DHCS

DAVID MAXWELL-JOLLY
Director

State of California—Health and Human Services Agency
Department of Health Care Services

ARNOLD SCHWARZENEGGER
Governor

December 22, 2009

Kimberly Belshé
Secretary
Health and Human Services Agency
1600 Ninth Street, Room 460
Sacramento, CA 95814

Dear Ms. Belshé:

In accordance with the Financial Integrity and State Managers Accountability Act of 1983, Government Code, § 13400 through 13407, I am submitting the enclosed report describing the review of our systems of internal control for the biennial period ended December 31, 2009.

Pursuant to the Governor's Executive Order S-08-09, Internal Audits' reports will be made available to the public within five working days of finalization. Accordingly, this report will be posted to the internet at http://reportingtransparency.ca.gov.

Sincerely,

Karen Johnson
Chief Deputy Director

Enclosure

cc: See next page.

cc: The Honorable Arnold Schwarzenegger
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Sacramento, CA 95814

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DEPARTMENT OF HEALTH CARE SERVICES

INTERNAL AUDITS

Financial Integrity and State Manager's Accountability Act of 1983

December 2009

DHCS

California Department of
HealthCareServices

09004

DEPARTMENT OF HEALTH CARE SERVICES
INTERNAL AUDITS

FINANCIAL INTEGRITY AND
STATE MANAGER'S ACCOUNTABILITY
ACT OF 1983

DECEMBER 2009

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ASSIGNMENT NO. 09004

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INTRODUCTION

INTRODUCTION

In accordance with the Financial Integrity and State Managers Accountability (FISMA) Act of 1983, the Department of Health Care Services submits this report on its review of the systems of internal control for the biennial period ended December 31, 2009.

This review was conducted pursuant to Government Code, § 13405. It requires that the head of each state agency submit a biennial report on the adequacy of the agency's internal control systems. Government Code, § 13402 states that state agency heads are responsible for the establishment and maintenance of a system or systems of internal accounting and administrative control within their agencies. Government Code, § 13403 states that the elements of a satisfactory system of internal control systems include, but are not limited to, the following:

- A plan of organization that provides segregation of duties appropriate for proper safeguarding of state agency assets.
- A plan that limits access to state agency assets to authorized personnel who require these assets in the performance of their assigned duties.
- A system of authorization and recordkeeping procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenditures.
- An established system of practices to be followed in performance of duties and functions in each of the state agencies.
- Personnel of a quality commensurate with their responsibilities.
- An effective system of internal review.

AUDITOR'S OPINION

AUDITOR'S OPINION

Internal Audits has made a study and evaluation of the systems of internal control of the Department of Health Care Services (DHCS or Department) in effect as of October 7, 2009. In addition to an evaluation of the Department's administrative and accounting controls, this review included an evaluation of risks that may prevent the Department from achieving its goals and objectives. Our study and evaluation was conducted in accordance with the Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors and included the audit tests we considered necessary in determining that the systems of internal control are in place and operative.

DHCS' management is responsible for establishing and maintaining adequate internal controls. This responsibility, in accordance with Government Code, § 13402 et seq., includes documenting internal controls, communicating requirements to employees, and assuring that the internal control is functioning as prescribed. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures.

The objectives of accounting and administrative controls are to provide management with reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition.
- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements.
- Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual.

Our study and evaluation did not reveal any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls. However, we did identify two vulnerabilities that could impact the Department's ability to achieve its goals and objectives. These vulnerabilities are described in the Evaluation of Risks and Controls section of this report.

In our opinion, DHCS' systems of internal control in effect as of October 7, 2009, taken as a whole, was sufficient to meet the objectives stated above.

As a result of changing conditions and the degree of compliance with procedures, the effectiveness of controls can change over time. Specific limitations that may hinder the effectiveness of an otherwise adequate system of controls include, but are not limited to: resource constraints, faulty judgments, unintentional errors, circumvention by collusion,

and management overrides. Establishing controls that would prevent all these limitations would not be cost effective; moreover, an audit may not always detect these limitations.

Thomas J. Rakela, C.F.E., Chief
Internal Audits

BACKGROUND

BACKGROUND

The Department of Health Care Services was created July 1, 2007, as a result of Senate Bill 162 (Ortiz, Chapter 241, Statutes of 2006). Senate Bill 162 established the California Department of Public Health (CDPH) within the existing Health and Human Services Agency. It statutorily transferred certain responsibilities from the California Department of Health Services (CDHS) to the new CDPH. At the same time, CDHS was renamed the Department of Health Care Services (DHCS or Department).

DHCS recognized that there were several benefits to this change. They included:

- More focused leadership in health care financing at the state level.
- Streamlined management of complex program components along functional lines.
- Increased accountability, responsiveness, effectiveness, and transparency for the health care purchasing functions of state government.
- Provided visibility on important health care issues to the providers, local health departments, the federal government, legislature, advocates, the press, and the general public.
- Increased ability to recruit and retain top quality staff.

As of November 23, 2009, there were 24 divisions within DHCS[1].

DHCS is one of 13 departments in the California Health and Human Services Agency (CHHSA). The CHHSA Action Plan contains five goals that guide DHCS' work. The CHHSA goals are:

1. Every child will live in a safe, stable, permanent home; nurtured by healthy families and strong communities.
2. Every Californian will have access to high quality, affordable health care coverage.
3. California will support and value healthy lifestyle behaviors, particularly physical activity and healthy eating, to improve health outcomes and reverse the upward obesity trend.

[1] See Attachment 1 for a copy of the organization chart.

4. Disabled and aged Californians will have the opportunity to live in their own homes and communities (rather than institutional settings) in the most integrated setting possible.

5. California will be maximally prepared to prevent and respond to natural or intentional disasters, including acts of terrorism.

MISSION

DHCS' mission is to preserve and improve the health status of all Californians. DHCS works closely with health care professionals, county governments, and health plans to provide a health care safety net for California's low-income and persons with disabilities.

DHCS' programs serve more than 7.2 million Californians. One in six Californians receives health care services financed or organized by DHCS, making the Department the largest health care purchaser in the State. DHCS invests over $38 billion in public funds to provide health care services for low-income families, children, pregnant women, seniors, and persons with disabilities and to maintain the health care provider safety net. The Department's programs provide access to comprehensive health services and emphasize prevention-oriented health care that promotes human health, well-being and individual choice. DHCS ensures appropriate and effective expenditure of public resources to serve those with the greatest health care needs. DHCS' programs include Medi-Cal, California Children's Services, the Child Health and Disability Prevention Program, the Genetically Handicapped Persons Program, and programs for underserved Californians including farm workers and American Indian communities.

