14-4)** The Department has weaknesses in the quarterly reporting of accounts receivable due to a cumbersome reporting system that relies on numerous subsystems and requires manual entries.

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 information is summarized on next page.}

**DEPARTMENT OF HUMAN SERVICES
FINANCIAL AUDIT
For the Year Ended June 30, 2014**

FINANCIAL INFORMATION - Governmental Funds (in thousands)	FY 2014	FY 2013
REVENUES		
Program revenue: charges for service.....	\$ 50,671	\$ 49,698
Program revenue: operating grants.....	5,213,617	5,304,531
General revenue: taxes, interest and other.....	12,249	7,408
Total revenue.....	<u>5,276,537</u>	<u>5,361,637</u>
EXPENDITURES		
Health and social services.....	8,332,765	8,563,442
Debt service - principle.....	649	391
Debt service - interest.....	77	83
Capital outlays	6,434	6,363
Total expenditures.....	<u>8,339,925</u>	<u>8,570,279</u>
OTHER SOURCES (USES)		
Appropriations from State resources.....	3,329,805	3,601,047
Transfers in.....	109,665	122,093
Transfers out.....	(87,256)	(100,154)
Receipts collected & transmitted to the State treasury.....	(160,153)	(151,842)
Lapsed appropriation.....	(71,455)	(63,464)
Other.....	(30,984)	(63,729)
Total other sources (uses).....	<u>3,089,622</u>	<u>3,343,951</u>
Increase in fund balance.....	26,234	135,309
Fund balance, July 1.....	96,196	(37,942)
(Decrease) for changes in inventories.....	(308)	(1,171)
Fund balance, June 30.....	\$ 122,122	\$ 96,196
SELECTED ACCOUNT BALANCES - June 30, Governmental Funds (in thousands)		
	FY 2014	FY 2013
ASSETS		
Cash and cash equivalents & investments.....	\$ 271,856	\$ 359,921
Due from other governments - federal & local.....	190,220	264,237
Loans, taxes and other receivables, net.....	162,137	49,123
Due from other Department and State funds.....	23,708	120,586
Inventories.....	7,037	7,511
Unexpended appropriations.....	402,759	472,966
Total assets.....	<u>\$ 1,057,717</u>	<u>\$ 1,274,344</u>
LIABILITIES		
Accounts payable and other liabilities.....	\$ 599,709	\$ 718,824
Unearned revenue.....	21,576	122,587
Due to other funds - State, federal, local & Department.....	120,372	170,407
Total Liabilities.....	<u>741,657</u>	<u>1,011,818</u>
DEFERRED INFLOWS OF RESOURCES - Unavailable Revenue.....	193,938	166,330
FUND BALANCE.....	122,122	96,196
TOTAL LIABILITIES AND FUND BALANCE.....	\$ 1,057,717	\$ 1,274,344
SECRETARY		
During the Audit Period: Ms. Michelle R. B. Saddler (7/1/13 through 1/19/15)		
Currently Acting: Ms. Melissa Wright (1/20/15 through current)		

**FINDINGS, CONCLUSIONS, AND
RECOMMENDATIONS**

**NEED TO IMPROVE REPORTING FOR GRANT
RELATED ACCOUNT BALANCES**

The Department of Human Services (Department) does not have adequate controls over the reporting of year-end balances related to various federal grant programs, resulting in material audit adjustments to the Department's financial statements

Flawed methodology used

In reviewing amounts reported in the GAAP Packages and Comptroller Forms (SCO 563 Forms) for federal grant receivables, payables and unearned revenue, we found that the process for reporting grants and related accruals for financial reporting was inadequate. During our testing of the year-end accruals reported on the SCO-563 Forms, we noted the accruals appeared unreasonable when analyzed at the overall Department level. As a result of additional testing, we found that the Department utilized a flawed methodology for the allocation of expenditures and calculating grant accruals. The flawed methodology was noted in 23 grants tested, resulting in gross adjustments totaling \$296 million.

The Department may report receipts and disbursements for a single grant program in 2 or more funds. Grant receipts are also not always deposited in the funds from which the corresponding claimed expenditures are spent. As a result, in order to report activity by fund for financial reporting purposes, the Department utilized a methodology for allocation of expenditures and computing year-end accruals. The methodology was found to be flawed and was not reviewed for reasonableness and substantiation.

We also noted the following additional grant related errors and omissions:

Missing reconciliation

- The November 2013 Consolidated Accounting and Reporting System (CARS) reconciliation of federal grant receipts was missing.