DHCS' programs are designed to:

- Deliver health care services to low-income persons and families who meet defined eligibility requirements;
- Emphasize prevention-oriented health care measures that promote health and well-being;
- Ensure access to comprehensive health services through the use of public and private resources; and
- Ensure appropriate and effective expenditure of public resources to serve those with the greatest health care needs.

GOALS AND OBJECTIVES

DHCS released the Department of Health Care Services Strategic Plan (Strategic Plan) in October 2008. DHCS' Strategic Plan includes the mission, core values, vision, and

goals and objectives of the Department. The Strategic Plan serves as a roadmap for DHCS' short- and long-term work through 2011. The goals and objectives are:

Goal 1: Organize Care to Promote Improved Health Outcomes

Objectives:
A. Ensure every beneficiary has a medical home
B. Provide care in settings that promote community integration
C. Promote use of preventive, health improvement and wellness services/activities
D. Reduce disparities in health care delivery and health outcomes
E. Increase care management for those with the highest health burdens and costs
F. Promote quality improvement within the health care delivery system

Goal 2: Promote Comprehensive Health Coverage

Objectives:
A. Enroll eligible individuals
B. Retain eligible persons in health coverage

Goal 3: Measure Health System Performance and Reward Improved Outcomes

Objectives:
A. Measure health outcomes and provide information to providers, individuals and the public
B. Reward health plans, providers and business partners who are top achievers

Goal 4: Increase Accountability and Fiscal Integrity

Objectives:
A. Establish and monitor performance metrics for DHCS
B. Identify and improve high priority business practices
C. Improve relationships with business partners, stakeholder groups and policymakers
D. Reduce waste and fraud
E. Act in accordance with state and federal statutes and regulations
F. Identify and secure federal policy and rule changes that support DHCS programs

Goal 5: Ensure Viability and Availability of Safety Net Services

Objectives:
A. Identify mechanisms to maximize federal reimbursement for safety net services
B. Maintain availability of and access to safety net services

Goal 6: Expand and Promote Use of Information Technology

Objectives:
A. Identify top priority systems for modernization and improvement

B. Establish governance for DHCS and the CDPH shared information technology infrastructure services
C. Transition the support and control of non-infrastructure information technology services to CDPH

Goal 7: Recruit, Retain, Train and Nurture High Quality, Diverse Staff

Objectives:
A. Improve human resource processes and outcomes
B. Increase communication with employees about the impact of DHCS' work
C. Promote worksite wellness
D. Support employee professional development and upward mobility
E. Participate in statewide and national policy organizations

In addition to the Strategic Plan, DHCS also has a separate Medi-Cal Fraud Control Strategic Plan and the Department's Information Technology Services Division (ITSD) has a Capital Plan. Both of these plans have been incorporated into the Department's Strategic Plan. This ensures that the goals and objectives in the Medi-Cal Fraud Control Strategic Plan and ITSD's Capital Plan support the Department's overall mission.

A component of DHCS' Strategic Plan is the Implementation Plan. It outlines the activities the Department will undertake to meet its goals and objectives. It also includes a timeline of when these activities will be completed. The Implementation Plan is updated quarterly.

ENVIRONMENT

The Strategic Plan states that the Department exercises its values through the following beliefs, practices, and behaviors:

- The Department recognizes that all Californians need high quality health care. The best care is person-centered and tailored to meet the needs of the individual. The Department is committed to maintaining and improving the health of those it serves.

- The Department assists individuals who are eligible for its programs. It understands the necessity of simplifying the eligibility and enrollment policies and processes. The Department is transparent in its decision-making regarding program rules.

- The Department strives to ensure access to services. It identifies and works to eliminate unnecessary barriers to care. It ensures that there are appropriate professional and institutional networks to provide for the health care needs of those it serves. The Department understands that access is dependent on

reasonable reimbursement for providers and efficient business processes such as provider enrollment, treatment authorization, and claims processing.

- The Department endeavors to reduce and eliminate the disparities in health outcomes between different people and groups with the goal of improving health outcomes for all. It works to eliminate variations in the delivery of health care when those differences do not contribute to better maintenance and improved health outcomes.

- The Department values and respects the diversity of our customers. It strives to provide culturally and linguistically appropriate care that meets the needs of the populations it serves.

- The Department provides community-based care alternatives to promote choice. It develops and implements care options to address the continuum of care needs from home care through hospital and skilled nursing care and adult day health care. The Department respects individuals' autonomy and self-determination.

- The Department acts with a sense of stewardship and service to the public. It ensures that maximum value is attained for taxpayer investments in the services it organizes, finances, and delivers.

- The Department supports and protects health care safety net services. It maximizes available funds to develop safety net care services that are not broadly available in the community such as burn centers, trauma centers, and children's specialty care.

- The Department clearly communicates its mission to legislators, business partners, and stakeholders. It engages stakeholders effectively and enlists them in implementing its vision of quality care that is accessible and affordable. The Department appreciates the value of collaboration and partnership.

- The Department strives to be excellent business partners. It acts with ethical integrity, ensuring that its communication and actions are honest, open, and straightforward. The Department strives to make it easy to do business with its programs.

- The Department is a leader among publicly financed health care programs in adopting promising health care innovations. It is a national leader in drug pricing. It is a leader in developing primary care though community designed reimbursement mechanism. The Department is a leader in efforts to establish cultural and linguistic access standards for health plans. It is a leader in information security and encryption and adoption of business practices based on state-of-the-art information technology standards.

- The Department prepares for natural and manmade disasters. It collaborates with the CDPH's Emergency Preparedness Office and responds appropriately to emergencies.

- The Department respects its staff and colleagues. It provides support, feedback, training, and opportunities for career advancement. The Department recognizes that a diverse workforce is a strong workforce. It recognizes and rewards employee excellence.

VACANT POSITIONS

VACANT POSITIONS

The Department of Health Care Services' Human Resources Branch certifies that it is in compliance with the provisions of Government Code, § 12439. The major provision of the Code is that any state position that is vacant for six consecutive monthly pay periods shall be abolished by the Controller on the following July 1. The six consecutive monthly pay periods may occur entirely within one fiscal year or between two consecutive fiscal years.

RISK ASSESSMENT

RISK ASSESSMENT

ORGANIZATIONAL WIDE RISK ASSESSMENT

In 2008, Internal Audits developed surveys for the Department of Health Care Services' (DHCS or Department) divisions to self-assess the adequacy of their internal controls in regards to cash receipts and billings, contracts, and electronic data security. These are activities that the divisions are engaged in on a daily basis.

Completed surveys were returned to Internal Audits for scoring purposes. Internal Audits assigned a weighted value to each survey question. If the question dealt with an area that was prone to greater risk, then the question was given more weight for scoring purposes. The higher the score, the more risk associated with that area.

All of the surveys received were scored and ranked. The ranking was based not only on the survey score, but also audit experience. The final ranking for the cash receipts and billings, contract monitoring, and electronic data security surveys have been incorporated into our yearly audit plan.

In addition to the cash receipts and billings, contract monitoring, and electronic data security surveys, Internal Audits also created a Control Environment Questionnaire (Questionnaire). This Questionnaire was created by using the Control Environment Questions provided by the Department of Finance's Office of State Audits and Evaluations. Our Questionnaire was sent to the Department's division chiefs and asked:

- What are the major issues facing their division?
- What must go right for their division to succeed and complete its mission or achieve its goals and how is success measured?
- How could operations be disrupted and what would be the impact?
- How could data, cash, or equipment be stolen?
- How could the division lose credibility with control agencies, the legislature, and the public?

All of the Questionnaires received were reviewed. Though some of the responses were specific to their program, most of the divisions expressed the following common concerns and/or issues.

The top three issues facing the divisions were:

1. Workforce Planning
2. a. System modernization and/or replacement
   b. Monetary issues: budget control and economy and its effect on collections
3. Ability to achieve objectives/implement the Department of Health Care Services Strategic Plan (Strategic Plan) (includes concern regarding workload and resources, but not personnel concerns)

The top four ways of how operations could be disrupted were:

1. Loss of staff and/or other resources
2. System failures/service interruptions (including natural disasters)
3. Workload issues: reduced funding, increased workload, competing priorities
4. Security breach

The top three ways that thefts could occur were:

1. Data and/or equipment taken from an office by a non-employee who gained unauthorized access to the building
2. Employee theft of equipment and/or data: e-mail to home computer, Citrix, other removable media, abuse of access privileges
3. Security breach – internally or through the network

The top three ways that credibility could be lost were:

1. Not protecting Personal Health Information/Personal Confidential Information
2. Providing inaccurate or inconsistent information
3. Not completing work in a timely manner

The results of this Questionnaire have been incorporated into our yearly audit plan.

GREATEST VULNERABILITIES

Based on the responses received from the Questionnaire, the Department's division chiefs identified that the greatest vulnerabilities are in the areas of workforce planning, system modernization and/or replacement, and the ability to achieve the objectives of the Strategic Plan.

The areas of workforce planning and system modernization and/or replacement have been identified as areas that may impact the Department's ability to achieve its goals and objectives. These areas will be discussed in the Evaluation of Risks and Controls section of this report.

Responses to our Questionnaire also included system failures, security breaches, thefts, and not providing accurate and consistent information. However, Internal Audits determined that the Department has already recognized that these are areas of risk. As such, the Department already has adequate policies and procedures in place to mitigate these risks.

The budget situation was one other area of risk identified as a result of our Questionnaire. Internal Audits recognizes this as a risk to meeting our goals and objectives; however, the Department's final allocated budget is determined by the Legislature passing and the Governor signing a budget. The State is currently facing a $20.7 billion budget deficit, which threatens the Department's ability to sustain current programs.

Though the results of our Questionnaire did not specifically identify this as a risk, DHCS has been impacted by the Governor's Executive Order S-13-09. Executive Order S-13-09 ordered the Department of Personnel Administration to adopt an amended plan to implement a furlough of represented state employees for three days per month, regardless of funding source, for fiscal year 2009/10. The furloughs do not change the Department's goals and objectives. However, the furloughs may affect the Department's ability to achieve its goals and objectives timely. The timeline identified in the Department's Implementation Plan may need to be adjusted as the year progresses.

AUDITS PERFORMED

Internal Audits

The information below summarizes Internal Audits' activities and accomplishments over the past two years. Internal Audits issued 26 assignments in calendar years 2008 and 2009. The assignments included mandated reviews, internal control reviews, requested reviews, special assignments, and investigations.

Mandated Reviews

Follow-up on the Findings and Recommendations Made in our Prior Biennial State Administrative Manual (SAM) 20000 Report Entitled *Review of the Department's Administrative and Accounting Controls*, issued November 2009

Internal Audits conducted a follow-up review on the Findings and Recommendations made in our prior biennial report entitled *Review of the Department's Administrative and Accounting Controls* issued on December 21, 2007. The prior report contained 14 findings and 20 recommendations.

Of the 14 findings and 20 recommendations made in the prior biennial report:

- Nine of the findings and 14 recommendations have been fully implemented. The table below lists those findings and recommendations by transaction cycle:

Transaction Cycle	Finding(s)	Recommendation(s)
Accounts Receivable	1	A, B, C, and D
Fixed Assets and Purchasing	3 and 4	F and G
Revolving Fund	6	I
Human Resources and Payroll	7	J and K
Information Technology Controls	8	L
Disbursements	9 and 10	M and N
Contracts	14	S and T

- One finding is no longer applicable: Finding 13 – Recommendations Q and R. This finding was related to the inclusion of the prevailing wage provision in a moving service contract. The contract was for a one-time service. Procedures have been implemented to ensure that the prevailing wage provision will be included in future contracts. Recommendations Q and R have been fully implemented.

- Two of the findings have been partially corrected: Finding 2 – Recommendation E and Finding 5 – Recommendation H.

  Finding 2 related to the reconciliation of the physical inventory of fixed assets to the fixed assets ledger. The Asset Management unit (AM) has received the physical inventory records for each division within DHCS and is in the process of completing this reconciliation.

  Though the general ledger fixed asset totals have not yet been adjusted, AM has the detailed physical inventory records for DHCS. As of October 7, 2009, AM was in the process of reconciling the physical inventory records to the fixed assets ledger and it is expected that this reconciliation will be completed before the close of the next fiscal year.

  Finding 5 related to the collection of outstanding salary advances. Accounting staff were using an Excel spreadsheet to monitor and collect outstanding salary advances. The Excel spreadsheet was not complete nor did it reconcile to the California State Accounting and Reporting System (CALSTARS) reports. Accounting now reconciles the Excel spreadsheet to the CALSTARS reports on a monthly basis.

- Two of the findings have not been corrected: Finding 11 – Recommendation O and Finding 12 – Recommendation P.

Finding 11 related to transactions posted to the Uncleared Collections account. Current transactions posted to Uncleared Collections are reviewed and cleared timely. However, more than half of the transactions posted to the Uncleared Collections were for calendar years prior to 2009.

Finding 12 related to contracts processed and approved after the start of the contract period. This finding was disclosed in our report entitled *Contract Exemption Review* issued in September 2009, discussed below.