**Failure to draw the monthly
maximum**

- The Department did not draw the monthly maximum allowed under the Cash Management Improvement Act Agreement with the U.S. Department of the Treasury for the Supplemental Nutrition Assistance Program (SNAP). The Department's draws amounted to \$2 million bimonthly for a total of \$48 million for the year. When the Department reconciled expenditures to draw amounts at the end of the fiscal year, a final draw of approximately \$59 million was effectuated for the expenditures that were incurred throughout the year.

Agreement lacked important provisions

- The Department received \$17.2 million every third month for the Department of Children and Family Services, totaling \$68.8 million for the year. The agreement provided to the auditors did not contain any information on the amount of the payments under the agreement, or the frequency of the payments. (Finding 1, Pages 55-57)

We recommended the Department implement a process for ensuring amounts reported for all grants are accurate and that controls are in place to ensure knowledgeable individuals validate amounts reported for these grants.

Department agrees with auditors

Department officials agreed with the recommendation and stated they have implemented a new GAAP process for grant reporting.

NEED TO IMPROVE REPORTING FOR ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Department overstated the allowance for doubtful accounts and did not utilize all information available.

\$462 million in receivables

\$430 million recorded as allowance for doubtful accounts

Estimated collection rate 7%

Historical collection rate 32%

The DHS Recoveries Trust Fund accounts for approximately \$462 million in receivables (gross) for overpayments to program recipients for things such as food stamps and grants. The Department initially recorded an allowance for doubtful accounts for these receivables of approximately \$430 million, resulting in a net receivable of \$32 million. The Department calculated the allowance amount by dividing the FY 2014 collections amount by the receivable balance at June 30, resulting in a collection rate of 7%. The remaining 93% was considered uncollectable, which was applied to the gross receivable balance at June 30, 2014 to estimate the \$430 million allowance amount. An analysis by the auditors of collections information dating back to 1986 determined an average collection rate of 32.37%.

Amount overstated by approximately \$112 million

In discussing the actual collection rate with the Department, they determined a revision to their estimate of the collection methodology was necessary. The revised calculation prepared by the Department considered a ten-year-average collection period and the allowance was recorded at 68.75% or \$317.5 million. As a result, the initial allowance for doubtful accounts was overstated by approximately \$112 million. (Finding 2, Pages 58-59)

We recommended the Department analyze all available collection data annually and adjust the methodology for calculating the allowance for doubtful accounts as necessary.

Department agrees with auditors

Department officials agreed with the recommendation and stated they developed a new methodology for calculating the allowance for doubtful accounts and will analyze all collection data annually to recalculate the allowance for doubtful accounts.

NEED TO IMPROVE FINANCIAL REPORTING TO THE ILLINOIS OFFICE OF THE COMPTROLLER AND PREPARATION OF YEAR-END FINANCIAL STATEMENTS

The Department's year-end financial reporting to the Illinois Office of the Comptroller contained inaccuracies and errors which resulted in changes being made to originally submitted information.

Inadequate general ledger and controls for financial accounting and reporting

The Department does not have an adequate general ledger or adequate controls over year-end financial reporting which resulted in significant errors in the GAAP basis draft financial statements, GAAP schedules prepared for the State Comptroller's Office, and additional supporting schedules and analysis.

Untimely recording of expenditures

The Department did not timely record all expenditures and receipts into CARS.

Department could not rely upon internal accounting records for payroll

- This included payroll transactions totaling \$204 million through June 30 and \$55 million for the lapse period (July and August 2014). The Department generally relied on inquiries from the Comptroller's Statewide Accounting Management System (SAMS) for payroll expenditure data because they could not rely on their own internal accounting records for payroll information.

Significant reconciling items

- When reviewing the expenditure reconciliations from the Department's accounting system to the Comptroller's accounting system at June 30, 2014, the auditors noted the General Revenue Fund had significant reconciling items which \$16.517 of expenditures were not posted to the Department's accounting system.

We also noted the following issues with the year-end financial reporting process:

Undocumented process for estimating liabilities

- The Department does not have a documented process for estimating liabilities payable from future year's appropriations for certain transaction types.

Process lacking to ensure certain costs and reimbursements are reported in proper period

- The Department does not have a process to ensure that indirect costs and the related reimbursements are captured and recorded in the proper period.

Transfers from General Revenue Fund overstated

- In FY 2013 the Department overstated operating transfers out from the General Revenue Fund to the DHS Public Assistance Recoveries Trust Fund by \$11.655 million. The physical transfer of the funds has not been made as of the date of this report.

Inadequate supervisor review

- The Department does not perform a supervisory review of all amounts recorded in its GAAP Packages and financial statements. These amounts include the following:
 - Payments made by the Department of Healthcare and Family Services (HFS). A spreadsheet is provided by HFS supporting the payments made by HFS; however, those charged with financial reporting at the Department do not have a full understanding of the information provided by HFS sufficient to identify amounts that might be inaccurate.