No other areas were reviewed and no new conditions were noted during the course of our fieldwork.

We qualified the opinion of our prior biennial report due to the inadequate controls over fixed assets and the untimely clearing of the receivables. Significant improvements have been made so that the conditions once considered pervasive in their effects on the accounting and administrative controls have been mitigated.

The physical assets will be reconciled to the fixed assets ledger by the end of the fiscal year and the receivables were found to be cleared in a timely manner. The prior report stated that outstanding receivables in excess of 120 days totaled $27,391,092. As of May 2009, the outstanding receivables in excess of 120 days totaled $3,150,947. This is a reduction of more than $24 million, or 88.50 percent, from our last biennial internal control review.

None of these audit findings, if left uncorrected, would impact the Department's ability to achieve its goals and objectives. Therefore, none of these findings and recommendations will be carried forward to the Evaluation of Risks and Controls section of this report.

Biennial Contract Exemption Review issued September 2009

Internal Audits reviewed DHCS' internal controls for the processing of specific contracts. This review is required by the Department of General Services (DGS) in its Exemption Letter 55.4 and its amendment. The exemption allows DHCS to authorize contracts under $75,000 without obtaining DGS approval. Our review was conducted in DHCS' Contract Management Unit (CMU) and applicable programs. The review included testing of contracts, grants, service orders, DHCS' CAL Card usage, and contractual agreements written under the Master Service Agreements and the California Multiple Award Schedules.

This report contained two audit findings:

- The majority of the 24 sampled contracts processed and approved were finalized after the start of the contract period. Additionally, work was started prior to contract approval.

- CMU and Program contract files did not include copies or original Contractors Certification Clauses.

The audit report opinion was qualified because contracts were not consistently approved on time (which is a repeat finding) as a result of untimely submission by the programs to CMU.

None of these audit findings, if left uncorrected, would impact the Department's ability to achieve its goals and objectives. Therefore, none of these findings and recommendations will be carried forward to the Evaluation of Risks and Controls section of this report.

Internal Control Reviews

Internal control reviews are extensions of the SAM 20000 Review of Accounting and Administrative Controls. Reviews are selected based upon the department-wide risk ranking analysis that Internal Audits performs periodically.

Internal Audits issued the following internal control review reports during calendar years 2008 and 2009:

Safety Net Financing Division (SNFD) (07537)
Internal Audits reviewed the contract monitoring procedures for the County Medi-Cal Administrative Activities Program.

Fiscal Intermediary and Contract Oversight Division (FICOD) (07548)
Internal Audits reviewed the payment process for the Fiscal Intermediary's invoices for Change Order 4.

SNFD (08602)
Internal Audits reviewed the contract monitoring procedures for the Hospital/Uninsured Care Demonstration Section and Inpatient and Monitoring Section.

Office of Administrative Hearings and Appeals (08604)
Internal Audits reviewed the case tracking system for completeness and accuracy.

FICOD (08620)
Internal Audits reviewed the payment process for the Fiscal Intermediary's invoices for the cost reimbursement invoices.

Information Technology Services Division (ITSD) (08625)
Internal Audits reviewed ITSD's contract monitoring procedures.

The audit findings and recommendations made in the above named reports are not so pervasive that if left uncorrected, would impact the Department's ability to achieve its goals and objectives. Therefore, none of the findings and recommendations from the above named reports will be carried forward to the Evaluation of Risks and Controls section of this report.

Special/Requested Reviews

The majority of these reviews were requested by DHCS management. Others were performed as a result of Internal Audits' risk ranking analysis or requests from outside agencies.

Internal Audits conducted the following special/requested reviews during calendar years 2008 and 2009:

Office of Medi-Cal Procurement
These reviews are designed to ensure that proposals are evaluated fairly and in an unbiased manner. The following proposals were reviewed:

External Quality Review Organization Narrative Portion (08612)
External Quality Review Organization Cost Portion (08615)
Other Health Coverage Identification and Recovery (08627)
Coordinated Care Management Project – Seniors and Persons With Disabilities (08628)
Coordinated Care Management Program – Serious Mental Illnesses (09007)
Health Information Technology for Economic and Clinical Health Act (09012)
California Medicaid Management Information System (09013)

FICOD (08605)
Internal Audits reviewed FICOD's procedures for the transfer and release of data containing Protected Health Information and Personal Confidential Information.

SNFD – School Based Medi-Cal Administrative Activities (08606)
Internal Audits observed the invoice review process and provided suggestions for improvement of efficiency and effectiveness of processing the School Based Medi-Cal Administration Activities claims.

Provider Enrollment Division (08607)
Internal Audits reviewed a proposal to streamline the provider enrollment process. The review compared prior procedures to proposed eliminations to ensure integrity.

FICOD and ITSD (08610)
Internal Audits conducted a Claim of Custody review for data disks for outgoing and incoming processes between distribution to and from Electronic Data

Systems, DHCS' ITSD, and the Department of Technology Services for security and integrity.

The audit findings and recommendations made in the above named reports are not so pervasive that if left uncorrected, would impact the Department's ability to achieve its goals and objectives. Therefore, none of the findings and recommendations from the above named reports will be carried forward to the Evaluation of Risks and Controls section of this report.

Internal Audits complies with the Governor's Executive Order S-08-09 by posting its internal audit reports to the Reporting Transparency in Government website (http://reportingtransparency.ca.gov) within five working days of finalization.

Also, in accordance with Government Code, §13405(c), Internal Audits tracks and follows up on all inadequacies and weaknesses identified in its audit reports every 30 days, six months, and one year or until the finding has been corrected.

External Audits

Internal Audits provides a central point for all audits and reviews conducted by federal and other state agencies. This is done through the Audit Coordinator position.

The Audit Coordinator acts as a liaison between external auditors and the Department. The main tasks include ensuring that appropriate departmental staff are notified of the audit or review, coordinating the entrance and exit conferences, coordinating the Department's response to the audit findings, and tracking the status of all recommendations made until the reported findings have been resolved.

See Attachment 2 for a list of audit reports issued by external audit agencies from January 1, 2008 through December 10, 2009. Internal Audits complies with the Governor's Executive Order S-08-09 by posting the external audit reports to the Reporting Transparency in Government website (http://reportingtransparency.ca.gov) within five working days of receipt.

Also, in accordance with the Department of Finance Audit Memo 10-01, see Attachment 3 for the Department's latest status report on the 2007/08 California Single Audit Report recommendations.

The audit findings and recommendations made in the external audit reports listed on Attachment 2 were not so pervasive that if left uncorrected, would impact the Department's ability to achieve its goals and objectives. Therefore, none of the findings and recommendations from these audit reports will be carried forward to the Evaluation of Risks and Controls section of this report.

EVALUATION OF RISKS AND CONTROLS

EVALUATION OF RISKS AND CONTROLS

Based on the responses received from the Control Environment Questionnaire (Questionnaire), the Department Health Care Services' (DHCS or Department) division chiefs identified the following vulnerabilities that could impact the Department's ability to achieve its goals and objectives:

- Workforce Planning
- System modernization and/or replacement

Issue 1 Workforce Planning

Condition

Most of the Department's division chiefs responding to our Questionnaire expressed concerns related to workforce planning. Specific concerns include: recruitment and retention, employee development, and key person dependency.

The Department is very concerned with workforce planning. However, it should be noted that workforce planning is an issue facing the entire State, not just DHCS. In its report entitled *High Risk: The California State Auditor's Initial Assessment of High-Risk Issues the State and Select State Agencies Face* (Report 2006-601, dated May 31, 2007), the Bureau of State Audits (BSA) identified several risks that encompass multiple state agencies. One of the risks identified was the management of human resources. BSA reported that the State will soon face the consequences resulting from the retirement of a significant portion of its current workforce, including many of its top managers and key staff. As a result, human resources management is a statewide high-risk area, because any large exodus of experienced employees could reduce the ability of state agencies to perform their core missions efficiently and effectively and could threaten the ability of state programs to deliver critical services. As large numbers of its workforce reach retirement age, the State will be further challenged by its ability to recruit and train enough employees to fill the vacated positions.

BSA issued an update to their Report 2006-601 entitled *High-Risk Update-Human Resources Management: A Significant Number of State Employees Are Beginning to Retire While Certain Departments That Provide Critical State Services Lack Workforce and Succession Plans* (Report 2008-605, dated March 19, 2009).

BSA specifically looked at DHCS in addition to four other departments.

In this report, BSA reported that as of June 30, 2008, there were 495 employees in leadership positions in DHCS. Of those, 61 percent were at least 50 years old and could potentially retire within the next several years. The statewide average of employees in leadership position as of June 30, 2008, was 52 percent.

In this same report, BSA reported that as of June 30, 2008, that the number of rank and file employees in DHCS was 2,295. Of those, 45 percent were at least 50 years old and could potentially retire within the next several years. The statewide average as of June 30, 2008, was 36 percent.

Corrective Action

The Department of Health Care Services Strategic Plan (Strategic Plan), Goal 7, "Recruit, Retain, Train and Nurture High Quality, Diverse Staff," demonstrates the importance of workforce planning. It shows that the Department is proactive. In the spring of 2008, the Department's executive staff (which includes the division chiefs) met to discuss human resource challenges and proposed activities that the Department should be engaged in from a human resources perspective. As a result, in July 2008, the Department established the Workforce Planning and Development Office (WPDO) to lead workforce planning and recruiting efforts.

WPDO's purpose is to establish recruitment, retention, and succession planning strategies that align with the Department's Strategic Plan. Upon establishment, the WPDO met with each division and issued a workforce planning report dated October 2008 with a number of findings and recommendations. The WPDO then developed business strategies, including assisting in improving human resources processes and outcomes; ensuring that divisions have a resource to better enhance their efforts to recruit and retain, train, and successfully prepare employees for the future.

One of the recommendations made by the WPDO was to establish an experienced worker program, which would identify a pool of experienced former employees who would be willing to come back to work as retired annuitants on a part-time basis. These retired annuitants would be used to coach and train current employees.

In addition to these activities, the Department has sent promising employees to multi-session executive training classes sponsored by the California State University, Sacramento. Also, DHCS staff participate in various committees and workgroups associated with the Human Resource Modernization Project.

Issue 2 System modernization and/or replacement

Condition Many of the Department's Information Technology Systems (IT) need to be upgraded or replaced.

Corrective Action The Strategic Plan, Goal 6, "Expand and Promote Use of Information Technology," demonstrates the importance of IT. The Department's Information Technology Services Division (ITSD) works closely with the other divisions in the Department to ensure that all IT projects have been identified and have been included in the Implementation Plan. This ensures that all IT projects support the goals and mission of the Department.

BSA stated in their report entitled *High Risk: The California State Auditor's Initial Assessment of High-Risk Issues the State and Select State Agencies Face* (Report 2006-601, dated May 31, 2007), that the State is at risk for ineffective and improper IT investment and use.

In their report entitled *High Risk: the California State Auditor's Update Assessment of High-Risk Issues the State and Select State Agencies Face* (Report 2008-601, dated June 25, 2009), BSA stated that in February 2009 the Governor issued a plan to reorganize statewide IT governance by consolidating IT functions under the Office of the State Chief Information Officer (CIO). In May 2009, the Governor's proposed reorganization took effect. The reorganization merged four existing state IT departments and offices and transferred key functions, such as enterprise IT management and information security, data center and shared services, and IT procurement policy, into an expanded Information Office.

The IT reorganization sets up the CIO federated governance model. Under this model, the State, agencies, and departments maintain authority and accountability for their respective government levels. Specifically, at the enterprise or statewide level, the Information Office will provide IT infrastructure and shared services and will engage in policy and direction, prioritize investments, and consolidate resources; departments will provide

daily operations and support. The State CIO believes that the federated governance model provides a framework for technology leadership and ensures the integrated and strategic use of technology resources statewide by bringing together the State's key IT policy and operating functions into a single organization.

In accordance with the State Administrative Manual and the State Information Management Manual, all of the Department's IT projects over $1 million have been approved by the Health and Human Service Agency and the State CIO. All of the projects listed in the CIO's Statewide IT Capital Plan (dated February 2, 2009) traced to the Department's Implementation Plan.

The risks noted in this section are identified in the Strategic Plan. A component of the Strategic Plan is the Implementation Plan. It outlines the activities the Department will undertake to meet its goals and objectives. It also includes a timeline of when activities will be completed. The Implementation Plan is updated quarterly.

CONCLUSION

CONCLUSION

In conclusion, the Department of Health Care Services' (Department) systems of internal control in effect as of October 7, 2009, taken as a whole, was sufficient to meet the objectives stated in our Auditor's Opinion letter.