Detailed support not provided

- A balance recorded by the Department for compensated absences payable in its financial statements (\$69 million as of June 30, 2014). The amount is based on a summarized report obtained from the payroll system (“timekeeping system”). In order to obtain the detail necessary to perform testing over the balance of accrued sick and vacation, the IT department had to be notified to run a special report. The detail was never obtained and reviewed by those responsible for financial reporting. (Finding 3, Pages 60-62).
This finding has been repeated since 2009.

We recommended management perform a thorough assessment of the year-end financial reporting process and determine the significant estimates that need to be re-evaluated. Also, the Department should work with management of HFS to gain a better understanding of the amounts reported in the Department’s financial statements.

Department agrees with auditors

Department officials agreed with the recommendation and stated they will perform a thorough assessment of the year-end financial reporting process and continue to make improvements to ensure accurate and timely preparation of GAAP reporting forms and year-end financial statements. (For the previous Department response, see Digest Footnote #1.)

WEAKNESSES OVER QUARTERLY REPORTING OF ACCOUNTS RECEIVABLE

The Department’s accounts receivable reporting system is cumbersome, relies on numerous subsystems, and requires manual entries.

Complex compilation of accounts receivables relies on multiple systems

During testing of the quarterly receivable forms required by the Office of the State Comptroller, the auditors noted the reports were manually compiled from multiple accounts receivable systems in order to issue a single report. The compilation is complex and cumbersome and, as a result, there is a potential for errors in reporting. The current process takes several hours to complete over a period of several weeks. The Department's current primary accounts receivable system is the Accounts Receivable System (ARS) and the secondary systems are the Consolidated Accounting and Reporting System (CARS) and the Reimbursement System II (RE2). The systems need to be updated to handle the quantity of transactions processed by the Department.

Auditors unable to reconcile account receivable amounts ranging from \$5 to \$10 million

The Department submitted accounting reports to the Comptroller that contained differences that could not be reconciled for the first two quarters of FY 2014. Auditors reviewed the supporting documentation for receivables but were unable to reconcile the amounts to the totals reported for the quarter end. For fiscal year 2014, differences ranged from \$5 million to \$10 million at the end of quarters one and two.

Due to the size of the Department and the balance of accounts receivable (approximately \$516.5 million), the current process for compiling the data does not efficiently or effectively integrate automation of its accounts receivable activity into the Department's financial accounting system, CARS, and makes it difficult to prepare an accurate aging of the Department's accounts receivable. (Finding 4, Pages 63-64). **This finding has been repeated since 2007.**

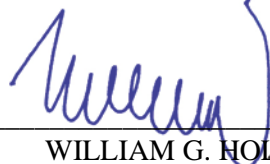
We recommended the Department implement a Department-wide accounts receivable system and work with the appropriate parties regarding any possible State-wide consolidated accounting system initiatives.

Department agrees with auditors

Department officials agreed with the recommendation and stated that the State of Illinois has received competitive proposals related to the acquisition of a system that will replace several major legacy systems. (For the previous Department response, see Digest Footnote #2.)

AUDITOR'S OPINION

Our auditors stated the financial statements of the Department of Human Services as of June 30, 2014, and for the year ended are fairly stated in all material respects.



WILLIAM G. HOLLAND
.. Auditor General

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SPECIAL ASSISTANT AUDITORS

Our Special Assistant Auditors for this audit were McGladrey, LLP.

DIGEST FOOTNOTES

#1 WEAKNESSES IN PREPARATION OF GAAP REPORTING FORMS AND FINANCIAL STATEMENTS

2013: The Department agrees with the recommendation. The Department will implement procedures and cross-training measures to ensure GAAP Reporting Packages are prepared in a timely, accurate and complete manner. This will include seeking or allocating sufficient staff resources and the implementation of formal procedures to ensure GAAP financial information is prepared and submitted to the Office of the Comptroller in a timely and accurate manner, and that all supporting documentation is maintained in a contemporaneous manner.

#2 WEAKNESSES OVER QUARTERLY REPORTING OF ACCOUNTS RECEIVABLE

2013: The Department agrees with the recommendation. The Department continues to review the Accounts Receivable agency wide. Based on the results of the review, we will establish and implement any changes as solutions occur. DHS would like to see one uniform Accounts Receivable System that would handle all DHS debt and would satisfy all receivable functions including financial reporting. Until a Statewide solution is implemented the Department will work to improve the systems it currently maintains. The Department will continue to work with the appropriate parties regarding any possible statewide consolidated accounting system initiatives.