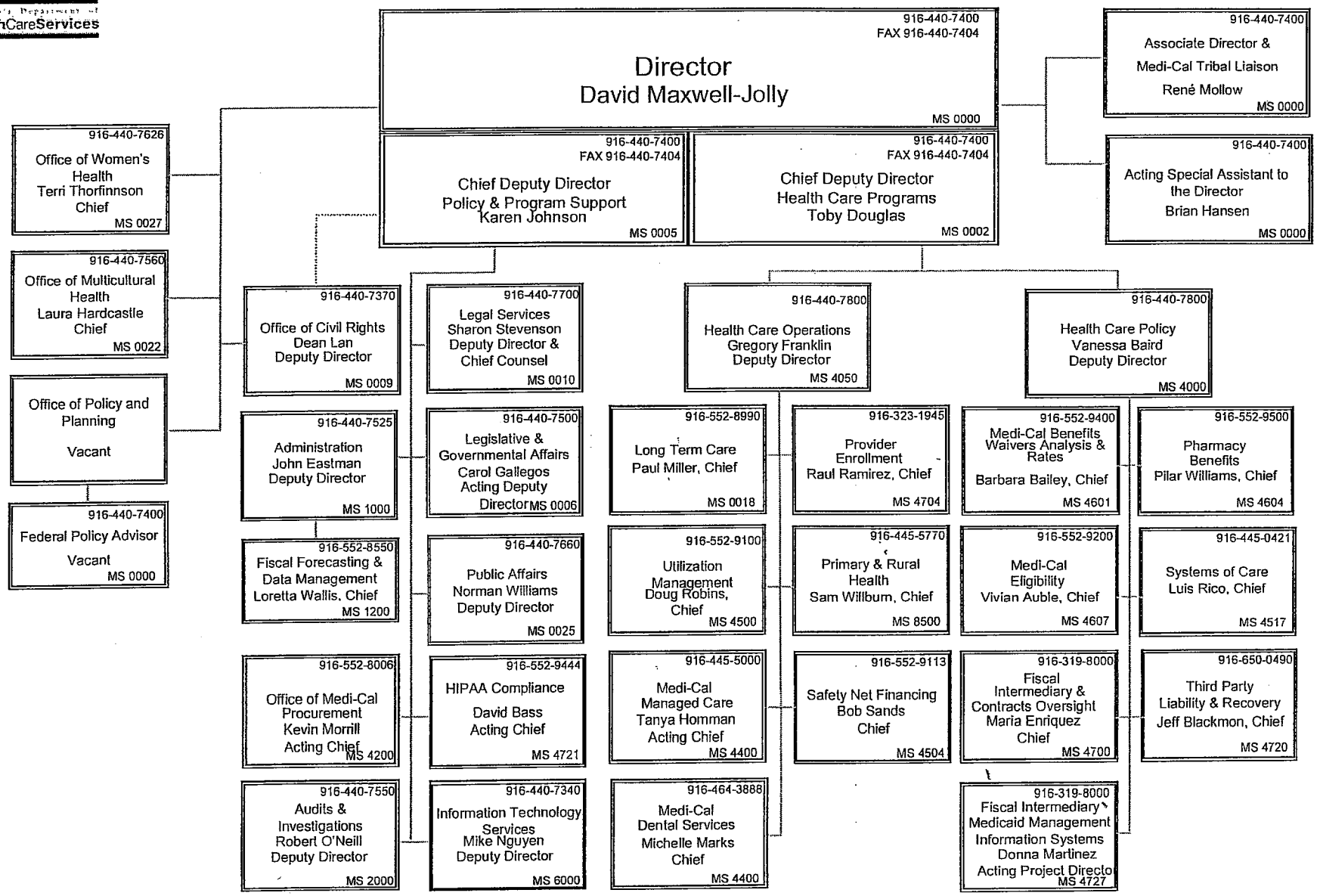
Our study and evaluation did not reveal any significant internal control problems or weaknesses that would be considered pervasive in their effects on the accounting and administrative controls. However, we did identify two vulnerabilities that could impact the Department's ability to achieve its goals and objectives. These vulnerabilities were described in the Evaluation of Risks and Controls section of this report.

ATTACHMENT 1
Department of Health Care Services' Organizational Chart

DHCS
California Department of HealthCareServices

Department of Health Care Services

Effective November 23, 2009



ATTACHMENT 2
Issued Audit Reports From External Audit Agencies

ATTACHMENT 2

Department of Health Care Services
Issued Audit Reports From External Audit Agencies
January 1, 2008 through December 10, 2009

Audit File Number	Audit Agency Report Number	Audit Agency	Audit Report Title	Date Issued
07-17	2007-041	BSA	Recommendations Not Fully Implemented After One Year	1/18/2008
07-11	A-09-07-00084	OIG	Follow-Up Audit of the Medicaid Drug Rebate Program in California	2/27/2008
07-07	09-FS-2007-CA-04	CMS	Review of California Medi-Cal Hospital/Uninsured 1115 Demonstration Waiver	4/10/2008
07-06	A-05-07-00058	OIG	Medicaid Payments For Services Provided to Beneficiaries With Concurrent Eligibility in California and Arizona for July 1, 2005 through June 30, 2006	4/14/2008
07-21	2007-122	BSA	Department of Health Care Services: Although Notified of Changes in Billing Requirements, Providers of Durable Medical Equipment Frequently Overcharged Medi-Cal	6/17/2008
07-09	2007-002	BSA	State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2007	6/26/2008
08-13		SCO	Senior Care Action Network	7/11/2008
05-04	09-FM-2005-CA-001-LTCSDU	CMS	California's Supplemental Reimbursement Program for Outpatient Hospital Services	7/24/2008
08-01	09-FA-2008-CA-01-F	CMS	Review of California Department of Health Care Services' Oversight of Administrative Costs Claimed by Other Governmental Agencies	9/3/2008
07-03	09-CA-02-06	CMS	Review of California Incentive Payments Paid to Negotiated Rate Providers Participating in the Short Doyle Medi-Cal Program	9/12/2008
08-30	2008-401	BSA	Data Reliability: State Agencies' Computer-Generated Data Varied In Its Reliability	10/23/2008
08-15	2008-503	BSA	Department of Health Care Services: The Department Was Not Able to Demonstrate That It Has Implemented Several Recommendations From Our Original Audit Report	12/4/2008
06-21	09-FM-2006-CA-003-DMHOP	CMS	Review of California Department of Mental Health Over-Billing in the Short Doyle Medi-Cal Program for State Fiscal Year 2003/2004	12/22/2008
08-03		CMS	California EPSDT Review Report Dental Services February 13-15, 2008 Site Visit	12/30/2008
09-04	2009-406	BSA	Implementation of State Auditor's Recommendations: Audits Released in January 2007 Through December 2008	2/24/2009

ATTACHMENT 2

Department of Health Care Services
Issued Audit Reports From External Audit Agencies
January 1, 2008 through December 10, 2009

Audit File Number	Audit Agency Report Number	Audit Agency	Audit Report Title	Date Issued
08-27	2008-605	BSA	High-Risk Update - Human Resources Management: A Significant Number of State Employees Are Beginnning to Retire, While Certain Departments That Provide Critical State Services Lack Workforce and Succession Plans	3/19/2009
07-01	A-09-07-00039	OIG	Review of Medicaid Outpatient Drug Expenditures in California for Fiscal Years 2004 and 2005	4/29/2009
08-05	A-09-08-00056	OIG	Review of California's Compliance With Demonstration Project Requirements for Reimbursement of State Costs for Provision of Medicare Part D Drugs (Claims Processed Through the Medicaid Management Information System)	5/7/2009
08-11	2008-002	BSA	State of California: Internal Control and State and Federal Compliance Audit Report for the Fiscal Year Ended June 30, 2008	5/27/2009
08-29	A-09-09-00056	OIG	Review of Medicaid Credit Balances at Scripps Memorial Hospital Encinitas as of December 31, 2008	5/29/2009
08-29	A-09-09-00079	OIG	Review of Medicaid Credit Balances at French Hospital Medical Center as of February 28, 2009	6/17/2009
09-07	2009-611.1	BSA	High-Risk Update - California's System for Administering Federal Recovery Act Funds: State Departments Are Preparing to Administer Aspects of Recovery Act Funding, but Correction of Control Weaknesses and Prompt Federal and State Guidance Are Needed	6/24/2009
09-01	2008-601	BSA	High Risk: The California State Auditor's Updated Assessment of High-Risk Issues the State and Select State Agencies Face	6/25/2009
08-29	A-09-09-00054	OIG	Review of Medicaid Credit Balances at Pioneers Memorial Healthcare District as of December 31, 2008	6/29/2009
07-14	09-FS-2007-CA-01-F	CMS	California's Adult Day Health Care Program	7/10/2009
08-29	A-09-09-00077	OIG	Review of Medicaid Credit Balances at Oroville Hospital as of February 28, 2009	8/27/2009
09-03	2009-103	BSA	Department of Health Care Services and Public Health: Their Actions Reveal Flaws in the State's Oversight of the California Constitution's Implied Civil Services Mandate and in the Department's Contracting for Information Technology Services.	9/10/2009

ATTACHMENT 2

Department of Health Care Services
Issued Audit Reports From External Audit Agencies
January 1, 2008 through December 10, 2009

Audit File Number	Audit Agency Report Number	Audit Agency	Audit Report Title	Date Issued
08-29	A-09-09-00078	OIG	Review of Medicaid Credit Balances at Tri-City Medical Center as of February 28, 2009	11/5/2009
08-29	A-09-09-00090	OIG	Review of California Medicaid Credit Balances for Kapi'olani Medical Center at Pali Momi as of December 31, 2008	11/5/2009

ATTACHMENT 3
2007/08 Single Audit Report Audit Finding Resolutions

Department of Health Care Services - 4260
Audit Finding Resolutions
2007/08 Single Audit Report

Finding Number	Federal Program	Category of Finding	American Recovery & Reinvestment Act		2007-08 Finding Status		
			Related?	Explanation	Status	Explanation	Correction Date
2008-1-3	93.778	Activities Allowed/ Allowable Costs - Health Care Services does not ensure that drug utilization data are provided to drug manufacturers/ labelers on a timely basis (for example, no later than 60 days after the end of the quarter) and to proactively monitor the receipt of payment from labelers.	No	System changes implemented to address the audit finding will not result in inappropriate claiming of increased ARRA funding.	A	DHCS implemented changes on April 1, 2009, which are expected to substantially reduce the amount of manual review time needed for all claims, including the blood factor claims which previously required significant manual review. Successful determination of these system changes will not be recognized until the 2nd quarter 2009 invoices are produced and mailed to the drug manufacturer labelers at the end of August 2009. These system changes should eliminate the bulk of the manual review processes needed, especially for blood factor invoices, resulting in timely mailing of all invoices.	April 1, 2009
2008-1-4	93.778	Activities Allowed/ Allowable Costs - Health Care Services lacks sufficient internal controls to ensure only medically necessary claims and eligible providers are paid, and to detect providers in violation of record retention rules.	Yes		B	Exceptions were noted for six claims. Letters requesting the recovery of the four claims determined not to be medically necessary or insufficiently documented will be sent to the providers. Exceptions involving two hospital claims will be recovered during the annual cost report review.	Recovery letters will be sent during the week of August 13, 2009. Recovery for the institutional providers will take place during Production Year 2009/10.
2008-2-2	93.778	Allowable Costs/ Cost Principles - Health Care Services lacks sufficient internal controls to ensure that it signs a CMC agreement with the provider.	No	The development and implementation of staff procedures for maintaining electronic images is not included in ARRA.	A	The Provider Enrollment Division has fully corrected this finding by developing and implementing new procedures and training staff to review thoroughly all CMC Agreements and making sure all of the pages of the CMC Agreements are scanned. These combined efforts will ensure the scanning of all CMC agreements.	June 1, 2009

Department of Health Care Services - 4260
Audit Finding Resolutions
2007/08 Single Audit Report

Finding Number	Federal Program	Category of Finding	American Recovery & Reinvestment Act		2007-08 Finding Status		
			Related?	Explanation	Status	Explanation	Correction Date
2008-2-3	93.778	Allowable Costs/ Cost Principles - Health Care Services lacks sufficient internal controls to ensure only medically necessary claims are paid, and to detect providers in violation of record retention requirements.	Yes		B	The Department continues to work on implementing the corrective action steps outlined in the Medi-Cal Payment Error (MPES) of 2005-06. Through these continuous efforts the Department is able to identify areas in the program that are the most susceptible and take additional steps to curtail any activity that may compromise the Medi-Cal program.	Continuous
2008-2-5	93.778	Allowable Costs/ Cost Principles - Electronic Data Systems (EDS)—the firm Health Care Services contracts with to authorize Medi-Cal payments—authorized Medi-Cal payments to some skilled nursing facilities (facilities) more than once for the same services. According to EDS, its examiners followed a flawed procedure that instructed them to override a specific type of suspended claim, resulting in duplicate payment authorizations. Special processing guideline instructs examiners in certain situations to continue to follow the flawed procedure, which could result in EDS continuing to pay duplicate claims related to the facilities.	No	Problem with the edit criteria guidelines that could have resulted in inappropriate claiming of increased ARRA funding was corrected in 2007, prior to implementation of ARRA.	B	Correction of the flawed special processing guidelines that caused duplicate payment authorizations was completely implemented on 9/15/07. Complete implementation of the five recommendations related to this finding will occur with implementation of the new Fiscal Intermediary (FI) contract and the replacement California Medicaid Management Information System (CA-MMIS). Implementation of the new contract is currently scheduled for 10/1/09, while phased implementation of the replacement CA-MMIS is scheduled to begin in July, 2010. These dates are subject to change depending on the outcome of the FI contract reprocurement, which is currently in the evaluation phase.	September 15, 2007

Department of Health Care Services - 4260
Audit Finding Resolutions
2007/08 Single Audit Report

Finding Number	Federal Program	Category of Finding	American Recovery & Reinvestment Act		2007-08 Finding Status		
			Related?	Explanation	Status	Explanation	Correction Date
2008-5-4	93.778	Eligibility - Health Care Services does not sufficiently monitor citizenship documentation and take appropriate corrective action on all eligibility cases for which individuals cannot produce the appropriate citizenship documentation. Health Care Services does not identify potential system interface issues between the consortium systems and MEDS, and take appropriate corrective action to resolve potential problems.	No	The DRA citizenship/identity requirements were in place prior to ARRA. No changes to the implementation of the DRA citizenship/identity rules were necessary in California to meet the requirements for receipt of ARRA funds.	B	The Department has reviewed the cases with citizenship verification that was questioned during the audit. All but three of the cases at issue currently have citizenship documentation noted in the MEDS record. Counties have been notified to correct the record in two cases and we are still researching one record in MEDS. We expect to complete our review by the end of August 2009. The Department has reviewed the citizenship /immigration status data on several cases since implementation of the DRA requirements and has not identified any interface problems. Incorrect citizenship data is most often the result of data entry errors.	August 31, 2009

Department of Health Care Services - 4260
Audit Finding Resolutions
2007/08 Single Audit Report

Finding Number	Federal Program	Category of Finding	American Recovery & Reinvestment Act		2007-08 Finding Status		
			Related?	Explanation	Status	Explanation	Correction Date
2008-5-5	93.778	Eligibility - Health Care Services lacks sufficient internal control to obtain and track the enrollment presumptive eligibility identification numbers issued to prevent unauthorized use of identification numbers. Health Care Services does not perform procedures to authenticate the existence of the recipient, prevent duplicate issuances, and reconcile the presumptive eligibility numbers with the recipient enrollment listing filed during the claims adjudication process.	No	The PE program existed before ARRA and there has been no change in methodology, policies or procedures since July 2008.	C	DHCS is unable to reconcile the presumptive eligibility number against the enrollment listing filed with it at this time without an automated system. DHCS is participating in an Enterprise Enrollment Portal (EEP) Feasibility Study Report (FSR) on a web-based application process to allow individuals to apply for health care and other public assistance programs through an electronic application. The EEP FSR will include the Presumptive Eligibility program for pregnant women. The EEP will automate the enrollment process for the Presumptive Eligibility programs and eliminate the problems associated with the current paper process. The timeline for EEP includes Acquisition and Design, Development and Implementation beginning in July 2012.	
2008-12-5	93.767	Reporting - Health Care Services does not ensure that amounts reported on its quarterly Children's Health Insurance Program Statement of Expenditures for Title XXI (CMS-21) report were classified correctly.	No	System changes implemented to address the audit finding will not result in inappropriate claiming of increased ARRA funding.	A	Fully implemented recommendation. This work was originally scheduled to be done under SDN 07040, but was consolidated into one project (SDN 08041). SDN 08041 - Add Federal Financial Participation (FFP) To The Claim Activity Record, was implemented on June 22, 2009. This provides the changes necessary to allow the FFP percentage to be determined for paid claims.	June 22, 2009

Department of Health Care Services - 4260
Audit Finding Resolutions
2007/08 Single Audit Report

Finding Number	Federal Program	Category of Finding	American Recovery & Reinvestment Act		2007-08 Finding Status		
			Related?	Explanation	Status	Explanation	Correction Date
2008-12-6	93.778	Reporting - The federal expenditures noted in the quarterly CMS-64, Quarterly Statement of Expenditures for the Medical Assistance Program, reports are not directly traceable to individual claims.	No	System changes implemented to address the audit finding will not result in inappropriate claiming of increased ARRA funding.	A	Fully implemented recommendation. SDN 08041 - Add Federal Financial Participation (FFP) To The Claim Activity Record, was implemented on June 22, 2009. This provides the changes necessary to allow the FFP percentage to be determined for paid claims.	June 22, 2009
2008-13-12	93.778	Subrecipient Monitoring - Health Care Services does not ensure that the identifying number of the federal program is included in each of its subgrant agreements.	No	Administrative claiming is not included in ARRA.	A	Language was added to each contract to address this issue.	Fiscal year 2007/08
2008-13-13	93.778	Subrecipient Monitoring - Health Care Services does not ensure that management collects and verifies the completeness of the subrecipient's OMB Circular A-133 audit reports nor ensure that it issues management decisions within six months of the State's receipt of the audit reports.	No	The development and implementation of staff procedures for monitoring and tracking OMB Circular A-133 audit reports is not included in ARRA.	A	The Department of Health Care Services maintains an annual list of counties and local government agency subrecipients subject to OMB Circular A-133 to ensure that all required reports are received and logged in timely and verified for completeness. Formal written procedures have been developed to ensure management decisions are issued within six months of the State's receipt of the A-133 audit report. See attachment for Procedures.	January 2009

Department of Health Care Services - 4260
Audit Finding Resolutions
2007/08 Single Audit Report

Finding Number	Federal Program	Category of Finding	American Recovery & Reinvestment Act		2007-08 Finding Status		
			Related?	Explanation	Status	Explanation	Correction Date
2008-14-5	93.778	Special Tests and Provisions - Provider Eligibility - Health Care Services and Public Health do not retain all provider agreements nor ensure that they obtain the appropriate certifications and agreements.	No	Record retention requirements are not included in ARRA.	B	The Provider Enrollment Division (PED) continues to re-enroll providers on continuing basis in accordance with all federal and state statutes and regulations to ensure that all providers have Medi-Cal Disclosure Statements and Provider Agreements on file. PED is working continuously with the California Department of Public Health to ensure all health facilities obtain the proper licensing for participation in Medi-Cal including the Medi-Cal Provider Agreement.	Continuous
2008-14-6	93.778	Special Tests and Provisions - Provider Eligibility - Health Care Services lacks controls to verify that provider licenses are current and active.	No	Continuous validation of provider licensure is not included in ARRA.	B	Provider Enrollment is currently working with Department of Social Services to develop and interface with their database used for the In-Home Support Services program to complete file matches with the department's suspended and ineligible list. PED will continue to work with other state and federal agencies to develop database interfaces that will improve the ability to monitor the licensure status of enrolled providers.	Continuous